

# Financial disruption and fragile markets

A political-economic perspective on SMEs in the Somali private sector under COVID-19

Jos Meester  
Johannes Claes  
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CRU Report



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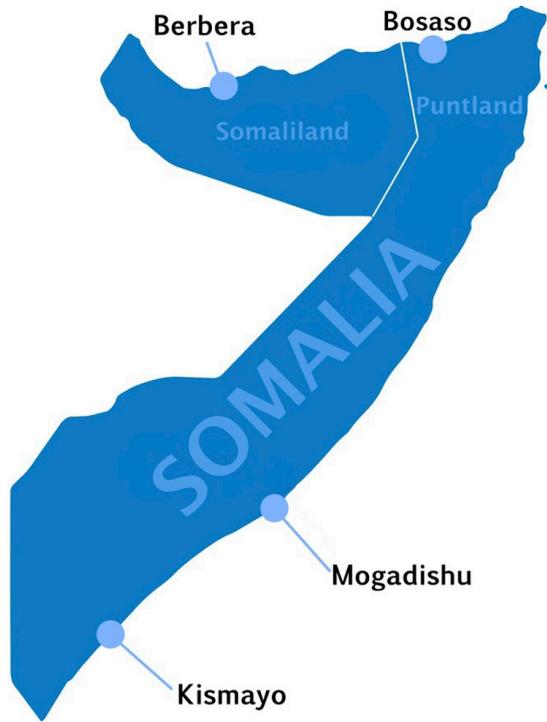
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# Abstract

This report explores SME growth and resilience in the fragile Somali context during the COVID-19 pandemic, including its relation to wider political-economic developments. The pandemic has demonstrated how Somali businesses have continued to be resilient and at times even thrive during crisis, but it has also exposed the sizeable vulnerability associated with the Somali territories' trade, import dependence and financing system. The global COVID-19 pandemic has disrupted the supply and trans-shipment of goods. This has created shortages and price fluctuations for Somalia's import-based economy and hampered the country's payment system. It has also reduced remittances, buying power, access to finance and tax revenues. Shifts in funding streams have realigned political financing patterns and created price instability as political actors seek new ventures through which to move funds. Somalia's private sector has taken a significant hit throughout the crisis. SMEs have been severely strained by COVID-19 imposed hardships, facing lower buying power, payment difficulties, difficult sourcing, increasing working capital requirements, shipping delays, reduced access to finance, and complex overlapping tax regimes. Larger corporate actors have faced major costs due to repayment holidays on loans, popular demands for price reductions on various services, and substantial contributions to the public COVID-19 response. Yet many have been able to weather the storm through their role in delivering COVID-19 aid and cash voucher schemes, foreign held capital reserves, preferential access to finance and the ability to negotiate tax exemptions directly with governance providers. The private sector has thus supported a range of social services and livelihoods throughout the Somali territories, critical as remittances saw a downturn. However, economic opportunities continue to rely on strong informal relations and preferential access to governance and networks that mean many small players suffer while large conglomerates prosper. Although the economic shock brought about by COVID-19 has not structurally changed the Somali political economy, it has exacerbated existing patterns of inequality. The contribution of the private sector to the COVID-19 response has likely supported a range of livelihoods throughout the Somali territories, yet the preferential access to governance and strong competitive position that allowed this also highlights a worrying level of inequality and market concentration, and raises questions regarding government legitimacy. It seems likely that the COVID-induced economic crisis has therefore reinforced rather than destabilised those dynamics that prevent small businesses from competing on an equal footing and fragile situations from developing and stabilising.

**Figure 1** Map of Somalia and the major port cities



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# Executive summary

- Despite decades of civil war, extremist insurgency, natural disasters and weak governance, the Somali territories have developed a growing domestic market largely in the absence of a state.
- Although private businesses have played a key role in driving economic growth, they have also driven the oligopolisation of markets and the privatisation of public goods, based on particularistic networks and the unequal distribution of resources, which has also marginalised small and medium enterprises (SMEs).
- The role of SMEs in fragile and conflict-affected situations (FCAS) has been highlighted for their potential to make a positive economic contribution (e.g. employment and livelihoods, availability of goods and services), as well as non-economic contributions (e.g. tax revenues, social externalities, contribution to reconstruction, trust building).
- SMEs operating in FCAS face many contextual challenges to continuity and growth, due to weak security, poor infrastructure, political and economic volatility, weak formal institutions, and individual difficulties (e.g. access to finance and skilled labour, land disputes, etc).
- In the Somali context, many SMEs deliberately deploy coping strategies that are 'survivalist' rather than growth oriented to overcome risks, relying on informal institutions and social capital to bolster continuity while remaining flexible.
- Larger corporate actors have adjusted their business model to control similar risks, strongly diversifying their operations and markets, controlling capital flows and developing favourable clientelistic relationships with governance providers.
- The COVID-19 pandemic has affected Somalia substantially, given its weak healthcare capacity and poor testing facilities, and has had significant economic impacts:
  - Heavy import reliance has led to shortages and losses as global measures against COVID-19 created a range of logistical bottlenecks delaying shipping and air travel.
  - Buying power has reduced substantially, as worsening economic conditions abroad translated into remittance drops, and air travel restrictions reduced diaspora travel.
  - Making payments and maintaining sufficient liquidity have become near impossible for businesses as the financial system has largely ceased functioning following air travel restrictions.
- The economic changes have translated into significant tolls on livelihoods and government revenues (largely based on import taxes).
- SMEs have been severely strained by COVID-19 imposed hardships, facing lower buying power, payment difficulties making sourcing difficult, increasing working capital requirements due to shipping delays, reduced access to finance, and complex overlapping tax regimes imposed by multiple governance providers.

- Although larger corporate actors have incurred major costs due to repayment holidays on loans, popular demands for price reductions on various services, and substantial contributions to the public COVID-19 response, many have been able to weather the storm through their role in delivering COVID-19 aid and cash voucher schemes, foreign held capital reserves, preferential access to finance, and the ability to negotiate tax exemptions directly with governance providers.
- Smaller ventures have been additionally hit by changes in political finance structures, as import tax reductions have been seized upon for political finance, thus destabilising prices, and racketeering around port clearances has also emerged.
- The support the private sector has provided to the COVID-19 response has likely supported a range of livelihoods throughout the Somali territories, yet the preferential access to governance and strong competitive position that allowed this also highlights a worrying level of inequality and market concentration, and raises questions regarding government legitimacy.
- It seems likely that the economic crisis caused by COVID-19 has therefore reinforced rather than destabilised those dynamics that prevent small businesses from competing on an equal footing and fragile situations from developing and stabilising.
- Additionally, the pandemic has exposed the sizeable vulnerability associated with the Somali territories' import dependence and financing system, creating sizeable risks to the livelihoods of those depending on these systems.
- Based on the analysis, the following recommendations are made:
  - Stimulate technical advances in SME finance in order reduce the vulnerabilities of SMEs to economic or logistical shocks.
  - Explore opportunities to invest in SME associations able to articulate SME interests and participate in inclusive policy-making efforts.
  - Building Back Better efforts post-COVID-19 should stimulate the non-trading economy in order to reduce the severe vulnerability of the Somali economy to external shocks.

