

Challenges to Somaliland Economic Governance: "Private Sector Investment Perspective"

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Abstract: *Somaliland is one of the world's least developed countries and its economic performance is heavily dependent on the livestock and majority of the population depends either directly or indirectly on livestock and livestock products for their livelihood. The country exhibits very open economy with a high ratio of foreign trade to gross domestic product, a low level of monetization and a dominant informal sector. Due to the limited capacity of the government, the private sector provides most of the basic services and it accounts for over 90% of the country's gross domestic product (GDP), and employment. Despite the substantial growth in the Somaliland's private sector and its contribution to the development of the economy, it has been constrained by a number of factors, including; the absence of financial institutions, Inadequate infrastructure and lack of effective enabling legal and regulatory frameworks. Therefore, the purpose of this paper is to address the above mentioned problems and challenges through investigating factors that affect the overall performance of the private sector investment which need to be mitigated in order to create an enabling environment for businesses and achieve government policy objectives of promoting private sector as key drivers of economic development in Somaliland*

Keywords: omaliland Economy, Private Sector Investment, Enabling Environment, Private Sector Challenges

1. Introduction

The Republic of Somaliland, which was a British Protectorate until 26 June 1960, and united with Italian Somali to form Somali republic, declared its independence on 18 May 1991. It shares borders with the Gulf of Aden in the North, Somalia in the East and Southeast, the Federal Republic of Ethiopia in the South and West, and the Republic of Djibouti to the Northwest and It lies between latitudes 8° and 11° 27' north and longitudes 42° 35' and 49° east. The total area of the Republic of Somaliland is estimated at 176,119 km² with a coastline of more than 850 km long. Climatically, Somaliland can be described as semi-arid and arid. [Ministry of National Planning and Development, *Somaliland In figures, Edition 12*, Hargeisa, Somaliland Gov, 2015, P. 1] Although its sovereignty has yet to be internationally recognized it is a democracy with a multi-party system and has accomplished a tangible economic and political reconstruction since its secession in 1991.

In the context of a post-conflict economic base, the country made remarkable progress in establishing functioning administrations, promoted peace and created positive and enabling environment for economic growth and social development. [Ministry of Trade and Investment, *Investment Guide to Somaliland Opportunities & Conditions (2013 - 2014)* Hargeisa, Somaliland Gov, 2013] The backbone and the source of wealth of Somaliland's economy is livestock and majority of the population depends either directly or indirectly on livestock and livestock products for their livelihood. [Gaani, M.X. *Regulating the livestock economy of Somaliland*. Academy for Peace and Development, 2002, p 5] Livestock has been traditionally the backbone of Somaliland's economy contributing with 28.4% of its GDP, The wholesale and retail trade (21.9%), real estate activities (7.6%) and crops (7.0%) are other important sectors. [Ministry of Notational Planning and Development,

Somaliland National Development Plan II 2017-2021, Hargeisa, Somaliland Gov, 2017. P, 19]

While in most Sub-Saharan African Countries, states are lead actors in the public services provision, in Somaliland, it is the private sector that provides most of the basic services as a result of stability, peace and security and the absence of restrictive government interventions. The sector is currently engaged in a wide range of commercial, service and industrial economic activities including retail, wholesale, import-export trade, hotels, property development, utilities, airlines, money transfer, health and education. According to the Ministry of National Planning and Development the private sector accounts for over 90% of the country's gross domestic product (GDP), and employment. [Ministry of National Planning and Development, *National Development Plan (2012-2016)*, Hargeisa, Somaliland Gov , December, 2011]

However, despite the substantial growth in the Somaliland's private sector and its contribution to the development of the economy in terms of creating employment, promoting growth, and reducing poverty, it has been constrained by a number of factors, including; the absence of financial institutions (commercial bank, credit institutions etc) that could provide capital and credit for business expansion or survival in difficult times, Inadequate infrastructure (roads, electricity supply etc) resulting high costs, and lack of effective enabling legal and regulatory frameworks.

Therefore, the purpose of this paper is to address the above mentioned problems and challenges through investigating factors that affect the overall performance of the private sector investment which need to be mitigated in order to create an enabling environment for businesses and achieve government policy objectives of promoting private sector as key drivers of economic development in Somaliland.

