

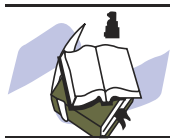
DIALOGUE FOR PEACE

Somali Programme



Funding the Future

Laying the Foundations for the Equitable and Accountable
Management of Public Funds in Somalia's Puntland State



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Back cover photo: *A young fisherman calls for the elimination of poverty*

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The Dialogue for Peace

How WSP International and its three partners are working to consolidate peace and support better governance across the Somali region

Rebuilding a country after conflict is about far more than repairing damaged buildings and re-establishing public institutions. Fundamentally, it is about restoring the people's trust and confidence in governance systems and the rule of law, rebuilding relationships at all levels, and providing the population with greater hope for the future. These processes are all critical to the consolidation of peace and security in fragile post-conflict situations. When they are neglected, the threat of conflict re-emerging is very real.

In this sense, state-building and peace-building are potentially contradictory processes – the former requiring the consolidation of governmental authority, the latter involving its moderation through compromise and consensus. The challenge for both national and international peacemakers is to situate reconciliation firmly within the context of state-building, while employing state-building as a platform for the development of mutual trust and lasting reconciliation. In Somali region, it goes without saying that neither of these processes can be possible without the broad and inclusive engagement of the Somali people.

WSP International – recently renamed the International Peacebuilding Alliance (Interpeace) – launched its Somali Programme in the northeastern part of Somali region known as Puntland in 1996. It subsequently expanded its programme to Somaliland in 1999, and to south-central Somalia in 2000. Working with highly respected local peace-building institutions established with the programme's support – the Puntland Development Research Centre (PDRC) in Garowe, the Academy for Peace and Development (APD) in Hargeysa, and the Center for Research and Dialogue (CRD) in Mogadishu – WSP has employed a highly successful 'Participatory Action Research' methodology to advance and support interlinked processes of peace-building and state formation. WSP's experience in the Somali region over the past decade indicates that the understanding and trust developed through the PAR methodology can help to resolve conflicts directly, while at the same time building consensual approaches to address the social, economic and political issues necessary for a durable peace.

As well as groundbreaking research throughout the Somali region, the Dialogue for Peace programme has provided unique opportunities for the three partners to engage with each other in collaborative studies and shared projects. In 2004, the CRD and PDRC teams agreed to combine their efforts in a jointly-managed peace-building programme. While managing its component of the Dialogue independently, the APD has continued to collaborate with the other two institutions on key technical and methodological issues. Over the past two years, the three partners have met regularly with WSP's Somali programme team to plan and coordinate their respective activities, as well as with a 'Dialogue Support Group' comprising the programme's donors at the European Commission, DfID, USAID, Switzerland, Sweden, Norway, Finland, Italy and Denmark.

The Dialogue's consultative process has involved extensive consultations with all sectors of society, from national-level political and business leaders to local elders and community leaders, youth and women's groups, NGOs and civil society organisations. Its Participatory Action Research has provided for an inclusive, consensus-oriented dialogue led by local actors and facilitated by Somali research teams based at each of the partner institutions. The discussions have been documented in written and video form, and every effort has been made to engage the local media and disseminate the findings as broadly and objectively as possible.

Initial consultations by each partner institution were based upon detailed ‘actor and conflict mapping,’ which enabled the programme to identify local and regional priorities for dialogue, as well as respected leaders to guide and promote the dialogue process. At the Project Group meetings held in November 2004 by PDRC and CRD in Nairobi and by APD in Hargeysa, several areas of focus, or ‘entry points,’ were agreed upon for research and discussion in each area. For APD, the focal areas were: democratisation; decentralisation of governance; and resource-based conflict. The PDRC’s areas of focus were: democratisation; public fund management; consolidation of the Mudug Peace Agreement; and reconciliation. The CRD’s focal areas were: security and stabilisation; the roles of the business sector and civil society in peace-building; and reconciliation.

At the outset of the main ‘consultative phase,’ Working Groups of primary stakeholders were established to guide the work on each focus area and to develop plans of action. The groups’ activities included: information gathering and analysis; the identification of key local, regional and national actors whose views or engagement would be required; consultations through interviews, workshops, informal and formal meetings at local, inter-regional or national levels; and the engagement of resource persons to provide particular expertise on complex issues. Extensive consultations over a period of a year or more were essential to ensure sustained public interest and to raise key issues to the level of political decision-makers. Each of the partners also organised regular forums for public discussion of topical issues of concern, as well as engaging in informal liaison as a means of conflict prevention.

This report forms part of a final series of publications designed to formally ‘package’ the findings of these consultations – both as a record for those involved, and as a formal presentation of findings and recommendations to the national and regional authorities and their supporters. Together with a short documentary film on each of the focal areas, it is also hoped that these publications will provide a practical platform for the sharing of lessons learned during each of these groundbreaking consultations.

In response to requests from different stakeholders, including members of the different governance structures, the Dialogue for Peace also set out to take its ‘research-for-action’ beyond the stage of recommendations to include more material contributions to peace- and state-building. One example was the reduction of tensions in Sool after a high-profile exchange of prisoners between Somaliland and Puntland, following extensive behind-the-scenes mediation supported by the APD and PDRC. To ensure that such practical hands-on support will continue into the next phase of the Dialogue, WSP has also initiated a comprehensive programme of managerial training, technical capacity building, and fundraising support at each of its partner institutions. And of course, it is continuing to provide practical opportunities for the three institutions to meet together and with other like-minded organisations in order to support other initiatives to foster long-term peace for the Somali people.

Funding the Future

Laying the Foundations for the Equitable and Accountable Management of Public Funds in Somalia's Puntland State

1. Introduction

While relative chaos has reigned through much of south-central Somalia for the past 15 years, the north-eastern regions collectively known as Puntland have remained comparatively stable and secure. The economy, while largely unregulated, has continued to grow. The fragile security situation was successfully monitored by Traditional Titled Elders and by competing factions of the former Somali Salvation Democratic Front (SSDF) until 1998, when the strong will of the people to embrace a modern, democratic system of governance led to the creation of a single administrative body, the Puntland State of Somalia.

At a broadly representative community conference held in Garowe in May 1998, an interim charter was promulgated with basic provisions for the creation of the legislative, judicial and executive arms of a state government. A transitional administration, comprising a president and vice president, a nine-member cabinet, and a 66-member House of Representatives, was duly sworn in on August 1st 1998 for an initial three-year term – after which elections for local councils and a state parliament would be held. However, by the end of its first term, the new government was already facing allegations of mismanagement and nepotism – leading to widespread public protests, and several incidents of armed conflict.

Despite some promising developments, such as the establishment of fledgling ministries, a police force and magistrates' courts, and the re-launch of some local-level social services, the misappropriation of public

funds continued to undermine confidence in the new administration into its second term. In such an environment, it was clearly going to be difficult to realise even the most basic prerequisites of democratic governance: a population census, voter registration, a draft interim constitution.



A nomad's camels are his most precious asset...

© Ryan Anson/ Interpeace

Throughout this difficult 'birthing period,' WSP International's Somali research team and its local partner, the Puntland Development Research Centre (PDRC), served as one of the state's most prominent civic voice on issues concerning democratisation and peace-building. A peacebuilding NGO established in Garowe with WSP's support in October 1999, the PDRC's primary objective has been to

promote cooperation and develop dialogue towards inter-clan reconciliation and the creation of a democratic system of governance. Between 1997 and 2001, the partners used WSP's Participatory Action Research (PAR) methodology to conduct wide-ranging studies throughout Puntland – creating a spirit of confidence and ownership which provided the basis for the Dialogue for Peace programme, and an essential consensus on the priority issues to be addressed (*see Rebuilding Somalia: Issues and Possibilities for Puntland*).

In early 2004, the PDRC and WSP agreed to collaborate on an initiative for a series of groundbreaking regional conflict resolution efforts as part of the Dialogue for Peace programme. Working with everyone from elders and politicians to legislators and civil society organisations, the partners spent several months ‘mapping’ the most pressing political and social priorities for the state’s peace process, in a comprehensive baseline survey covering Bosaso, Gardo, Garowe and Galkayo. The issues identified were then put to local leaders and stakeholders in a series of high-profile consultative meetings, with a final ranking that identified political ‘democratisation’ and public revenue management as the most pressing priorities at the local level, the consolidation of the 1993 Mudug Peace Agreement at the regional level, and national reconciliation at the country level. The mapping also provided compelling evidence of the public’s support for specific reconciliatory activities, including community meetings and public debates.

Funding the Future

From the earliest days of Puntland’s democratic process, public sector corruption and mismanagement are said to have been a source of continual consternation and criticism from both civil society and the international community. Nepotism and favouritism in the recruitment of public officials and defiance of provisional laws have continued to drain the state’s resources, while the widespread acceptance of “*fadlan*” (literally, “please”) payments to officials’ relatives and supporters has provoked mounting public outrage. Although there have been efforts to establish more formal public revenue channels – notably through customs levies collected at the ports and airports at Bosaso and Galkayo – funding of the public sector continues to suffer from widespread graft and mismanagement. It is no coincidence that most of the major conflicts in northeast regions/ Puntland since 1992 have arisen from disputes over the control of Bosaso port – the state’s main source of funding.



...but serious environmental degradation threatens the pastoral economy – as can be seen from this gully caused by severe erosion © Ryan Anson/ Interpeace

Politically, progress has also been slow in coming. After two years of simmering internal conflict – and armed confrontations in July 2002 – the signing in May 2003 of a peace accord between Puntland’s then president, Abdullahi Yousuf Ahmed, and the opposition leader, General Mohamoud Mussa Hersi ‘Adde’, appeared to signal a new chapter of hope for the consolidation of Puntland’s peace. Across the state, the agreement was seen as heralding a new era of inter-clan reconciliation, with thousands of Puntland militiamen integrated into the regular armed forces to serve alongside their former enemies.

