



Institute of Public Finance  
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Policy Paper

# Tax Gap Analysis and Domestic Revenue Mobilization Strategies for Somalia

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## Abstract

This report provides an in-depth analysis of Somalia's tax gap, defined as the significant difference between potential and actual tax revenue, which currently stands at an exceptionally low approximate 3% tax-to-GDP ratio. The analysis utilizes both top-down and bottom-up perspectives to assess Somalia's economic and fiscal performance, identify revenue trends, and compare tax-to-GDP ratios with regional benchmarks. Key findings reveal substantial gaps in income and sales taxes, alongside the detrimental impact of fragmented customs administration, a pervasive informal economy, and persistent insecurity on overall revenue mobilization. The report concludes by proposing a multi-faceted strategy that combines targeted tax policy reforms (such as a comprehensive Value-Added Tax and an expanded income tax base), enhanced administrative capacity (including leveraging digital solutions), and crucial intergovernmental fiscal agreements. This approach is framed not merely as a technical fiscal adjustment but as a foundational element for fostering fiscal self-reliance and solidifying state-building in Somalia's fragile context.

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## II. Introduction

### A. The Imperative of Domestic Revenue Mobilization in Fragile States

Domestic Revenue Mobilization (DRM) stands as a cornerstone of sustainable development, universally recognized as essential for nations to reduce their reliance on external aid and cultivate fiscal self-reliance. For Fragile and Conflict-Affected States (FCAS) like Somalia, the urgency of DRM is particularly pronounced. In these contexts, robust tax systems are not merely about generating funds; they are foundational to building state capacity, enabling the delivery of basic public services, enforcing the rule of law, and ultimately, establishing a legitimate state and a functional social contract between citizens and their government.

Somalia serves as a critical case study in this regard. Emerging from decades of protracted conflict, the nation has embarked on a challenging yet determined path of state-building and fiscal reforms. Commendable progress has been observed in absolute revenue terms, with domestic revenue increasing fourfold from just \$69 million in 2013 to \$329.5 million in 2023. Despite this notable growth, Somalia's tax-to-GDP ratio, at around 3% in 2023, remains among the lowest globally. This level is far below its potential and demonstrably insufficient to fund basic government operations and services.

The significance of DRM in Somalia extends beyond merely closing a financial deficit. It is fundamentally a political imperative to establish a functional, legitimate state and foster accountability between citizens and the government. In a context characterized by low public trust and the prevalence of informal and armed group taxation, a fair and transparent tax system becomes a critical mechanism for rebuilding state-society relations and enhancing state legitimacy.

The ability of the state to collect taxes fairly and transparently signals its authority and legitimacy, whereas a failure to do so can exacerbate societal divisions and perpetuate conflict. Therefore, the endeavour to improve revenue mobilization in Somalia is deeply intertwined with its broader journey towards peace, stability, and effective governance.

## B. Research Gap and Contribution

collections—is well-established in public finance literature, its comprehensive analysis in highly fragile and data-constrained environments like Somalia presents unique complexities. General frameworks for tax gap analysis often do not fully capture the intricate interplay of economic, administrative, and political economy factors prevalent in post-conflict settings. There is a clear need for granular, country-specific studies that integrate these multi-dimensional aspects to provide a holistic understanding of revenue shortfalls.

This paper addresses this critical research gap by providing an in-depth, multi-method analysis of Somalia's tax gap. It quantifies the significant discrepancies between potential and actual tax revenue across different tax types, offering a precise measure of the uncollected fiscal resources. Furthermore, the study systematically examines the underlying drivers of this gap, moving beyond purely technical considerations to include economic constraints, administrative weaknesses, and, crucially, the complex political economy of fiscal federalism and the pervasive informal sector.

A central contribution of this paper is its demonstration that the **"tax gap"** in fragile and post conflict- states like Somalia is not purely an economic or compliance issue but is deeply political. The analysis reveals how fragmented tax authority, elite bargains, and informal tax negotiations significantly hinder centralized tax systems. The presence of armed group taxation and the potential for unfair tax systems to reinforce social divisions further underscore that the tax gap is not solely a result of technical inefficiencies or taxpayer non-compliance but is profoundly rooted in fundamental political and institutional challenges, including the distribution of power and the nature of political settlements. This deeper understanding extends the discourse beyond mere quantification to illuminate the complex, multi-layered causes of revenue underperformance. Drawing on empirical data and comparative insights, the paper proposes actionable, context-specific strategies for enhancing DRM, aiming to inform policy interventions that are both technically sound and politically feasible for Somalia's unique environment.