2. Literature Review

2.1. An Overview of the Somaliland Economy

Somaliland has managed to secure peace and stability for over 25 years and has progressed rapidly after its reassertion of sovereignty in 1991 due to the security and stability. However, Somaliland's economy still remains one of the lowest in the world. According to the Ministry of Notational Planning and Development, Somaliland's GDP in 2012 was estimated at US\$ 1,558.4 million and Somaliland income per capita was estimated at \$ US\$ 444 and is considered one of the lowest in the world. [Ministry of Notational Planning and Development, Somaliland National Development Plan II 2017-2021, Hargeisa, Somaliland Gov, 2017. P, 18]

Somaliland's economy is dominated by low-productivity sectors with livestock and retail trade making up over 50% of GDP. Somaliland's economy is very open with a ratio of imports and exports to GDP of 91.5% the 7th highest in Sub-Saharan Africa, and the 45th highest in the world – \$883 million imports and \$387 million exports. [Muhumed Mohamed Muhumed, Somaliland Trade, Exports and Imports: An Overview. Developing Country Studies, Vol. 6, No. 12, 2016, P, 138. <https://www.academia.edu/> (accessed 10 July 2017)]

Livestock production has been the backbone of the country's economy for many centuries and the majority of people directly or indirectly obtain their livelihoods from animal husbandry. It is the country's biggest export commodity where most of the country's hard currency is generated through the export of livestock. Based on 2015 government estimates of livestock numbers, Somaliland had about 1,758,000 camels, 424,000 heads of cattle, 9,360,000 goats and 9,358,000 sheep in 2015. [The Ministry of National Planning and Development, Somaliland In-Figures, edition 13, Hargeisa, Somaliland Gov, 2016. P, 11]

Somaliland mainly exports livestock with primary species of camels, cattle, sheep and goats and its byproducts including hides and skins together with frankincense. Between 2011 and 2015, around 16.840 million heads of livestock [ibid P, 35] and 25.193 million pieces of hides and skins [ibid] were exported through Berbera to the Arabian Peninsula markets which constitute the first and second biggest export of Somaliland. The destination of Somaliland's livestock exports is mainly the Saudi Arabia, and Yemen is also the second most important market. Frankincense and other natural gums and resins constitute the third largest export commodity after Livestock, hides and skins. These are harvested from wild trees controlled by customary rights which have protected this resource from over exploitation. Between 2011 and 2015, around 4,241,249 (Kg) of Frankincense and natural gums were exported from Berbera port. [Ibid P, 36]

In Somaliland farming contributes 7% of the GDP, and it is estimated that less than 10% of the land is suitable in agriculture. The farming in Somaliland is predominantly subsistence in nature. The principal grain crop grown under rain fed conditions is sorghum, followed by maize; and both crops are grown primarily for household consumption by

small-scale farmers. Fruit and vegetable crops, which are relatively small, are grown mainly for commercial purposes and the principal commercial crops are tomatoes, lettuce, onions, watermelon, peppers, cabbages, oranges, lemons, and papaya. Rain-fed farming accounts for 90% of the total area cultivated, while the area under irrigation constitutes only 10%, supporting about 4,000 farm families. [Ministry of Trade and Investment, Investment Guide to Somaliland Opportunities & Conditions (2013 - 2014) Hargeisa, Somaliland Gov, 2013] Furthermore, the fishing industry is still underdeveloped, but the country's 850 mile coastline has rich fishing grounds. [ibid]

Remittance money constitutes another important sector of the Somaliland economy, by helping drive the economic engine through cash circulation and large transfers that are used for investment, and for household income and maintenance. [UN-OHRLLS. The Role of Remittance in the Economic Development of Somaliland, [Online] Available from: <http://unohrlls.org/> [Accessed 3 July 2017]] This means that remittance money in Somaliland has not only played a positive role towards economic development and livelihood improvements but also in conflict reduction and stability by allowing poor households to receive vital maintenance money, sent by their relatives from the Diaspora, without a delay thereby allowing enterprise and trade to grow, enabling authorities from Somaliland to collect import taxations and other tariffs, which are in turn spent on security to sustain peace and stability and on social development and reconstruction programs.