# Abbreviations

<b>AS</b>	Al-Shabaab
<b>CSR</b>	Corporate social responsibility
<b>DB</b>	Doing Business (World Bank's <i>Ease of Doing Business</i> reports)
<b>FCAS</b>	Fragile and conflict-affected situations
<b>FGS</b>	Federal Government of Somalia
<b>FMS</b>	Federal Member State
<b>ICU</b>	Islamic Courts Union
<b>IDP</b>	Internally displaced person
<b>IMF</b>	International Monetary Fund
<b>MSME</b>	Micro, small and medium enterprise
<b>MTO</b>	Money transfer operator
<b>NISA</b>	National Intelligence and Security Agency
<b>ODA</b>	Official Development Assistance
<b>PPE</b>	Personal protective equipment
<b>PSD</b>	Private sector development
<b>SFG</b>	Somali Federal Government
<b>SISh</b>	Somaliland Shilling
<b>SME</b>	Small and medium enterprise
<b>SoSh</b>	Somali Shilling
<b>USD</b>	United States Dollar
<b>WASH</b>	Water Sanitation and Hygiene
<b>WHO</b>	World Health Organization

# 1 Introduction

The Somali territories<sup>1</sup> have faced several decades of civil conflict and extremist insurgency, while experiencing weak or non-existent formal central governance, compounded by a range of natural disasters such as floods, droughts and locust infestations.<sup>2</sup> Continued fragmentation and instability have ensured that Somalia has maintained a position at or near the top of most indices of state fragility for years.<sup>3</sup> The legacy of fragility continues to impose significant hardship on the nation's population through ongoing local conflict, poor governance, corruption and an overall weak infrastructure providing little in terms of utilities or public services.<sup>4</sup> Although significant segments of the Somali population hence face internal displacement, unemployment, poverty, recurring hunger and insecurity, it should be noted that over the past few years livelihoods in the Somali territories have seen substantial improvements following economic transformation and growth. While some decades ago the nation's economy might have been best described as an ungoverned war economy relying on remittances, the diversion of aid resources and the smuggling of goods, the security

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- 1 Several definitions of the Somalia exist. The terms 'Somalia' and 'Somali territories' are used in this paper to refer to the areas included in the former Somali Republic (including Somaliland), but does relate to questions regarding (legal or legitimate) statehood.
  - 2 For a brief but comprehensive background on the situation in Somalia, see Webersik, C., Hansen, S. J. and Egal, A. 2018. *Somalia: A Political Economy Analysis*, Oslo: Norwegian Institute of International Affairs. In terms of governance, the entities that have been established since 2000 (Transitional National Government, Transitional Federal Government, and now the Federal Government of Somalia) have struggled to effectively exert control over the country. As for natural disasters, major events over the past decades have included draughts in 1992, 2011 and 2016, a tsunami in 2004 and a cyclone in 2013. At the time of writing, the country is battling a locust infestation and the most powerful cyclone in its history.
  - 3 World Bank. 2018. 'Harmonized List of Fragile Situations', <http://www.worldbank.org/en/topic/fragilityconflictviolence/brief/harmonized-list-of-fragile-situations> (accessed on 30 November 2020); Fund for Peace. 2020. 'Fragile States Index', <https://fragilestatesindex.org/> (accessed 30 November 2020); Carment, D. et al. 2017. *The CIPF Fragility Index: New Trends and Categorizations A 2017 Country Indicators for Foreign Policy Report*, Ottawa: Carlton University; Bertelsmann Stiftung. 2020. 'Bertelsmann Transformation Index', <https://www.bti-project.org/en/home.html?&cb=00000> (accessed November 30, 2020); Menkhaus, K. 2014. 'State failure, state-building and prospects for a functional failed state in Somalia', *The Annals of the American Academy of Political and Social Science* 656(1), 154-172; Menkhaus, K. 2007. 'Governance without government in Somalia: spoilers, state building, and the politics of coping', *International Security* 31(3), 74-106; Grosse-Kettler, S. 2004. *External Actors in Stateless Somalia: A war economy and its promoters*, Bonn: Bonn International Center for Conversion.
  - 4 Webersik, C., Hansen, S. J. and Egal, A. 2018. *Somalia: A political economy analysis*, Oslo: Norwegian Institute of International Affairs.

situation and business environment have significantly improved and lucrative domestic markets have emerged in the Somali territories.<sup>5</sup>

Over the years, Somalia has been a major beneficiary of aid and other assistance from international donors, receiving over a billion US dollars in official development assistance (ODA) annually since 2013.<sup>6</sup> In addition to humanitarian aid, donor support has focused on: 1) good governance and institution building, aiming to increase the government's institutional capacity, service delivery and authority; 2) public-private partnerships and business environment reform; and 3) humanitarian action (mainly resilience related).<sup>7</sup> Although such donor support has played a role in relieving human suffering across several crises, it has so far failed to establish functional, effective and legitimate governance structures. Extensive patronage networks, widespread corruption, unstable political coalitions and a volatile security situation persist, and they have hindered improvements in Somalia's business climate, as exemplified by the country's poor performance in the World Bank's *Doing Business* reports.<sup>8</sup> Instead of public or international actors, it has been Somalia's adaptive business community that has been the main driving force of the Somali territories' economic resurgence and the improving urban livelihood situation. Placing the fragile and unpredictable Somali business environment at the core of their business models, a number of companies have been able to establish resilient and fast-growing operations. This has allowed them to supply

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5 Cassanelli, L. 2010. 'Private sector peacemaking: business and reconstruction in Somalia', *Accord* 21, 41-44; Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*, CRU Report, The Hague: Clingendael Institute.

6 Organisation for Economic Co-operation and Development. 2019. 'Aid at a glance charts', <https://www.oecd.org/dac/financing-sustainable-development/development-finance-data/aid-at-a-glance.htm> (accessed 30 November 2020).

7 Federal Government of Somalia. Aid Coordination Unit of the Office of the Prime Minister. 2017. *Aid Flows in Somalia: Analysis of aid flow data*, 17.

8 Since 2017, the first year in which Somalia was included in the *Doing Business* reports, the country has always ranked 190th out of the 190 countries surveyed by the World Bank (World Bank. 2020. 'Doing Business', <https://www.doingbusiness.org/> (accessed 30 November 2020)). Somalia's poor performance in terms of corruption is well captured by its low ranking (180th/198 countries) in Transparency International's Corruption Perceptions Index (Transparency International. 2020. 'Corruption Perceptions Index', <https://www.transparency.org/en/cpi> (accessed 30 November 2020)), as well as in the Bertelsmann Transformation Index (Bertelsmann Stiftung. 2020. 'Bertelsmann Transformation Index', <https://www.bti-project.org/en/home.html?&cb=00000> (accessed 30 November 2020)). For Somalia's fragile security situation, see: Hiraal Institute. 2020. *Semi-annual Somalia Security Report*; Felbab-Brown, V. 2020. 'Facing elections and a potential US troop withdrawal, risks to Somalia's security abound', *Brookings Institution*, 23 November 2020, <https://www.brookings.edu/blog/order-from-chaos/2020/11/23/facing-elections-and-a-potential-us-troop-withdrawal-risks-to-somalias-security-abound/> (accessed 7 December 2020).

a wide range of goods and services, present the financial basis for the reopening of several ports and other trade facilities, and even start domestic production.<sup>9</sup>

As well as driving economic growth, the aggressive way in which private businesses reacted to statelessness in Somalia has also resulted in inefficient monopolies, coordination failures, externalities, and the privatisation of public goods. The increasingly oligopolistic markets, dominated by a range of large Somali-owned transnational conglomerates branching out into virtually every market segment, have reinforced clan power hegemonies, status quo politics based around established patronage networks, and the unequal distributions of resources.<sup>10</sup> Business incentives frequently coincide with processes aimed at establishing legitimate and representative governance (for instance through businesses funding electoral campaigns and unfair government tendering practices).<sup>11</sup> Although significant sections of the population have benefited from improved livelihoods and corporate social responsibility (CSR) efforts during humanitarian crises, growing inequality and instances of exploitation signal the clear social limits attached to this growth model.<sup>12</sup>

In the absence of open, competitive and regulated markets, both small and medium enterprises (SMEs) and forms of diaspora investment have struggled to survive, let alone flourish. It is, however, exactly these SMEs that are essential to market competitiveness, equitable growth, and broader social and political inclusion.<sup>13</sup> A growing field of SMEs is generally seen as having a role in building social cohesion, fostering state legitimacy and restoring community security.<sup>14</sup> Additionally, a vibrant segment of SMEs is an

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9 Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*, CRU Report, The Hague: Clingendael Institute.