However, the looming expiry of the government’s second term on June 30th 2004 – and the apparent intent of some leaders to remain in power – continued to hang over Puntland’s political future. While committees and budgets had been established to prepare for municipal elections in 2005, disagreements over the process had driven a wedge between the cabinet and parliament – leading the politicians even further from the social development that people were looking to them for. When the government’s mandate was extended for a further six months, many saw it as a ruse to cement its power.

In October 2004, the election of Abdullahi Yousuf as Somalia’s transitional federal president was welcomed by his supporters, but also threatened the fragile peace back in Puntland. Yousuf’s extended involvement

in the reconciliation conference in Kenya had not only drained Puntland’s coffers, but had also deprived it of a working president. In his absence, his vice-president, Mohamed Abdi Hashi, twice tried to seize control of the parliament – and then to extend the mandate of the government. Ironically, the national reconciliation process ultimately served to divide Puntland’s cabinet into two opposing camps.

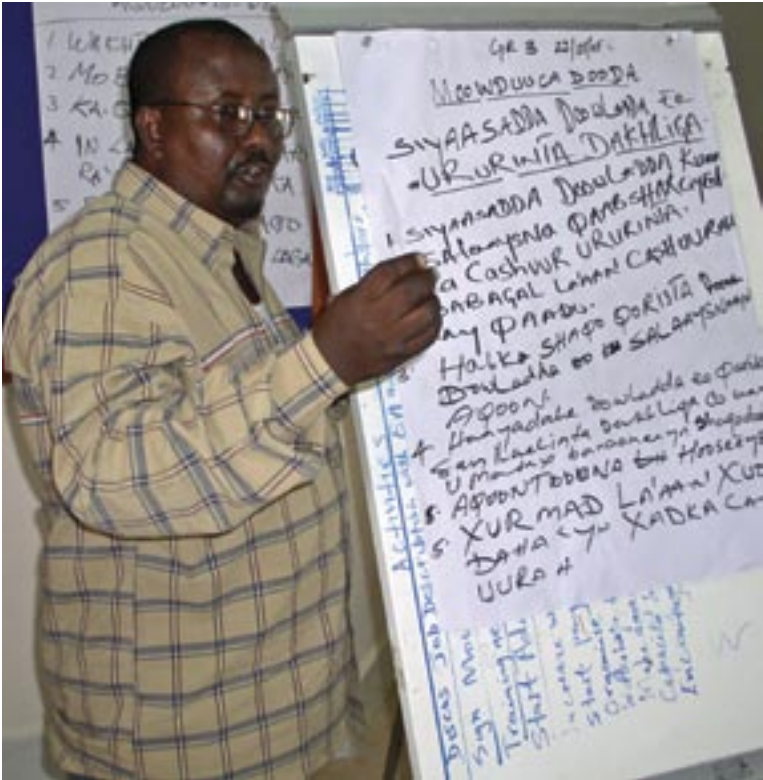
During the confusion that followed Yousuf’s election, the PDRC played a critical role in bringing senior elders together in a series of high-profile consultations to chart the way forward for the state. Fortunately – in what many saw as a promising portent for Puntland’s democratic future – unanimous agreement was reached on the makeup of a new parliament, which would be charged with electing a new president. Eventually, on January 8th 2005, opposition leader General Adde was elected as the new president – and Puntland’s recovery could begin again.

In early 2005, the new government took steps to push social and economic reform back to the top of the state’s agenda through the launch of a five-year development plan. As well as measures for economic growth and job creation, the programme targeted inefficiency and corruption in public institutions, security and the rule of law, and the promotion of “positive cultural and moderate Islamic values.” A proposal for *Addressing Better Administration* in Puntland was further refined in March 2006, when the president appointed four independent commissions to oversee reforms in security and the armed forces, public finances, the judiciary, and public service institutions.

The Research Project

Following the ‘mapping’ of Puntland’s priorities for peace, the PDRC in mid-2004 launched the second stage of its project to analyse the current situation of public revenue management in the state and to make practical recommendations to improve systems of revenue collection and expenditure. Following the baseline survey, which had clearly demonstrated a relationship between Puntland’s recurrent conflicts and its public revenue collection, management and expenditure, four primary goals were established for the

- participatory action research:
- To improve the public revenue collection and management capacity of the Puntland administration;
 - To boost public revenue allocations for basic social services across the state;
 - To raise public confidence in the administration by improving systems and practices of accountability; and
 - To instigate greater accountability, transparency and the provision of public information on revenue and expenditure.



Ali Jama, the Director of Puntland’s Inland Revenue, played an active and critical role in the public fund management research facilitated by the PDRC

The tried and tested WSP methodology of PAR, which aims to contribute to lasting and sustainable results in the ongoing national reconciliation process, had already enabled the PDRC to bring together a wide variety

of ‘peace-builders’ to share ideas and develop networking opportunities. In the case of this focus area of research, the main stakeholders included government ministers and lawmakers, revenue collection institutions, local authorities, civil society organisations, prominent businessmen, religious leaders, clan elders, and the leaders of representative urban and rural communities. Bearing in mind the specialised nature of the public finance sector, invitations were also extended to relevant government departments and local NGOs that could advocate for change in public opinion.



Livestock tax collectors at the port of Bosaso

© Ryan Anson/ Interpeace

The research process and the ensuing report made use of a variety of PAR tools and systems, adapted where necessary to suit the local situation, including: literature reviews; individual and focus group interviews; questionnaires to collect data and information on revenue management; and participatory workshops to devise recommendations for the administration. A panel of experts was also established to elaborate upon the workshop proceedings and formalise their recommendations.

The PDRC has also been using short films produced by its audio-visual unit to disseminate the findings and recommendations of its research – particularly to less literate sections of the population. The storyboards on each research activity have proved a valuable tool in keeping participants abreast of the project’s findings, and in giving all those involved a broad ‘picture’ of its evolving directions. The final documentary film will become a major asset for future awareness-raising initiatives.

The focus of this research was inspired by and based upon preliminary observations about public resource management in Puntland, which clearly pointed to a need for inclusive and wide-ranging dialogue on the future of revenue collection and expenditure. These observations included:

- The risks of lineage and faction competition for control of public revenue leading to political rivalry – and often to catastrophic conflicts;
- The tendency of the mismanagement of public resources to ignite regional or district conflicts;
- Disproportionate budgetary allocations of public revenue, which are responsible for widespread social, economic and political grievances.

In the baseline mapping and prioritisation of the hurdles facing long-lasting peace in Puntland, many respondents had pointed to the disproportionate allocation of state funds to security and “political funds” – at the expense of more pressing social and development needs. Inequality in the management and disbursement of public revenue was repeatedly cited as the prime source of hostility within and towards the administration – and, therefore, a major source of potential civil unrest in Puntland’s near-term future.

Beginning the Dialogue

by Ali Farah, Research Coordinator, PDRC
& Pat Johnson, Sr. Programme Officer, WSP

Many of those familiar with the situation in Puntland recognise the necessity for improvements in public fund management in order that the administration can be enabled to serve its citizens more effectively. But in any setting, issues of revenue collection, public expenditure, and allocation of budgets for different sectors can be extremely sensitive. So how did the PDRC manage to engage so successfully in this critical area?

Two key factors helped to enable in-depth research and active engagement with the primary stakeholders. First, the election of General Mohamoud Mussa Hersi 'Adde' as president of Puntland in January 2005 heralded a new phase in the Puntland administration, characterised by a desire to make changes and bring new thinking to the challenges faced by the Puntland people. With this new era, both the administration and the people have demonstrated a widespread willingness for proactive engagement in order that Puntland can move forward.

Second, in keeping with WSP practice, the PDRC has been able to demonstrate over time that its interest is in maintaining a neutral political space through which it can engage with all actors in the interest of building and consolidating peace, and in working *alongside* both the administration and key stakeholders to this end.

Through discussions between PDRC staff and the Ministry of Finance and other members of the administration, confidence was developed that the aim was not to undermine the administration or expose its shortcomings, but to support the Ministry and work together on overcoming obstacles to effective public resource management. For example, the PDRC made it clear that, far from engaging in an audit of public finances, the intention was to examine administrative gaps in order to assist those concerned in devising practical solutions to plug them.

While the Minister of Finance initially agreed to the process on condition that "we get the results of the research," the PDRC suggested instead that they work together on the implementation of recommendations, including training and other assistance to overcome obstacles or deficiencies. In this way, the PDRC and the Ministry were able to begin the process of research and discussions on the way forward for more effective public fund management. Key staff from the Ministry who are contributing to this research include the Directors of Finance, Budgeting, Inland Revenue and Personnel.

One of the first outcomes of the project was the administration's positive response to lobbying from different quarters for an increase in the annual budget allocation for social services, from 3% to 15% in the budget for 2005-06. This is reflected, for example, in an increase in the number of teachers receiving salary payments from 100 to 300 teachers.

In this and its other early achievements, the Dialogue for Peace between the PDRC and its partners in the Puntland administration provides a compelling example of the ways in which collaborative research-based action can contribute to more effective public resource management.