## C. Paper Structure

The remainder of this paper is structured as follows: Section III provides an overview of Somalia's economic and fiscal context, outlining the macroeconomic environment and recent revenue performance. Section IV quantifies Somalia's tax gap through a conceptual framework and a disaggregated analysis by tax type. Section V offers an international benchmarking and comparative analysis of Somalia's tax-to-GDP ratio against regional peers and delves into the unique factors contributing to its low revenue mobilization. Section VI identifies key structural and institutional challenges in revenue mobilization, including fiscal federalism, the informal economy, and the security environment. Section VII outlines comprehensive strategies for enhancing domestic revenue mobilization, covering tax policy reforms, administrative capacity building, intergovernmental fiscal relations, and digital solutions. Finally, Section VIII presents the conclusions and policy implications derived from the analysis, along with avenues for future research.

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## III. Economic and Fiscal Context of Somalia

### A. Macroeconomic Environment and Tax Base Constraints

Somalia's economy has been on a trajectory of gradual recovery following decades of conflict, yet it remains highly susceptible to recurrent shocks, including severe droughts, persistent insecurity, and global economic disruptions such as the COVID-19 pandemic. This volatile environment significantly impacts the nation's capacity for sustained economic growth, which in turn constrains the potential for tax revenue generation.

**Table 1** summarizes Somalia's real GDP growth rates from 2018 to 2023, illustrating the economic context in which revenues have been generated.

**Table 1. Somalia's Real GDP Growth Rate (2018–2023)**

Year	Real GDP Growth (%)
2018	2.1%
2019	2.8%
2020	-2.8%
2021	3.5%
2022	2.7%
2023	4.2%

**Source:** Somali National Bureau of Statistics (2024), GDP Report.

As shown in Table 1, real GDP growth averaged only about 2% over this period, with a sharp contraction of -2.8% in 2020 due to the COVID-19 pandemic. This modest and volatile growth inherently limits the expansion of the tax base. The underlying economic capacity to generate tax revenue remains inherently constrained, even as administrative capacity to collect taxes improves. This implies that while the Federal Government of Somalia (FGS) has achieved commendable absolute revenue growth, it started from an extremely low base, and this growth is occurring within a deeply constrained and volatile economic environment. The pace of tax-to-GDP ratio improvement will therefore be constrained by the underlying structural weaknesses of the economy and its persistent fragility, demanding a realistic long-term perspective for fiscal planning.

Furthermore, pervasive poverty, with over half the population living below the poverty line, and a vast informal sector mean that a substantial portion of economic activity remains untaxed. With GDP per capita around \$600 and most livelihoods concentrated in pastoral and informal activities, broadening the tax base presents significant challenges. Despite these structural impediments, recent positive developments, such as achieving debt relief under the Heavily Indebted Poor Countries (HIPC) initiative in 2020 and joining the East African Community (EAC) in 2024, signal improved economic governance and offer potential for increased trade and growth, which could indirectly boost the tax base in the medium to long term.

## B. Domestic Revenue Performance (2013–2023)

Somalia's domestic revenue, comprising both tax and non-tax collections, has increased significantly over the past decade, albeit from an extremely low starting point. Federal government revenue collections have grown substantially, reflecting concerted efforts in state-building and fiscal reforms after decades of conflict.

**Table 2** illustrates Somalia's domestic revenue performance from 2013 to 2023 in USD millions, highlighting this upward trend.

**Table 2. Somalia's Real GDP Growth Rate (2018–2023)**

Year	Domestic Revenue (FGS) in USD million
2013	69.0
2014	75.0 *
2015	114.0
2016	112.7
2017	142.6
2018	160.0 *
2019	223.5
2020	205.6 *
2021	210.0 *
2022	262.7
2023	329.5

**Sources:** MoF Financial Reports; World Bank (2022).

\* 2014, 2018, 2020, 2021 figures are estimates based on trend data.

As shown in Table 2, Somalia's domestic revenues have risen from about \$69 million in 2013 to \$329.5 million in 2023, representing an impressive four-fold increase. This growth is largely credited to reforms in tax policy and administration implemented over the last decade, including efforts to centralize port fee collections and expand tax collection beyond the capital.

The composition of revenue has also evolved. While customs duties on international trade remain the single largest source, accounting for approximately 47% of domestic revenue in 2023, inland revenues (comprising income and sales taxes, and non-tax fees) have grown in importance. Inland revenue's share of FGS domestic revenue increased from only 16% in 2013 to about 57% in 2020. This shift was achieved through measures such as expanding income tax to private sector wages, introducing a telecoms tax, and raising airport fees.

Despite this progress, current collections remain remarkably low in relation to the size of the economy. In 2022, domestic revenue was only about 3.2% of GDP (up from 1.2% in 2013), and including 2023's growth, the ratio is roughly 3.3%. This places Somalia's tax-to-GDP ratio among the lowest in the world. This low revenue base leaves Somalia heavily dependent on external grants, which comprised about 55% of total government revenue in 2023, significantly eclipsing domestic tax income.