On the other hand, the government's role in the economy has been limited since independence in 1991. Tax revenue as a percentage of GDP in Somaliland (approximately 7% in 2012) is less than half the sub-Saharan Africa average. Historical low levels of domestic revenue have only been able to sustain core Government functions and maintain peace and stability. In 2013, central and local government spending was around 8.5% of GDP and, although public spending has increased, levels of public investment remain very low ranking 180 out of 188 countries in the World for gross fixed capital formation as a percentage of GDP, [Mousley, Peter, et al. *Somaliland's Private Sector at a Crossroads: Political Economy and Policy Choices for Prosperity and Job Creation*. World Bank Publications, 2015. p, 64] with Hargeisa ranking 174 out of 183 in the Doing Business Index in 2012 [World Bank and IFC, "*Doing Business in Hargeisa, 2012*" Washington, DC. World Bank, 2012]. Therefore, it is required the government should improve the capacity development of all economic actors and seek successful transformation of the economic fortunes in order to put the economy on a sustainable path to recovery and growth.

2.2. The Private Sector

Private sector investment has been the engine of employment and income creation, provision of infrastructure as well as social services. It contributes to development in different ways, jobs creation, domestic productions, foreign exchange gains and solving marketing constraints. [Nwakoby, Clem, and Alajekwu Udoka Bernard. "Effect of private sector investment on economic growth in Nigeria."

NG-Journal of Social Development VOL. 5, No. 4, August 2016, P 150-167.
https://www.arabianjbm.com/NGJSD_index.php (accessed 15 July 2017)]

The private sector in Somaliland is currently engaged in a wide range of commercial, service and industrial economic activities including retail, wholesale, import-export trade, hotels, property development, utilities, airlines, money transfer, health and education. For example, there are private hospitals and clinics which offer health care provisions to the public and in education private schools and colleges run alongside the public ones. According to the Ministry of National Planning and Development the private sector accounts for over 90% of the country's gross domestic product (GDP), and employment [National Development Plan (2012-2016) P 93]. Furthermore, under the Investment Guide to Somaliland Opportunities & Conditions 2013 – 2014, private sector investment into the Somaliland economy, particularly Diaspora community has been steadily growing as peace and stability has improved. [Investment Guide to Somaliland Opportunities & Conditions 2013] Similarly, under the Somaliland Special Arrangement (2013 -2016) in the New Deal, PSG4 on economic foundations recognizes private sector development as the key driver for economic development. [NEW DEAL (2013 -2016) *Somaliland Special Arrangement*, 2013] For this reason private sector investment play a major role in Somaliland's economy.

On the other hand, in 2011, the Government of Somaliland published the Somaliland long-term vision 2030 statement titled “*A Stable, Democratic and Prosperous Country Where the People Enjoy a High Quality of Life*” and National Development Plan which covers the five year period from 2012 to 2016. The Plan was structured in line with Somaliland's Vision 2030 and was based on five main pillars, namely Economic Development, Infrastructure Development, Governance and rule of law, Social Development and Environmental Protection.

The Economic Development Pillar consists of nine sectors which Private Sector Development was one of them. The government was committed to improve the business climate and create an environment that is conducive to the sector's development by (i) Providing tax incentives to foreign investors, (ii) Streamlining business registration and formation processes, (iii) Proving the regulatory framework required for the development of a strong financial sector, (iii) Encouraging the manufacturing sector with tax concessions, providing technical support and the establishing industrial zones, (iv) Introducing credit schemes and support services for start-ups and small businesses, (v) Developing free trade zones, (vi) Improving infrastructure, (vii) Supporting the chamber of commerce and other business associations, (viii) Expanding the market for domestic products through trade agreements and customs union with neighboring countries, (ix) promoting exports, (x) providing training and advisory services to private businesses, and (xi) strengthening peace, law and order. [National Development Plan (2012-2016) P 4]

Nevertheless, Progress towards these goals has been limited, despite the successes of the private sector and the future investment and growth prospects for the whole economy appear to be very promising.

2.3. Private Sector Characteristics

The private sector in Somaliland comprises a wide cross section of larger, medium, small, and micro-enterprises. The World Bank's Enterprise Survey (ES 2013) which was the first survey of its kind in Somaliland, found out that; out of 500 survey sample firms, 125 were micro firms with fewer than 5 employees, 236 were small firms with between 5 and 19 employees, and 108 medium-sized firms with between 20 and 99 employees, and the remaining 31 were large firms. [World Bank, *Somaliland formal enterprise survey technical note*, 2013, p 2] According to this survey, for about 45 percent of the firms were not registered with the Ministry of Commerce, which significantly higher among micro and small firms (65.6 and 41.4 percent, respectively). For this reason the majority of private sector in Somaliland consists of informal SMEs [ibid p 17]. The largest size category includes banks/remittance companies; telecommunication companies; locally owned airlines, import and export enterprises and energy (petroleum and electricity). At the other end of the scale, the smallest size category includes small retail outlets (for example, food, clothing, books), repair shops (for example, shoes, tires, bicycles), and catering outlets (tea shops). [Mousley, Peter, *Somaliland's Private Sector at a Crossroads*, P 7]

