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## Intergovernmental fiscal relations in Somalia:

Fiscal federalism, fiscal decentralization and 'making decentralization work' in a multi-level governance system

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## Fiscal federalism, fiscal decentralization and ‘making decentralization work’ in a multi-level governance system

### 1. Introduction

Fiscal federalism and fiscal decentralization processes involve the distribution of fiscal powers and resources across different government levels or administrative tiers, and typically consider the four main aspects or pillars of intergovernmental fiscal relations: expenditure assignments; revenue assignments; intergovernmental fiscal transfers and subnational borrowing and debt. Because of the complexities of intergovernmental finances, fiscal decentralization policies and related discussion of intergovernmental fiscal systems generally do not exclusively focus on any single pillar of fiscal decentralization, but rather, consider the interaction and alignment between the different pillars of fiscal decentralization. In addition, any complete discussion of fiscal decentralization and intergovernmental finance should consider the alignment of the fiscal aspects of decentralization with the political and administrative dimensions of the decentralized system.

Policy discussions surrounding fiscal federalism, fiscal decentralization and intergovernmental fiscal arrangements in Somalia are no exception to this observation. An added complexity in the Somali context, however, is that—until now—policy discussions on intergovernmental fiscal relations have largely taken place along two separate trajectories.

First, for many years, policy discussions and development interventions on fiscal decentralization have focused on strengthening the role of local-level institutions in providing public services. This decentralization trajectory was an important part of internationally-led attempts to re-establish public sector institutions in the void left by the collapse of the Somali state in 1991. These interventions—focused mainly in Somaliland and Puntland—required the establishment of governance entities at the lowest level possible in order to achieve a platform for collective decision-making that had the potential to be inclusive, responsive and accountable in the (post-)conflict environment. This eventually resulted in formal Fiscal Decentralization Strategies being developed for Somaliland and Puntland which seek to strengthen the role and functioning of decentralized local governments in these jurisdictions. This policy trajectory has largely evolved without considering the role of a potential federal government level or the context of an overarching federal structure in Somalia.

A second trajectory of policy discussion on intergovernmental fiscal relations in Somalia is formed by the policy discussions and analysis focused on the distribution of financial powers and resources between the Federal Government of Somalia (FGS) and the Federal Member States (FMS). Policy discussions focused on fiscal federalism at the federal-state level relate more closely to the distribution of constitutional powers, including politically contentious issues such as who should be responsible for providing key public services—including internal security—and the question who should be given the power to collect key public sector revenues, including customs revenues. These policy discussions are

largely taking place without consideration of the role of local governments in the federal structure or state-local relations within the Federal Member States.

This document seeks to bring together these two seemingly disparate streams of policy discussions to consider fiscal federalism, fiscal decentralization and intergovernmental finance in Somalia in the context of a federal potentially three-tiered system multi-level governance system. In doing so, this document aims to provide an overview of the ground already covered by the existing analyses and policy discussions (Section 2) before focusing on the gaps in the current policy debate surround fiscal federalism and fiscal decentralization that have resulted from considering federal-state and state-local relations in isolation.<sup>1</sup>

By bringing together the discussions on federal-state level fiscal federalism reforms and state-local level fiscal decentralization efforts in the context of an emerging three-level federal structure, this note aims to inform both the discussions surrounding fiscal federalism at the federal level (in the context on constitutional consultations and reforms) as well as ongoing fiscal decentralization processes at the state and local level.

Before proceeding any further with the analysis, an important caveat should be made regarding the nature of (fiscal) federalism and reforms of intergovernmental (fiscal) relations, which is universal but especially relevant for countries or contexts that are seeking to emergence from conflict and fragility: although efforts to improve the legitimacy, effectiveness and efficiency of the public sector in a multi-level governance system requires extensive consideration of technical aspects—including in the realms of public sector governance, public administration and public finance—federalism and decentralization reform are inherently political in nature, as they seek to shape the distribution of power and resources between the people and the state, and as they deal with the re-distribution of power and resources within the public sector.

As a result, the evolution of federalism and intergovernmental relations in Somalia is defined and driven to a large extent by its specific social, ethnic, cultural, economic, political and institutional complexities.<sup>2</sup> Despite the inherently important role played by political economy forces in shaping policies and decision-making regarding intergovernmental fiscal relations and public financial management at all levels in Somalia, this note will largely abstract away from these complexities in order to focus on its core ambition: providing a unified analytical framework for considering future intergovernmental fiscal relations—including expenditure assignments (Section 4); revenue assignments (Section 5); and intergovernmental fiscal transfers (Section 6)—across the three tiers of Somalia’s emerging public sector structure. Concluding thoughts are provided in Section 7.

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<sup>1</sup> A more in-depth assessment of different aspects of intergovernmental fiscal relations—looking mainly at federal-state relations—is currently being produced by the World Bank (2020). The World Bank report provides greater in-depth analysis of federal and state expenditures and revenues, whereas the current report complements the World Bank’s efforts by looking across all government levels in an integrated manner.

<sup>2</sup> See, for instance, [LSE \(1995\)](#).

## 2. Intergovernmental fiscal relations in Somalia: a brief situation analysis

This section provides a brief situation analysis with respect to the constitution and the state of federal-state relations (section 2.1); the general nature of revenue assignments and sharing, and fiscal transfers from federal to states (section 2.2); a brief overview of state-level decentralization efforts and legislation (section 2.3); and the role of international development support in shaping the system of intergovernmental fiscal relations in Somalia (section 2.4).

The situation analysis presented in this section aims to highlight the “state of play” of the overall policy context and the main reform processes associated with fiscal federalism and fiscal decentralization in Somalia. Subsequently sections will present a more in-depth discussions, assessments and options for going forward on specific intergovernmental finance issues, including issues related to the assignment of functions and expenditure responsibilities (section 4); the assignment of revenue powers and revenue administration (section 5); and the design and implementation of intergovernmental fiscal transfers (section 6).

### 2.1 The constitution and the state of federal-state relations

**Background.** The historical context for policy discussions around (fiscal) federalism and intergovernmental relations in Somalia is provided by the collapse of central authority in 1991, and subsequent period of anarchy in which there was a return to clan-based governance under customary and religious law in most regions of the country. Peacebuilding and state-building efforts have followed a two-pronged approach: first, consolidating power and ensuring inclusive and responsive governance from the ground up, initially especially focused on the two relatively peaceful northern regions of Somaliland and Puntland; and second, re-establishing a degree of central control over the national territory by re-establish a national-level government.

An internationally-backed unity government formed in 2000 has struggled to establish control over the country’s territory, especially as Somaliland and Puntland had effectively broken away from central control and established their own public sector institutions. Since 2012, when a new internationally-backed government was installed and a Provisional Constitution was adopted, Somalia has been inching towards stability.

The peace-building and state-building efforts continue to be informed by ongoing violence and the threat of violence. In 2006, the seizure of the capital Mogadishu and much of the country’s south by a coalition of insurgents prompted an intervention by Ethiopian, and later, African Union, forces. Although the amount of territory controlled by armed factions has been substantially reduced over time, federal and state authorities continue to face challenges from Al-Shabab insurgents, complicating Somalia’s moves towards a functioning intergovernmental system and its exit from fragility.

**Provisional Constitution.** A watershed moment in efforts to re-establish a central (national) authority in Somalia was the adoption of a Provisional Constitution on August 1, 2012 by a National Constitutional Assembly in Mogadishu. The Provisional Constitution provides the legal foundation for the existence of the Federal Republic and is the source of legal authority for the Federal Government of Somalia and— together with State Constitution—provides the source of legal authority for the Federal Member States

**Commented [AM1]:** Puntland is not broken away from central control, but country has adopted federal system which give autonomous authorities to member states including puntland.

(FMS). The Provisional Constitution sets out the rights and duties of its citizens, and defines the structure of government.

While the provisional constitution provides a constructive foundation for negotiating the power relationship between federal and state-level actors, the constitutional framework by itself does not settle any of the key issues that would underlie a functioning intergovernmental system. For instance, the provision constitution does not define the exact state-level territorial-administrative architecture of Somalia;<sup>3</sup> it does not provide for clear functional assignments (beyond assigning a limited set of key national functions to the federal level); it does not settle revenue assignments between the federal and state levels; and while the provisional constitution recognizes the existence of local governments as entities belonging to the respective Federal Member States, it does not define anything about the nature of intergovernmental relations at the state-local level.

Technical-level discussions currently are underway (with international community support) to consider more permanent constitutional framework. However, given the contested relationship between federal and state authorities (discussed immediately below), it may be premature to expect significant movement on this front in the near future.

**Federal-state relations.** The relationship between the FGS and the FMS continues to be a contested one. Currently, the five Federal Member States that recognize the authority of the Federal Government of Somalia include Puntland, Jubbaland, Southwest State, Galmudug and Hirshabele. The Banaadir Regional Authority—which includes the federal government seat, Mogadishu—appears to function in a hybrid position as part member state, part federal capital territory.<sup>4</sup>

Somaliland (officially the Republic of Somaliland) is a self-declared state, but continues to be considered by the international community to be an autonomous region of Somalia. As such, for the purposes of analyzing fiscal federalism and intergovernmental fiscal relations in Somalia, Somaliland could perhaps best be considered as a quasi-state or state-like entity until its status is resolved.