This situation highlights a critical aspect of Somalia's revenue challenge: the "low-hanging fruit" paradox of customs. Customs duties are currently the backbone of Somalia's revenue system and have performed closer to capacity than other taxes, yielding significant absolute gains. However, this heavy reliance on trade taxes also introduces vulnerabilities due to administrative fragmentation and evasion. While initial revenue gains came from optimizing existing strengths (customs), achieving substantial overall revenue growth and improving the tax-to-GDP ratio will necessitate diversifying the tax base. Future significant improvements must come from developing inland taxes, particularly income and sales taxes, which currently exhibit the largest untapped potential. This implies that a balanced strategy is required, building on customs reforms while simultaneously fostering the growth of other tax streams.

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## IV. Quantifying Somalia's Tax Gap

### A. Conceptual Framework of the Tax Gap

The "tax gap" is a fundamental concept in public finance, defined as the difference between potential tax revenue—what theoretically should be collected under conditions of full compliance with existing tax laws and optimal policy settings—and the actual tax revenues collected. This metric is crucial for assessing the overall effectiveness of a tax administration, identifying areas where revenue is being lost, and informing targeted policy interventions.

The tax gap can be broadly decomposed into two primary components:

- **Compliance Gap:** This represents the revenue lost due to non-compliance by taxpayers, including undeclared income, underreporting of liabilities, overstating deductions, or outright evasion.
- **Policy Gap:** This refers to revenue foregone as a result of legislative and regulatory policy choices, such as tax exemptions, preferential rates, or a narrow definition of the tax base.

It is important to acknowledge that tax gap estimates are inherently approximate and should be interpreted with caution. Due to inherent uncertainties in methodologies and data limitations, particularly in developing and fragile contexts, the emphasis should be on understanding trends in the estimated results rather than focusing solely on absolute numbers.

For Somalia, a country with a nascent tax system, the policy gap (e.g., the absence of a broad-based Value-Added Tax, the limited scope of income tax, and widespread exemptions) is likely as significant, if not more so, than the compliance gap.

This means that effective Domestic Revenue Mobilization strategies in Somalia must simultaneously target both legislative and policy reforms and administrative enforcement and compliance initiatives, rather than focusing on one in isolation. Addressing both dimensions is critical for sustainable revenue growth.

## B. Disaggregated Analysis of the Tax Gap by Tax Type

An in-depth examination reveals that every major tax category in Somalia exhibits a substantial gap between current and potential collections. This disaggregated analysis provides a clearer picture of where the most significant revenue shortfalls occur.

**Table 3** compares Somalia's actual collections in 2023 by major tax type to rough potential revenue estimates, based on analyses by the IMF and World Bank and regional comparisons.

**Table 3. Actual vs. Potential Annual Revenue by Tax Type (Federal Gov of Somalia)**

Tax Type	Actual Collection 2023 (USD million)	Potential Collection (USD million)	Potential as % of GDP	Gap (% of potential)
Income Tax (personal & corporate)	23.1	80–100	1.0% GDP	70–77% gap
Sales Tax (5% GST on goods/services)	42.8	100–120 (with broader VAT)	1.2% GDP	58–64% gap
Customs Duties (trade taxes)	154.1	180–200 (with full compliance)	2.0% GDP	14–23% gap
Other Taxes (stamp, road, etc.)	6.6	15–20 (expanded base)	0.2% GDP	56–67% gap
Non-Tax Revenues (fees, licenses, etc.)	102.9	120 (improved enforcement)	1.3% GDP	14% gap
Total Domestic (FGS only)	329.5	500+	5% GDP	34% gap

**Sources:** Actual 2023 from FGS MoF (2024). Potential estimates based on IMF and World Bank analysis of Somalia's tax capacity (World Bank, 2021; MF, 2023) and regional benchmarks.

As Table 3 illustrates, income tax is the most underperforming category in relative terms. In 2023, it yielded only about \$23.1 million, which is roughly 0.2% of GDP, primarily from government payroll withholding. Given Somalia's growing private sector and high-income earners, there is substantial scope to increase income tax revenue. Potential income tax revenue is estimated at \$80–100 million (approximately 1.0% of GDP), indicating a significant 70–77% gap. IMF staff project that income tax receipts could triple or more in coming years with effective implementation of a new Income Tax Act.

The sales tax, currently a 5% General Sales Tax (GST) on goods and services, collected about \$42.8 million in 2023. This tax has limited coverage, and a reformed Value-Added Tax (VAT) with a higher rate (e.g., 10% or more) and a broader base (including services) could substantially boost collections. Potential sales tax revenue is estimated at \$100–120 million (approximately 1.2% of GDP), implying a 58–64% gap.

