

Reintroducing Sales Tax in Somalia: Economic Impact, Implementation Challenges, and Policy Strategies

Brief Policy Paper #1 VOL

Purpose of the Policy

The purpose of this policy paper is to provide a comprehensive analysis of the implementation of sales tax in Somalia. It aims to examine the rationale behind introducing this tax after three decades, considering its potential economic impacts, including revenue generation and effects on consumer prices. The paper also seeks to assess the social implications of the tax, particularly its effects on low-income populations who rely on mobile money services.

Additionally, the paper highlights the importance of stakeholder engagement, emphasizing the need for collaboration among businesses, telecom companies, and civil society to ensure a smooth implementation process. It addresses concerns and opposition raised by the public and lawmakers, offering insights into how these issues can be effectively managed. Ultimately, the paper aims to provide actionable recommendations for the government to facilitate successful implementation and maximize the positive outcomes of the sales tax.

Introduction

The recent announcement by the Somali Minister of Finance regarding the implementation of a sales tax marks a significant turning point in the country's fiscal policy, representing a shift towards greater financial regulation and revenue generation after three decades of inaction. This policy paper aims to explore the multifaceted implications of this sales tax, considering various perspectives that encompass economic, social, and regulatory dimensions.

From an economic standpoint, the sales tax is designed to provide a new source of revenue for the government, addressing the pressing need for funding public services and infrastructure projects. By imposing a 5% tax on mobile money transactions, the government seeks to tap into the burgeoning digital economy, where mobile money has become an essential tool for many Somalis. This approach aligns with global trends where digital financial services are increasingly recognized as viable contributors to national economies.

However, the introduction of this tax raises important questions about its impact on consumers and businesses. Proponents argue that the sales tax will enhance the government's ability to provide essential services and improve overall economic stability. In contrast, critics express concerns that the tax may disproportionately burden low-income populations who rely heavily on mobile money for their daily transactions. These concerns are particularly relevant in a country where a significant portion of the population operates within an informal economy, making them vulnerable to any increase in transaction costs.

Additionally, the implementation of the sales tax necessitates effective stakeholder engagement. Collaboration with businesses, telecom operators, and civil society is crucial for ensuring that the tax is integrated smoothly into the existing financial framework. The government must navigate the complexities of this engagement to address the concerns of various stakeholders while promoting compliance and transparency.

This policy paper will delve into these various perspectives, examining the historical context of the sales tax in Somalia, its objectives, potential impacts, and the concerns surrounding its implementation. By providing a thorough analysis, the paper aims to contribute to informed dialogue and decision-making regarding this critical fiscal initiative.

Background

2.1 History of Sales Tax in Somalia

The sales tax was first introduced in Somalia in 1984 as part of an effort to generate government revenue. However, due to various challenges, including technical difficulties and limited administrative capacity, the tax was not effectively enforced. Over the past three decades, Somalia has faced significant political and economic instability, further hindering the implementation of such tax policies. The recent announcement indicates a renewed effort to leverage technological advancements and improved governance to reintroduce and enforce the sales tax.

2.2 Mobile Money in Somalia

Mobile money services have become a cornerstone of the Somali economy, facilitating transactions in a country with limited banking infrastructure. Over the past decade, mobile money has played a crucial role in promoting financial inclusion, allowing people to send and receive money, pay for goods and services, and access credit. The widespread use of mobile money has supported economic activities, particularly in rural and underserved areas. Companies like Hormuud Telecom have led the way, with millions of users relying on mobile money for daily transactions. The new sales tax will leverage this widespread mobile money usage for tax collection.

2.3 Economic Context

Somalia's economy is heavily reliant on the informal sector as demonstrated table 1 below, which employs a large portion of the population. The informal sector includes small businesses, street vendors, and unregistered enterprises that operate outside formal regulatory frameworks. Despite its significance, the informal sector faces

challenges such as limited access to capital, lack of legal protections, and vulnerability to economic shocks. The introduction of the sales tax must be considered within this context to understand its potential impacts on economic activities and livelihoods. The Somali economy is also characterized by high levels of poverty and unemployment, with limited access to formal financial services for many citizens.