Furthermore, About 93 percent of the firms in the full sample Survey (ES 2013) were either sole proprietorship firms or partnership firms (65 percent and 28 percent respectively) [World Bank *Somaliland formal enterprise survey technical note*, 2013, p 4]. Foreign national's ownership of the private sector undertaking was limited (0.12 percent in the full sample) [ibid]. The finding of this survey indicates also that, exporting activities of the Somaliland private sector is low while the use of imported inputs is high. In the full sample, about 10.6 percent of the firms exported some or all of their outputs where over 97 percent of them use imported inputs and these inputs constitute about 85 percent of a typical firm's purchases of all inputs. [ibid]

In relation to the trade, a few prominent businessmen dominate the Somaliland economy, monopolizing much of the trade in livestock, food and construction materials as well as the clearance, retail, wholesale and transportation services, leaving no room for smaller traders and merchants. [Gaani, M.X. *Regulating the livestock economy of Somaliland*. p 12] The problem with these smaller traders is that, they do not generate enough capital to grown into large-scale enterprises or provide employment opportunities beyond family members. In addition, the sector appears to lack the ability to initiate original business ideas.

The general practice is one of imitation, so that many similar enterprises are found in close proximity or provide parallel services to the same area. An obvious example of this tendency is the Beverage Industry companies that operate in the same cities or neighborhoods, often in direct competition

with one another. [Chairman of the Somaliland Chamber of Commerce, Personal interview. 21 July 2017] This uncontrolled competition constrains them from developing regulatory mechanisms, associations or creation of joint ventures. Therefore, the majority of the private sector firms in Somaliland are characterized sole proprietorship informal SMEs with a limited foreign national's ownership.

3. Methodology

Qualitative research design was employed and both primary and secondary data were used in this paper. The primary data was obtained using interviews with the selected central government institutions responsible for Economic Governance and particularly Private Sector Investment development. In addition interview with the chamber of commerce to complement the data collected from the government and secondary sources.

Secondary data were gathered by way of reviewing all available data on Somaliland's private sector, including data made available by the Somaliland ministry of planning and economic development, ministry of commerce and investment, chamber of commerce and the World Bank, government laws and policy papers and sector studies. This study also made use of existing indicators, including from the Doing Business, Enterprise Surveys and Investment Climate Assessments in Somaliland to measure results.

The purpose of this literature scan was to capture the structure, conduct, and performance of private firms in Somaliland, as well as the quality of the business climate to scope various elements such as the availability of physical infrastructure, effective government policies regulatory framework and financial institutions like commercial banks and credit institutions that could provide capital and credit for business expansion or survival in difficult times.

4. Challenges and Constraints faced by private sector

4.1. Access to Finance

Somaliland has been without a formal commercial banking institution and the absence of this conventional financial system is significantly hindering access to finance which is the number one constraint on private sector activity in the Country.

The Central Bank of Somaliland, established in 1994, is responsible for monetary policy. It acts as a central bank and a commercial bank at the same time. The objectives of the bank were to: (i) maintain price and exchange rate stability; (ii) promote credit and trade conditions which support balanced economic growth; (iii) support the economic and financial policies of the government. However, the Central Bank of Somaliland is not in a position to perform key central bank functions, as it has not developed the typical standard instruments necessary to conduct monetary policies. [National Development Plan (2012-2016) P. 38]

Another main problem for the country's banking sector is the absence of sufficient capital and credit services. If investors require capital, the Bank of Somaliland is not able to provide it, because there are no commercial banks to comply with reserve requirements or lend to, and there are neither government securities nor a bond market. [Dahir, M. M. H. Non-recognition of Somaliland in international law and its legal implications for foreign investment. (Doctoral dissertation). University of Pretoria 2013]

The Current functions of the Central Bank is large extent involved in elementary treasury and government payment functions and at the same time offers basic commercial banking activities, mainly offering national remittance services through its branches and savings and current accounts to a limited number of clients, especially government bodies. In this context, the Somaliland financial sector remains underdeveloped, with no legal framework for commercial banks, and no banking supervision function and regulatory.