10 Ibid. See also Musa, A.M. 2019. 'From trust to oligopoly: Institutional change in livestock trade in Somaliland after 1991', DIIS Working Paper.

11 Isak, N. 2018. 'Challenges of domestic revenue mobilization in Somalia', *International Journal of Economics, Commerce and Management* VI(9), 172-181; de Waal, A. 2015. *The Real Politics of the Horn of Africa: Money, war and the business of power*, Cambridge: Polity Press, 124; Verjee, A. et al. 2015. *The Economics of Elections in Somaliland: The financing of political parties and candidates*, Nairobi: Rift Valley Institute; Fartaag, A. 2016. *Breaking Point in Somalia: How state failure was financed and by whom*, Nairobi: Fartaag Research & Consulting; Interview, prominent business elites, Mogadishu and Nairobi, September 2016.

12 Jaspars, S., Adan, G.M. and Majid, N. 2020. *Food and Power in Somalia: Business as usual?*, London: LSE Conflict Research Programme.

13 See, for instance: Peschka, M.P. 2010. *The Role of the Private Sector in Fragile and Conflict-Affected States*, World Development Report 2011 Background Paper.

14 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.

important form of resilience against increasing oligopolistic practices.<sup>15</sup> The challenge in the Somali territories is, therefore, how to stimulate the growth and stabilisation of the entrepreneurial middle class in spite of the fragile and conflict-affected environment and business climate.

## 1.1 Research objective

This study aims to contribute to the private sector development debate on SME growth in fragile and conflict affect states during crises, including its relationship to wider social political developments. Deepening the understanding of the dynamics faced by SMEs in the Somali territories may support improving the effectiveness of and reducing the risks to programming efforts in the territories, most notably in the fields of good governance, rule of law, inclusiveness and private sector development (PSD). Insights derived from economic developments in the Somali territories may also be informative for other fragile states going through processes of economic recovery and market concentration, potentially undermining governance efforts. The exploratory question the study seeks to answer is how crisis situations affect SME growth in relation to developments in the wider business environment. This study takes the constraints imposed by the global COVID-19 pandemic as a natural experiment of a crisis. Although the strain posed by COVID-19 on public health is significant, it should be kept in mind that its impact on Somali businesses is compounded by an international economic crisis, supply constraints and weak governmental capacity offering virtually no support measures, and coincides with a resurgence of Al Shabaab activity in Puntland and the southern parts of Somalia. The report thus explores the questions of how the COVID-19 constraints have affected the Somali markets and SMEs operating in those markets, and also how identified market changes influence the wider political system, including governance and its relation to the larger conglomerates. It therefore also aims to support the adaptation of donor programming in light of the changed circumstances in the post-COVID-19 period.

This study is based on research conducted following a political economy analysis framework. It builds on insights derived from telephone interviews with Somali entrepreneurs, Somali academics and aid workers focusing on Somalia and Somaliland. The interview methodology followed a multi-cited ethnographic practice, covering mostly urban locations across Somalia, Somaliland, the United Arab Emirates and the

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15 European Bank for Reconstruction and Development. 2020. 'Why small businesses matter?', *ERDB Sectors and topics*, <https://www.ebrd.com/what-we-do/sectors-and-topics/why-small-businesses-matter.html> (accessed 7 December 2020). Also, the OECD has highlighted SMEs' role in delivering more inclusive growth (Organisation for Economic Co-Operation and Development. 2017. *Enhancing the Contributions of SMEs in a Global and Digitalised Economy*, Paris: OECD).

United Kingdom. Research was conducted during the COVID-induced lockdowns across various research locations (from August to December 2020), hence necessitating phone interviews. Unfortunately, it was not feasible to include the China-based community, the aid-based business activities in Eastleigh (Nairobi, Kenya) nor peripheral agricultural sectors. Given such limitations, the insights derived are thus indicative of developments in urban Somali markets but cannot claim to be comprehensive. Market and political dynamics vary widely over the Somali territories due to clan groupings, historical circumstances and the degree of institutionalisation of state structures. Hence dynamics described here cannot be expected to hold uniformly across all Somali territories. Extrapolations to other territories that do not take into account local context may thus obscure important differences (for further details on the methodology and its limitations, please refer to the Appendix).

## 1.2 Structure of the report

This report explores the behaviour of SMEs in fragile and conflict-affected situations in relation to broader political-economic developments at times of crisis, such as that brought about by the COVID-19 pandemic. The report sets out with a discussion on the theoretical underpinnings of the significance of SMEs in fragile and conflict-affected situations (FCAS), as well as their significance in the face of broader political developments. It subsequently discusses the business environment in Somalia, illustrating the links between political and private sector actors. In this chapter, a brief overview of the spread of COVID and the formal response to the pandemic are also presented. The next chapter explores the economic impact of the (global) pandemic and responses to it on the Somali territories, tracing its impact through parts of their supply chains, remittance corridors and government revenue developments. The following chapter lays out the political-economic impact of the constraints previously identified and described. The paper traces the differential impact on larger and smaller private enterprises, their position in the market, and their relationship to governance. The final chapter concludes the discussion by presenting a summary of the key political-economic impacts, and presents three recommendations for future donor programming.

## 2 SME performance in FCAS

The last two decades have witnessed a growing interest in the impact that the private sector – and more specifically SMEs<sup>16</sup> – can have in fragile and conflict-affected situations. On the one hand, it has been more and more widely recognised that SMEs can play a constructive role in improving people’s livelihoods.<sup>17</sup> In these difficult economic and social contexts, SMEs have the potential to make a positive economic contribution, for instance by providing the local urban population with employment, and also by ensuring the availability of a range of goods and services. At the same time, SMEs can have a positive impact through non-economic contributions. For instance, increased employment can generate positive social externalities and contribute to reconstruction following conflict, cooperation among SMEs can increase the level of trust in society, and taxes paid by these businesses can contribute to restoring the legitimacy of often weak states.<sup>18</sup>

This potential notwithstanding, SMEs operating in FCAS are faced with a wide array of challenges that threaten to stifle their operations and their growth. First of all, in conflict-affected settings businesses are constantly faced with a lack of physical security – not only for their staff and their assets, but also for the infrastructure they rely on (most notably energy and transport). This is compounded by a high level of political volatility, as well as weak legal frameworks and public institutions, which create an unpredictable environment for enterprises. Post-conflict economic troubles – including macroeconomic instability, market distortions and reduced purchasing power – further complicate the economic environment in which these businesses operate. Finally, other specific issues – such as difficulties in accessing finance and skilled labour, as well as

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16 The term SME is used broadly throughout this study, including micro enterprises, businesses of necessity, small traders, retailers involved in petty trading and medium-sized enterprises. Subsistence agriculture and self-employment are excluded, as are any companies or larger traders able to leverage sufficient political capital in order to dominate the sector(s) they are active in.

17 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute; World Bank. 2017. *Providing Essential Infrastructure in FCV Affected States: A toolkit for enabling SME participation*, Public-Private Infrastructure Advisory Facility Report; Peschka, M. P. 2010. *The Role of the Private Sector in Fragile and Conflict-Affected States*, World Development Report 2011 Background Paper.