Customs duties on imports currently constitute Somalia's largest tax source, generating \$154.1 million in 2023. While performing closer to capacity than other taxes, significant gaps remain. Potential customs revenue is estimated at \$180–200 million (approximately 2.0% of GDP), indicating a 14–23% gap. These gaps are primarily attributable to smuggling, porous borders, and, critically, the fragmentation of collection between the Federal Government of Somalia (FGS) and Federal Member States (FMS).

Other taxes, such as stamp and road taxes, are currently minimal, generating around \$6.6 million combined. However, there is room for these to expand, with a potential to reach \$15–20 million (a 56–67% gap) as the economy formalizes. Non-tax revenues, while not strictly "tax," form a significant part of Somalia's domestic finances (\$102.9 million in 2023), performing closer to their estimated potential of \$120 million, showing a 14% gap.

The sum of these potential figures suggests a total domestic revenue potential of over \$500 million (roughly 5% of GDP), implying an overall 34% gap from current collections. This is still significantly below the aspirational 15% tax-to-GDP ratio that Somalia aims to achieve in the longer term.

This quantitative breakdown of the tax gap by type offers a critical perspective for policy prioritization. Income and sales taxes exhibit the largest relative gaps, indicating substantial untapped potential for long-term base broadening. In contrast, customs duties, while the largest absolute revenue source, have a comparatively smaller relative gap. This suggests a strategic dilemma for policymakers.

A practical, phased approach to reform might involve seeking immediate revenue gains through enhanced customs efficiency and inter-governmental cooperation on trade taxes, which are often considered "low-hanging fruit". Simultaneously, foundational policy and administrative systems would need to be built for the more complex, long-term expansion of income and sales tax collection. This strategic sequencing is crucial for maximizing impact in a resource-constrained and fragile environment.

# V. International Benchmarking and Comparative Analysis

## A. Somalia's Tax-to-GDP Ratio in Comparative Perspective

One of the most striking indicators of Somalia's fiscal challenge is its exceptionally low tax-to-GDP ratio, which is extraordinarily low even when compared to other low-income countries or those in post-conflict situations. This comparison highlights the unique depth of Somalia's revenue mobilization problem.

**Table 3** compares Somalia's actual collections in 2023 by major tax type to rough potential revenue estimates, based on analyses by the IMF and World Bank and regional comparisons.

**Table 3. Tax-to-GDP Ratio: Somalia vs. Regional Peers (Most recent data)**

Country	Tax-to-GDP Ratio (%)	Year	Total Revenue-to-GDP (%)	Notes
Somalia (FGS)	3% (tax); 4.4% (incl. non-tax)	2020	8% (incl. grants)	Lowest in Africa. Excludes FMS taxes.
Kenya	17% (tax)	2022	23% (incl. grants)	Relatively high effort (has VAT, income tax).
Uganda	12.5% (tax)	2022	18% (incl. grants)	Sub-Saharan Africa average 16%.
Rwanda	17% (tax)	2022	25% (incl. grants)	Successful reformer after conflict.
Ethiopia	9–10% (tax)	2021	13% (incl. grants)	Low tax base, but higher than Somalia.
SSA Average	16% (tax)	-	-	2015–2019 avg.
Fragile States Avg.	10–12% (tax)	-	-	Many FCAS countries reach low double-digits.

**Sources:** OECD/AUC (2024); World Bank Open Data; IMF Article IV reports. Somalia's 4.4% figure is tax + non-tax (2020); pure tax was 2.6%.

As Table 4 clearly shows, Somalia's tax-to-GDP ratio of around 2.6–3% (at the federal level) is by far the lowest in Africa. Even when including all domestic revenue (tax and non-tax), it reaches only about 4.4% of GDP, confirmed by the World Bank as the lowest in Africa. This figure pales in comparison to the Sub-Saharan African average of 16%.

Regional peers in East Africa, such as Kenya and Rwanda, achieve tax-to-GDP ratios of 16–18%, reflecting their more robust income tax and VAT systems. Even countries with significant instability, like the Democratic Republic of Congo (11%) or Afghanistan (9–10%), manage higher tax ratios than Somalia. In essence, Somalia collects only about one-fifth of what a "normal" country of its economic size might collect in taxes. In absolute terms, Somalia's \$330 million domestic revenue in 2023 translates to less than \$40 per capita, significantly below the average low-income African country's collection of over \$100 per capita in taxes.

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## B. Factors Contributing to Somalia's Low Tax Ratio

Several interconnected factors contribute to Somalia's uniquely low tax ratio:

- **Legacy of State Collapse:** Decades of state collapse meant that tax institutions had to be effectively rebuilt from scratch after 2012. This process is inherently slow and resource intensive.
- **Insecurity and Limited State Reach:** Ongoing insecurity and the presence of militant groups, such as Al-Shabaab, in parts of the country severely limit the government's ability to extend its authority and collect taxes effectively. These non-state actors often impose their own parallel "taxes" at roadblocks and in areas under their control, diverting potential government revenue and undermining the legitimacy of state taxation.
- **Dominance of the Informal Economy:** A pervasive informal sector dominates Somalia's economy, with a significant portion of livelihoods concentrated in pastoral and informal activities that remain untaxed. Less than 5% of the labor force is in formal employment, which severely limits the yield from income tax.