Vibrant alternative actors in financial sector are remittance companies which provide essential money transfer, foreign exchange services and, in some cases, deposit facilities, although without any deposit protection scheme in place [Humphrey G. Kajimba and Kamau Kabbucho, *Financial Sector Diagnostic Study for Hargeisa, Somaliland. ILO, 2013, P 21*]. These companies are effectively a half-way house to banks, and function efficiently, providing quick and inexpensive services to all parts of Somaliland. However, these companies do not provide the full range of financial services required for dynamic private sector-led recovery and growth. Consequently, private sector-led growth remains highly constrained unless a functioning banking system is developed to provide financial resources and other supporting banking services to strengthen these investments.

According to the findings of the Somaliland Enterprise Survey (ES 2013) based on 500 formal and informal private Sector businesses, the percentage of firms that reported the obstacle as more than a minor obstacle (moderate, major or very severe obstacle) was highest for access to finance (74.7 percent), followed by access to land (72.3 percent) and electricity (46.7 percent) [World Bank, *Somaliland formal enterprise survey technical note 2013 P 12*]. Furthermore, as evidenced economies measured by "Doing Business 2012, Hargeisa was ranked the last in the world for the cost and ease of getting credit compared to 183, behind Sudan (166), Djibouti (177) and Ethiopia (150). [World Bank, *Doing Business in Hargeisa, 2012 P, 36*]

The Somaliland firms finance your enterprise either through shareholding or through their own funds and families or through remittances from abroad on personal connections rather than investment opportunities. Therefore, lacking the basic institutions and regulations necessary for the formal financial system and lacking the commercial banks offering longer term loans for investments created a challenge for all private sector development in Somaliland.

4.2. High Cost of Energy

Energy use in Somaliland is extremely low by world standards. It is currently estimated at 200 to 280 kilogram Oil Equivalent (kgoe) per capita per year and is mainly dominated by biomass based fuels. The main commercial fuel used is imported petroleum and electricity. Establishments in the Service Sectors and Commercial Enterprises consume an average of energy of 8.6 Tons of Oil Equivalent (toe) monthly (103 toe annually), out of which 76% is attributed to petroleum and electricity (generated from diesel). [Ministry of Mining, Energy and Water Resources. *Somaliland Energy Policy*. Hargeisa Somaliland Gov, 2010]

Although Somaliland has its own energy resources especially wind, solar, and fossil fuels, this potential is largely under-utilized. Instead, electricity is generated almost exclusively from imported diesel. Hence, the country experiences the highest cost of electricity in the world and the current price of electricity is (US\$ 0.8–1 per kWh). [ibid] Besides fluctuations in international oil prices, the inefficient production and distribution of electricity and many uncoordinated players on the market are factors adding to the cost of electricity production.

Despite the high tariff rate price of electricity in Somaliland, 68% of urban and peri-urban households and 96% of firms have access to electricity [ibid]. This is high compared to the Sub-Saharan Africa average, where the electrification rate in urban areas is 57.5%. [World Bank Group. *Addressing the Electricity Access Gap*. Washington, D.C.: World Bank Group. 2010] However, Somaliland's network is characterized by extremely high costs, high wastage, poor quality, unreliability and losses of power. In reality, local firms often rely on their own generators to face power outages. [ibid *Somaliland Energy Policy*]

According to the findings of the Somaliland Enterprise Survey, electricity was the third most frequently cited as the biggest obstacle. (Access to finance (74.7 percent), followed by access to land (72.3 percent) and electricity (46.7 percent)). [World Bank, *Somaliland formal enterprise survey technical note* 2013, P. 12] In addition the importance of energy, as being one of the main challenges facing new investments and industry in Somaliland, and was highlighted by the large number of industry study respondents who said that it was their number two concern (more than 75% respondents, only second to lack of finance). [Ministry of Trade and Investment, *An Investment guide to Somaliland: Opportunities and conditions* 2013]

The current government-run power supply service is largely limited in scope and coverage which is very far below the needs of private sector business particularly manufacturing or industries. As a result of this, the majority of firms rely entirely on private sources for electricity with most of that in the form of diesel generators which has limited electricity supply, resulting in low access.

4.3. Access to Land

Land access is defined by the availability of land with the required security of ownership, desirable physical and economic attributes, reliable credit and property information and the level of transparency and fairness of transactions. [Ahene, R.A. Measures to improve access to land resources and related benefits in Uganda. In *World Bank/FIG Conference on Land Governance in Support of the MDG's: Responding to New Challenges*, Washington, DC. 2009] Equally important is how access to land is secured and how inclusive ownership of land can be documented especially in customary tenure areas.