2. Activities

In addition to the usual PAR tools of interviews, focus groups and participatory workshops, the researchers also spent time immersing themselves in the real business of public revenue collection and management – through direct observations of tax collection processes and attendance of ongoing negotiations between the administration and members of the catering sector. The research subject – Public Revenue Collection, Management and Expenditure – emerged from the consultative survey held in July 2004, which established a direct relationship between the mismanagement of public resources and the outbreak of sporadic conflicts between key actors. Indeed, since the onset of civil strife in the Mudug region in 1991, almost every political and civil dispute in Puntland has had its roots in the struggle for control and management of the state's public revenues.

A provisional schedule of research activities was initially drawn up by the 15-member Working Group established by the PDRC to supervise and guide the research process. The schedule comprised the following key activities:

- Working Group meeting for guidance and planning (15 members);
- Assessment of sources of revenue, taxation processes and expenditure;
- Participatory workshop on revenue collection (40 participants);
- Participatory workshop on revenue expenditure (40 participants);
- Participatory meeting on workshop outcomes (40 participants), leading to a list of recommendations;
- Panel of experts to review workshop outcomes and formalise recommendations;
- Sensitisation and lobbying of the House of Representatives to approve recommendations on revenue, regulations and fiscal/budgetary allocations;
- Two-day Working Group meeting to review results;
- Preparation of final report;
- Follow-up monitoring by PDRC of implementation of adopted actions.

Although most of these activities were carried out as planned, some had to be deferred due to the frequent changes occurring within the administration and its public revenue institutions during the research period. Given the highly sensitive nature of the subject matter, and the mistrust that the project could easily have generated, the researchers were compelled to maintain the utmost sensitivity and diplomacy in all of their activities.

The outcomes, details and recommendations of each research activity are sequentially described in the following pages, with a summary of the main findings and recommendations provided at the end of the report.

The Working Group

Based upon the implementation strategy of the Dialogue for Peace programme, and following a Zonal Project Group Meeting in late February 2005, the PDRC appointed a Working Group to guide the research project during a two-day meeting at its premises in March. In order to ensure that the research would be conducted in a wholly inclusive, objective and representative manner, the Centre invited representatives from all the major concerned sectors of Puntland society, from administrators and bankers to businessmen, security experts and senior government officials. (A full list of the Working Group members and their professional affiliations appears at the end of this report.)

As well as supervising the overall schedule of research activities, the Working Group members met monthly to monitor the progress of each activity and to provide expert advice and oversight. Some of the members also attended and contributed their expertise to the larger workshops held to discuss public revenue collection, management and expenditure. The presence of several high-profile officials in the Working Group allowed for some particularly candid discussions, as evidenced by this statement from a senior government official on the importance of public spending on security – a statement that was pointedly delivered in the direction of a local police chief.

“We have to have guns to defend ourselves, because we’re responsible for our security and we cannot get protection from the security forces...”

– Ismail M. Warsame
Director General, Ministry of Rural Development & Local Government

During their initial meeting, the Working Group members discussed a wide variety of issues related to the collection and expenditure of public revenue and agreed a workplan to guide the research activities. They then prepared a questionnaire to guide the initial assessment of public revenue management, including the government’s fiscal policies and financial practices, taxation processes and procedures, legal and procedural documentation, sources of revenue, and budget allocations to various sectors. The meeting also designed the following outline for the assessment survey, to provide a basic structure for the research product:

1. Current government taxation and revenue collection policy
2. Existing sources of public revenue
3. Potential but unexploited sources of public revenue
4. Government budget allocations to various sectors
5. Major challenges facing revenue collection and management
6. Effect of levies and commissions on government revenue collection systems and their accountability (e.g. the Northeast Somalia Highway Authority, the Puntland State Agency for Water, Energy and Natural Resources, the Puntland Chamber of Commerce, port and airport duties)
7. Tax collection practices
8. Revenue expenditure practices.

The Assessment Survey

The assessment survey, undertaken in April 2005, targeted two major sites chosen for their significant contributions to Puntland’s economy: Bosaso, the commercial capital and the state’s major deep-sea port, and Galkayo, its main livestock market. As well as representing the administration’s main revenue collection bases, these two towns were thought to provide genuinely representative information of revenue collection and expenditure in the state.



Bosaso port has thrived since 1991, exporting livestock from across Somalia and importing a huge range of foodstuffs, building materials and household goods

In summary, the assessment found that the basic structures and legal frameworks for conducting systematic public revenue collection and management are in place, including almost all necessary documentary and procedural arrangements. However, owing to the inevitable lack of financial controls and accountability arising from the inexperience and poor management of the local authorities, the survey identified several critical weaknesses in the revenue collection and management systems in Bosaso and Galkayo, including:

- Widespread disregard and lack of respect for existing laws, regulations and financial and accounting procedures;
- A total absence of genuine financial management policy and strategy;
- Limited qualified personnel capable of delivering the services required;
- Unrealistic and often irrational budgeting processes;
- Absence of reliable Financial Information Systems (FIS);
- Inability of auditing and supporting judicial/law enforcement systems to measure accountability and transparency, and to provide evidence of mismanagement or misappropriation to the House of Representatives and other public bodies;
- Poor coordination of the government's financial institutions, and the high risks incurred in transporting public funds by road (which have led to several robberies in recent years);
- Lack of baseline statistical data on macro-economic issues and quantitative assessments of potential sources of public revenue.

The Workshops and Expert Panel

In the light of these broad-ranging and persistent constraints, and the growing public mistrust they have inevitably created, it was seen as vital to engage with a broad cross-section of Puntland society in analysing the results of the assessment study. For this purpose, two follow-up workshops were held in Garowe in May



Ali Jama (left), the Director of Puntland's Inland Revenue, interacts with participants at the workshop on Public Revenue Collection, Garowe, May 2005

and June 2005 – one focused on public revenue collection and management, the other on the government's revenue expenditure. The outcomes and recommendations of these workshops were then forwarded to a Panel of Experts, selected for their expertise in various public fund management disciplines, for further analysis and elaboration. As well as financial and legal advice from financial and economic affairs experts, the panel also considered the potential impacts of specific recommendations on security and stability in different areas.

Both the workshop participants and the Panel of Experts broadly criticised the lack of adequate written policy guidelines available to govern and regulate the collection, allocation and management of public revenue. In analysing the application of specific laws, regulations and standing orders in the provisional 2005 revenue budget, the Panel of Experts discovered major systematic faults and irregularities in this official document.



Camels are loaded onto a motorised dhow for export to the Gulf

© Ryan Anson/ Interpeace

In order to tailor the government's expenditure to fit available revenue – rather than the other way around – both the workshops and the panel agreed that the government should 'go back to basics' in adopting the following fundamental principles of revenue collection and allocation:

- a) Taxation laws and procedures must go through a number of steps before they can be formally applied:
 - Identification and listing of goods, services and incomes that can be taxed and the rates of taxation to be charged
 - Enacting of taxation laws by parliament, elected regional or district municipal authorities, or a delegation of a legislative body;
 - Promulgation by the president, followed by the publication of the tax laws (statutes) in an official bulletin;
 - Public awareness-raising and preparation of required documents (receipts, registration and deposit books, etc.) by the service ministry or agency/agencies charged with responsibility for tax collection.

- b) The primary goal is to generate, collect and manage revenue in a transparent and accountable manner and to ensure that these activities are carried out in accordance with the provisions of relevant laws, including the constitution, laws concerning the budget, and laws and procedures governing the state's financial and accounting systems.

In this regard, most of the workshop participants arrived at the conclusion that the problems hindering the efficient and effective collection and management of public revenue in Puntland stem from inappropriate application of the existing laws, regulations and procedures, rather than the absence or inadequacy of these laws and procedures. The current status and level of use of the major legal and financial documents available to Puntland's financial institutions are listed on the following page.

Table 1: Legal Documents Used by Puntland's Financial Institutions

	Document / Description	Status
1.	The Puntland Transitional Constitution	Currently under review
2.	Law of Annual Budget	Requires reviewing (national/ foreign expertise)
3.	Financial and Accounting of the State	Partially used
4.	Law of Direct Taxation (Decree Law No. 5 of November 5 th 1966)	Partially active
5.	Somali Civil Code	Partially enforced
6.	Direct Taxation (Taxation on income from lease/rents of buildings: 22.5%; see Law No. 6 of December 28 th 1971 and also supply U.B. No. 1 of January 5 th 1972)	Partially active
7.	Decree Law No. 6 of December 7 th 1966, Imposta Di Bollo (Stamp Duty)	Not active
8.	Law No. 15 of November 1 st 1969 (SRC Decree) on the establishment of a commission for deliberation of the Fiscal Contention	Not established
9.	Law No. 7 of January 29 th 1977 (Law No. 11 of February 8 th 1967) of Foreign Investment (See revised version of Puntland State)	Not in use
10.	Law No. 21 of January 19 th 1973 – Supervision and Control of WAQF Property (U.B. No. 3 of February 28 th 1973)	Not active
11.	Canshuurta Ijaarka Daaraha (10%) – Tax on real estate rent (10%)	Not active
12.	Indirect Taxation (Canshuurta Dadban Law No. 9 of April 14 th 1999 – Canshuurta Moorka Ganacsiga, Cansh. Moorka Mush/ yinka etc.)	Active
13.	Law No. 3 of November 29 th 1998 – Administrative Law of the MOF	Active
14.	Puntland Customs and Excise Duty (Law No. 16 of December 1998) – Customs duty tariffs – <i>ad valorem</i> on qat/khat at 20%	Active
15.	Law No. 6 (December 1998) on property tax/ unmovable assets	Not known
16.	Concessions and permits (Royalties and registration fees)	Not known
17.	Law No. 6 – Health business licenses	Just activated
18.	Land Concessions Law	Disputed between MoF and municipalities
19.	Trademark law	Not active
20.	Export/Import License Law No.14	Not active
21.	Telecommunication Law No. 13	Partially active
22.	Entertainment licenses	Not active
23.	Registration Law	Confusion over competence Not active
24.	Bulletino Ufficiale, Suppl. No. 8-12, of December 31 st 1961	Not applied
25.	Bulletino Ufficiale, Suppl. No. 8-12, of December 31 st 1962	Not applied
26.	Bulletino Ufficiale, Suppl. No. 9, of December 31 st 1962	Not applied
27.	Bull. Ufficiale, Suppl. No. 1, of January 1 st 1972	Not applied

Discussions by the workshops and the expert consultations focused on the need to reduce Puntland's dependence upon sources of 'indirect taxation,' such as customs duties and levies – and to replace them with more direct tax sources, such as taxation on incomes. While a departure away from customs and excise duties would ultimately turn the state's airports and seaports into 'free zones,' the experts agreed that this proposal was not feasible at the present time, due to the delicate security and economic situations and the frail administrative capacity of the state. However, they agreed that a gradual and cautious transition from indirect to direct taxation was desirable in the long run, and should be developed into a long-term strategic objective within the government's fiscal policy.