In a sign of the continued volatile relationship between federal and state authorities, as recently as September 2018, the leaders of Somalia's Federal Member States declared that they had suspended all ties with the Federal Government of Somalia, at the conclusion of a four-day conference in the southern coastal city of Kismayo. The leaders of Galmudug, Hirshabelle, Jubaland, Puntland and South West states accused the Mogadishu government of failing to handle the country's security, of failing to fulfill its responsibilities toward the states in line with the country's federal structure, and of taking its eye off the fight against al-Qaida-linked Islamist militants. The arrest in December 2018 of Mukhtar Robow—a former Islamist militant who seeking election as the president of South West State—have served to heighten the tensions between Somalia's federal government and the FMS.

During 2019, international peace-building and state-building efforts have largely focused on de-escalation tensions between the federal and state levels by de-emphasizing politically contentious issues and focusing on strengthen technical intergovernmental systems instead.

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**Commented [AO3]:** Further to the contest between FGS and FMS, the paper need to also capture current situation in Galmudug where the presidential election led to disagreement and misunderstanding among the different parties including FGS, former President, Presidential candidates and the Ahlusunah group. Also, the case the Jubbaland where the FGS rejected the election of Jubbaland's presidents in August 2019

<sup>3</sup> Somalia's evolving subnational institutional architecture is considered further in Section 3.4.

<sup>4</sup> While some perceive Mogadishu to be autonomous from Banaadir, others insist that Mogadishu is part of BRA.

## 2.2 Nature of current sharing of federal-state revenue sharing and fiscal transfers

According to Article 50(2), “[t]he responsibility for the raising of revenue shall be given to the level of government where it is likely to be most effectively exercised”. However, unlike many other constitutions, the provisional constitution does not specifically designate (or limit) which government level or entity should collect which revenue source.

**Revenue assignment and revenue sharing.** The only other constitutional articles meaningfully dealing with intergovernmental revenue assignments are Article 124 and 125, which empower the federal government to establish national legislation on matters of public financial management (including—specifically—a legal framework for the “preparation, timetable and procedure for presenting the budgets of Federal Member States and districts in a transparent, accountable and efficient manner”), as well as empowering the federal parliament to enact a law to establish a National Reserve, which shall also “determine legitimate revenue collection and expenditure disbursement relating to institutions at all levels within the Federal Republic of Somalia”.

As discussed further in section 5, public sector revenues in Somalia are dominated by customs duties and other import taxes. In practice, customs duties are currently set, collected and retained by the respective Federal Member States.<sup>5</sup> This suggests that, in a *de facto* sense, Federal Member States are—for the time being, at least—acknowledged to be the level of government where “the power to collect these revenues is most effectively exercised”. The federal Ministry of Finance—through the Finance Ministers Fiscal Federalism Forum (FMFF)—seeks to work with the FMS to ensure that import duties are harmonized.

The main exception to the *de facto* assignment of custom revenue to the state level is formed by the customs revenues collected at the port of Mogadishu, with customs duties collected here being funneled into the FGS budget, with 15 percent being returned to Banaadir Regional Administration for the purpose of funding regional/local administration.

**Federal-state transfers.** Currently, the federal government provides approximately 10 percent of its budget to FMS in the form of intergovernmental transfers. The FGS provides various types of intergovernmental fiscal transfers to FMSs, including discretionary transfers from the FGS local funds as well as a number of DP-funded grant schemes (including Recurrent Cost and Reform Financing (RCRF) grants; Surge Support program funds; and transfers of EU budget support funds to FMS. The federal-state intergovernmental fiscal transfer system is discussed in further detail in Section 6.1.

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<sup>5</sup> A key point to note is that Southwest, Galmudug and Hirshabelle states lack major ports, and therefore have little or no direct access to customs revenues. Being outside the formal federal structure, Somaliland collects and retains its own customs duties.

<sup>6</sup> It should be noted that, relatively speaking, local governments in Puntland are collecting more substantive amounts of local revenue.

### 2.3 Overview of state-level decentralization efforts and legislation

**Local territorial-administrative structure.** Although the figures vary between different reports, the national territory of Somalia is currently divided into 18 regions and 90 districts. Regions typically have an (estimated) population of between 500,000 – 800,000 residents (with a handful of outliers in each direction). Districts have an average population of around 135,000 residents, with considerable variation in population size between urban areas and more remote and rural jurisdictions.

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Source need to be cited, as the issue of population size has strong link with pillars of fiscal decentralization

However, as different states have taken ownership over the local government level, there has been a tendency to increase the number of districts.<sup>7</sup> For instance, in Puntland, the number of districts has increased from 43 to 49 and there is an on-going process of demarcating a new region (thus increasing the number of regions from 9 to 10). Although politically expedient, the creation of new local governments tends to create smaller local jurisdictions and a more fragmented local government level, which is closer to the people, but is also more difficult and costly to manage efficiently.

**Local government legislation.** Somaliland and Puntland were early-adopters when it comes to decentralized local governance in Somalia. The main law governing local governance in Somaliland is the *Regions and Districts (Self Management) Law (Law No: 23/2002)*, which has been extensively revised and added to in subsequent years. Likewise, Puntland adopted legislation to form elected local governments in 2009. In more recent years, local government laws have been developed and adopted by each of the remaining Federal Members States (Galmudug, Hirshabelle, South West, Jubbaland).

**Local governance and administration.** Despite the adoption of local government laws in the various FMS, local governance and administration practices are not uniform either between or within different states. Administratively, districts are classified into different grades. At this time, there is no comprehensive tabulation of the number of district councils in Somalia, but it appears that fewer than half of all districts in Somalia have properly constituted councils.<sup>8</sup>

The establishment of (either elected or selected) district councils in different FMS requires intensive dialogue and facilitation at the local level. As a result, district councils are being established in an incremental manner rather than all at once, typically with more populous and more administratively capable districts going first. This process often takes place with support from development partners, either directly, or through the federal Ministry of Interior, Federalism and Reconciliation (MOIFAR) or the relevant state-level Ministries of Interior.<sup>9</sup> Frequent council dissolutions and insecurity in some of the new FMSs have greatly contributed to the increasing number of districts without councils.

Even where councils are properly elected and constituted, field work in Puntland suggests that councilors rarely influence service delivery within their district because district-level decision making is

<sup>7</sup> Somaliland has a total of 81 districts. Of these, 23 Grade A – C districts were legally established, approved by the Parliament and mentioned in the law. In addition, 19 grade D districts are mentioned in the law but not approved by the Parliament and 39 grade D districts are not mentioned in the law.

<sup>8</sup> It was noted, for instance, that a majority of district in Puntland (63%) does not have Councils, as many of them had their Councils dissolved. In Somaliland, out of 23 Grade A – C districts, 20 had elected councils but the tenure of office for these councils expired in April 2019. As the work of demarcating Grade D district borders is not yet done, Grade D districts in Somaliland do not (yet) have elected councils.

<sup>9</sup> At the federal level, MOIFAR is coordinating with various states on devolution of power and political and fiscal decentralization.

mainly carried out either by the Mayor; the Executive Secretary (who is appointed by the MoI); or by the various line ministries (DEGE 2019). The limited involvement of councils in decision making greatly limits council oversight and accountability functions.

Administratively, there is a general notion that the administrative structure for local government departments should be based on a district's grade. In some states (such as Puntland), these organizational structures have been formally standardized. In practice, however, there are considerable variations in local administration staffing. Even in the more decentralized states, local governments generally lack specialized professional staff, with most sectoral service delivery implemented by the sector ministries through the deconcentrated regional offices.

**Local government functions.** The assignment of functions and expenditure responsibilities between the state and local level is a matter of state law. In Somaliland, Article 11 (2) of Law 23/2002 assigns to every district responsibility to provide social and economic services, such as health, education up to elementary/intermediate school level, livestock husbandry, internal security, water, electricity, and such services in so far as they are able to do so.

Likewise, in a drive to promote decentralization in Puntland, the State enacted a decentralization policy to guide the promotion of decentralized service delivery from 2013 to 2020. According to this policy, five sectors were identified as a basis of the first round of decentralization reforms, including roads; water; sanitation and hygiene; natural resource management; health and education.

In practice, however, the situation is quite different, with local governments playing a relatively minor role in many of the functions assigned to them by law or policy. While this is certainly the case for Puntland and Somaliland, this is most likely also the case in the other states as well.

For instance, although education was noted as being one of the sectors to be decentralized to the local level in Puntland, an overwhelming majority of teachers in the state are recruited, supervised and managed by the state government through its (state-level) Ministry of Education, while local governments have no role in hiring them or paying their salaries.<sup>10</sup> Instead, within education services in Puntland, in practice, only a number of operation and maintenance-related tasks have been devolved to the local government level, including tasks such as routine maintenance, rehabilitations, provision of soap for handwash, hygienic storage of water, toilet maintenance, furniture repairs, black boards and chalks, payments of water and electricity bills, salaries for cleaners and security guards. In the meantime, the state's Ministry of Education continues to be responsible for the management and delivery of the critical functions in the education sector.<sup>11</sup>

Despite being assigned a wide range of functional responsibilities (by policy or law), evidence suggests that most local government expenditures are directed towards basic local needs, including ensuring security, infrastructure (roads), the provision of sanitation and local welfare service. It is not unusual, internationally, for local governments to prioritize these functions: when left to their own devices, local

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<sup>10</sup> Surprisingly, although 80 percent of teachers in Puntland are government teachers their payments are generally met by the community members through payment of fees and other contributions, as the Ministry of Education only caters for payment of only 21 percent of all teachers (DEGE 2019).