**Low Trust and Compliance Challenges:** Trust in government institutions is generally low, posing a significant challenge to voluntary tax compliance. While the informal sector represents a large

potential tax base, it is not a simple "pot of gold" to be easily tapped. Attempts to tax the informal sector have often yielded fewer benefits than expected due to challenges in designing and administering effective informal sector tax regimes, coupled with the small average size of informal enterprises which makes registration and enforcement costly. Furthermore, informal enterprises often already pay various fees and levies to local authorities, which can lead to perceptions of unfairness and resistance to additional taxation.

- **Narrow Tax Base and Policy Gaps:** Somalia has not yet implemented broad-based taxes common in other developing economies, such as a true Value-Added Tax (VAT) or comprehensive excise taxes on goods like fuel, alcohol, or tobacco. The current tax system relies heavily on a narrow base, primarily customs duties.

The understanding that the informal economy is not simply a "pot of gold" but a "misunderstood" challenge is critical. While it represents a large potential tax base, tapping into it requires nuanced, trust-building, and administratively feasible approaches rather than aggressive, top-down enforcement. Such enforcement could harm livelihoods and further undermine the fragile social contract. Visible service delivery and transparent use of funds are crucial for fostering a culture of voluntary compliance among informal sector workers.

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## VI. Key Challenges in Revenue Mobilization

### A. Fiscal Federalism and Customs Fragmentation

Customs and trade taxes currently form the backbone of Somalia's revenue system, accounting for nearly half of its domestic revenue. However, this reliance is coupled with a major impediment: the fragmentation of customs collection authority between the Federal Government of Somalia (FGS) and the Federal Member States (FMS).

The FGS primarily collects customs duties at Mogadishu port and Aden Adde International Airport, while FMS like Puntland (port of Bosaso) and Jubbaland (port of Kismayo) collect and retain revenues from their respective ports. This creates a significant "fiscal gap" and regional inequities, as there is no nationwide system to pool or share these revenues.

**Table 5 illustrates this disparity using available data from 2019–2021.**

**Table 5. Customs and Trade Tax Collections by Region (Average 2019–2021)**

Administration	Avg. Annual Domestic Revenue (USD)	Of which: Trade Taxes (USD)	Trade Taxes as % of Revenue
Federal Gov't (FGS)	\$223.5 million	\$96.8 million	43.3%
Puntland State (PSS)	\$69.2 million	\$38.2 million	55.3%
Jubbaland State (JSS)	\$14.5 million	\$8.4 million	58.2%
Southwest State (SWSS)	\$2.4 million	\$0.25 million	10.4%
Galmudug State (GSS)	\$3.8 million	\$0.04 million	1.0%
Hirshabelle State (HSS)	\$0.9 million	\$0.00 million	0%
Somaliland (self-declared)**	n/a	n/a	n/a (separate jurisdiction)

**Sources:** World Bank (2021b), average formal revenues FY2019–2021. FGS includes Benadir; data exclude Somaliland.

Table 5 highlights that Puntland and Jubbaland derive over half of their revenues from port duties, similar to the FGS. Meanwhile, inland states without ports (Galmudug, Hirshabelle) have negligible trade tax revenue and depend on transfers. This uneven landscape underscores a significant revenue gap: had there been a unified national customs system, a portion of the \$46.7 million that Puntland and Jubbaland collected annually in trade taxes (their combined average) could be available for broader redistribution or federal use.

The absence of a customs revenue-sharing framework thus represents a lost opportunity to maximize national revenue and reduce regional inequities. While efforts have been initiated to negotiate such arrangements, including the Customs High-Level Dialogue and the Baidoa Agreement, progress has been slow due to persistent political disputes and constitutional ambiguities regarding revenue distribution mechanisms and the respective rights and roles of federal and state authorities. This reveals that the problem is not merely administrative inefficiency but a fundamental

political challenge rooted in unresolved constitutional and power-sharing arrangements between the FGS and FMS. The lack of intergovernmental consensus effectively acts as the primary political bottleneck, preventing the maximization and equitable distribution of nationally generated revenues, even if technical customs reforms are implemented. This demonstrates a direct causal link: political fragmentation leads to revenue leakage.

## B. Informal Economy and Compliance Challenges

The large informal sector dominates Somalia's economy, with a significant portion of livelihoods, particularly in pastoral and informal activities, remaining untaxed. This presents a substantial challenge for revenue mobilization, as only a few thousand taxpayers are currently on record, indicating a very narrow formal tax base.