In Somaliland, land is a public property and officially belongs to the government of Somaliland as stated in Article 12 of the Constitution. In practice however, land is tribally or communally owned and it become a major economic resource and profitable commodity which costs very high price. For example, in Hargeisa, 40 square meters of land (430 square feet) in the center of Hargeisa costs more than US\$ 100,000. [As observed, land along the sides of the main streets in Hargeisa is sold very high price, for example in the middle of the town areas one squire meters of land costs approximately 3000 USD. This is one of the main obstacles faced by the business investors] Land Policy Scoping Study Reported that 24m x 24m plot size of land in Burco Town cost between \$20,000 and \$55,000 in 2015. [Interviews with *dillaal* (land Brokers) who described haw land price constantly is rising] This high cost price of land constitutes one of the main constrains faced by the investors.

As evidenced by 2013 Somaliland enterprise survey, access to land problems was among the biggest complaints of investors in all regions. according to the findings of this survey, When asked to choose the single most important or biggest obstacle to their business from a list of 16 obstacles, poor access to finance was the most commonly chosen obstacle (by 48.8 percent of the firms) followed by access to land (by 24.8 percent of the firms). [World Bank, *Somaliland formal enterprise survey technical note* 2013]

Furthermore, the responsibility over all urban land management legally rests with the Ministry of Public Works, Housing and Transport (MoPWHT). The principal functions of the ministry include; physical planning, control and development of urban lands and preparing land titling and property registration policies. [Article 2 and 3 of Urban Land Management Law. law No; 17/2001] However, to date none of the above has been put into effect due to capacity bottleneck in the Ministry. As a result of this there is no industrial development zones established in all regions In order for the industrial sector to have land accessibility.

Land titling, registration, and formalization take place also at the local level without clearly defined authority, capacity and guidance in dealing with this issue. As a result of this, disputes frequently arise over ownership of land due to lack of physical plan as well as inadequate procedures for land titling and registration. [Mousley, Peter, *Somaliland's Private Sector at a Crossroads*, 2015, P. 31] These land disputes, in practice, are resolved outside the courts through customary [Barry, M. and Bruyas, F. "Formulation of Land

Administration Strategy in Post-Conflict Somaliland." *Surveying and Land Information Science Journal*, Vol. 69. N. 1, 2009, P 3. <http://www.salis-journal.org/> (accessed 13 July 2017)] law where illegal claimants regularly receive pay-offs or some land. The perpetuation of false claims thereby becomes worthwhile and as a result, it is nowadays a common practice for personal enrichment

These policies barriers together with domestic challenges have led to inefficiencies in the accessibility of land for the investors and investment opportunities both from local and foreign investors.

4.4. High Transportation Costs

In Somaliland Road network is the principal mode of internal transport due to a lack of railway infrastructure. The road network is estimated to consist of around 780 km of paved roads, 1,225 km of unpaved roads, and approximately 6,800 km of unpaved wheel truck roads [Ministry of Planning and Economic Development, *the Somaliland National Development Plan 2012-2016*, (2012)]. The majority of these roads were constructed between 1972 and 1982 and many of them have cracks, potholes and patches and have now reached the end of their design life. [Ministry of Trade and Investment, *investment guide*, p. 121]

In addition, Berbera is the main port of Somaliland and it handles roughly 95 % of all imports and exports in Somaliland. [ibid] This means all imports coming into the country come through the port of Berbera and travel inland from Berbera to other major cities and regions of the country.

On the other hand, private sector firms operation and production within Somaliland is heavily depends on both port and inland transport infrastructure. Imports constitute a large share of firm inputs with 97% of firms currently importing inputs and 85% of inputs are imports. [Ministry of Planning and Economic Development, *the Somaliland National Development Plan 2012-2016*, (2012)] However, several studies identified the current Poor transport infrastructure significantly raises production costs for the private sector.