Frankincense tapped from trees in the mountains on the northern coast provides a valuable export product

In examining the workshops' recommendations, the experts sought to draw up a comprehensive strategy for optimising public revenue collection and management to present to the administration. Various suggestions were presented for this strategy, including:

- Decreasing customs duties and increasing the presently low direct taxation component of the government's income revenue;
- Gradually reducing indirect taxation levels and simultaneously increasing direct taxation through the re-enactment of a number of presently redundant financial laws;
- Decreasing export taxation by 50% to encourage the export of domestic products, such as livestock, frankincense and fishery products;
- Preparing an action plan to carry out taxation policy changes, based upon a *gradual* shift from an indirect to a direct taxation system;
- Establishing a public information/liaison office within the Ministry of Finance to assist in aligning the government's taxation policy with taxpayers' individual abilities to pay. This office should gather information related to the incomes and living standards of different sectors of society, and disseminate public awareness materials designed to restore public confidence in the taxation system.

While recommending new revenue sources and taxation rates, however, the participants also acknowledged that these may be beyond many taxpayers' financial means – and could therefore breed conflicts with dangerous implications for the state. For this reason, the introduction of any new tax systems or rates must take heed of prevailing economic and market conditions. Most participants were of the opinion that any new tax systems should be introduced with very low rates, and should be preceded by clear and comprehensive public awareness campaigns.

The following specific recommendations were presented by the participants:

- I. There is an urgent need for reconsidering, reviewing and reforming the Puntland Administration's fiscal and financial policies, including the above-listed laws and regulations. Such a review should consider the potential for establishing and revising taxation and service charge rates in line with financial and macro-economic conditions on the ground.
- II. Public revenue reform must also incorporate the provision of training courses and on-the-job training packages, together with adequate incentives, for staff to upgrade their professional capacities and build their levels of motivation.
- III. Public awareness-raising should be provided for revenue mobilisation and enhanced collaboration and information-sharing between tax offices, tax collectors and taxpayers.

- IV. New fiscal policies and taxation laws should be introduced, revised and harmonised as and where needs arise.
- V. Existing Central Bank (State Treasury) regulations should be applied efficiently so that public revenues are deposited or transferred promptly by and to concerned parties.
- VI. An integrated regulatory framework should be established for all agencies and ministries involved in the collection, management, allocation or distribution of public revenues (taxes and non-tax revenues). This framework should clearly define the specific roles, responsibilities and competencies of each institution, and identify areas of cooperation and collaboration between them.
- VII. Efforts to develop human and technical resources in the public finance sector should be coordinated with the inputs and activities of international agencies.

Tax Reform: Fuelling Development

In his definitive study, *The Wealth of the Nation*, economist Adam Smith proposed four basic principles of equitable taxation:

- Persons should pay according to their ability;
- Levels of taxation should be clear to everyone concerned;
- The convenience of the contributor should be maximised as regards payment; and
- The cost of collection should be minimised in relation to the yield.

While indirect taxation in the form of customs and excise duties forms the basis of Puntland's public revenue, more direct forms of taxation are preferable for two major reasons: their reliability, and the alleviation of the economic burden on ordinary citizens. Indirect taxation is generally unreliable and more vulnerable to insecurity. Despite this, however, the Puntland government clearly cannot do away with customs and excise duties completely because of the prevailing security and economic situations, its own weak administrative capacity, and – above all – the lack of a monetary reserve to 'plug' the revenue gap that such a transition would incur.



Preparing to load camels for export at Bosaso port. Most of Puntland's revenue comes from import duties and export tax
© Ryan Anson/ Interpeace

During the early years of the Somali civil war, port fees and customs duties collected at the port of Bosaso formed the sole source of public revenue for the north-eastern regions that would later become Puntland. Some 1.3 billion Somali shillings (nearly US\$ 90,000, at an exchange rate of US\$1/14,500 shillings) were collected at the port each month. These funds were adequate to cover the wages of the customs, treasury and militia staff, and transfers to the regional representatives in Bari, Mudug and Nugaal, as well as to the SSDF and defence forces. But there were never sufficient funds to cover any contingency expenses – let alone any socio-economic development in the wider region.

With the formal establishment of Puntland State in 1998, the Ministry of Finance was charged with the financial and budgeting functions of the state, as highlighted in the first provisional charter and government policy guidelines of 1998-2001. In the absence of any banks or financial institutions, the urgent formulation of a sound and viable fiscal policy was recognised as a critical foundation for Puntland's future financial

management and resource mobilisation. Accordingly, under Presidential Decree-Law No. 3 passed on November 29th 1998, the Ministry of Finance was given responsibility for the generation (through taxes, service fees and other levies), distribution, and control of public revenue.

In addition to administering public funds, the ministry is entrusted with preparing budget estimates, managing the accounts of the state, currency and banking services, and tax enforcement. As well as Puntland's 'ordinary budget,' the ministry also prepares a 'development budget' and a 'special expenditure (counterpart funds)' budget, which cover government and donor contributions to development projects in the state. According to Article 14 of Presidential Decree No. 10, signed on January 24th 2006, the development budget will include "sums provided in the ordinary budget, the proceeds of internal and external loans, [and] contributions given by the donors (international organisations and other states)" and will be used for "projects undertaken for the said purposes."

Presidential Decree No. 10 was seen as a strong signal of the government's commitment to overcoming its administrative deficiencies, by separating and defining the responsibilities and functions of the various levels of the administration. Before the passage of this decree, some of Puntland's ministers were reported to be conducting all of the financial transactions of their ministries in person – including the collection of funds from the State Treasury.

Presidential Decree No. 10 of January 24th 2006

The Administration of Ministries and Government Institutions

THE PRESIDENT OF PUNTLAND,

- Having seen:** The Constitution of Puntland
- Having seen:** The necessity to enhance the performance of the Ministries and Government Institutions
- Having seen:** Art. 52 of the Constitution

HAS RULED:

1. The Administration, Finance, Accounting and Assets, the day-to-day operations and the general management of Ministries and Government Institutions of the Puntland Government are the responsibilities of Director Generals and General Managers and will be accountable for.
2. The Ministers and Deputy Ministers will be confined to political matters, supervision and implementation of programmes, coordination of their respective Ministries and Government Institutions, as well as Constitutional and other functions that are conferred on them by law.
3. All Ministries and Government Institutions of the Regional Government of Puntland are requested to fully implement this Constitutional decision.
4. This Presidential Decree will enter into force upon its signature by the President.

Mohamoud Musa Hersi
President of the Puntland Government

3. Public Revenue Collection

Budgeting Procedures and Sectoral Allocations

After thorough and exhaustive discussions, the participants of the workshop on revenue collection, in three group discussion teams, made the following principal **recommendations**:

- I. As per the provisions of Article 11.1 of the Financial and Accounting Procedures of the State, the preparation of the (ordinary) budget should be carried out in line with the provisions of existing financial laws and procedures, with the full involvement of all concerned organs, agencies and/or individuals who are entitled to participate in this budgetary process.
- II. As suggested in Table 2, while law enforcement and security related sectors should continue to have primary priority in terms of the 2006 budget allocation, due consideration and adequate resource allocations should be accorded to the provision of infrastructure and the delivery of basic services within the social service sector.
- III. Within the framework of the 2006 budgetary allocation, up to 15% of the ordinary budget should be reserved for the social service sector.
- IV. In line with and pursuant to the provisions of Articles 52.7 and 52.8 of the Interim Constitution and Article 14 of the Law of Financial and Accounting Procedures, resource inputs allocated to the social service sector that do not currently figure in the ordinary budget, such as those of the special and development budgets, should be shown in the annual budget of the government.
- V. Budgetary allocations for socio-economic development sectors should increase in direct proportion to the estimated revenues generated in any given financial year.

The table on the following page summarises the proposals made by the three discussion groups (noting that groups 1 and 2 were in agreement of the same proposals).



A koranic school in Garowe. All Somali children are expected to attend koranic school but not all of their parents can afford fees for formal education, a high priority in Puntland

© Ryan Anson/ Interpeace

Table 2: Proposed (Ordinary) Budget Allocations to Various Sectors

Sectors	2003	2006 (Groups 1 and 2)	2006 (Group 3)	Average
	%	%	%	%
Security and Civil Servants (salaries)	46	46	55	50
General Services (inc. political funds)	29	21	10	15
Ministries (except MoF, MoE and MoPW)	14	14	10	12
Ministry of Finance	8	4	5	5
Social Services/ Development	3	15	10	12
Emergencies	0	0	5	3
Reserves	0	0	5	3
Total %	100%	100%	100%	100%

Participants of the workshop on Public Revenue Collection and Management had assumed the 2003 financial year as a benchmark, because it represented the most recent fiscal year in which an annual budget was properly prepared and adhered to.