<sup>11</sup> This is not inherently contradictory to a decentralized federal system. As noted in section 4, federal countries like Germany and India employ teachers at the state level (in order to ensure that rural areas are well-served), while leaving responsibilities for operating and maintaining schools to the local level.

communities tend to priorities short-term goals (such as ensuring livelihoods and community-level infrastructure) over longer-term development objectives (health and education). This is in line with the experience in Puntland (and anecdotal evidence in other states), where very little money is spent on social sector services.<sup>12</sup> In addition to revealing local preferences, this pattern could partially be explained by the fact that the bulk of social service delivery is done by the state-level ministries.

#### 2.4 Nature of sharing of revenues and fiscal transfers from state to local level

Different states have different approaches to sharing revenues and providing intergovernmental fiscal transfers to their local governments.

As far as the available evidence suggests, other than (and possibly including) donor funded grant schemes, state transfers to local governments tend to be negotiated on an *ad hoc* basis, resulting in a highly discretionary and inequitable allocation of resources. Furthermore, the disbursement of these resources is highly unreliable and unpredictable.

This is even the case in states that have more extensive experience with decentralized local governance. For instance, in Puntland, the State Government formally provides two types of transfers to local governments: first, a transfer of 1.5% of total domestic revenues to Garowe, in addition to a number of *ad hoc* transfers to other local governments; and second, a state contribution to the Local Development Fund which is distributed to local governments. However, the disbursement of resources to Garowe (and other local governments) is not being made in a timely or complete manner.

The closest thing to a “regular” state-local intergovernmental fiscal transfer scheme (funded from government resources) in Somalia is the “municipal subsidy” in Somaliland. The municipal subsidy is basically a state-local transfer funded by 6 percent of customs revenues, allocated to 42 districts named in Law 23/2002.<sup>13</sup> One of the weaknesses of this transfer is that its allocation to different districts is not based on objective, transparent and clear criteria. Furthermore, at times, the Ministry of Interior unilaterally changes the allocation or diverts funds to other emerging priorities.

Many of the weaknesses of the municipal subsidy in Somaliland (as identified by DEGE, 2019) are generally relevant to state-local transfer schemes in other states, including:

- Lack of transparent, simple and objective allocation formula;
- Incomplete presentation in the government budget; only lumpsum amount of the transfer is reflected in the government budget without indication of amounts allocated to each local government;
- There is no communication of indicative planning figures (IPFs) to assist local governments when preparing their annual budgets;

<sup>12</sup> The local expenditure pattern appears to be slightly different for local governments in Somaliland. In 2018, JPLG-supported local governments spent between 28% and 50% of their budgets on service delivery. A large proportion of this expenditure was on roads sector (56.9%) followed by education (9.2%), health (7%), security (5.9%), fire-fighting (5.2), solid waste management (4.5%), water (3.9%), markets (2.9%) and sports (1.7%). To the extent that local governments have been contributing money from their own budgets to finance education and health; however, some of this funding has been directed to functions outside of their mandates, such as higher education, funding regional hospitals, etc. (DEGE 2019).

<sup>13</sup> Prior to 2018, the vertical share of local governments was 12.5 percent.

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Ahmed's comment

- The transfer does not reflect administrative capacity to effectively spend the money. The amount is transferred to all 42 districts regardless of whether they meet the basic conditions and safeguards for proper use of the funds; and
- Lack of transparency with regards to actual disbursement of funds to local governments.

Given the extremely small revenue base of state governments, the cash flow constraints associated with their fiscal position, and political economy forces acting upon them, it appears difficult for FMSs – without external assistance—to introduce formula-based grant schemes that disburse resources to local governments in a regular, timely manner.

### **3. Fiscal federalism and intergovernmental fiscal relations in Somalia: towards an emerging multi-level governance system**

Some of the recent analyses of fiscal federalism and intergovernmental fiscal relations in Somalia have focused on a specific pieces of the intergovernmental finance puzzle: for instance, state-local fiscal decentralization reforms are often discussed without giving considering federal-state fiscal relations; federal-state fiscal relations are analyzed without considering state-local relations; intergovernmental fiscal transfers are debated considering without considering expenditure assignments; and so on.

The piece-meal consideration of intergovernmental fiscal issues is certainly reasonable and understandable given the breadth of the topic; the need to explore topics in depth; the speed with which different part of the intergovernmental fiscal system are evolving; the political complexities involved; and the fact that policy debates are taking place simultaneously at different government levels and with the support of different partners. Furthermore, in these debates, it is natural that different stakeholders—both within government as well as within the international community—have different views and emphasize different points.

It is important, however, to also look at the bigger picture in order to make sure that different aspects of intergovernmental finance are designed to fit together well and that reforms at different levels converge and connect. The ambition of the current note is therefor to provide a potentially different viewpoint by stepping back and looking at the “big picture” of intergovernmental fiscal relations in Somalia by:

- Considering the three government levels (federal, state and local) together;
- Viewing intergovernmental fiscal systems as part a multi-level governance approach; and
- Considering the decentralization or localization of key sectors.

#### **3.1 Considering the three government levels (federal, state and local) together**

It is the intent of this document to outline what lessons can be learnt when the basic principles of fiscal decentralization are applied to a multi-level federal-state-local system along the four pillars of fiscal decentralization (expenditure assignment; revenue assignments; intergovernmental fiscal transfers; and subnational borrowing and debt), and thus, when federal-state and state-local fiscal relations are considered through the prism of a three-level public sector.<sup>14</sup>

#### **3.2 View intergovernmental fiscal relations as part a multi-level governance approach**

This background note considers that establishing an effective public sector is one of the preconditions of an effective and legitimate state.<sup>15</sup> While devolution (the transfer of power and resources to elected

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<sup>14</sup> Since subnational borrowing and debt is typically a very minor part of subnational finance in developing and transitional countries (if permitted at all), this initial review of the topic will concentrate on the first three pillars.

<sup>15</sup> As noted before, political economy considerations—including the empowerment of different population groups through the decentralization of power and resources, as well as the equitable horizontal distribution of resources—are important political economy considerations in the design of intergovernmental (fiscal) systems, particularly in a post-conflict context. While this document is not oblivious to the political economy forces involved

subnational governments) has specific advantages over other types of decentralization in terms of democratic participation and accountability, all types of decentralization should be considered if the goal is to pursue an effective and responsive multi-level governance structure ([OECD 2019](#)).

[OECD \(2011\)](#) notes that “[t]he ability of sub national governments to “better spend”, by identifying relevant paths for territorial competitiveness and effective delivery of public services, is largely enshrined in their institutional background. Rather than isolated actors, sub national authorities and central governments are “mutually dependent”. In this context, ... , the key underlying question is not whether to “decentralize or not” or even opt for a specific decentralization model, but to look at ways to improve capacity and co-ordination among public stakeholders at different levels of government to increase efficiency, equity and sustainability of public spending. This question of ‘multi level governance’ is therefore accurate, whatever the constitutional framework of countries, federal or unitary.”

### **3.3 Considering the decentralization and localization of key sectors**

Up to now, this note has focused on two sets of policy actors: first, those involved in discussions around federal-state relations, and second, the stakeholders involved in state-local fiscal decentralization and local governance policies.

For completeness, it is important to introduce a third set of stakeholders in the debate surrounding intergovernmental (fiscal) relations: those involved in the delivery of key sectoral services. Sector ministries—and their supporters within the development community—for a third set of stakeholders who have their own views on vertical and intergovernmental relationships. Unless their views are taken on board up front, it is easy to settle on a course of action that turns out to be unworkable—either for technical or for political economy reasons—later in the devolution process.

Health and education are typically the two key public sector functions considered in the context of decentralization. As further discussed in Section 4 below, internal security is another public sector function that warrants significant consideration in the Somali context.

A global analysis of health and education spending in close to 30 countries revealed that countries typically rely on a combination of different models of decentralization and localization—not only devolution, but also deconcentration, delegation and direct or centralized approaches—to deliver front-line health and education services ([DELOG/UI 2014](#)). This analysis finds that by focusing exclusively on devolved expenditures, previous research may have overlooked up to two-thirds of all local public sector expenditures on health and education. Conversely, this means that local governments account for only about one-third of local public sector spending in the examined countries. The analysis further reveals that countries that spend less on public services via devolved mechanisms tend to make up the difference by spending more on local service provision via other modalities of decentralization or localization.