4. Potential Impacts

4.1 Economic Implications

The sales tax could have significant economic implications, including increased transaction costs and potential reductions in the use of mobile money services. Higher transaction costs may discourage people from using mobile money, reducing the volume of transactions and potentially slowing economic activity. This section will explore the potential positive and negative impacts on economic activities. While the tax could generate much-needed revenue for the government, it may also impose additional burdens on businesses and consumers, particularly those in the informal sector.

Positive Economic Implications

1. **Increased Government Revenue:** The sales tax is expected to provide a significant boost to government revenue, which can be used to fund public services and infrastructure projects. This increased revenue can support economic development and improve the overall quality of life for Somali citizens.
2. **Formalization of the Economy:** By formalizing transactions, the sales tax can help bring more economic activities into the formal economy. This can improve financial transparency, reduce tax evasion, and create a more predictable economic environment.

Negative Economic Implications

1. **Increased Transaction Costs:** The 5% sales tax will increase the cost of transactions for businesses and consumers. This may discourage the use of mobile money services and reduce the volume of transactions, potentially slowing economic activity.
2. **Burden on Informal Sector:** The informal sector, which employs a large portion of the Somali population, may be disproportionately affected by the sales tax. Small businesses and informal traders may struggle to comply with the new tax regulations, leading to increased costs and reduced profitability.

4.2 Social Implications

Social implications include the potential impact on financial inclusion and access to services. The tax may disproportionately affect low-income individuals and those reliant on mobile money for everyday transactions. Increased costs could make financial services less accessible to the poorest segments of the population, potentially exacerbating social inequalities. This section will analyze the potential effects on different social groups and the broader implications for social cohesion and economic stability.

Positive Social Implications

1. **Enhanced Public Services:** Increased government revenue from the sales tax can be used to improve public services such as education, healthcare, and infrastructure. This can enhance the quality of life for Somali citizens and promote social cohesion.
2. **Financial Inclusion:** By formalizing transactions, the sales tax can help promote financial inclusion. More people

may be encouraged to use formal financial services, which can improve access to credit and other financial products.

Negative Social Implications

1. **Impact on Low-Income Individuals:** The sales tax may disproportionately affect low-income individuals who rely on mobile money for their daily transactions. Increased costs could make financial services less accessible and exacerbate social inequalities.
2. **Reduced Access to Financial Services:** Higher transaction costs may discourage people from using mobile money services, reducing access to financial services for vulnerable populations. This could have negative implications for financial inclusion and economic empowerment.

4.3 Business Environment

The business environment may be affected by increased costs for small businesses and informal traders, potentially leading to reduced economic activity and job losses. Small businesses that rely on mobile money for transactions may face higher operational costs, making it harder to compete and survive. This section will examine the impact on the business landscape in Somalia, including potential shifts in business practices and the overall economic environment. The introduction of the sales tax may also prompt businesses to seek ways to evade the tax, leading to increased informality and reduced tax compliance.

Positive Business Environment Implications

1. **Level Playing Field:** The sales tax can help create a level playing field for businesses by formalizing transactions and reducing tax evasion. This can

improve competition and support the growth of formal enterprises.

2. **Improved Business Confidence:** A more predictable tax environment can enhance business confidence and encourage investment. Businesses may be more willing to invest in the Somali economy if they have greater certainty about tax obligations.

Negative Business Environment Implications

1. **Increased Operational Costs:** The sales tax will increase the cost of transactions for businesses, particularly those in the informal sector. This may reduce profitability and make it harder for small businesses to survive.
2. **Risk of Tax Evasion:** The introduction of the sales tax may prompt some businesses to seek ways to evade the tax, leading to increased informality and reduced tax compliance. This could undermine the effectiveness of the tax policy and reduce government revenue.

5. Concerns and Uproar from the Somali Parliament

The announcement of the sales tax has generated significant concerns and opposition from various stakeholders, including members of the Somali Parliament. Critics argue that the tax could harm the informal sector, increase the cost of living, and disproportionately affect the poor. This section will outline the key concerns and arguments presented by opponents of the tax, including potential economic and social consequences. The debate highlights the need for a careful and balanced approach to tax policy, ensuring that the benefits of increased revenue are not outweighed by the negative impacts on vulnerable populations.