Lack of funding means that mentally disturbed patients are chained up and receive inadequate care – a serious constraint throughout the Somali region

The Panel of Experts also noted that certain ethical principles had been completely absent from the government's recent accounts – particularly in the equity of revenue distribution. For example, they cited the social security benefits that have become common practice in the developed world, but seem to have passed Somalia by. With the poor prevailing political and security situations, the experts noted, the people of Puntland might not expect perfect management of the public purse – but they should at least be able to see the fair and transparent collection and use of what they do contribute.

Sources of Public Revenue

For the purpose of increasing overall government revenue, by tapping existing sources and identifying potential new avenues of funds, the participants made the following observations:

- Existing sources of public revenue are definitely not fully exploited;
- Taxable individuals and organisations are unequally taxed across Puntland;
- More than 26 taxation laws have become redundant;
- There is an excessive dependence upon customs duties on imported and exported goods, which on average provide 75-80% of the state's total annual revenue.

Having identified these constraints to comprehensive and equitable taxation, the participants formulated the following specific recommendations:

- I. An *ad valorem* taxation system should be introduced and applied on imported goods throughout the state. (N.B. *Ad valorem* duties are commonly levied on commodities at a rate relative to their value.)
- II. While some legally established service charges are collected from a few locations (e.g. sales taxes from hotels in Bosaso town), and civil servants and security personnel are obliged to pay income taxes, only a fraction of eligible individuals or corporations actually pay their taxes. Applying and enforcing taxation laws, regulations and procedures uniformly and equally throughout the state would ensure a substantial increase in public revenue and an equitable distribution of the tax burden among various categories of taxpayers – thus ensuring a fiscal policy based upon social justice and equality.
- III. Participants have come to the conclusion that customs duties and other import-export charges contribute an average of 75-80% of Puntland's total annual public revenue, whereas Inland Revenue, which is comprised largely of direct taxes, service charges and fines, constitutes less than 10% of total revenue. Such figures point to the need for urgent policy change.

Revenues from the sale of state goods and services, such as fees charged for mineral or oil exploration rights, fishing licences and exploitation of other natural resources and public property, have also been identified as potential sources of significant revenue (see Articles 1 and 2 of the Law of Financial and Accounting Procedures of the State, Decree No. 2, December 29th 1961). To this end, political determination and capacity to implement and enforce existing laws and regulations will be essential.

Coordination of Financial Institutions

The participants emphasised the need to redress the lack of coordination between the government's financial institutions, both in processes of collection and expenditure of public revenue. The collection of taxes, levies and other charges is carried out in a haphazard manner by a number of public offices and government agencies. It was also noted that the collection of public revenue is not fully synchronised between different departments and offices within the Ministry of Finance – leading accountants and customs officers to clash in their day-to-day routines. In addition, several public agencies, including the civil aviation department, the livestock laboratory and the Puntland Chamber of Commerce, have not officially registered with the relevant Ministry of Finance departments for taxation or statistical purposes.

In the group discussions, the participants identified the following major constraints to the coordination of the government's financial institutions:

- Lack of information sharing between financial institutions;
- Collection of taxes and charges at offices operating independently from each other;
- Limited expertise and financial know-how;
- Inadequate financial services provided by the Central Bank (Treasury);
- Lack of budget preparation coordination between concerned departments and institutions;
- Lack of evaluations or monitoring of the performance of financial institutions;
- Lack of legally binding reporting procedures in financial accounting matters.

After a thorough discussion of these and other impediments to the government's financial apparatus, the workshop participants and the consulted experts agreed to forward the following recommendations to the administration:

- I. A workshop/seminar should be held to introduce representatives from all of the government's financial institutions to the principles, objectives, skills and relationships of good governance.

- II. Reliable and appropriate Financial Information Systems should be introduced to enhance the cooperation and performance of all these institutions
- III. A central financial statistical database should also be established.
- IV. Tax and duty collection offices should be rationalised and harmonised in order to promote the transparent monitoring of public revenue collection.
- V. Transportation of public revenues should be conducted solely by the Central Bank in order to minimise the risks involved.
- VI. The Ministry of Finance should promote the use of new and existing training institutes in order to boost the financial management skills of its staff. Regular refresher courses should be arranged for the financial officers of the ministry and its agencies.
- VII. Recruitment of all government finance personnel should be based upon specific criteria and individual merit. Normal contracting procedures should be reinstated, in place of the current nomination system, for the employment of these staff.

Conflicts Related to Public Revenue

Concern over conflicts and confrontations sparked by the collection of public revenue, first highlighted during the consultative survey of 2004, re-emerged repeatedly during the assessment study and the workshops that followed. The questionnaire respondents and workshop participants identified several critical mismanagement practices that could trigger unrest or even armed confrontations, including:

- Non-compliance with laws, both on the part of taxpayers and the revenue collection agencies and institutions;
- Misunderstandings between revenue collectors and taxpayers;
- The forced collection of due or accumulated taxes;
- The increase of taxation rates without sufficient prior public awareness-raising (liable to ignite public unrest or even riots);
- The practice of Regional Finance Officers to offer ‘discounts’ on taxation rates, which creates disparities and animosity between regions;
- The unequal application of taxes in different regions (e.g. sales taxes collected only in Bosaso, income taxes deducted only from civil servants and security personnel);
- Illegal ‘sales taxes’ charged on transiting goods by district/local government ‘tax points’ on tarmac roads, which have been known to trigger armed confrontations;
- Tax evasion by force by qat dealers – identified as “a time-bomb waiting to explode”;
- High unemployment rates among youth flocking to urban areas, which could exacerbate any of the above risks, particularly during prolonged droughts or economic recessions.

It is worth mentioning that, in most tax disputes, the taxpayers usually claim they are ready to pay the monies they owe – but are disputing either the rate of taxation or the means used to collect it. With the exception of isolated cases of tax evasion, there has never been a case in which a taxpayer categorically refused the payment of taxes to the Ministry of Finance.



A woman frankincense seller in Bosaso market



Calculating the taxes due on livestock exports

© Ryan Anson/ Interpeace

The Bosaso Sales Tax: A Lesson in Peace-Building

In many settings, tax collection is a hotly contested issue, with a strong potential for igniting personal and institutional conflict. When the PDRC/WSP project was undertaking its initial assessment survey in April 2005, a row erupted in Bosaso over payment of the new sales tax authorised by the Ministry of Finance. Following the arrest of two prominent businessmen for refusing to pay the tax, the Bosaso business community rallied to their defence. For the first time, wholesale businesses went on strike and the local market closed. During confrontations between hoteliers and tax collectors, the latter called in armed police officers to the hotels. The situation deteriorated rapidly, and it was only a timely response by the Ministry that averted the potential for violence.

While the Ministry of Finance is responsible for resource generation and management through taxation, it is not fully capable of collecting the revenues due. In particular, the Ministry's Inland Revenue Department is very weak. In the early days of its establishment, very few services were taxed, while others were charged through a system of compound lump-sum rates. Businesses became accustomed to this system and took it for granted.

When the Ministry initiated its new sales tax collection in Bosaso, no effective strategy was developed to prepare for its implementation. Officers simply presented a circular from the Minister of Finance to various hotel owners and business managers, stipulating that the new tax had to be paid with immediate effect. It was hardly surprising that the business owners protested over the tax, and demanded to pay according to the old lump-sum arrangements. When the tax collectors called in the police, the hotel managers responded with recourse to their security guards – and it was fortunate that the administration recognised the danger and immediately intervened, inviting the businessmen for a round-table discussion with its senior finance officials.

The PDRC's public finance researcher was present at that meeting, chaired by the Minister of Commerce and Industry at the Bosaso offices of the Puntland Chamber of Commerce. Other senior figures who attended included the Minister of Finance, the Deputy Minister of Livestock, Agriculture and

Environment, the Director of Inland Revenue, and officials from the Chamber of Commerce, with the hoteliers and businessmen represented by a committee.

The hotel managers submitted a petition outlining their position on the new tax, in which they clearly reaffirmed that, while they did not object to sales taxes in principle, they resented the manner in which the tax was being implemented. This included both the threatening approach of Ministry of Finance officers and the high rates of the new tax system, which also required them to register all hotel guests. The Minister of Finance acknowledged their concerns and took the opportunity to explain the Ministry's intentions to formalise the taxation system. The old lump-sum system, based upon four categories of hotels, had been envisaged as a temporary and symbolic payment. In upgrading the system, he said, the Ministry intended to replace this with a legally stipulated taxation practice, such as registering hotel guests. The Minister assured the hoteliers that the administration would have recourse to the law – but would never use force for tax collection.

After extensive discussions, agreement was reached between the minister and the hoteliers to begin implementing the new sales tax at a rate of 20% – rather than the 30% originally proposed. The conflict was duly amicably resolved.

The process highlighted several important lessons for Puntland's public finance managers. Firstly – and most importantly – it confirmed that open negotiations are gradually replacing recourse to violence. Secondly, it showed that the administration is becoming more transparent about its procedures and the reasons for their implementation. Thirdly, it demonstrated that taxpayers are ready to pay their dues, as long as their concerns are given proper consideration. Finally, it illustrated that the Ministry of Finance is still undergoing a process of transition from its original rudimentary taxation practices – and still requires technical as well as moral support in developing more advanced financial management procedures. Despite this, however, progress is clearly being made, which remains a vital element in the consolidation of dialogue and peace in Puntland.