18 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute, p. 10-14.

unresolved (land) ownership disputes – often make it even more challenging for SMEs to operate in FCAS.<sup>19</sup>

While SMEs have the potential to positively affect people's livelihoods in FCAS, the circumstances in which they operate make it difficult for these businesses to flourish. It can be an interesting opportunity for policymakers – both locally and internationally – to find ways to enable these enterprises to thrive and to realise their full potential in terms of contributing to the societies in which they are embedded. With this in mind, this chapter will analyse how formal and informal institutions shape the environment in which SMEs operate, as well as how entrepreneurs in FCAS tend to confront the challenges they face. This analysis will serve as a background to understand the issues faced by Somali SMEs and the coping strategies adopted by Somali entrepreneurs in a crisis, with an eye to the most appropriate policy responses that international donors could promote to improve the socioeconomic situation in Somalia.

## 2.1 Institutions and business

It is broadly understood in the literature that institutions – i.e. 'the rules of the game in a society' – influence the development of entrepreneurship, for instance by creating incentives, opportunities or constraints to the action of entrepreneurs.<sup>20</sup> These institutions can be either formal or informal in terms of regulatory authority or practical terms.<sup>21</sup> On the one hand, formal institutions consist of all rules that have been coded and made explicit. These include, for instance, legal and judicial systems aimed at enforcing contracts, securing property rights and protecting economic freedom. Moreover, they also include policies that regulate the operations of businesses, ranging from taxation to enterprise support.<sup>22</sup> Besides these codified institutions, by contrast, there is a range of other institutions not explicitly defined, and hence categorised as informal. These include commonly held values and the ensuing norms of behaviour,

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19 Peschka, M. P. 2010. *The Role of the Private Sector in Fragile and Conflict-Affected States*, World Development Report 2011 Background Paper, p. 10-15.

20 North, D.C. 1990. *Institutions, Institutional Change and Economic Performance*, New York: Cambridge University Press; Welter, F. and Smallbone, D. 2011. 'Institutional perspectives on entrepreneurial behavior in challenging environments', *Journal of Small Business Management* 49(1), 107-125; Boettke, P.J. and Coyne, C.J. 2009. 'Context matters: institutions and entrepreneurship', *Foundations and Trends in Entrepreneurship* 5(3), 135-209. For further information on institutional theory and entrepreneurship, see: Bruton, G.D., Ahlstrom, D. and Li, H. 2010. 'Institutional theory and entrepreneurship: Where are we now and where do we need to move in the future?' *Entrepreneurship Theory and Practice*, May 2010, 421-440.

21 North, D.C. 1991. 'Institutions', *Journal of Economic Perspectives* 5(1), 97-112.

22 Sobel, R.S. 2008. 'Testing Baumol: Institutional quality and the productivity of entrepreneurship', *Journal of Business Venturing* 23(6), 641-655; Reynolds, P.D. et al. 2000. *Global Entrepreneurship Monitor*, Kauffman Center for Entrepreneurial Leadership.

attitudes, conventions and codes of conduct – all ‘rules of the game’ that are based not on a formal agreement, but rather on norms, culture and social relations.<sup>23</sup> While a division between formal and informal institutions can be helpful when analysing a specific economic system, it is equally important to note that often there is not a strict separation between the two, as with the strong connections between formal and informal markets. Individuals often move between the formal and the informal and the relationship between the two is often one of coexistence and symbiosis rather than exclusivity.<sup>24</sup>

As far as entrepreneurship in FCAS is concerned, it has been argued that formal institutions are subordinate to informal ones.<sup>25</sup> This can be traced to the fact that formal institutions, in order to function appropriately, generally need to be trusted, both personally and institutionally.<sup>26</sup> Informal institutions, which are rooted in a society’s values and norms, have the power to generate such trust, and thus can play a major role in shaping a country’s economic performance. This is particularly true in contexts where the reliability of formal institutions – and hence people’s trust in them – is low.<sup>27</sup> Therefore, in emerging economies, and even more so in fragile and conflict-affected

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- 23 Thornton, P.H., Ribeiro-Soriano, D. and Urbano, D. 2011. ‘Socio-cultural factors and entrepreneurial activity: An overview’, *International Small Business Journal* 29(2), 105–118; Granovetter, M. 1985. ‘Economic action and social structure: The problem of embeddedness’, *American Journal of Sociology* 91(3), 481–510.
- 24 Schoofs, S. 2015. *Making Sense of Informal Economies in Fragile Contexts*, CRU Policy Brief, The Hague: Clingendael Institute; Godfrey, P.C. 2011. ‘Toward a theory of the informal economy’, *Academy of Management Annals* 5(1), 231–277; Gong, X., van Soest, A. and Villagomez, E. 2004. ‘Mobility in the urban labor market: A panel data analysis for Mexico’, *Economic Development and Cultural Change* 53(1), 1–36; Hart, K. 1973. ‘Informal income opportunities and urban employment in Ghana’, *The Journal of Modern African Studies* 11(1), 61–89. For a more specific study on the Horn of Africa, see: Little, P.D., Tiki, W. and Debsu, D.N. 2015. ‘Formal or informal, legal or illegal: The ambiguous nature of cross-border livestock trade in the Horn of Africa’, *Journal of Borderland Studies* 30(3), 405–421.
- 25 Thornton, P. H., Ribeiro-Soriano, D., and Urbano, D. 2011. ‘Socio-cultural factors and entrepreneurial activity: An overview’, *International Small Business Journal* 29(2), 105–118.
- 26 Welter, F. 2002. ‘Trust, institutions and entrepreneurial behaviour’, in Hohmann, H.H. and Welter, F. (Eds.), *Entrepreneurial Strategies and Trust: Structure and Evolution of Entrepreneurial Behavioural Patterns in East and West European Environments - Concepts and Considerations*, Bremen: Research Centre for East European Studies, 37–42.
- 27 Hoffmann, A. and Lange P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute; Carrier, N.C.M. and Elliott, H. 2018. ‘Entrust we must: The role of “trust” in Somali economic life’, DIIS Working Paper, No. 2018:2.

settings, informal institutions acquire a greater importance, as they come to play the regulating role that ineffective formal institutions cannot play.<sup>28</sup>

In their efforts to address economic issues affecting emerging economies and FCAS, international actors – and especially Western-led entities such as the World Bank and the International Finance Corporation – have often stressed the importance of developing formal institutions in order to promote economic development and business opportunities.<sup>29</sup> In these actors' analyses, a number of barriers to the growth of SMEs are identified. These often include weak legal frameworks (e.g. contract enforcement, property registration), access to finance (e.g. availability, cost, sources), and infrastructure constraints (e.g. electricity, transport, water).<sup>30</sup> In order to effectively address these issues, a number of recommendations are outlined, often focusing on the legal, administrative and policy domains, and devoting much attention to the state's capacity to regulate and influence the business environment.<sup>31</sup>

While the issues identified by these actors are indeed common problems for SMEs in fragile settings, the problem with the analysis outlined above lies with the solutions that it advocates. Grounded in the experience of advanced economies, the World Bank's analyses often propose solutions based on the reform of formal institutions, focusing on

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- 28 Welter, F. and Smallbone, D. 2011. 'Institutional perspectives on entrepreneurial behavior in challenging environments', *Journal of Small Business Management* 49(1), 107–125; Amoako, I.O. and Lyon, F. 2014. "‘We don't deal with courts’": Cooperation and alternative institutions shaping exporting relationships of small and medium-sized enterprises in Ghana', *International Small Business Journal* 32(2), 117–139; Estrin, S. and Prevezer, M. 2010. 'A survey on institutions and new firm entry: How and why do entry rates differ in emerging markets?', *Economic Systems* 34(3), 289–308; Peng, M.W., Wang, D.Y.L. and Jiang, Y. 2008. 'An institution-based view of international business strategy: A focus on emerging economies', *Journal of International Business Studies* 39(5), 920–936.
- 29 For instance, when dealing with SMEs' role in providing infrastructure in FCAS, the World Bank has a strong focus on issues such as legal frameworks, institutions and regulatory aspects, and capacity building (World Bank. 2017. *Providing Essential Infrastructure in FCV Affected States: A toolkit for enabling SME participation*, Public-Private Infrastructure Advisory Facility Report, 87–90). For other instances of such kind of focus, see: World Bank. 2019. 'Governments Worldwide Launched 294 Reforms Over the Past Year to Make Doing Business Easier', World Bank Press Release, 24 October 2019, <https://www.worldbank.org/en/news/press-release/2019/10/24/governments-worldwide-launched-294-reforms-over-the-past-year-to-make-doing-business-easier> (accessed 3 December 2020); World Bank. 2000. *Reforming Public Institutions and Strengthening Governance*, Washington DC: World Bank Group.
- 30 World Bank. 2020. 'Doing Business', <https://www.doingbusiness.org/> (accessed 30 November 2020).
- 31 World Bank. 2017. *Providing Essential Infrastructure in FCV Affected States: A toolkit for enabling SME participation*, Public-Private Infrastructure Advisory Facility Report, 87–90; World Bank. 2000. *Reforming Public Institutions and Strengthening Governance*, Washington DC: World Bank Group.