Due to their specific technical expertise, sectoral stakeholders tend to have a more nuanced view of the potential pros and cons of different approaches to decentralization and localization in terms of improvements in sectoral services. At the same time, sectoral stakeholders tend to have their own institutional biases—often preferring sectoral deconcentration (transfer responsibilities to territorial

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in the reform of intergovernmental relations in Somalia, a discussion of these political economy aspects is left for a later time.

administrative units that continue to be part of the sector ministry) or the delegation of powers and resources directly to front-line service delivery units (again, under the continued purview of the ministry itself)—over devolution of sectoral powers and responsibilities to subnational departments that are part of elected governments at a lower level.<sup>16</sup>

When looking at different aspects of sectoral decentralization, it may be useful to separately consider the role of front-line service delivery units, such as schools or health facilities as part of the “last mile” of the vertical service delivery chain (Figure 1).<sup>17</sup>

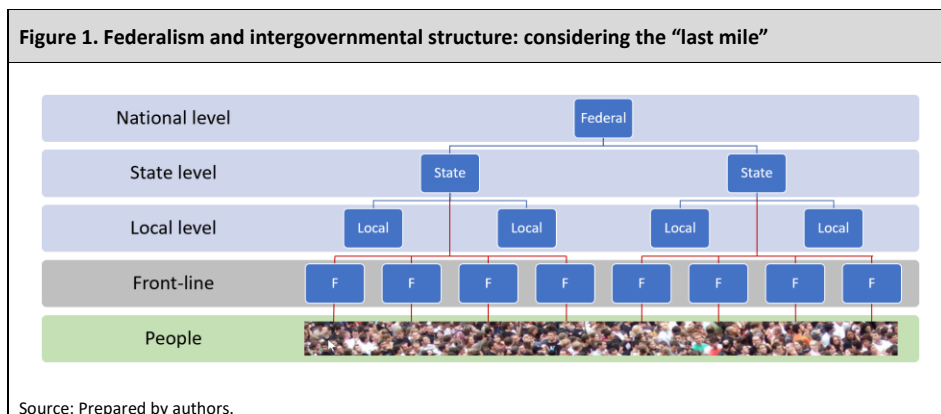


Figure 1 highlights that the public sector does not stop with the formal government levels or tiers that are traditionally considered as part of discussions on federalism and intergovernmental relations: in addition to the federal, state and local government levels, front-line service delivery facilities such as public schools and public health facilities—while not a full-blown governance level—nonetheless form an important *de facto* administrative tier of the public sector. Not only are these facilities closer in proximity to the people than even local governments, they play a direct role in delivering services to the people.

Unlike in highly devolved countries, in Somalia, most public schools, health centers, and other front-line service delivery facilities do not “belong” to the local government, but rather, they report to state-level sector ministries. In addition, as discussed in Section 4 below, there is considerable community involvement in the operation and management of these facilities, including in terms of their financial support. This realization has important implications for the evolution of the local government level and the evolution of intergovernmental systems. For instance, if funding for education is placed with the federal government, should the resources flow from federal government to state government; state government to local government; and local government to front-line service delivery facility? As

<sup>16</sup> The centralized biases of sector ministries are not infrequently compounded by the biases of sectoral units within development partner organizations, that are prefer to deal with a single national-level partner, rather than dealing with the complexities of a decentralized system.

<sup>17</sup> Note that Figure 1 does not display the deconcentrated regional administration tier which is present in many states.

decentralization reforms are being pursued by state governments, what is the value addition that local government would bring to service delivery outcomes in different sectors? And would the value-added by local governments exceed the possible delays and inefficiencies that would be associated by inserting a government level between the state ministries and front-line service delivery facilities? These are important questions to be asked when considering the intergovernmental architecture of federalism and intergovernmental relations in Somalia.

### 3.4 Somalia's evolving (and contested) subnational governance architecture

The current background note will have to consider the evolving "big picture" of intergovernmental fiscal relations in Somalia in the context of considerable uncertainty. Indeed, especially to the extent that we wish to look beyond the framework of the Provisional Constitution, numerous questions with respect to the country's federal and intergovernmental architecture are yet to be resolved. While these issues are beyond the scope of this note to resolve, they are commented on here briefly.

First, there is considerable and obvious uncertainty about the structure and composition of the state level (Box 1). What will the number and composition of Federal Member States be and will they have a symmetric or asymmetric relationship with the federation?

#### **Box 1. Provisional Constitution references to federal and intergovernmental architecture**

##### **Article 48. The Structure of the State**

- (1) The structure of the state in the Federal Republic of Somalia is composed of two levels of government:
  - (a) The Federal Government Level;
  - (b) The Federal Member States Level, which is comprised of the Federal Member State government, and the local governments.
- (2) No single region can stand alone. Until such time as a region merges with another region(s) to form a new Federal Member State, a region shall be directly administered by the Federal Government for a maximum period of two years.

##### **Article 49. The Number and Boundaries of the Federal Member States and Districts**

- (1) The number and boundaries of the Federal Member States shall be determined by the House of the People of the Federal Parliament.
- (2) The House of the People of the Federal Parliament, before determining the number and boundaries of the Federal Member States, shall nominate a national commission which shall study the issue, and submit a report of its findings with recommendations to the House of the People of the Federal Parliament.
- (3) The nomination of the commission referred to in Clause 2 shall be preceded by the enactment of a law by the House of the People of the Federal Parliament, which shall define:
  - (a) The responsibilities and powers of the commission;
  - (b) The parameters and conditions it shall use for the establishment of the Federal Member States;
  - (c) The number of the commissioners, requirements of membership, nomination methods, office tenure, and their remuneration.
- (4) The number and the boundaries of the districts in a Federal Member State shall be determined by a law enacted by the parliament of the Federal Member State, which must be approved by the House of the People of the Federal Parliament.
- (5) Federal Member State boundaries shall be based on the boundaries of the administrative regions as they existed before 1991.
- (6) Based on a voluntary decision, two or more regions may merge to form a Federal Member State.

A second key question is whether—in future constitutional discussions—the composition and role of the local level (or sphere) of government—should be defined in the federal constitutional framework, along with details regarding state-local relations? This approach was taken in South Africa and—more recently—Nepal. Alternatively, should the constitution permit each Federal Member State to structure its own state-local relations, as is currently provided for in the Provisional Constitution (and as, for instance, is the case in the United States)?

A combination of factors—including the asymmetry of conditions across different Federal Member States, and the fact that the *de facto* nexus of state power appears to lie below the federal level—suggests that there may be merit in allowing different FMS to define their own system of local governance. Without seeking to pre-judge future discussions on the architecture of federal and intergovernmental systems in Somalia, at this stage, it would be prudent to assume that an asymmetric federal system might emerge where different FMS may opt for different local government structures and different state-local relationships.

A third policy concern, regardless whether the local level is constitutionally defined or not, would be to ensure that the local government structure within each state deals effectively with rural as well as urban local governments.

Fourth, as noted in the previous section: what should the role of Mogadishu (and/or Banaadir Regional Authority) be in the federal / intergovernmental architecture?

Fifth, to what degree have decentralization efforts been successful in ensure that districts are more like local governments than like local administrations? In other words: what share of local jurisdictions are currently being led by elected / representative local councils?

A final—but not unrelated— question is whether development partners should exclusively operate through the Federal Government of Somalia (in order to strengthen its authority over the country's national territory), or whether it makes sense—for now, or into the future—for development partners to continue to operate directly through the Federal Member States? This is an important legal and policy decision to be made by each international organization.

In the context of a federal system, it can make sense for development partners to continue to work together directly with FMS in areas of functional responsibility within their constitutional purview. The ability of international development partners to work effectively through the federal government depends to a large extent on the capacity, ability and institutional willingness of federal government ministries, departments and agencies to work effectively through intergovernmental systems.

## 4. Expenditure assignments across three tiers: considerations and options

The assignment of powers, functions and expenditure responsibilities to different government levels and units is widely understood to be the first pillar of intergovernmental finance. Since the task of the remaining pillars of the intergovernmental fiscal system is to provide the fiscal powers and resources to finance these functions (in a way that is vertically and horizontally balanced), it is critical to have a degree of consensus of expenditure assignments across different levels of government before proceeding with in-depth discussions on revenue assignments or on the design of intergovernmental fiscal transfers.

### 4.1. Expenditure assignments: Observation on the *status quo*

The Provision Constitution states that “[t]he allocation of powers and resources shall be negotiated and agreed upon by the Federal Government and the Federal Member States (pending the formation of Federal Member States), except in matters concerning: (A) Foreign Affairs; (B) National Defense; (C) Citizenship and Immigration; (D) Monetary Policy, which shall be within the powers and responsibilities of the federal government.” (Article 54)

In addition, the Provision Constitution defines a number of principles of federalism pertinent to the assignment of functions and expenditure responsibilities, including that “[p]ower is given to the level of government where it is likely to be most effectively exercised” (Box 2). Although the exact extent of federal involvement in the different public sector functions will be a matter of ongoing policy debate, it appears Article 52 of the Provisional Constitution foresees little more than a coordinating or policy oversight role—and possible a financing role—for the federal level in key functional areas.

#### Box 2. Principles of Federalism and Cooperation

##### Article 50. Principles of Federalism in the Federal Republic of Somalia

The various levels of government, in all interactions between themselves and in the exercise of their legislative functions and other powers, shall observe the principles of federalism, which are:

- (a) Every level of government shall enjoy the confidence and support of the people;
- (b) Power is given to the level of government where it is likely to be most effectively exercised;
- (c) The existence and sustainability of a relationship of mutual cooperation and support between the governments of the Federal Member States, and between the governments of the Federal Member States and the Federal Government, in the spirit of national unity;
- (d) Every part of the Federal Republic of Somalia shall enjoy similar levels of services and a similar level of support from the Federal Government;
- (e) Fair distribution of resources;
- (f) The responsibility for the raising of revenue shall be given to the level of government where it is likely to be most effectively exercised;
- (g) The resolution of disputes through dialogue and reconciliation.