Efforts to tax the informal sector in developing countries, including Somalia, face several inherent challenges:

- **Low potential revenues vs. high administrative costs:** While the informal sector is vast, the potential revenues from taxing small, often survivalist, enterprises are frequently not as high as anticipated. The costs associated with designing, implementing, and enforcing effective tax regimes for these businesses can outweigh the fiscal benefits.
- **Risk of harassment and regressive taxation:** Informal workers are often subjected to multiple, regressive fees and levies at the local level, even if they escape national taxation. This can lead to perceptions of unfairness, harassment, and a disproportionate tax burden on the most vulnerable.
- **Lack of transparency and perceived benefits:** Low trust in government and a lack of clear linkage between tax payments and visible public services contribute to low compliance. Informal workers are often willing to pay taxes if they are fair, transparent, and if they perceive tangible benefits in return, such as improved infrastructure or basic services.

The understanding that the "social contract" is a prerequisite for informal sector taxation, rather than merely a consequence, is vital. Instead of taxation building the social contract from scratch, a rudimentary social contract—or at least a perception of fairness, transparency, and tangible benefits from government—might be a prerequisite for achieving widespread compliance, especially among informal sector workers. This implies that aggressive enforcement alone will be insufficient; visible service delivery and transparent use of funds are crucial for fostering a culture of voluntary compliance and bridging the trust gap between citizens and the state.

## C. Security and Governance Environment

The ongoing insecurity and the pervasive presence of non-state armed groups, such as Al-Shabaab, in various parts of Somalia significantly limit the government's ability to extend its authority and effectively collect taxes. These groups frequently impose their own parallel "taxes" at roadblocks and in territories under their control, directly diverting potential government revenue and undermining the state's fiscal legitimacy. Improving security and extending state authority are therefore critical prerequisites for converting currently untaxed economic activity into official customs and inland revenue.

While one study on the Banadir region surprisingly found that corruption perceptions did not play a major role in influencing tax compliance, weak governance and high levels of corruption are generally cited as significant impediments to sustained revenue collection and reform efforts in fragile and conflict-affected states. These issues erode public trust and reduce the willingness of citizens and businesses to comply with tax obligations.

The relationship between security and tax capacity is complex, with security acting as both a direct impediment and an indirect enabler of tax collection. Improved security not only expands the geographic reach of tax collection by allowing government presence in previously inaccessible areas but also enhances the willingness to comply among taxpayers. For instance, private sector entities, particularly in sectors like telecommunications, are more willing to pay taxes when the state is able to provide better levels of services, especially security, which creates a more stable operating environment for businesses.

This suggests a positive feedback loop: investments in security are not merely recurrent expenditures but strategic investments that can directly and indirectly enable greater tax capacity and strengthen the fiscal-social contract by demonstrating the state's capacity to provide essential public goods.

## VII. Strategies for Enhancing Domestic Revenue Mobilization

Addressing Somalia's substantial tax gap requires a comprehensive and multi-faceted approach that integrates tax policy reforms, administrative capacity building, improvements in intergovernmental fiscal relations, and strategic leveraging of digital solutions. These strategies must be tailored to Somalia's unique context, considering both technical feasibility and political realities.

### A. Tax Policy Reforms

- **Broadening the Tax Base:** Accelerating efforts to register taxpayers and gradually integrate the large informal sector into the tax net is paramount. This involves implementing targeted taxpayer registration drives in urban centers and establishing clear linkages between business licensing and tax registration. To begin capturing informal activity, especially from small businesses, the introduction of a simple presumptive tax or a turnover tax could be explored. However, the formalization process presents a critical challenge: balancing the need for revenue with fostering business growth. Overly aggressive or complex formalization drives could inadvertently stifle nascent private sector development, as Small and Medium-sized Enterprises (SMEs) often remain informal due to high compliance costs and difficulties in accessing regulations. Therefore, policy should prioritize simplifying the tax system, reducing compliance costs, and creating a "promising environment for SMEs" through incentives, rather than solely relying on punitive enforcement, to ensure sustainable base broadening.
- **Strengthening Income Tax Framework:** The enactment and effective enforcement of the new Income Tax Act are crucial steps towards increasing revenue from this underperforming category. The focus should be on bringing more businesses and high-income earners into the tax net, moving beyond the current reliance on government payroll withholding. IMF staff project that with effective implementation, income tax receipts could triple or more in the coming years. The expansion of income tax is closely linked to overall economic development and administrative capacity. As Somalia's formal economy grows and urbanization increases, the income tax base will naturally expanding leakages and enhancing the integrity of the tax system.

However, effective income tax expansion requires well-designed tax policies that consider incentives, avoid deficit financing, and are supported by robust administrative capacity. This implies that Somalia's strategy should foster broad-based economic formalization and simultaneously invest in administrative tools, such as the Integrated Tax Administration System (ITAS), to capture this growth effectively, rather than solely relying on rate increases.