A mural at a Galkayo school says it all: "Peace is prosperity and economic development. We want peace, we want rule of law"
© Pat Johnson

4. Public Revenue Expenditure

Conflicts Related to Public Revenue Expenditure

The workshop participants unanimously agreed that most of the conflicts that have occurred in Puntland over the past 15 years have been heavily influenced by the mismanagement or misuse of public revenue. The situation has been exacerbated by widespread poverty, clan and tribal interests and patronage systems, and a lack of effective justice. Despite the fact that the present administration is trying to reinstate the comparatively systematic financial management of the state's earliest years, the prospects for proper public revenue distribution remain bleak.

During the workshop on revenue expenditure, the participants were divided into three discussion groups to analyse the potential causes of conflicts related to current financial management practices. In plenary, the groups identified the following as the major causes of conflicts related to the disbursement and spending of Puntland's public revenue:

- Use of public revenue for purposes not listed in the approved budget, such as 'fake' emergencies or security operations, or political 'deals' that create widespread public suspicion;
- Disregard for official disbursement procedures, which has led to the abuse of approved expenditure and the partisan distribution of resources;
- The redirecting of funds intended for the salaries of unpaid civil servants or security personnel;
- Arbitrary 'advances' in the form of salaries and allowances to favoured individuals or institutions;
- Uncertainty over the actual number of security personnel and civil servants, which has been used to lodge unlawful demands for salaries for "ghost" (fictitious) employees and security officers. Such illegal payments remain a primary source of the government's outstanding debts.

As well as generating widespread suspicion and mistrust – particularly in politically marginalised areas – such disparities in revenue allocation and disbursement also place an enormous strain on the government's approved budget. To assist in overcoming such problems, the workshop participants emphasised the following:

- I. The government should adapt to the approved public revenue expenditure procedures by following existing laws, regulations and procedural guidelines.
- II. An overall review of existing administrative and financial management systems should be undertaken in order to enhance the administration's performance and efficiency.

Approved Budget Expenditure

The Puntland financial year usually begins on the first day of January and ends on the last day of December. The annual expenditure budget is largely regulated by the Financial and Accounting Procedures Law No. 29 of 1961, with other official financial management documents including vouchers, receipts and vote-books (in which budget lines are registered). The relevant legal provisions from Law No. 29 include:

- Budget Preparations (Article 10): The Ministry of Finance, on the basis of proposals from each ministry/ agency and data gathered by its officers, shall prepare by not later than September 30th the draft estimated budget for the following financial year.
- Contents and Classification (Article 12): All estimated revenue and expenditure of the state shall be shown in gross in the budget.

- Variations and Virement – funds that are transferred from one sub-head to the other through the House of Representatives (Article 16):
 - Article 16.1: During the financial year, it is necessary to make variations consisting of new expenditure on the virement of sums from one head or sub-head of the ordinary budget to another; the said shall be decided through the normal process of the law.
 - Article 16.2: Where variations involving new or larger expenditure are made, the law shall specify the means for meeting such expenditure.
 - Article 16.3: In the law approving the budget, the House of Representatives may confer on the government (Ministry of Finance) the power to make virements between sub-heads of the same head.

Ministries, agencies and other government institutions, such as the offices of the president and the vice president, may make commitments and incur expenditures within the limits established in their respective budget allocations, subject to the availability of funds. However, the Council of Ministries, with the approval of the Ministry of Finance, may reverse expenditures in the approved budget, except for payments that the government is legally bound to make.

Having identified that the government’s approved budget expenditure is inconsistent with realities on the ground, the workshop participants agreed that it therefore contravenes the provisions of the Financial and Accounting Procedures Law. In order to avoid repeated recourse to parliament to approve variations in expenditure, the Ministry of Finance has grouped all expenditure types under a single budget ‘head’ with various sub-heads.



Shops advertise their wares with colourful murals, Garowe

Moreover, the participants found, the Ministry does not follow its budgetary sub-heads sequentially – a questionable financial manoeuvre that enables it to randomly prioritise payments under various sub-heads.

Dissemination and Distribution

The workshop participants noted with concern that the estimated revenue and expenditure budget – arguably the most important statutory document after the state’s provisional constitution – is not published in the government’s official bulletin for the scrutiny of the executive, the legislature, or the public at large. Nor is this vital legal instrument usually covered in any great depth by the local media.



Porters carry boxes of imported goods from ships docked at Bosaso port
© Pat Johnson

The participants also expressed repeated concern over the presence in the budget of inflated contributions for spurious security operations. The workshop heard how major operations arranged for simple police tasks often drained significant funds from the budget – while often compromising rather than restoring security. They called on senior security officials to abide by the economic principle of ‘Frugality of Expenditure,’ which states that public funds should only be spent on security “when this is a real necessity.”

On these issues, the workshop participants made the following key recommendations:

- I. As a document of major public concern, the annual approved budget (estimated revenue and expenditure) should be published in the official bulletin and distributed to all concerned individuals and institutions (for the payment of a small fee).
- II. The financial and accounting procedures of the state should be strictly followed, and all related regulations and decrees should be duly reinstated and properly functionalised to replace all current non-procedural practices.
- III. Service funds allocated to various ministries and security force administrations are widely misused, and it should be mandatory to reinstate the normal financial management system by posting able and skilled accountants to all these offices.



Lorries heading south from Bosaso port laden with imported foodstuffs

Observance and Compliance

Throughout their discussions, the workshop participants repeatedly claimed that established rules and regulations are routinely flouted in the implementation of the government's expenditure budget. The participants noted that the Ministry of Finance was often in contravention of its own laws, which stipulate that approval must be secured for every expenditure payment, and that all payments must come "from the appropriate [budget] head and sub-head" (Law No.3, November 29th 1998). Such contraventions not only wreaked havoc within the financial system, but generated widespread grievances – particularly among the security forces, the civil service, and members of the House of Representatives. It was also noted that non-compliance and disrespect for the approved budget further undermines the administration's credibility, both at local and international levels.

In this respect, the workshop participants made the following recommendations:

- I. Every government ministry, agency, public or private individual or institution involved in the disbursement, authorisation, request of payment, control or approval of budgetary expenditure should follow and respect the relevant established accounting procedures, laws and regulations. Enacted laws, regulations and procedures must not be altered or modified to suit the interests or convenience of a particular individual or group.
- II. Monthly expenditures indicated in the heads and sub-heads of the approved budget should be released and disbursed by a legally competent authority, and in strict compliance with the state's accounting procedures and financial regulations.
- III. Suitable skilled human and financial resources should be allocated to the organs of control and audit of budgetary expenditure (i.e. the offices of the Accountant General and General Auditor) in order to optimise their capacity and performance. To this end, the auditing agents and accounting officers representing these offices should be permanently stationed at the Central Bank and all ministries, agencies, regional or municipal offices, and other public institutions involved in the collection or disbursement of budgetary revenue and expenditure.
- IV. The executive, legislative and judicial arms of the state should fully execute their functions and responsibilities with regard to budgetary revenue, in strict accordance with the provisions of the Provisional Constitution, the Annual Budget Law, the Financial and Accounting Procedures Law, and other statutory laws and regulations governing the financial matters of the state.

Outstanding Government Debts

Since the early years of its inception, the Puntland administration has been struggling with the payment of major outstanding debts and arrears. The workshop participants described these debts as the single greatest hurdle to the state's strained budgets. Although the actual size of these debts is disputed, Ministry of Finance officials estimate that the current figure stands at between 300 and 500 billion Somali shillings (US\$ 2 to 3.5 million). Ironically, the government's official budget deficit, estimated at 20 billion Somali shillings (approximately US\$ 160,000) in 2004, is much lower than these astronomical figures suggest.



The Working Group on public fund management engaged in a brainstorming session in Garowe, June 2005

The government's debts consist mainly of sums borrowed from private businesses (in the form of fuel, food for security forces, transport, etc.), the costs of unpaid government services, and health grants to citizens and state security personnel. A typical example is a bill for the rental, over several years, of a car amounting to 2 billion Somali shillings (US\$ 160,000) – a sum sufficient to purchase 10 brand new cars of that particular model! Several of the items listed include cars and other materials billed at double or even triple their market value. The state debt also includes debts incurred during the integration of the Darawiish (paramilitary police) and the GBP (former opposition militia), which pose a major threat to former opposition leader-turned-president, General Adde. The debts provide plenty of political ammunition to future opposition parties, as well as to a long list of self-proclaimed creditors.

During deliberations by the panel of experts, the size and legitimacy of these 'official' debts came under intense scrutiny. However authentic they may be, however, the experts agreed that the debts pose a major



Fishing provides a basic livelihood: small fishing boats at Bosaso port

threat to Puntland's political and economic stability, as well as a stumbling block to the government's financial services and future social development.

Another perplexing issue concerns the ongoing repayment of the debts. During the discussions it emerged that, despite significant debt repayment allocations in the annual budget (amounting to 12.7% in 2004 and 13.7% in 2005), no reduction in the actual size of the debts has ever been reported.

While validating the recommendations made by the workshop participants, the Panel of Experts emphasised the need for the government to take urgent action on its outstanding debts – given their dire implications for Puntland's future governance. Among the other recommendations to be forwarded to the government were:

- I. A comprehensive analysis should be undertaken to determine the current status and legitimacy of each of the government's debts.
- II. Genuine debts could be 'sold' to private companies, with a predetermined schedule of payments and agreed interest rates.