##### Article 52. Cooperative Relationships Between the Various Federal Member State Governments

(1) The Federal Government and Federal Member State governments shall ensure that meetings between the Presidents of the Federal Member States and high-ranking officials be held regularly to discuss issues that affect their territories, including:

(a) Water sources;	(g) Education;
(b) Agriculture;	(h) Relations and dialogue amongst traditional leaders, and the protection and development of traditional law;
(c) Animal husbandry;	(i) Relations amongst religious scholars; and
(d) Pasture and forestry;	(j) Youth.
(e) The prevention of erosion and the protection of the environment;	
(f) Health;	

In the absence of a specific, detailed constitutional or legal (*de jure*) assignment of functional powers and responsibilities, budgeted federal spending suggests that, *de facto*, the functional responsibility over most key public services—beyond general administration and the national-level functions specifically defined in Article 54—lies with the Federal Member States, as the federal government spends little or no resources on front-line public services such as health or education.<sup>18</sup>

		<b>Budget (US\$)</b>	<b>Per Capita</b>	<b>Percent</b>
100	Administration	133,940,539	10.87	38.9
200	Defense and security	110,767,024	8.99	32.2
300	Economic services	24,373,206	1.98	7.1
400	Social Services	26,394,266	2.14	7.7
	<i>o/w Health</i>	<i>7,260,440</i>	<i>0.59</i>	<i>2.1</i>
	<i>o/w Education</i>	<i>16,009,178</i>	<i>1.30</i>	<i>4.7</i>
500	Special Projects	48,724,001	3.96	14.2
		<b>344,199,036</b>	<b>27.95</b>	<b>100.0</b>

Data are currently not available to prepare an intergovernmental public sector expenditure profile that would reveal federal, state and local government spending by function, which would provide a (rough) indication of the relative functional responsibility borne by each government level for different functions. In addition, it would be useful to map out development partner assistance to the public sector—across different functions and different government levels. These would be useful further extensions of the current effort to consider fiscal federalism and intergovernmental finance in Somalia in the context of a three-tiered multi-level governance structure.

Policy discussions about the assignment of functions and expenditure responsibilities have been taking place in a bifurcated and disconnected manner at the federal-state level and the state-local level. Policy discussions surrounding functional assignments at federal-state level seem to be driven largely by political economy considerations rather than by conceptual or technical considerations.

Fiscal decentralization reforms at the state level appear to be constrained by the tensions between to desires: on one hand, the desire to be as efficient as possible by delivering public services in a centralized manner through state-level institutions, and on the other hand, a desire to deliver services as close to the people as possible. While state-level policy discussions surrounding functional assignments at state-local level are perhaps somewhat less contentious than federal-state level policy

<sup>18</sup> Federal level education spending seems to be tilted towards higher education, with Somali National University and Somali Academy of Science and Arts receiving more than US\$ 4.3 million.

discussions, state-level policy discussions on the topic—and the implementation of the resulting policies—are not free from political economy considerations.

Although efforts by development partners have been made to link the fiscal decentralization strategy to sector decentralization efforts (especially in Somaliland and Puntland), these state-level dialogues appear to be disconnected from the federal-state level sectoral dialogues about sectoral aspirations to work across multiple government levels (e.g., see Box 3 for a discussion on education). International experiences suggest that it is much easier to get governments commit to a decentralization strategy than it is to functionally operationalize such commitments.

### **Box 3. Aspirations to establish a multi-level system of education**

Federal government education officials in Somalia aspire to establish a multi-level system of education in which the federal ministry of education would be the focal point of state ministries of education in unifying the policies, legislation, and curriculum in the country. Towards developing the new structure, the Ministries of Education of the Federal Member States (FMS) have met with federal MoECHE officials on multiple occasions to discuss ways to harmonize their systems and formulate a new structure.

Somalia's education system lacks an agreed upon intergovernmental (constitutional or legal) framework to guide the federal vis-à-vis the sub-national roles and responsibilities. As a result, Federal Member States have gone ahead and established their own Education Ministries for overseeing planning and service delivery in their jurisdictions and have formulated their own Education Sector Strategic Plans. In part, the establishment of these separate ministries of education in the member states and other jurisdictions springs from a need to accommodate the country's broader political system of power-sharing with both majority and disadvantaged clans in the country and to address associated inequalities in distribution of power and representation in decision-making.

The draft Constitution of Somalia and Draft National Education Policy state that free and compulsory education is the right of every child, thus placing the responsibility for access on the state. However, the inability to ensure access and acceptable quality of infrastructure contributes to Somalia having one of the lowest rates of enrolment in the world wherein gender disparity is notable. Non-state actors have emerged to help fill the access gap, with over half of primary students and 70% of secondary students are currently educated outside the public sector. Service delivery in the states in the Central and Southern parts of the country is dominated by private education providers, including from Saudi Arabia, Kuwait, Yemen and Ethiopia. This has contributed to unequal access rates, as nomadic communities, internally displaced persons and the poor are not served by either the state or non-state system. Further complicating the Somalia situation is the occurrence of periodic droughts as well as continued terrorist attacks by Al-Shabaab.

Employment of teachers lacking proper qualifications is a problem across the country, although there are significant differences between Somaliland and the rest of the country in terms of teachers. To start, there are more certified teachers in Somaliland than in the rest of the country, though. Further, in contrast to Somaliland, in the majority of the country most teachers are not paid by the government, reducing top-down accountability within the system and reducing the space for effective teacher performance management. The federal Ministry of Education (MoECHE) has been almost completely removed from teacher payment, reducing leverage over provincial Ministries. This is changing, however, as World Bank financing has enabled some inter-governmental fiscal transfers, with the goal of gradually putting about 3,000 teachers on the payrolls of the Federal Member States.

Source: World Bank 2018. [Education in Federal Systems: Lessons from Selected Countries for Somalia](#) (July 5, 2018)

## 4.2 Applying the subsidiarity principle in the context of a three-tiered system

Most countries apply a principle commonly known as the “subsidiarity principle” in order to assess or determine “who should do what” in the context of a multi-level governance system. This principle states that government functions should be performed by the lowest government level that can perform the function efficiently. As such, the principle acknowledges the ability of lower-level governments to be more responsive to community needs and preferences, while at the same time recognizing the need to achieve a minimum efficient scale in the delivery of public services.

The question of assigning powers or functions, however, is more complicated than simply applied the subsidiarity principle to a list of government functions or subfunctions: it would be too simplistic to simply apply the subsidiarity principle broadly to public sector functions such as primary health services or primary education.<sup>19</sup> Instead, there is a need to consider that “government functions” can be divided or unbundled into various different aspects of functional responsibility, including policy and regulatory responsibility; responsibility for service provision; and responsibility for financing. Even when we consider a single function or service (say, local health services), we ought to apply the subsidiarity principle separately to these different elements, which may result in different aspects of the function to be assigned to the same government level, or to different government levels.

For instance, it is not unusual for policy-setting powers and responsibilities to be assigned to the federal (or state) level, while responsibility for service provision is (in part or in whole) to the local level, while the responsibility for financing is assigned to the state (or federal) level. Indeed, in many countries, key aspects of service delivery in social sectors (schools or health clinics) are assigned to the state or local level—where proximity to the people and front-line service delivery facilities gives them an advantage in the hands-on delivery of services in a responsive and accountable manner, while the responsibility for financing of such social sector services is often assigned to the federal or state level, in order to ensure sectoral resources are distributed equitably.

In addition to recognizing policy, provision and financing as three distinct aspects of functional assignment, a granular consideration of functional assignments should consider that a single public service has different inputs, and that the management of each of these inputs may have different economies of scale associated with them (thus resulting in different assignment decisions when subjected to the subsidiarity principle). Inputs to be considered in this context include (1) human resources (functionaries or staff); (2) operation and maintenance inputs; (3) supplies used and/or provided to end-users in the provision of public services (such as school books; medicines; or fertilizer); (4) capital investments (facilities and other capital infrastructure); and (5) the coordination, management and oversight of inputs to achieve outputs and outcomes.

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<sup>19</sup> The IMF’s Government Finance Statistics manual provides a Classification of the Functions of Government, which is divided into ten main functional areas or categories, which in turn are further broken down into subfunctions. See [Boex \(2015\)](#) for a detailed discussion on functional assignments.

#### Box 4. Assignment of functions and expenditure responsibilities: international experiences

It is hard to draw lessons or firm conclusions from international experiences for Somalia with respect to the assignment of functional assignments, as only a few federal countries have undergone a process of national consolidations that Somalia is currently experiencing. The United States, Switzerland and the Palestinian Territories are a few of the modern-day entities where the national-level government was formed by and/or created with the consent of the constituent states.

Despite applying broadly the same principles, different federal countries have come up with vastly different functional assignments, and even within these countries, the functional solutions evolve over time. In the United States, in most states, primary and secondary education services are delivered at the local level, with elected local school districts responsible for the provision of public education (including the construction of schools; the hiring and employing of teachers; the management and oversight of service delivery; and the operation and maintenance of schools), while this public education at the primary and secondary level is primarily funded by a combination of local taxes and state grants. In contrast, in Germany and India, however, teachers and health workers are employed at the state level, while local governments contribute in areas of school construction and operation and maintenance.