issues such as legislative reform, new policies and the enhancement of state capacity.<sup>32</sup> This tendency, however, clashes with the fact that, as mentioned above, in fragile contexts informal institutions are actually more influential than formal ones in shaping the incentive structures experienced by entrepreneurs on the ground.<sup>33</sup> This does not mean that formal institutions do not matter; rather, it suggests that a lack of clarity on what formalisation should entail can have adverse effects.<sup>34</sup> In fragile and conflict-affected settings this means that attempts to change formal arrangements without regard to informal dynamics can at best have limited impact or, in some cases, have the potential to trigger resistance.<sup>35</sup>

The World Bank's Doing Business (DB) reports provide a good example of the distinction between formal and informal institutional dynamics, as well as the peculiarity of fragile contexts. To begin with, the DB exercise has been criticised for its excessive reliance on formal indicators (e.g. legislation and assessment by local experts), which in fragile contexts could provide a picture that is quite different from what is actually happening on the ground.<sup>36</sup> In addition, critics have noted that the DB reports neglect some pivotal aspects of entrepreneurship in fragile settings, such as the potentially ambiguous role (i.e. both positive and negative) of entrepreneurs, and the complex legacies of conflict economies.<sup>37</sup> In light of these observations, therefore, it seems advisable to analyse entrepreneurship in fragile settings through a different lens – that is, one that stresses

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32 World Bank. 2017. *Providing Essential Infrastructure in FCV Affected States: A toolkit for enabling SME participation*, Public-Private Infrastructure Advisory Facility Report, 87-90; World Bank. 2000. *Reforming Public Institutions and Strengthening Governance*, Washington DC: World Bank Group.

33 Amoako, I.O. 2019. *Trust, Institutions and Managing Entrepreneurial Relationships in Africa: An SME perspective*, Cham: Palgrave Macmillan.

34 Schoofs, S. 2015. *Making Sense of Informal Economies in Fragile Contexts*, CRU Policy Brief, The Hague: Clingendael Institute, 8; Powell, W. and Dimaggio, J. 1991. *The New Institutionalism in Organizational Analysis*, Chicago: University of Chicago Press.

35 See Gulane, J.T. 2013. 'Informal land markets and conflict in Maguindanao', in Deles, T.Q. et al. *Out of the shadows: Violent conflict and the real economy of Mindanao*, London: International Alert, 145-196; Goodfellow, T. and Lindemann, S. 2013. 'The clash of institutions: Traditional authority, conflict and the failure of "hybridity" in Buganda', *Commonwealth & Comparative Politics* 51(1), 3-26. In the specific case of Somaliland, some authors have criticised the World Bank's approach for failing to give recommendations on how the recommended reforms should institutionalise (rather than erode) the informal dynamics that underpin Somaliland's economy (Musa, A.M. 2017. 'Review of World Bank report "Somaliland's Private Sector at a Crossroads"', *GOVSEA Blog*, 20 February 2017, <https://govsea.tumblr.com/post/157481346849/review-of-world-bank-report-somalilands-private> (accessed 18 January 2021)).

36 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute, 15-16. For instance, while DB indicators show what it takes on average for entrepreneurs to complete certain procedures in a given country, they do not tell anything about the different treatment received by different entrepreneurs in that country.

37 Guglielmetti, C. 2010. 'Measuring the Business Environment for Entrepreneurship in Fragile States', UNU-WIDER Working Paper No. 2010/14.

the embeddedness of these entrepreneurs in their particular social, political and economic context.

## 2.2 Embeddedness and social capital

In contrast (and in response) to the relatively standardised approach outlined above, there is a growing body of literature that highlights the need for context-specific analyses of entrepreneurship in fragile settings, calling for a greater consideration of the informal institutional dynamics that shape the business environment in emerging economies or in FCAS.<sup>38</sup> It is generally understood that individuals are affected by their social contexts.<sup>39</sup> The same applies to entrepreneurs, whose activities are deeply embedded in local, indigenous institutions that allow for the creation of the trust and variety of relationships needed to conduct business. In this context of embeddedness, the economic success of many SMEs in fragile settings derives not from the strength of formal institutions, but rather from the degree to which these businesses are able to overcome market and institutional failure by leveraging local, informal support systems.<sup>40</sup>

Research has shown how SMEs in FCAS develop a variety of social and business networks built on trust and cooperation, which allow them to function in the absence of strong formal institutions.<sup>41</sup> In order to compensate for the weakness of public

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- 38 See for instance Guglielmetti, C. 2010. 'Measuring the Business Environment for Entrepreneurship in Fragile States', UNU-WIDER Working Paper No. 2010/14; Stel, N. 2012. 'Entrepreneurship and innovation in a hybrid political order: The case of Lebanon', UNU-WIDER Working Paper No. 2012/78; Spark. 2014. *Tackling Barriers for SMEs in Fragile States*, Discussion Paper at Ignite Conference, 19 November 2014, Amsterdam; Goodwell Investments. 2013. *Dutch Good Growth Fund: Enhance access to finance for SME segment in developing countries*, Strategic advice by Goodwell Investments, commissioned by Dutch Ministry of Foreign Affairs; Kaplan, S. 2013. 'What the World Bank does not understand about "Doing Business"', Global Dashboard, <https://www.globaldashboard.org/2013/05/02/what-the-world-bank-does-not-understand-about-doing-business/> (accessed 3 December 2020); Amoako, I.O. 2019. *Trust, Institutions and Managing Entrepreneurial Relationships in Africa: An SME Perspective*, Cham: Palgrave Macmillan; Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.
- 39 Granovetter, M. 1985. 'Economic action and social structure: The problem of embeddedness', *American Journal of Sociology* 91(3), 481–510.
- 40 Baumol, W.J. and Strom, R.J. 2007. 'Entrepreneurship and economic growth', *Strategic Entrepreneurship Journal* 1, 233–237; Welter, F. and Smallbone, D. 2011. 'Institutional perspectives on entrepreneurial behavior in challenging environments', *Journal of Small Business Management* 49(1), 107–125.
- 41 Chell, E. 2007. 'Social enterprise and entrepreneurship: Towards a convergent theory of the entrepreneurial process', *International Small Business Journal* 25(1), 5–26; Thornton, P.H., Ribeiro-Soriano, D. and Urbano, D. 2011. 'Socio-cultural factors and entrepreneurial activity: An overview', *International Small Business Journal* 29(2), 105–118; Welter, F. and Smallbone, D. 2011. 'Institutional perspectives on entrepreneurial behavior in challenging environments', *Journal of Small Business Management* 49(1), 107–125.

institutions, SMEs in emerging economic and fragile settings have developed a wide array of strategies. One of these entails increasing reliance on family or ethnicity-based networks, which can improve a business' capacity to access credit or resources.<sup>42</sup> Alternatively, businesses can substitute for weak institutions by establishing private support mechanisms, including long-term business relations in business groups, as well as horizontal and vertical cooperation networks among firms.<sup>43</sup> SMEs might also resort to particularistic practices as a way to overcome security threats or obtain services from formal institutions that might otherwise be unable or unwilling to provide them.<sup>44</sup> Finally, another solution for businesses operating in fragile contexts where state presence is weak is to cooperate with non-state actors, who often come to substitute for the state's authority in FCAS.<sup>45</sup> Overall, it is thus crucial to stress that entrepreneurs in emerging economies and FCAS do not just succumb to institutional weakness.