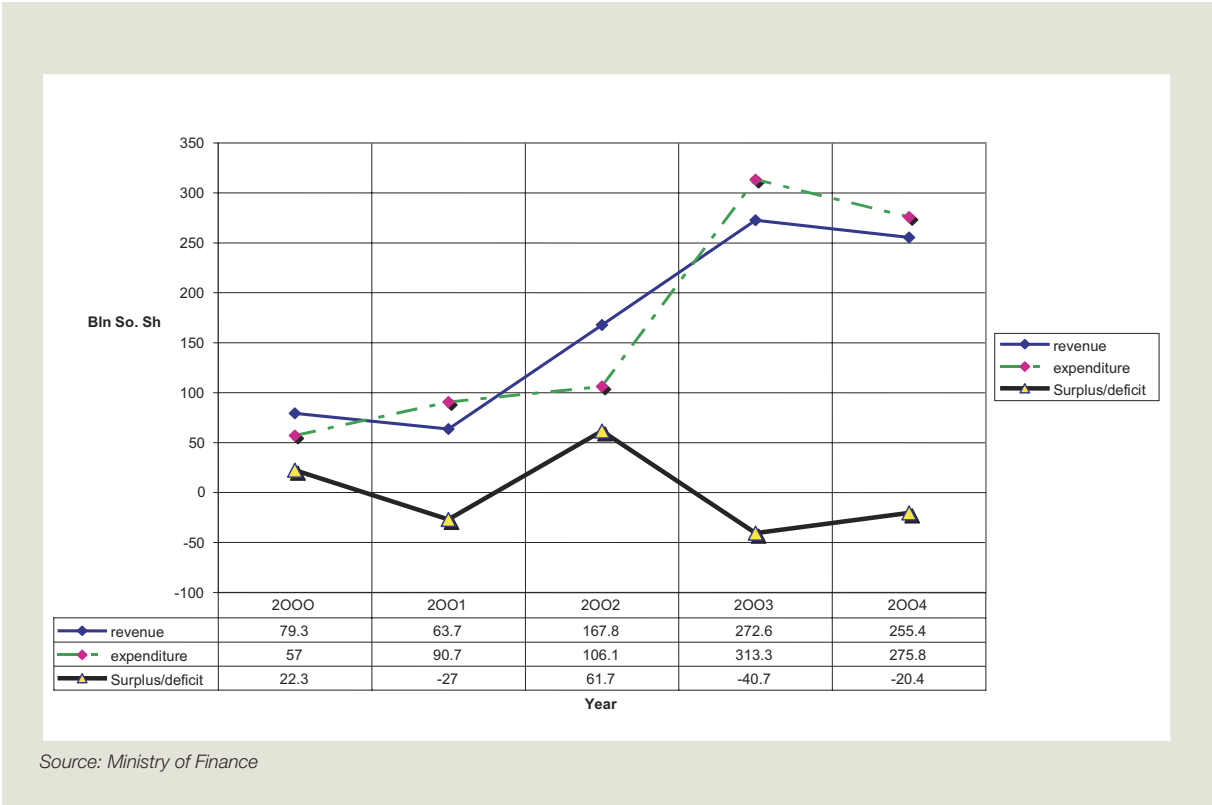
- III. Limits must be placed on the incurring of any further government debts.
- IV. Assistance should be sought from donor organisations through the demonstration and propagation of good governance practices at home.

While some economic analysts have postulated that Puntland’s massive debts call for a strategic technical process of individual assessment and negotiation, others claim that the questionable legitimacy of some of the debts calls for a tough political stand – in other words, a blanket ‘write-off’ of all debts. Some solutions put forward by the experts included:

- The debt issue should be addressed through the Central Bank, which functions as the State Treasury;
- Some of the debts could be paid by printing new money, but as this practice has in the past fuelled inflation and led to the devaluation of the Somali shilling, with adverse long-term consequences for the state, it is not recommended;
- The government could service some of the debts by borrowing money from local businesspeople, although this has in the past negatively affected Puntland’s ability to attract grants or loans from international donors.

An analysis of the government’s revenue and expenditure between 2000 and 2004 (Table 3) shows that, at least on its balance sheets, there are no major debts. In 2001, the government budget experienced a major deficit following the outbreak of the constitutional crisis. Although the recorded deficit amounted to 27 billion shillings (US\$ 1.8 million), in reality it was much bigger than officially stated. The majority of the deficit was covered by the sizeable, although unrecorded, reserves of the Central Bank. However, between June and November 2001, Puntland’s central accounting systems were barely functional – and certainly not accurate.

Table 3: Puntland Government Revenues and Expenditure, 2000-2004



Soon after the settlement of the political crisis in May 2003, both government revenue and expenditure increased sharply. It is not clear, however, what motivated the 61.7 billion shilling (US\$ 4.1 million, at an



A nomad with his sheep at the livestock market in Bosaso. Somali sheep and goats are in particularly high demand in the Gulf during the Haj
 © Ryan Anson/ Interpeace

average exchange rate of US\$ 1=15.000 Somali Shillings) surplus peak in the previous year. The fact that expenditure surpassed revenue in both 2003 and 2004 is probably due to active political expenditure, resulting from the integration of the GBP militias into the Darawiish and the expansion of the state cabinet, as well as the national reconciliation initiatives taking place in Kenya.

Both the workshop participants and the experts who analysed the management of the government's outstanding debts jointly made the following recommendations:

- I. An ad hoc technical commission or committee should be established at state level, comprising professionals selected for their skills, experience and integrity, to conduct an in-depth assessment and analysis of the government's outstanding debts, with the aim of:
 - a. Identifying and distinguishing (quantitatively and qualitatively) the 'real' and 'false' components of the public debt;
 - b. Preparing a plan of action and proposed schedule for the identification of new sources of income/ revenue for the repayment of genuine debts (e.g. grants and donations from external donors, including members of the Diaspora, the TFG, the private sector, civil society, and the World Bank).
- II. Measures should be introduced to prevent state authorities, including the Ministry of Finance, from incurring any new debts, unless there is an *absolute necessity* to do so. In the case of new debts, all relevant laws, regulations and procedures governing state expenditures must be respected and adhered to, particularly the Transitional Constitution, the Approved Budget Law, and the Financial and Accounting Procedures of the State.



The Working Group at the PDRC offices in Garowe with research coordinator Ali Farah (on the far left), who led the research process, May 2005

5. Achievements and Impacts

During the 12 months between the beginning of the research project and the last of the follow-up workshops, the Working Group was heartened to observe several promising new developments in the systems and processes of Puntland's public revenue management. Among the most significant of these were:

1. Gradual and systematic remedying of certain identified financial management faults, initiated by leading Ministry of Finance officials who participated in the project. Following a general 'coordination meeting' of the state's financial institutions attended by the president in February 2006, the various departments of the Ministry of Finance began to work more closely and cohesively – leading to a substantial increase in the amount of public revenue collected.
2. The nomination in October 2005 of a highly respected former banker and senior member of the Working Group, Ahmed Ali Dad, as Puntland's new Accountant General.
3. The launch of an official five-year Government Development Plan and the establishment of an independent commission on public finance reform, incorporating several of the recommendations made during the project's workshops and expert meetings.
4. An allocation in the 2006 ordinary budget to increase the number of secondary school teachers by 200 – in keeping with the key project recommendation to increase budgetary allocations to social services from 3% to 15%.
5. Coordination and involvement of senior officials from all relevant ministries in the preparation of the 2006 ordinary budget, as recommended by participants of the project workshops and meetings.
6. Preparation of an analytical report on the state of Puntland's public finances, which was released to the administration and the general public in November 2005.
7. A notable decrease in the size of debts incurred by ministries and state agencies, following a cabinet meeting in January 2006 at which ministers were urged to adhere to their budgetary allocations.
8. A documentary film produced by the PDRC's audio-visual unit in April 2006, which provides a uniquely accessible record of the research project and a tool for raising public awareness on the problems facing Puntland's financial authorities.



Parliament approved an increased budget for social services in 2006 and demonstrated the high priority placed on education by increasing the number of salaried teachers. These girls make the most of the opportunity for secondary education in Galkayo

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6. Analysis and Lessons Learned

If the Puntland administration is to move forward in developing a modern system of democratic governance – and regaining public confidence after years of mismanagement and mistrust – it is imperative for it to build an efficient and accountable series of institutions to oversee the management of its public resources. Likewise, the state's political, legislative and law enforcement bodies must all be held accountable to the law. Only by ensuring genuine equity, justice and transparency in all aspects of public life will the state be able to build upon the recent advances made in its political and social reconstruction.

A key issue without which good governance cannot be realised is equity in public human and resource management. As well as purging inefficient and unskilled employees, the government needs to reconsider its unpopular and nepotistic employment procedures, and to promote stronger fiscal and professional development incentives to ensure it attracts more high quality staff. The absence of solid fiscal policies has often hampered the performance of Puntland's public institutions, particularly in the field of public fund management. On the other hand, the administration clearly needs also to reduce its bloated and inefficient security forces through the revival of donor-funded demobilisation initiatives.

Since its earliest years, the Puntland government has been struggling to clear huge outstanding debts and arrears. During the PDRC/WSP project, the participants of the workshops and expert consultations all pointed to these debts as the single greatest hurdle facing the state's overstretched budgets – and thus an enduring threat to the region's hard-won peace. The fact that the size, origins and authenticity of these debts remain shrouded in mystery has only compounded this problem.