A cross-country study that considered the provision of basic health and education services in 29 countries found that, in practice, it is very rare for the provision of health or education to be the responsibility of a single government level (DELOG/UI 2014). Instead, the responsibility for service delivery (in practice) is almost always divided among stakeholders at different levels, through a combination of devolution, deconcentration, delegation and direct (centralized) service delivery, with different countries pursuing different combinations and permutations of assigning functional responsibility for different inputs.

### 4.3 Considerations and options for Somalia

It falls beyond the scope of the current background note to conduct a full assessment of the assignment of powers, functions and expenditure responsibilities across all government levels (federal, state and local) taking into account the unbundling of public sector functions (both into policy-making; service provision and financing; as well as into different inputs). It would be an extremely worthwhile to conduct such an exercise in a participatory manner, including representatives from all government levels and from different states.

It is hard to speculate the outcome of a detailed functional assignment analysis in Somalia. However, a cursory review of the situation in Somalia suggests that two outcomes are *a priori* somewhat unlikely.

First, it is unlikely that the application of the subsidiarity principle to the situation in Somalia would result in a recommendation for a highly devolved solution where the provision of all major services should be devolved to the local government level. Given the state of public sector institutional development, given the fragmentation of local-level institutions, and given the presence of scale economies in the management public service inputs (especially, human resource) it is unlikely that district-level governments in many FMS would be able to deliver key public services (such as health, education and public safety) in an efficient and cost-effective manner (as required by the subsidiarity principle). It is likely that local government would be able to efficiently deliver certain local public services (e.g., construction and operation of local markets; solid waste management; urban

**Commented [AO6]:** True to some extent, but whether or not devolution of social services is doable in Districts, particularly, those with elected councils or long supported by JPLG as Adado, requires separate and independent assessment of the prevailing capacities, existing legal and policy framework. But this option paper cannot solely judge it. Yet, this is in contradiction with the provisional constitution which advocates to place powers to the lowest possible units that can effectively discharge powers.

infrastructure and services) if they were to be assigned exclusive responsibility over these functions. In addition, local governments could play some role in the efficient delivery of social sector services within FMS (e.g., construction of new facilities; or funding the operation and maintenance of existing facilities), but it is unlikely that they would be able to efficiently deliver health, education, and other social sector services if placed fully in charge of these public services.<sup>20</sup>

Second, it is unlikely that the application of the subsidiarity principle to the situation in Somalia would result in a recommendation for a highly centralized solution where federal government directly delivers (and thus finances) all key public services itself. Instead, key public services delivered by the federal government are likely limited to a handful of major national responsibilities, such as national defense, international relations and some upstream sectoral functions, such as higher education or referral hospitals. Following the subsidiarity principle from the lowest level upward, for many services, the state level seems to have sufficient scale and scope to deliver key public services in an efficient manner.

Instead, it is much more likely that the application of the subsidiarity principle to unbundled sectoral functions in Somalia would suggest a hybrid assignment of functional responsibilities across different levels, for instance, with federal government setting policy objectives and certain sectoral standards, where states are quite likely to be responsible for employing and posting teachers and health workers (potentially in a deconcentrated manner). The role of local governments in the delivery of sectoral services might include funding the operation and maintenance (O&M) of front-line facilities; supervising locally-posted staff to make sure they show up; and constructing additional facilities in response to local needs. This is merely an example of a possible assignment of functional responsibilities, however, and it should be noted that different sectors may come up with different solutions based on technical and political economy considerations. However, it is likely that the bulk of public services (with the exception of the major national responsibilities noted above) can be delivered in a relatively efficient and responsive manner at the state-level or below.

This hybrid assignment of functional responsibilities—with local governments actually being responsible for a relatively limited slice of sectoral service delivery—is likely not only to be driven by a technical assessment of the subsidiarity principle, but also by the likelihood that sectoral ministries (at the state and federal level) are unlikely to give away substantial power over their sectoral responsibilities.

Implications for federal-state functional assignments. If the provision of many key public services is done at the FMS level or below, the main points of contention at the federal level will relate to the degree and manner of involvement of the federal government in the policy-setting and financing of public services. After all, even if the power and responsibility to deliver primary and secondary education is assigned to Federal Member States (or below), the federal government may have an interest in promoting health and education across the entire country, both for equity purposes, as well as to promote national economic growth. The exact role and extent of the federal government in policy-setting and financing of public services, however, will depend on the nature and strength of the evolving social contract within and between groups within the country.

**Commented [AM7]:** Functional assignments are based on political, social, and cultural conditions, as well as geographic features of the country so address the existing context in of Somalia.

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<sup>20</sup> The provision of such public services in the context of a modern public administration requires considerable professional and technical overhead, which results in a relatively large “minimum efficient scale”. As a rule of thumb, in developing and transition economies with a limited pool of professional administrators (lawyers, accountants, etc.), one may need jurisdictions in the range of 100,000-200,000 residents in order to efficiently administer key public services.

In addition, the strength of the federal government in the evolving federal system will depend to a large extent on the assignment of revenues and the targeting of development partner support in line with the adage that “who has the gold makes the rules”.

In this regard, international partners need to carefully balance their interest in ensuring stability and increased national unity (which suggest routing funding through the federal government) with their interest in state legitimacy and effectiveness (which suggests providing support to the state and local level based on their constitutional mandates for service provision, in line with the subsidiarity principle).<sup>21</sup>

Implications for state-local functional assignments. If the provision of most front-line public services is to remain the responsibility of the FMS level (including the local governments within each state), this should re-invigorate the debate in each FMS (and state-like entities) about the appropriate degree of (fiscal and sectoral) decentralization at the state-local level. Given their different conditions (in terms of population size, geography, and other characteristics), different states may end up with different local government structures and different functional assignment.

Whereas Puntland and Somaliland each already have a Decentralization Policy (2013-2020) and have adopted Fiscal Decentralization Strategies, these it may be worth considering these plans and strategies in light of a more nuanced view regarding the likely extent and nature of functional assignments in the future.

For instance, beyond their focus on devolved local provision of public services, it would be appropriate for such a document to consider the more effective deconcentration of resources in different sectors and/or other approaches to ensure decentralized or localized public service delivery. In fact, some countries have found it helpful to focus on how best to “localize the Sustainable Development Goals” as a neutral way to consider improving the efficiency, performance, d responsiveness and accountability of the public sector across multi levels of government.

At the same time, care should be taken to ensure that support to decentralized institutions is realistic with respect to the long-term prospects for state-local decentralization in the Somali context. In this light, the fact that ensuring the presence of representative local councils continues to be a challenge (due to security issues in part of the country, and due to governance challenges in other cases) suggests, on one hand, the importance of continuing to strengthen local governments in order to promote inclusion and build social capital, while on the other hand, revealing the limitation of local governments as an integrated platform for local service delivery in the foreseeable future.

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<sup>21</sup> It is important to recognize that most development partner actors—by their own institutional and operational nature—tend to have a bias towards working with nation-states in a manner that is often quite centralized.

## 5. Revenue assignment across three tiers: considerations and options

In most countries, the degree of expenditure decentralization is considerably higher than the degree of revenue decentralization. The relatively higher degree of revenue decentralization is typically due to a number of factors, including the fact that there are considerable scale economies in public revenue administration; the greater ability of central government to legally enforce revenue collections; and the greater ability to ensure professional and political accountability over revenue collections at the national level.

### 5.1. Revenue assignments: Observation on the *status quo*

Somalia's revenue structure sets the country apart from many other developing and transitional countries, with several factors hindering revenue mobilization. Somalia's economy is largely informal, with most of the population engaged in pastoral and agricultural activities. As a result, the revenue base is narrow. Most of the country's ports and airports (its main revenue-generating assets) are not under the full control of the FGS ([World Bank 2017](#)).

Budget estimates for the FGS (2019) project that US\$ 189.9 million will be collected from domestic revenue sources, with donors contributing US\$154.3 million (US\$ 344.2 million total revenue). Taxes on international trade and transactions account for US\$ 97 million, while non-tax revenue sources account for another US\$ 54.7 million. Tax revenue from all other sources accounts for US\$ 38.2 million. Similarly, in Somaliland, customs revenues plays a key role, accounting for 70 percent of state-level revenues ([ISIR 2019](#)).

Although it is hard to exactly quantify the total amount of revenue collected by type and government levels in Somalia, customs revenues are by far the largest domestic revenue source. The distribution of oil revenues is an emerging—and potentially quite contentious—issue. As a result, the assignment of these revenue source—which level gets to collect them, and how the revenue will be shared (if at all)—will be a defining feature of the future intergovernmental (fiscal) architecture of Somalia.

### 5.2 Applying the subsidiarity principle to revenues in the context of a three-tiered system

Although (international) trade offers an effective tax handle to whichever government level controls transit routes, there is an extensive literature on taxation that argues that subnational collection of customs revenues is likely to result in an inefficient level of taxation and an inequitable distribution of revenues, as customs revenues allow state and/or local governments to export their tax burden (and thereby break the “Wicksellian link” between the marginal benefit of local spending and the marginal cost of collecting this revenue from local taxpayers).