According to the World Bank (2012), *"Doing Business in Hargeisa"* The biggest share of the cost for both imports and exports is represented by inland transportation. For example exporting and importing a container to Hargeisa through the port of Berbera has a total cost of \$1,940 and \$1,920 respectively which 57% (\$1,100) of this cost represents the inland transportation. [World Bank and IFC, *"Doing Business in Hargeisa, 2012"* P. 49]

Furthermore, the Somaliland enterprise survey finds out that, over 40% of firms identifies transportation as more than a minor constraint on their business [World Bank, *Somaliland formal enterprise survey technical note* 2013, P. 12]. This is because of infrastructure limitations, for example, the road that connects Hargeisa to the port of Berbera is narrow and not well paved, which prevents large container trucks from using it. Hargeisa's urban infrastructure does not allow for

the free circulation of heavily laden or larger trucks. As a consequence, cargo for exports is typically manually loaded into smaller trucks at the warehouse, taken to Berbera, and then manually loaded onto containers available at the port. Additionally, import containers are seldom released for transportation on land or, if they are, it is against high deposits and the risk of detention charges. Because the shipping lines do not have empty container depots near Hargeisa or any other inland destination, importers must have to pay to return the empty container to port or unload the container in the port.

This makes inland handling and transportation cumbersome, driving costs up which contributes the problems and challenges faced by the private sector investment in Somaliland.

4.5. Skills and Reliable Information

Investors and entrepreneurs have little access to reliable information about domestic and international markets. Information about business performance is far from ideal and investors have difficulties to understand the real potential of the business opportunities in the country. The common practice is to replicate a successful entrepreneur rather than look for a business opportunity that has not been explored yet. This problem relating the market information that encountered mainly by new investments resulted many small and medium industries unsustainable and closed down. According to assessment report conducted by the Somaliland National Industry Association (SNIA), 39 of the 54 small and medium industries registered by this association were closed in between 2001 and 2012 [Somaliland National Industry Association assessment report, 2012. un published]. According to this report, most of these industries that failed belonged to Diaspora investors who didn't have basic market information, including cost of energy, availability of raw materials and skilled labor force as well as business plan when investing in the country.

Furthermore, Private sector Firms face challenges in employing a large variety of workers which reflects the low human capital within Somaliland. This is apparent from the Somaliland Enterprise Survey conducted by the World Bank. According to this survey many firms employed skilled foreigners to address technical skill gaps and Diaspora investors identified that the lack of basic skills and sector-specific technical skills are the major deterrent for investing in Somaliland comparing to other counties [World bank ES 2013 p 6]. The Diaspora interviewees also confirmed that turnover tends to be high for most locally hired employees [ibid].

4.6. Enabling Legal, Regulatory and Administrative Environments

The Somaliland Constitution is based on guarantees of private property rights and the protection of the free market. However, despite the strong commitment of the Constitution to economic development, the same cannot apply to the entirety of the legal framework regarding businesses' matters. This can be understood from the current taxation laws and existing applicable tariff structure.

Domestic taxes are governed by the Law No. 86/96, while the customs operations and taxes on international trade are governed by Customs Law, (Law No. 91/96). However, the rates and tariff structures in these laws have been changed over the years by executive, without updating the legislations by the parliament, thus tax systems are informality and arbitrariness. [the tariff structure and rates are usually developed by the ministry of finance, and these are changed over a time, usually whenever a new government comes, it updates and increases the existing tariffs without reviewing the legislations]

In addition, profit taxation is very high and business companies have to pay 101.9% of their profits which is almost twice the regional average of Sub-Saharan Africa (57.1%). [World Bank and IFC, *“Doing Business in Hargeisa, 2012”*, p. 45] Business registration process also remains expensive in Somaliland, and entrepreneurs have to pay 130.6% of income per capita (\$276) to start a business in Hargeisa comparing with 183 economies measured by Doing Business, and that makes Hargeisa among the top 15 most expensive cities in the world to start a business. [ibid]

The current tax law in Somaliland is broad in its scope and the general provisions do not provide sufficient detail which makes implementation difficult. According to the former Accountant General, the lack of generally accepted accounting standards, including regulations on depreciations and deductions, makes it difficult for businesses to comply with their tax obligations. [Mohamed Abdi Bade, former Accountant general, Personal interview. 24 July 2017]

Furthermore, currently Somaliland does not have a formal coherent revenue policy and this create a variety of problems including underdeveloped data recording systems, inadequate revenue collection analysis capacity, limited capacity for tax forecasting and tax policy analysis functions. According to the senior officials of the finance ministry, both customs and internal revenue collections are manual processes with little effective supervision or control. Similarly, in the department of customs all revenue data systems are manually created and maintained, including information on declaration of goods to be imported or exported, registration of goods, calculation of duties and tax obligations, recording of payments and other basic functions. [Abdikarim Ibrahim, Ministry of Finance, Personal interview. 1 August 2017]

Although the commercial code tends to remain in place, in most cases it does not apply to the private sector and most of the disputes are resolved through traditional justice system, and this affects the ability of firms to enforce contracts and resolve commercial disputes. According to a survey conducted by Ministry of Trade and Investment and USAID in 2012 only 5% of Diaspora respondents said that the existing legal framework was sufficient to arbitrate business conflicts. Therefore, this indicates lower confidence by Diaspora investors about the legal framework and hence most of them rely to the informal dispute resolution system.