- **Developing a Value-Added Tax (VAT) Law:** Replacing the current flat sales tax with a comprehensive VAT law is a key reform. A moderate VAT rate (e.g., 10% or more) with broader coverage, including services, could substantially boost consumption tax collections, aligning Somalia with regional practices. However, VAT implementation in developing countries faces significant challenges, including high revenue concentration in a few large firms, disadvantages for small firms (e.g., not claiming input credits), and long refund delays due to weak administrative capacity and fraud risk. Successful VAT implementation requires prior sales tax experience, adequate taxpayer records, and a strong administrative service. Therefore, Somalia's VAT implementation needs to be carefully phased, potentially starting with a simpler design, and must explicitly address informality (e.g., through high registration thresholds or VAT withholding for large firms) while simultaneously building robust administrative capacity and a credible refund system to avoid distortions and ensure compliance.
- **Introducing Excise Taxes:** Phasing in excise taxes on specific goods, such as fuel, khat, and luxury products, can generate revenue with relatively low administrative demands, making them a feasible option for early gains.
- **Reducing Exemptions and Leakages:** A thorough review and tightening of existing tax exemptions, which erode the tax base, is essential. Exemptions for entities like NGOs, diplomatic missions, and certain imports should be rationalized or capped. Furthermore, curbing corrupt practices by improving oversight and accountability in revenue collection, and implementing strict penalties for tax evasion and bribery, are critical to reduc

## B. Enhancing Tax Administration Capacity

- **Modernizing Administrations:** Significant investment in modernizing both the Inland Revenue and Customs administrations is crucial. This includes comprehensive training for staff, improving taxpayer services, and expanding electronic tax systems.
- **Digital Transformation:** Continuing the rollout and expansion of the Integrated Tax Administration System (ITAS) and the Somalia Customs Automation System (SOCAS) is vital. These systems digitize declarations, reduce discretion, and improve compliance monitoring. Digital solutions serve as a catalyst for trust and efficiency, not merely a technical upgrade. They are crucial for enhancing transparency and reducing opportunities for graft, which are vital for building public trust and improving voluntary compliance in a fragile state. The shift to digital can fundamentally alter the social contract by making tax processes more visible and accountable, as seen in successful digital tax systems in Estonia, Singapore, and Brazil. Strategies like mandatory electronic invoicing and pre-filled tax returns, as implemented in Latin America, can significantly improve efficiency and transparency.
- **Data Utilization and Analytics:** Expanding the use of third-party data, such as banking records and import data, to cross-check tax declarations and identify under-reporting is a key administrative improvement. While advanced tools like the Tax Gap estimation Toolkit, which leverages machine learning, rely on comprehensive data (tax returns, audits, supporting firm data), applying such sophisticated methods in data-constrained countries like Somalia can be challenging due to limited or incomplete data. This indicates that while the long-term goal is sophisticated data analytics, the immediate strategy must involve foundational data collection efforts, prioritizing key data points (e.g., customs data, telecom data) and gradually integrating more advanced methods as data quality and availability improve. This requires a pragmatic, phased approach to data-driven tax administration.

## C. Intergovernmental Fiscal Relations

- **Customs Harmonization and Revenue Sharing:** Prioritizing the finalization and Implementation of agreements between the FGS and FMS on customs revenue sharing is essential. This involves developing a formula that allocates a fair share of port revenues to the states while ensuring a portion goes to federal coffers, potentially through the establishment of an "equalization fund". Such agreements are vital to encourage cooperation, address fiscal fragmentation, and pave the way for a unified customs territory. The successful implementation of revenue sharing is not merely a technical exercise of designing an optimal formula but a complex

**political process** requiring sustained dialogue, trust-building, and the ability to address underlying power dynamics and elite bargains. External partners can play a crucial role in making consensus credible and monitoring revenue collection at both national and sub-national levels.

- **Strengthening Border Control:** Alongside revenue sharing, implementing robust anti-smuggling initiatives, possibly with support from international partners, is critical to increase the capture of trade flows in official records and reduce revenue leakage.

## D. Leveraging Digital Solutions for Compliance and Transparency

Expanding the use of e-payments and mobile money integration for tax payments is a strategic move, capitalizing on Somalia's vibrant mobile money sector. This facilitates easier tax compliance for citizens. Furthermore, the establishment of comprehensive digital records is crucial for improving transparency, reducing opportunities for graft, and enhancing accountability within the revenue collection process. Digitalization, as a core component of tax administration modernization, can fundamentally transform how information is managed, leading to improved efficiency and reduced human error.