As such, strong arguments can be made that the federal government is the lowest government level that is able to collect customs revenues efficiently. This implies that these revenues should be collected by the federal government and then—presumably—distributed among the FMS through a revenue sharing mechanism. Similarly, strong arguments can be made that the bulk of natural resource revenues should be collected nationally, but shared in part with subnational governments in proportion to the negative externalities suffered in relation to their extraction.

### **5.3 Considerations and options for Somalia**

If technocrats had their way, then, state and local governments would yield their interest in collecting customs revenues and natural resource revenues to the federal level (as discussed further in World Bank, 2020).

Technical prudence, however, is seldom the sole determinant of the ultimate assignment of revenue powers. Instead, perhaps even more so than on the expenditure side of the budget, political economy considerations often dominate in revenue assignment decisions. As such, it should be expected that the federal-state and state-local revenue assignments in Somalia will continue to be informed by a contestation of power, which may evolve over time as social, economic, institutional and political circumstances evolve. It is difficult to see a clear motivation for FMSs (and even more so, for Somaliland and Puntland) to give up these revenue powers and agree to a more centralized assignment of revenue powers).

Given the current revenue situation, revenue diversification and improved coordination, collection and administration revenues will be key policy issues at all government levels (federal, state and local) for the foreseeable future.

## 6. Intergovernmental fiscal transfers across three tiers: considerations and options

As the third pillar of intergovernmental fiscal relations, intergovernmental fiscal transfers (IGFT) play an important role in intergovernmental finance by filling the gaps between expenditure requirements and revenue collections for jurisdictions and different levels.

### 6.1. Intergovernmental fiscal transfers: Observation on the *status quo*

The FGS provides four types of intergovernmental fiscal transfers to FMSs, three of which are tied to specific development partner programs:

- Discretionary transfers from the *FGS local funds (FGS-LF)*;
- **Recurrent Cost and Reform Financing (RCRF) grants**, which are World Bank-funded conditional grants providing wage support for education and health to qualifying states;
- **Surge Support** program funds (targeted support from a Multi-Partner Fund); and
- Transfers of **EU budget support** funds to FMS.

Currently, the federal government provides approximately 10 percent of its budget to FMS in the form of intergovernmental transfers. Under the auspices of the federal Ministry of Finance, US\$ 27.5 million is allocated in the form of current IGFT to the state level. An additional US\$ 7.5 million is allocated to states under the Ministry of Interior, Federalism and Reconciliation (MOIFAR).<sup>22</sup>

State	2017 actual	2018 revised	2019 budget
Somaliland	-	200,000	200,000
Puntland State	4,205,002	6,494,863	5,286,275
Jubaland State	2,466,402	3,383,278	3,136,769
Hirshabelle	1,150,000	1,390,000	2,656,591
South West State	1,510,033	2,328,927	3,551,183
Galmudug	1,652,545	2,507,525	3,890,183
Banaadir Regional Administration	11,787,042	10,530,000	8,830,000
<b>Total</b>	<b>22,771,024</b>	<b>26,834,593</b>	<b>27,551,000</b>

Source: FGS Budget, 2019

Similarly, at the state level, FMSs (and Somaliland) typically provide a portion of their budget resources to the local level. For instance, in Somaliland, transfers to the local government level represent approximately US\$ 2.6 million, or roughly 11 percent of Somaliland's 2019 budget (ISIR 2019).

Despite the provision of intergovernmental fiscal transfers both at the federal-state and state-local level, the vertical and horizontal distribution of these transfers is determined in the absence of a formal policy framework. Similarly, there is not proper legal framework dealing with intergovernmental fiscal transfers. As such, grant allocations are generally determined in an *ad hoc* manner, and funds are generally not released in a predictable or timely manner.

<sup>22</sup> The budget for MOIFAR allocates US\$ 2.52 million each to three states: Hirshabelle; South West and Galmudug.

## 6.2 Applying the principle that “finance should follow function” in the context of a three-tiered governance system

In their design, intergovernmental fiscal transfer systems typically try to follow the mantra that “finances should follow function”, so that the future design of the IGFT system in Somalia will depend a lot on the exact assignment expenditure responsibilities as well as the assignment of key revenue sources (i.e., customs revenues).

For instance, if the states are willing to give the federal government a monopoly over customs taxes, and assuming that the provision (delivery) of key social services (such as basic education and health) would be the responsibility of the state level (or below), the federal government would be in a position to finance the bulk of social services by providing a substantial intergovernmental fiscal transfers to the state level for these functions.

In contrast, if FMSs retain (all, or the bulk of) customs revenues as a state-level revenue, it is much more likely that FMSs (potentially together with their local governments) will cover the majority of funding in the education and health sectors, with the federal government playing a much more limited role. Under this latter scenario, the federal government might focus its financing to the state-level on fiscal equalization (by providing equalization grants to states that have higher expenditure needs or more limited revenue capacity), or alternatively, federal ministries might focus on specific sector programs that supplement state-level funding of health and education services (e.g., school lunch programs, and so on).

Of course, regardless whether the money starts at the federal treasury or is collected by the state, the money (for wages and other service delivery inputs) eventually has to find its way from the federal treasury or the state treasury to the front-line facilities (and in the case of wages, into the pockets of teachers and health workers in the field). This could either be accomplished through effective state-level management; more effective deconcentration, or potentially through the accounts of local/district governments.

One lesson from international experience that may be quite relevant to Somalia is the fact that considerable fund leakage can occur in multi-level governance systems, especially when money is passed down through multiple governance levels to the front-line service delivery unit. For instance, a survey of public primary schools in Uganda by Reinikka and Svensson (2001) revealed that (on average, during the period 1991-95) schools received only 13 percent of the central government's allocation for the schools' nonwage expenditures.

## 6.3 Considerations and options for Somalia

As noted above, the appropriate technical design of system of intergovernmental fiscal transfers is informed by, first, the assignment of functional (expenditure) responsibilities, and second, the assignment of revenue sources. At the same time, an effective transfer system should consider not only the federal-state relationship, but also—as relevant, depending on *de facto* functional assignments—the relationship between states and local governments. In choosing between various policy options, consideration should also be given to the relative ability of state and local governments to manage the “last mile” of service delivery funding (i.e., the link between government finance systems and front-line service delivery facilities) in an efficient and accountable manner.

**Scenarios at the federal-state and state-local levels.** Given the large number of unknowns in Somalia's evolving federal and intergovernmental relationships, it is useful to sketch out a number of policy options based on a number of scenarios at the federal-state and state-local levels.

At the federal-state level, it might be useful to consider three policy scenarios in terms of the federal government's role in expenditures and revenues:

- **Limited / medium federal role.** If states end up being assigned the bulk of functional responsibilities as well as the bulk of revenue sources, the federal level may be left to play a more limited role in the federal structure.
- **Strong federal role.** If the federal government is assigned the bulk of revenue-raising powers (as good public finance practice would suggest), it is likely to be able to play a stronger role in ensuring effective and equitable delivery of key public services. In this case, two main institutional structures might be explored:
  - **Strong federal role in the context of hierarchical federalism.** Somalia might retain a hierarchical constitutional structure that governs federal-state relations, and that considers state-local affairs to be within the purview of each state.
  - **Strong federal role in the context of collaborative federalism.** Alternatively, Somalia might pursue a collaborative federal structure that assigns specific powers or functional responsibilities to federal, state and local governments, by which the federal government directly interacts with local governments (e.g., by providing sectoral funding directly to local governments for functions within their functional mandate).

At the state-local level, it would also be useful to consider three policy scenarios in terms of the state-versus-local government's role in expenditures and revenues:

- **State provision of main public services (deconcentrated).** The first scenario considers that local governments focus on "local affairs" (local roads, community infrastructure, solid waste management, local livelihoods activities and other local priorities). Under this scenario, key social sector services would be provided through state-level line ministries (centrally or through deconcentrated administrative offices at the regional or district level).
- **Hybrid provision of main public services (combination of deconcentration and devolution).** Under the second scenario, in addition to focusing on strictly local affairs, local governments are also assigned partial responsibility for social sector services (education, health, agricultural extension, etc). However, important parts of the provision of key social sector services (possibly: providing and funding teachers) would be the responsibility of state-level line ministries (centrally or through deconcentrated administrative offices at the regional or district level).
- **Local provision of main public services (strong devolution).** Under the third scenario, local governments are expected to take on full responsibility not only for strictly local affairs, but also for all aspects of key social sector services (education, health, agricultural extension, etc.), including the funding and employment of teachers, health workers, and so on.

Based on these 3x3 scenarios, Table 3 presents a number of appropriate intergovernmental fiscal transfer designs, reflecting federal-state transfers in blue, and corresponding state-local transfer mechanisms in green. The implications for the design of the different scenarios are explored below.

Scenarios	1. Limited / medium federal role	2. Stronger federal role, hierarchical fed.	3. Strong federal role, collaborative fed.
	Equalization grants to FMS; Limited earmarked grants	Sectoral grants to states	Unconditional and conditional federal grants to state and local governments
1. State provision (deconcentrated)	No (or limited) state-local transfers		Limited state-local transfers
2. Hybrid provision (shared state/local)	General-purpose state-local transfers		
3. Local provision (strong devolution)	General-purpose and cond. state-local transfers		

**Policy options.** Under the different scenarios, different intergovernmental fiscal transfer systems might emerge.

**Column 1. Limited / medium federal role.** The first column in Table 3 explores scenarios in which both revenue collection and public service provision are largely assigned to the state level (or below), and where it is generally felt that state and local governments are generally more responsive and accountable to the people, so that the federal government plays a relatively limited role.