In terms of protecting investors, the Foreign Investments Law presents conditions that in principle are favorable including; guaranteed against expropriation measures, tax

free profits for a period of three years; and free transfer of profits after three years, but Conditioned by approval by the Foreign Investment Board. [Article 15 of the Somaliland Foreign Investment Law, Law Lr; 29/2004]

The arbitration procedure for possible settlement of disputes does, however, clearly present a problem. Article 19 declares that procedures have to be agreed upon with the investor, or in the absence of such an agreement within the framework of the agreements in force between the Somaliland Republic and the investor's home country. [ibid Article 19] As no state currently recognized Somaliland, such frameworks do not exist and this has to be seen as a high risk factor. Therefore, the above mentioned Legal and Regulatory problems are among the challenges faced by the Somaliland private sector intending to invest the country, particularly, foreign investment activity.

5. Conclusion and Recommendations

5.1. Conclusion

Somaliland, which was a British Protectorate until 26 June 1960, became a part of the Somali Republic on 1 July 1960 and independent Republic of Somaliland on 18 May 1991. It is a democracy with a multi-party system and located in the Horn of Africa. Somaliland has already experienced two decades of major changes in its security situation, its political system, its economy, the regional environment, and technological changes. Despite the years of destruction brought on by the civil war, Somaliland has been the site of impressive levels of economic recovery due to the peace and security, a durable social contract, high flows of remittances from the Somaliland Diaspora, a robust private sector and a powerful cultural tradition.

Somaliland's GDP for 2012 is estimated to have been \$1.4 billion US\$ with GDP per capita estimated at \$347. Almost 30% of GDP is derived from the livestock industry followed by 20% from wholesale and retail trade (including the informal sector); 8% from crops and 6% from real estate activities. With a very limited enabling environment and minimal government support, the private business sector has grown rapidly and has significantly contributed to the growth of Somaliland's economy, in delivering key public goods and services, providing employment opportunities and capital investment for the process of reconstruction. However, the private sector faces significant constraints including; access to finance. Poor infrastructure, limited human capital and insecure land rights also constitute major constraints to private sector growth. Thus at the heart of this challenge is the issue of economic governance.

5.2. Recommendations

In order to overcome the problems and challenges faced by the private sector and to create business enabling environment, the government, among other things, should undertake the following;

- 1) Passing appropriate legislation and tailoring policies to create an enabling environment for private sector growth.

- 2) Encouraging private sector investments in the energy sector, promoting the development of renewable energy sources and adopting regulatory framework for sustainable production, distribution and marketing of electricity for greater efficiency and lower costs.
- 3) Developing an investment law that provides key services including access to land and infrastructure, via the establishment of enterprise zones or industrial parks and allocating in a transparent and accountable manner and in accordance with well-defined and well-documented eligibility criteria
- 4) The government's recent initiatives linked to new investments in Berbera Port and investment in the highway linking Berbera port to border with Ethiopia will dramatically decrease the cost of doing business in Somaliland. However, investments in transports should go beyond the corridor and improve the national road network as a whole.
- 5) Undertaking a comprehensive taxation reform and developing detailed tax regulations, including deductions and accounting standards, to encourage trade and investment, as well as providing capacity-building and educating entrepreneurs on the taxation system to fill the gaps between the taxation laws and their practical implementations.
- 6) Improving business registration systems particularly related to business start-up and licensing, and establishing easily accessible step by step guidelines on business registration to saves time and increase predictability.
- 7) Promoting the formation of financial institutions-commercial & investment banks, insurance Co etc- that provides Credits, accepts deposits, and other financial services
- 8) Developing effective legal instruments on financial supervision and regulation including; remittance companies and other financial institutions regulations and oversight, and laws preventing or detecting money laundering and related financial crimes to maintain reliable links to foreign financial institutions and to assess and mitigate risks to make rational business, and
- 9) Developing sufficient governmental capacity to implement policies and regulate the economy.
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