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- 42 Some authors note the importance of family-based support networks (Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute). Others highlight how tight, ethnicity-based networks can facilitate access to credit through informal channels, such as supplier credit (Biggs, T. and Shah, M.K. 2006. 'African SMES, networks, and manufacturing performance', *Journal of Banking and Finance* 30(11), 3043–3066; Fafchamps, M. 2000. 'Ethnicity and credit in African manufacturing', *Journal of Development Economics* 61(1), 205–235). However, the literature also suggests that entrepreneurs should be careful in leveraging their social capital for business purposes, since very dense social capital networks can also put a drag on business performance (Kebede, G.F. 2018. 'Social capital and entrepreneurial outcomes: Evidence from informal sector entrepreneurs in Ethiopia', *The Journal of Entrepreneurship* 27(2), 209–242; Khayesi, J.N.O., George, G. and Antonakis, J. 2014. 'Kinship in entrepreneur networks: Performance effects of resource assembly in Africa', *Entrepreneurship Theory and Practice* 1323–1342). The work of Khayesi et al., for instance, shows that while reliance on dense social networks can help entrepreneurs to raise more resources, these resources are raised at a higher cost, thus leading to a net negative impact on the business performance.
- 43 Some authors show how African SMEs have been able to improve their ability to export by creating business groups (Tajeddin, M. and Carney, M. 2019. 'African business groups: How does group affiliation improve SMEs' export intensity?', *Article Entrepreneurship Theory and Practice* 43(6), 1194–1222). Others also deal with the positive impact of long-term business relations, including relations in which larger businesses support smaller ones (Biggs, T. and Shah, M.K. 2006. 'African SMES, networks, and manufacturing performance', *Journal of Banking and Finance* 30(11), 3043–3066). Moreover, other works show that, in environments characterised by weak infrastructure and institutions, horizontal cooperation among SMEs can enable access to collective resources and joint product innovation, while vertical ties can improve productivity along the supply chain (Mesquita, L.F. and Lazzarini, S.G. 2008. 'Horizontal and vertical relationships in developing economies: Implications for SMEs' access to global markets', *Academy of Management Journal* 51(2), 359–380).
- 44 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute, 44–45.
- 45 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.

Rather, they respond strategically and reflexively to the situation that they find themselves in, in order to steer their business towards success – or at least survival.<sup>46</sup>

Literature generally distinguishes between bonding social capital and bridging social capital.<sup>47</sup> Bonding social capital refers to cohesion within small groups, usually limited to family members, close friends and neighbours. Bridging (also called weak-tie) social capital leads to contacts and collaboration with members outside of an individual's immediate group of contacts, such as distant friends, associates and colleagues.<sup>48</sup> Literature has often stated that those in fragile or poor settings are typically more inclined to rely on a close-knit circle of connections than on extensive bridging social capital that would allow them to get ahead and gain access to contacts far outside of their social circle.<sup>49</sup> However, empirical studies have generated mixed results about the importance of bridging social capital in developing countries.<sup>50</sup>

Over recent years, research about the embeddedness of SMEs in fragile contexts has also included works that, instead of merely focusing on the business environment in which SMEs operate, try to investigate the experiences of entrepreneurs themselves – i.e. the challenges they face, as well as the solutions they tend to adopt.<sup>51</sup> Research in

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- 46 Peng, M.W., Wang, D.Y.L. and Jiang, Y. 2008. 'An institution-based view of international business strategy: A focus on emerging economies', *Journal of International Business Studies* 39(5), 920–936.
- 47 Granovetter, M. 1973. 'The strength of weak ties', *American Journal of Sociology* 78(6), 1360–1380; Gittel, R. and Vidal, A. 1998. *Community Organizing: Building social capital as a development strategy*, London: Sage Publications; Coleman, J.S. 1988. 'Social capital in the creation of human capital', *American Journal of Sociology* 94, S95–S120; Burt, R.S. 1982. *Toward a Structural Theory of Action: Network models of social structure, perception, and action*, Academic Press.
- 48 Woolcock, M. 2001. 'The place of social capital in understanding social and economic outcomes', *Canadian Journal of Policy Research* 2(1), 11–17.
- 49 Bebbington, A. 1999. 'Capitals and capabilities: A framework for analyzing peasant viability, rural livelihoods and poverty', *World Development* 27(12), 2021–2044; Briggs, X. de S. 1998. 'Brown kids in white suburbs: Housing mobility and the many faces of social capital', *Housing Policy Debate* 9(1), 177–221; Woolcock, M. 2001. 'The place of social capital in understanding social and economic outcomes', *Canadian Journal of Policy Research* 2(1), 11–17.
- 50 See for instance: Kebede, G.F. 2015. *Social Capital and the Urban Informal Economy: The case of street vendors in Addis Ababa, Ethiopia*, Doctoral Thesis at University of Trento; Barr, A.M. 2002. 'The functional diversity and spillover effects of social capital', *Journal of African Economies* 11(1), 90–113; Berrou, J.P. and Combarrous, F. 2011. 'The personal networks of entrepreneurs in an informal African urban economy: Does the "Strength of Ties" Matter?', *Review of Social Economy* 70(1), 1–30; Singh, R.P. et al. 1999. 'The entrepreneurial opportunity recognition process: Examining the role of self-perceived alertness and social networks', *Academy of Management Proceedings*; Fafchamps, M. and Minten, B. 2001. 'Social capital and agricultural trade' *American Journal of Agricultural Economics* 83(3), 680–685; Bian, Y. and Ang, S. 1997. 'Guanxi networks and job mobility in China and Singapore', *Social Forces* 75(3), 981–1005.
- 51 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.

this regard has shown that many businesses in FCAS – despite being equipped and eager to grow – often deliberately choose to limit themselves to coping strategies, in order to minimise risks and avoid creating mistrust in the communities where they operate.<sup>52</sup> This means that instead of being focused on growth, these businesses often opt for resilience, a strategy that in FCAS can still be perceived as productive and producing positive effects in the broader political and societal environment.<sup>53</sup>

These observations should induce both local and international actors (i.e. donors) to start a serious reflection on their practices in terms of support to the private sector – and especially SMEs – in fragile contexts. Currently, funds and technical support are often provided to SMEs that can exhibit optimistic plans for growth. However, as it becomes evident that in fragile contexts growth is not necessarily sought by entrepreneurs,<sup>54</sup> nor does it automatically translate into positive social outcomes,<sup>55</sup> this approach should be recalibrated. Rather than focus on growth, for instance by interventions that primarily target start-up businesses, the focus could be broader and consider how to stimulate economic development that includes the growing field of middle-sized entrepreneurs that have development and stabilisation potential.

## 2.3 Conclusion

A survey of the existing literature has shown that a strong focus on embeddedness is of crucial importance in order to understand how SMEs operate in FCAS. Most of the time, constraints identified in salient analyses represent real challenges for entrepreneurs in fragile settings. However, what these analyses often miss is how these entrepreneurs navigate these challenges by leveraging the support of informal institutions – be it in the form of long-term business relationships, or family- and ethnicity-based social networks. These observations have important repercussions for the policy choices that governments in FCAS and their international supporters will have to make. In order for SMEs to have a positive impact on the fragile settings in which they operate, a full understanding of both formal and – especially – informal dynamics is thus of paramount importance.