Among others, Switzerland, Germany, Canada and the United States might fall into this category.

Under these conditions, two types of federal-state grants might be expected (column 1; blue cell). First, the federal government might engage in some type of fiscal equalization by which by the federal government provides unconditional equalization grants to states that have higher expenditure needs or limited revenue capacity (such as in Germany and Canada). Alternatively, federal government might provide relatively limited—but highly targeted—earmarked grants for specific purposes (such as grants for school feeding programs, highway construction, and so on), as is the case in the United States.

Under this federal-state scenario (as under the next), three different state-local grant systems are possible (Column 1; green cells):

- First, if the bulk of subnational public service provision is centralized at the state level (possibly through an effectively deconcentrated state apparatus), there would be little or no need for state-local transfer (state-local scenario 1). Since the main mandate of local governments would be to function as a platform for local-decision making and managing strictly local affairs (whereas the state government would provide the bulk of social services), local governments could largely operate from own revenues. State-level support for devolved local government could come in the form of direct salary support for local administration staff, or possibly, in the form of a (relatively small) unconditional formula-based grant to support local administration and local development interventions.
- Second, if FMSs pursue a decentralization approach in which the responsibility for delivering key social services is shared between the state and local level (in addition to exclusively local services), it would no longer be appropriate for the state government to expect local governments to fund its activities exclusively from own revenue sources (given the considerable variation in local revenue capacity). In this case, a more robust formula-based state-to-local unconditional grant might be

introduced to support local administration and local development interventions, possible in combination with targeted grants for sectoral purposes—for instance, facility grants or capitation grants for the operation and maintenance of schools and health facilities.

- Third, if a FMS chooses to pursue a decentralization approach in which the bulk of the responsibility for delivering key social services is assigned to the local level, this would require a considerable devolution of state resources, most likely through a combination of a fairly major unconditional transfer (either formula-based revenue sharing or a general-purpose grant) as well as robust conditional sectors grants at the state-local level.

Since under the first federal-state scenario there is only a limited federal role and no meaningful federal-state sector transfers, each state would have considerable flexibility in formulating and managing their own state-level grant system. In fact, under the current constitution disposition, it be possible for different states to asymmetrically implement different state-level decentralization strategies and follow different state-local grant systems, as appropriate to each state’s preferences and circumstances:

Column 2: Stronger federal role, in the context of hierarchical federalism. The second column in Table 3 presents a number of policy scenarios where there is a stronger federal role in intergovernmental relations in the context of hierarchical federalism—where local governments are creations of their respective states, and funds flow vertically through the hierarchy. In Somalia this situation might occur if the federal government is assigned increasing control over key public sector revenues, but states retain the power and responsibility for delivering key public services (and to decide on their own state-local relationships).

In this case, in addition (or instead) of unconditional federal-state grants, we would expect a system of conditional sectoral grants to emerge, where state and local public services—such as education and public health—are predominantly funded from federal sector grants.

Internationally, Ethiopia and Mexico might be an example of such a federal structure: states receive a relatively large share of their resources from the federal government, and in turn pass a considerable part of their resources on to the local level, in a hierarchical manner.<sup>23</sup>

Under this scenario, however, federal sector grants must be relatively flexible in nature, as different FMS could still have different state-level approaches to decentralized/public service delivery. In the case of state-level (e.g., deconcentrated) provision of sectoral services, the federal sectoral grants would simply be used by the respective state-level sector ministries to fund front-line services, with little or no provision of state-local grants. However, in the case of (partial or complete) local provision of sectoral services, federal sector grants would presumably be passed on by the state level—in part of in full—by state governments to the local governments ultimately responsible for the delivery of the public services.

**Commented [AM8]:** There is decentralization policy in puntland and Somaliland which are clearly giving full responsibility to local government on service delivery. Paper should refer these efforts in the ground

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<sup>23</sup> An option not shown here is a system that relies on unconditional grants at the federal-state level as well as at the state-local level. Ethiopia is arguably a country that combines (unconditional) equalization transfers at the federal-state level with gap-filling equalization grants at the state-local level. Despite the seemingly unconditional nature of the state-local grant system, states in Ethiopia have a high degree of administrative control over the local government level (to the point where it is unclear whether districts in Ethiopia are devolved entities or deconcentrated units of the state).

Column 3: Strong federal role, in the context of cooperative federalism. The final set of scenarios (column 3 in Table 3) considers a collaborative federal structure, where the constitution recognizes not only state level governments, but where the constitution defines local governments as a constitutional level or sphere, in a way that permits the federal government to transfer funds directly to local governments for functions within their constitutional mandate.

Under this scenario (a three-tiered collaborative federal system), the federal government would most likely have a significant role to play in funding public services which would be delivered at the state as well as local level. This most likely would involve both unconditional as well as conditional (sectoral) grants from the federal level to both the state level as well as the local level. Under this scenario, there would be only a limited role for state-local transfers (if any), because the federal government would have already distributed the necessary funding to the state and local level (and states would likely have limited additional resources to share with the local level).

This approach is relatively common around the world, especially among newer federal or quasi-federal governance systems. Nepal, Indonesia, and South Africa would be examples of such three-tiered collaborative intergovernmental fiscal systems.

This scenario, however, does not appear to be a likely outcome for Somalia in the foreseeable future.

**Political economy implications.** Like other aspects of intergovernmental finance, the design and evolution of an intergovernmental fiscal transfer system is not just a technical exercise. In fact, little is more political than determining the mechanism through which government finances will be distributed—vertical and horizontally—to different levels and units of governments. In other words: the design and implementation of intergovernmental fiscal transfer systems is inherently political, and the political economy of different policy options should not be ignored.

Out of the three scenarios reviewed, one might have to consider the emergence of a three-tiered collaborative federal system emerging in Somalia —by which the federal government is assigned extensive revenue powers and local governments are recognized as constitutional entities in their own right—as a scenario with a relatively low probability.

The design and mix of the federal grant system, then, will largely be determined by the extent to which the federal government is able to make the case that collecting key revenue sources nationally—and distributing them efficiently and equitably through intergovernmental fiscal transfers—is a superior option to continuing a more decentralized assignment of revenues.

Channeling an increased portion of domestic revenues as well as international development assistance (including funding for education, health, and other sectors) through the federal level to the state-level in the form of sectoral (block) grants would provide a meaningful incentive for all states and state-like entities to increasingly act as a member of the federation. At the same time, such grants could act as an incentive for states to improve the effectiveness with which public sector service are delivered.

An effective federal system and an effective public sector are seen by many as essential for a virtuous cycle of peacebuilding and stability and an eventual exit from fragility for Somalia. As a result, some international actors—including the World Bank—are trying to support this process by strengthening the role of the federal government, by which incentives are created at the margin for all states and state-like

entities (including Puntland and potentially even Somaliland) to increasingly see benefits from acting as a member of the federation.

At the same time, the interaction between the intergovernmental fiscal transfer system and the (post-) conflict context is not limited to the federal level. In Somalia, as in many (post-)conflict context, state legitimacy depends to a large extent on the public sector having a visible and constructive presence at the local level, where public sector decisions can be made in an inclusive and contestable manner. Peacebuilding and state legitimacy are not enhanced when federal or state-level resources fail to reach the front lines.

## **7. Conclusions and way forward**

A successful system of intergovernmental fiscal relations in Somalia—one that supports an eventual exit from fragility—requires, first, that the federal government is able to push money to the state level in an effective, systematic and timely manner (without money getting stuck at the federal level), and second, that effective mechanisms for further decentralization or localization of these resources are in place at the state level to ensure that resources reach the front-line of service delivery.

On the first point, the unpredictability of grant releases from the federal to the state level seems to undermine the trust of FMS in the federal government. As such, there is a continued need to strengthen the management of intergovernmental fiscal transfers at the federal level and to put in place appropriate checks and balances to ensure that all stakeholders play their respective parts, allowing intergovernmental fiscal transfers to flow in a stable, timely and predictable manner.

This will require continued forward momentum, through the Finance Ministers Fiscal Forum, moving away from an ad hoc, discretionary grant allocation towards a coherent intergovernmental fiscal transfer policy that—in addition to clarifying operational issues surrounding disbursements and reporting—defines the envisioned future composition of the grant system (e.g., conditional versus unconditional), clarifies for purpose these grants are provided, along with clear ideas or expectations about the vertical and horizontal distribution of resources.

On the second point, care should be taken that the gradual build-up of the federal role in financing front-line services does not undermine the decentralization strategies being pursued at the state level, which are equally important ingredients for peacebuilding and state-building. This is a two-way process: the emerging federal-state grant system has to be sensitive to the existence (and possible diversity in) state-local relations, but state-level decentralization policies and strategies may need to be revisited to ensure that they are realistic with respect to the degree of devolution that is possible and desirable given the current state of (institutional and economic) development in Somalia.

Furthermore, state-level decentralization and localization reform efforts may be expanded not only to strengthen the role of devolved local government entities, but also to ensure that deconcentrated sectoral resources (especially in education and health) arrive at the local level for the purpose of improving front-line services to the people.