Key Concerns

1. **Economic Burden on the Informal Sector:** Lawmakers argue that the sales tax will impose an additional burden on the informal sector, which employs a large portion of the population. Increased transaction costs may reduce economic activity and lead to job losses.
2. **Impact on the Poor:** The sales tax may disproportionately affect low-income individuals who rely on mobile money for their daily transactions. Increased costs could make financial services less accessible and exacerbate social inequalities.
3. **Timing and Economic Context:** Critics argue that the current economic situation may not be conducive to the introduction of a new tax. High levels of poverty and unemployment make it difficult for people to absorb the additional costs associated with the sales tax.

6. Recommendations to the Ministry of Finance

To mitigate the potential negative impacts of the sales tax, the following recommendations are proposed:

Mitigation Strategies

1. **Implement Targeted Exemptions or Reduced Tax Rates for Small Transactions and Essential Services:** Exempting or reducing the tax rate for low-value transactions and essential goods can help protect vulnerable populations and ensure that basic needs remain affordable.
2. **Develop Financial Literacy Programs to Help Informal Sector Actors Comply with Tax Regulations:** Providing education and support can help

businesses and individuals navigate the new tax system, improving compliance and reducing the burden on the informal sector.

3. **Invest in Alternative Revenue Sources to Reduce Reliance on the Sales Tax:** Diversifying the revenue base can help mitigate the risks associated with over-reliance on a single tax, ensuring a more stable and sustainable fiscal system.
4. **Collaborate with Mobile Money Providers to Minimize the Impact on Informal Sector Transactions:** Working with mobile money companies can help develop solutions that reduce the burden on users and support the continued growth of mobile money services.

Implementation Recommendations

1. **Gradual Implementation:** Introducing the sales tax gradually can help businesses and consumers adjust to the new tax regime. Phased implementation can reduce the shock to the economy and provide time for necessary adjustments.
2. **Stakeholder Engagement:** Engaging with key stakeholders, including businesses, consumers, and lawmakers, can help address concerns and build support for the sales tax. Transparent communication and consultation can improve understanding and compliance.

3. **Monitoring and Evaluation:** Establishing mechanisms for monitoring and evaluating the impact of the sales tax can help identify and address any issues that arise. Regular assessment can ensure that the tax policy is effective and responsive to changing economic conditions.

4. Step by step Implementation

7. Conclusion

The reintroduction of the sales tax in Somalia presents both opportunities and challenges. While it has the potential to increase government revenue and formalize financial transactions, careful consideration and targeted strategies are necessary to ensure it does not disproportionately harm the informal sector and vulnerable populations. This policy paper has highlighted the potential impacts of the tax and proposed recommendations to mitigate its negative effects. Ensuring a balanced approach that supports economic development while protecting the most vulnerable is crucial for the success of the sales tax policy.

Table 1: Mobile Money Usage Statistics

Year	Mobile Money Users (in millions)	Total Transactions (in billions)	Average Transaction Value (USD)
2015	2.3	1.2	10.5
2016	3.1	1.8	11
2017	4.2	2.6	12
2018	5.5	3.4	13
2019	7	4.5	13.5
2020	8.5	5.6	14
2021	10	7	14.5
2022	12	8.5	15

Informal Sector Employment Data

Year	Total Employment (in millions)	Informal Sector Employment (in millions)	Percentage of Informal Employment
2015	3	2.1	70%
2016	3.2	2.3	72%
2017	3.5	2.6	74%
2018	3.8	2.9	76%
2019	4	3.1	78%
2020	4.2	3.3	79%
2021	4.5	3.5	78%
2022	4.8	3.7	77%

Transaction Cost Comparisons

Type of Transaction	Average Cost (Before Tax)	Average Cost (After Tax)
Small Transaction	\$0.10	\$0.12
Medium Transaction	\$0.25	\$0.30
Large Transaction	\$0.50	\$0.60

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Authors

Mohmed Kamil Yusuf

Public Financial Management Expert

Email: kamilsugal@outlook.com

Aden M. Hudle

Public Sector Specialist

Email: qabiir2015@gmail.com