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## VIII. Conclusion and Policy Implications

### A. Summary of Key Findings

Somalia's tax gap analysis reveals a nation making commendable progress in absolute revenue terms over the past decade, yet still dramatically under-collecting relative to its economic potential and the experience of peer nations. With a tax-to-GDP ratio hovering around 3%, Somalia remains the lowest in Africa, indicating substantial untapped revenue potential. The analysis identifies that the largest proportional tax gaps exist within income and sales taxes, highlighting significant room for growth in these nascent areas. While customs duties remain the largest revenue source, they also present uncollected potential due to institutional fragmentation between the Federal Government and Federal Member States, as well as ongoing evasion. The underlying drivers of this wide gap are multi-faceted, stemming from a legacy of state collapse, the pervasive dominance of a large informal economy, persistent insecurity limiting state reach, and critical fiscal federalism challenges that impede unified revenue collection.

### B. The Imperative of DRM for Fiscal Self-Reliance and State-Building

Bridging this substantial tax gap is not merely a fiscal exercise; it is fundamental for Somalia to reduce its heavy reliance on external aid, effectively fund its own development goals, and solidify the social contract between its citizens and the state. The long-term vision for Somalia is to elevate its tax-to-GDP ratio to approximately 15%. The proposed recommendations, therefore, are not just immediate solutions but crucial steps towards this ambitious long-term objective. A well-executed Domestic Revenue Mobilization strategy can foster sustained economic growth and political stability, which are not only prerequisites for successful tax reform but also direct outcomes of a more robust fiscal system. This shifts the perspective from merely addressing a deficit to actively building a resilient and legitimate state capable of self-financing its development priorities, thereby moving Somalia from fiscal survival to sustainable development.

## C. Actionable Policy Implications and Recommendations

Based on the comprehensive analysis, the following actionable policy implications and recommendations are put forth for enhancing Somalia's domestic revenue mobilization:

- **Broadening the Tax Base:** Implement targeted taxpayer registration drives, particularly in urban centers, and establish clear linkages between business licensing and tax registration. To gradually bring the informal sector into the tax net, explore simplified presumptive or turnover taxes for small businesses. Crucially, manage compliance costs carefully to avoid stifling formalization efforts, ensuring that the tax system encourages, rather than deters, formal sector growth.
- **Strengthening Tax Policy Framework:** Accelerate the enactment and effective enforcement of the new Income Tax Act, focusing on expanding its reach to the private sector and high-income earners. Develop a phased Value-Added Tax (VAT) law to replace the current sales tax, learning from developing country experiences to ensure broad coverage, appropriate rates, and effective administration, particularly for managing informality (e.g., through high registration thresholds or VAT withholding for large firms). Systematically review and tighten existing tax exemptions that erode the tax base.
- **Enhancing Tax Administration Capacity:** Continue significant investment in modernizing both the Inland Revenue and Customs administrations. This includes comprehensive staff training programs and the full rollout of the Integrated Tax Administration System (ITAS) and the Somalia Customs Automation System (SOCAS) to improve efficiency and reduce discretion. Prioritize leveraging digital solutions, such as e-payments, mobile money integration, and data analytics, to enhance transparency, reduce opportunities for graft, and improve overall compliance. In data-constrained environments, a pragmatic, phased approach to data-driven tax administration is necessary, starting with foundational data collection and gradually integrating more advanced methods as data quality and availability improve.

- **Reforming Intergovernmental Fiscal Relations:** It is imperative to finalize and implement robust agreements between the FGS and FMS on customs revenue sharing, potentially establishing an equalization fund. This will address fiscal fragmentation, reduce tax competition, and promote national unity. This requires sustained political dialogue, trust-building, and consensus-building to navigate the complex power dynamics. Concurrently, strengthen border control and anti-smuggling initiatives, possibly with international support, to increase the capture of trade flows in official records.
- **Building Trust and Legitimacy:** Adopt a "services first" approach where feasible, demonstrating tangible benefits of taxation (e.g., improved security, basic public services) to foster greater voluntary compliance and strengthen the social contract between citizens and the state. This approach acknowledges that a rudimentary social contract, built on fairness and perceived benefits, is often a prerequisite for widespread tax compliance in fragile contexts.

## D. Avenues for Future Research

Further research is crucial to deepen the understanding of Somalia's unique fiscal challenges and to refine policy interventions. Key avenues include:

- Conducting rigorous empirical studies on the specific impacts of various informal sector taxation approaches (e.g., presumptive taxes) on livelihoods, business formalization, and the social contract in Somalia.
- Undertaking further qualitative and quantitative analysis of the political economy dynamics that continue to hinder fiscal federalism reforms and evaluating the effectiveness of different negotiation strategies in post-conflict contexts.
- Evaluating the long-term effectiveness of digital tax solutions in improving compliance, reducing corruption, and expanding the tax base in data-constrained, fragile environments like Somalia.
- Investigating the optimal sequencing of tax policy and administrative reforms in highly fragile contexts, considering political feasibility, capacity constraints, and the intricate interplay between security improvements and revenue mobilization.

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