The efficient and equitable management of public revenue will continue to remain one of the greatest challenges facing the Puntland administration – and one of the greatest keys to the future of its inter-regional peace. As well as the fair and transparent collection and distribution of funds, the management of public finances will have to be closely tied to government policies on employment, access to natural resources, imports and exports, environmental conservation, and other critical state legislation. In moving forward, the government will need to maintain open and impartial channels of communication with the critical players in each of these fields, including clan elders, the business community, and key civil society organisations.



Young people enjoy a football match in Garowe to mark 'Peace Day', September 21st 2005

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7. Recommendations and Further Engagement

Since the establishment of the Federal State of Puntland in August 1998, the processes of peace- and state-building have continued to make progress in spite of inherent challenges rooted in the legacies of the past. The key challenges of good governance and public revenue management have been compounded by a backlog of unfinished political business and ongoing border disputes. As well as the key achievements listed in Chapter 5, the Puntland Government and Parliament also established a Reform Commission in May 2006 to address within a period of three months a number of critical areas of concern, including the establishment of new government structures, the appointment of key senior civil servants, and pressing issues of state security.

Headed by Said Firdhis, a long-term PDRC facilitator and consultant, the Reform Commission has also been charged with overseeing key reforms in the public finance sector, which are expected to take forward a number of draft recommendations made by the PDRC's Working Group. The recommendations were forwarded to the Ministry of Finance in early 2006 under various headings related to the state's legal and fiscal policies, sources of revenue, public expenditure allocations, budgeting and documentation procedures, the coordination of financial institutions, and the government's outstanding debts.

For the sake of a practical synopsis, the Working Group's recommendations can briefly be summarised as follows:

- I. Urgently revisiting, reviewing and reforming the Puntland administration's fiscal and financial/economic policies.
- II. Designing and providing training packages and appropriate professional incentives for State Treasury staff.
- III. Promoting more extensive public awareness-raising for revenue collection mobilisation.
- IV. Reinforcing existing Central Bank (State Treasury) regulations.
- V. Introducing and applying an ad valorem taxation system on all imported goods.
- VI. Devising and implementing systems and procedures to ensure that taxes are collected equitably – geographically, institutionally, and individually.
- VII. Applying and enforcing revenue collection laws, regulations and procedures uniformly and equally throughout the territory of Puntland.
- VIII. Gradually shifting the policy focus from indirect to direct taxation.
- IX. Holding training workshops/seminars on financial and institutional coordination for all financial institutions.
- X. Introducing appropriate, practical and efficient Financial Information Systems (FIS).
- XI. Establishing a central financial statistical database centre.
- XII. Ensuring that the Ministry of Finance establishes a staff training institution, or makes use of existing financial management courses at the East Africa University in Bosaso or the Puntland Community College in Garowe.
- XIII. Ensuring that recruitment of all Treasury employees is based upon strict professional criteria and individual merit.
- XIV. Initiating an ad hoc technical commission or committee at state level, with members elected on the basis of their professional skills, experience and integrity, to:
 - a. Identify and distinguish (quantitatively and qualitatively) genuine outstanding public debts;
 - b. Prepare a plan of action and proposed schedule for the identification of new sources of revenue for the repayment of genuine debts.

XV. Devising and initiating measures to prevent state authorities, including the Ministry of Finance, from incurring any new debts.

It is clear that the PDRC's comprehensive research over the past two years into the key challenges and opportunities facing Puntland's public fund management has already produced a number of concrete results. As well as greater cooperation and synchronicity between the various departments of the Ministry of Finance, and notable increases in both public revenue collection and development expenditure, the Working Group and the Panel of Experts have provided badly-needed consensus on long-standing weaknesses and gaps in Puntland's official procedures for managing its revenues. As a result, the coming months should see the launch of further initiatives to train key Ministry of Finance staff, introduce more accountable taxation systems and incentives for taxpayers, and boost community participation in the payment and equitable distribution of taxes.

For its part, the Puntland Development Research Centre has committed to continue its efforts to facilitate, promote and attract greater international and local support for such vital initiatives. While it is widely accepted that an implementation plan for the reforms identified must be locally owned and driven, it is clear that such a major undertaking will require the coordinated involvement and support of key international agencies and experts. It is also clear that the technical assistance of agencies such as the UNDP's Governance Programme would have beneficial effects not only for the Puntland Government – and the state's taxpayers in general – but on administrations and taxpayers throughout the Somali region.

Participants of the PDRC/WSP Public Finance Working Group

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2.	Ahmed Ali Daad	Former banker	Sool/Lasaanood
3.	Ahmed Mohamoud Hassan	Chief, Finance Police	Garowe/Nugaal
4.	Mohamed Mohamoud Yousuf	Local government official	Sanag/Badhan
5.	Shire Yusuf Fuqyare	Businessman	Bari/Alula
6.	Ahmed Abas Deni	CSO manager and former banker	Nugaal/Garowe
7.	Fayza Abdi (Dhalac)	Journalist	Sool/Garowe/Laska
8.	Omar H. Said	Budgeting Department official	Ministry of Finance
9.	Ismail M. Warsame	Director General, Ministry of Rural Development & Local Government	Ministry of Rural D'ment & Local Government
10.	Bashir Jama Bihi	Administration and Finance Manager,	Galkom Galkayo
11.	Abdurahman Nima'ale Aden	Administration Manager, Puntland Somali Highways Association (PUSHA)	Garowe/Nugaal
12.	Mohamud Sheikh Hamud	Manager, KAALO (local NGO)	Nugaal
13.	Abdurahman Osman Ali	Intellectual	Galkayo
14.	Col. Gani Mohamed	Police Chief	Garowe/Nugaal
15.	Abdulrizak Yousuf Elmi	Telecommunications/Somtel	Galkayo/Mudug

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Lorries bring livestock for export from as far away as the central regions, and depart with imported sugar, pasta, rice and other goods
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There is high demand for sharks' fins for export to the Far East, despite the negative environmental impact on marine life

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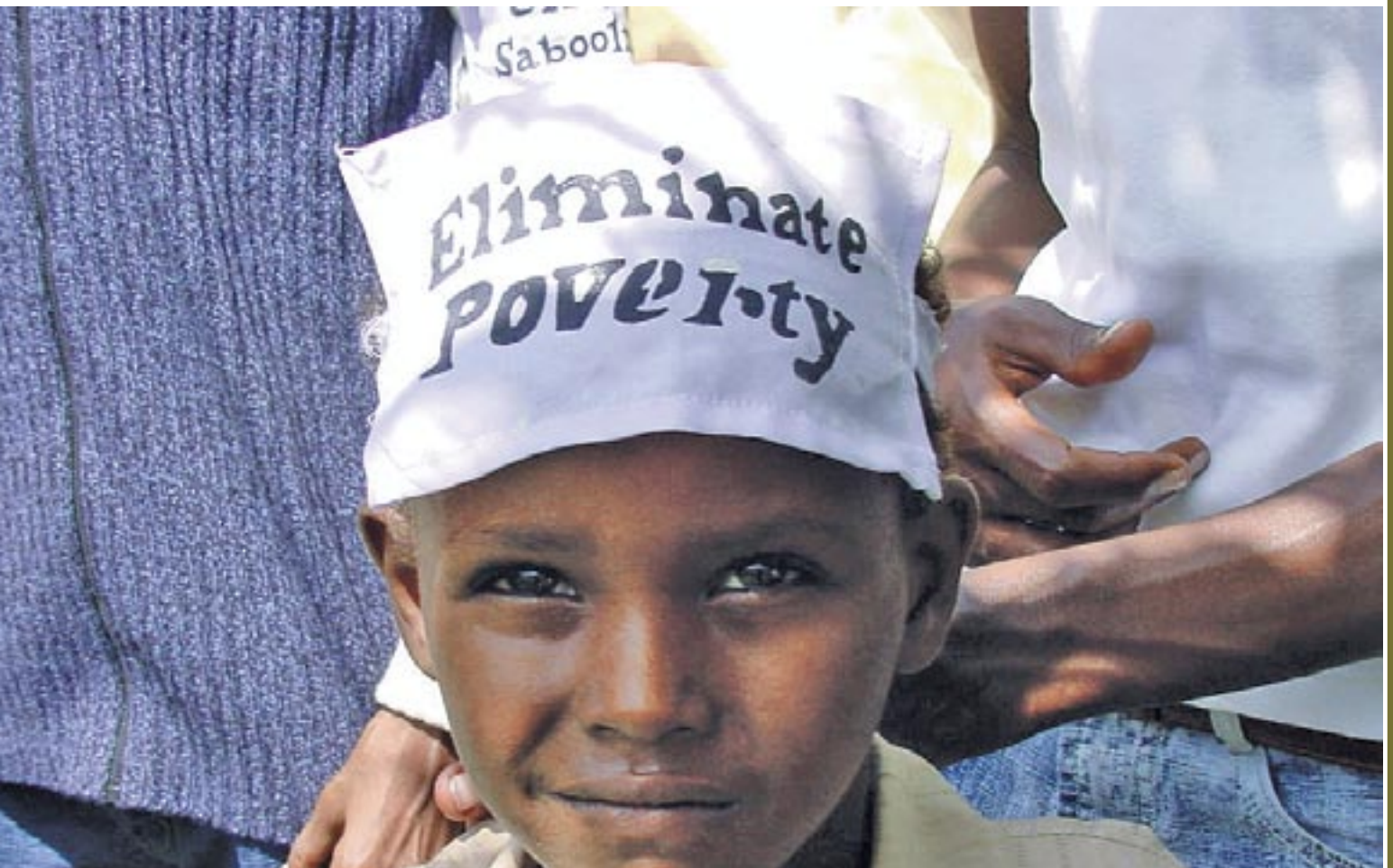
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