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52 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.

53 Naudé, W. 2007. 'Peace, prosperity, and pro-growth entrepreneurship', UNU-Wider Working Paper No. 2007/02; Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute, 50.

54 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.

55 Naudé, W. 2007. 'Peace, prosperity, and pro-growth entrepreneurship', UNU-Wider Working Paper No. 2007/02.

## 3 Robust growth in a fragile context

The largely ungoverned (by state institutions) Somali economic model is exceptional in its form and functioning, owing not only to the protracted civil war but also to a legacy of state exploitation under Siad Barre and antipathy towards central authority.<sup>56</sup> As highlighted elsewhere, the Somali economy is also quite exceptional in its reliance on its diaspora communities for remittances and skilled employees. Although weak governance and remittances remain defining features of the Somali economy, significant economic growth, improvements in key infrastructure and rapid urbanisation have changed dynamics in both markets and politics. In order to understand the role of SMEs in the Somali context and the COVID-induced shock, this chapter gives a high-level overview of market dynamics and provides an overview of the way COVID-19 has affected Somalia and Somaliland.

### 3.1 Business environment

While Somalia has outperformed a number of other fragile states (such as South Sudan, Yemen and Afghanistan) and in terms of real GDP growth since 2015, it has ranked at or near the bottom of business environment indices trailing behind those same countries.<sup>57</sup> Somalia's poor ranking reflects the weak or absent formal and central governance felt in most areas. Most sectors of the economy are virtually unregulated, domestically generated government revenues are mostly limited to airport and port fees supplemented with poorly enforced tax collection, while the national court system

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56 Interview with an entrepreneur in the construction sector, Hargeisa, February 2019. Note, however, that considerable socioeconomic differences between the four major clans and minority clans have existed for a long time (Lewis, I. 2003. *A Modern History of the Somali: Nation and State in the Horn of Africa*, London: Longman).

57 In terms of real GDP growth, Somalia's average annual growth rate (2.8%) has been slightly higher than that of Afghanistan (2.3%), and significantly higher than that of South Sudan (-6.5%) and Yemen (-7.9%) (World Bank. 2020. 'Macro Poverty Outlook - Data Dashboard', <https://www.worldbank.org/en/publication/macro-poverty-outlook#sec4> (accessed 21 December 2020)). At the same time, however, Somalia has ranked 190th out of 190 countries in the 2019 and 2020 *Doing Business* index of the World Bank, and it ranks among the bottom five countries on 7 out of 10 of the index's topical measures (World Bank. 2020. *Doing Business 2020: Somalia*).

is frequently considered incapable of fairly resolving business disputes.<sup>58</sup> Access to credit is severely constrained as the financial sector is poorly regulated, and relevant infrastructure is often expensive to access as it is provided by private suppliers (if available at all) (e.g. electricity).<sup>59</sup> Although the Federal Government of Somalia (FGS) and the government of Somaliland are attempting to increase their roles as regulators, neither have been able to break the clientelist ties between businesses and politicians as well as civil servants.<sup>60</sup> Instead, the FGS has remained noted for its gatekeeper role in elite extraversion and rent-seeking practices, while the Somaliland government is notable for enforcing protectionist regulations across a number of key markets.<sup>61</sup> Meanwhile, a range of Federal Member States (FMSs) have attempted to implement highly varying regulatory frameworks, creating additional hurdles for companies operating, selling or sourcing across member states' boundaries.<sup>62</sup>

In the absence of effective public initiatives improving the business climate, it has been the private sector that has in practice taken the lead in economic development. As indicated by a range of business actors, Somali markets are underserved in terms of both volume and the range of products on offer.<sup>63</sup> As such, most sectors have been highly profitable, with entrepreneurs citing average returns of 10 to 20% on investment on a 6-month cycle.<sup>64</sup> As most goods are imported, limited up-front investments frequently suffice to enter into trading or retailing activities for a range of goods,

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58 World Bank. 2017. *Somalia Economic Update, July 2017: Mobilizing Domestic Revenue to Rebuild Somalia*, Nairobi: World Bank Group; Rift Valley Institute and Heritage Institute for Policy Studies. 2017. *Land Matters in Mogadishu: Settlement, ownership and displacement in a contested city*, RVI and HIPS; Interviews with business individuals and diaspora returnees, Mogadishu, February 2019, indicate poor tax collection capacity and the frequent use of Al Shabaab courts for the resolution of business disputes.

59 Owuor, V. 2013. *Somalia Banking: Transfers, challenges and opportunities*, Shuraako; African Development Bank. 2015. *Somalia: Energy sector needs assessment and investment programme*, Abidjan: AfDB Group. Still, it should be noted that the telecommunication sector is a major exception to this trend, as it provides affordable services to a large part of the Somali population (Hesse, B.J. 2010. 'Where Somalia works', *Journal of Contemporary African Studies* 28(3), 343–362; Feldman, B. 2007. 'Somalia: Amidst the rubble, a vibrant telecommunications infrastructure', *Review of African Political Economy* 34(113), 565–572; International Telecommunications Union. 2018. 'Somalia', in *Measuring the Information Society Report 2018 – Volume 2*, 166).

60 Interview with Somaliland government officials, Hargeisa, February 2019; Interview with a former presidential aspirant, Mogadishu, December 2018; Fartaag, A. 2016. *Breaking Point in Somalia: How state failure was financed and by whom*, Nairobi: Fartaag Research & Consulting.

61 Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*, CRU Report, The Hague: Clingendael Institute.

62 Hiraal Institute. 2019. *Doing Business in a War Zone: Somali banks and telecoms*.

63 For instance, as one diaspora entrepreneur in Hargeisa noted: 'In the West one needs to struggle to come up with an original idea and find a niche in the market – here, every idea is new' (February 2019).

64 Interviews with entrepreneurs in construction and property in Hargeisa, as well as Somali traders in Dubai, December 2018 to February 2019.

potentially allowing for substantial growth. On the other hand, limited access to capital, the range of financing modalities and high interest rates have severely constrained individuals' ability to set up new enterprises or scale up existing SMEs.<sup>65</sup> Lacking financing options, most SMEs have been forced to rely solely on organic growth or investments raised among family and social circles. As raising capital to seize on a profitable opportunity is constrained and professional skills are poorly available, most SMEs operating in the Somali territories should be seen as enterprises of necessity arising in response to persistently high unemployment. While some have been able to move into the import/export business, construction or small-scale industries, the vast majority are involved in petty trading activities.<sup>66</sup> Such activities are supplemented by small enterprises speculating on rising property prices, capturing aid rents, and in the service sector leveraging advanced skills and elite networks (e.g. through returning diaspora professionals) criticised for doing little to innovate or develop new sectors.<sup>67</sup>

Besides numerous micro, small and medium enterprises (MSMEs), several large transnational conglomerates are operating across a range of markets. Although these companies primarily serve the Somali market, their operations span several countries in order to overcome the institutional weaknesses of the Somali territories. For instance, many companies are incorporated in the United Kingdom in order to sign legal agreements in an internationally more accepted and predictable legal environment, while conducting their financial operations through Dubai's flexible financial system. Most of these corporations maintain significant operations in one of the Somali markets that allows easy access to hard currencies (mostly finance and/or telecoms). Access to hard currency subsequently allows for rapid expansion into a wide range of other markets, importing required goods, skills and/or capital rather than organically expanding new ventures based on domestic resources.<sup>68</sup> The disparity in access to credit and foreign currencies between the major conglomerates and SMEs has allowed the former to branch out and enter markets outside of their core business, ranging from

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65 Note that the Somali finance sector uses *Murabaha* instead of interest, and that the two terms are not equivalent. Benson, J. et al. 2016. *Somalia Diaspora Investment Survey Report: Typologies, drivers, & recommendations*, Shuraako and the International Fund for Agricultural Development; Interviews with a Somaliland minister and a business consultant, Hargeisa, February 2019 and November 2020.

66 Benson, J. et al. 2016. *Somalia Diaspora Investment Survey Report: Typologies, drivers, & recommendations*, Shuraako and the International Fund for Agricultural Development. For further insights on the specific case of women-owned micro businesses involved in petty trading (as well as the impact of COVID-19 on these businesses), see: Raagsan, 2020. *Socio-Economic Implications of COVID-19 on Micro, Small and Medium Women-Owned Enterprises – A case of Mogadishu*.

67 Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*, CRU Report, The Hague: Clingendael Institute, 51.

68 Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*, CRU Report, The Hague: Clingendael Institute.

foodstuffs to electricity provision and luxury cars.<sup>69</sup> Rather than developing a few related markets, several of the major conglomerates rapidly established a dominant presence in most sectors, attempting to close them off from other business actors. SMEs are thus often at a disadvantage in scale, financing, logistical efficiency and branding, often making their growth opportunities reliant on their ability to collaborate with one of the bigger players. Some conglomerates have further leveraged inequalities in access to finance at times of drought or other natural calamities in order to acquire undervalued assets and land in affected areas, contributing to protracted displacement.<sup>70</sup>

The oligarchic market system established in Somalia is further solidified through clientelistic relationships between large corporate actors and politics. Electoral support from the private sector has frequently been repaid with preferential access to government contracts and licences, and has thereby been key to the establishment of a number of government-mandated and natural monopolies.<sup>71</sup> The unequal capacity of government actors and private actors has led to negotiated tax payments rather than set tax regulations, giving major companies influence over the expenditure of the funds thus raised.<sup>72</sup> Sizeable debt relations have further increased the private sector's leverage over governance, and is supplemented by other individualised relationships between companies and civil servants.<sup>73</sup> Several large conglomerates have thus been able to operate largely unhindered by state authority, and have on occasion mobilised state authority in order to protect their market, access funds disbursed through government tenders, or otherwise support their revenue growth.<sup>74</sup> Regardless of the dominant position of the private sector, however, it should be noted that most SMEs

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69 Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*, CRU Report, The Hague: Clingendael Institute, 37.

70 Jaspars, S., Adan, G.M. and Majid, N. 2020. *Food and Power in Somalia: Business as usual?*, London: LSE Conflict Research Program.

71 Phone interview with an NGO worker active in Somalia in the electricity sector, Netherlands, August 2020.

72 According to one ministerial employee from Somaliland, 'Whether you call it taxes, charities, or CSR, whenever the government needs help they can call the private sector and ask for the money', Hargeisa, February 2019. Similar concerns were voiced by an INGO worker active Mogadishu (interviewed in The Hague, March 2019).

73 Elder, C. (forthcoming). 'Powerbrokers and Somalia's violent political economy: theorising about the logistics industry, reigning "tenderpreneurs" and protracted state collapse', *African Affairs*; Elder, C. 2020. 'The humanitarian response to COVID-19 in Somalia will increase capital flight and violent conflict', *LSE Africa Blog*, 30 April 2020, <https://blogs.lse.ac.uk/africaatlse/2020/04/30/humanitarian-response-covid-19-somalia-capital-flight-debt-relief-violence/> (accessed 8 December 2020).

74 Interview with an insurance provider, Hargeisa, February 2019, and prominent business elites, Mogadishu and Nairobi, September 2016; Musa, A.M. and Horst, C. 2019. 'State formation and economic development in post-war Somaliland: the impact of the private sector in an unrecognised state', *Conflict, Security & Development* 19(1), 35–53; Rubin, M. 2019. 'Somaliland can't wait for recognition to address monopolies', 25 October, *Wardheer News*, <https://wardheernews.com/somaliland-cant-wait-for-recognition-to-address-monopolies/> (accessed 24 December 2020).

and conglomerates see themselves as part of the communities in which they operate. Most private actors have gone out of their way to provide public services that are lacking and as well as extensive corporate social responsibility programmes (in addition to undisclosed zakat contributions). By providing a wide range of services, from direct payments to running fire departments and rehabilitating roads, corporate actors manage to build their licence to operate across various territories, while also contributing to social development.<sup>75</sup> Additionally, corporate actors have often served as important conduits for diaspora donations to combat previous disasters, given their reputation for deploying rapid, targeted and trusted disaster responses. Thus, when the COVID-19 pandemic arrived in the Somali territories, both government agencies and private businesses formed part of the response.

### 3.2 COVID-19 spread and health response

The number of COVID-19 cases and associated deaths has remained relatively low in the Somali territories so far (see Figure 2). However, it is likely that such low figures are strongly related to the lack of testing capacity, as the number of burials appears to have risen.<sup>76</sup> The virus is likely to be spreading throughout the area unchecked for some time, and actual cases may be higher than reported.<sup>77</sup> At the onset of the crisis, Somali samples were transported to other testing facilities in the region (such as Kenya), due to the lack of facilities able to detect COVID in Somalia and Somaliland (although some testing capacity has since been developed).<sup>78</sup> The Somali territories have a relatively

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75 Interview with CSR employee of a large MTO, Hargeisa, February 2019.

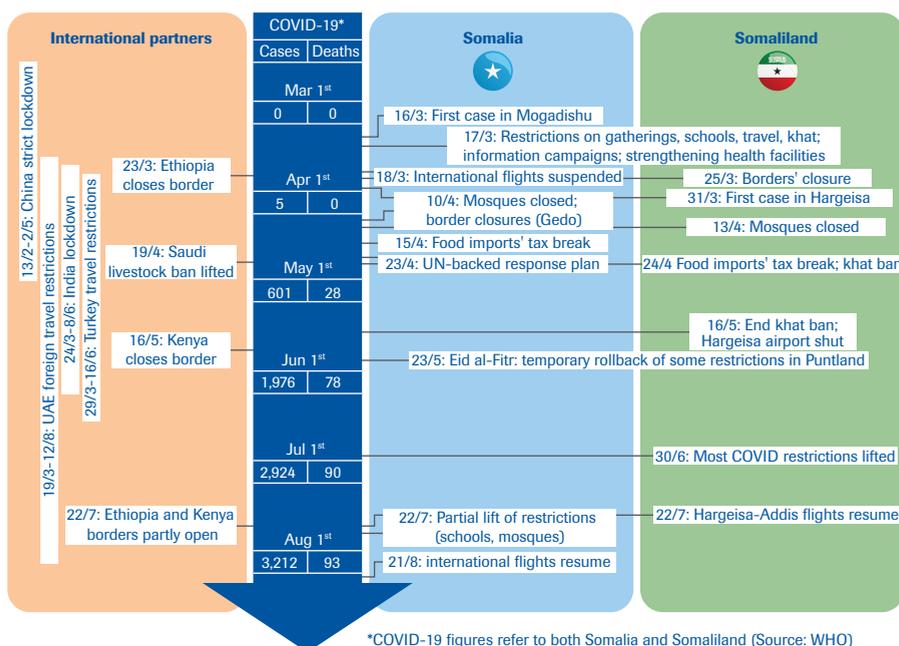
76 Republic of Somaliland. Ministry of Planning and National Development. 2020. *Impact of COVID-19 on the socio-economic status of Somaliland*, 6-8; Ravelo, J.L. 2020. 'With no labs for testing, Somalia braces for COVID-19', *Devex – Inside Development*, 3 April 2020, <https://www.devex.com/news/with-no-labs-for-testing-somalia-braces-for-covid-19-96882> (accessed 10 December 2020); Burke, J. and Mumin, A.A. 2020. 'Somali medics report rapid rise in deaths as Covid-19 fears grow', *The Guardian*, 2 May 2020, <https://www.theguardian.com/world/2020/may/02/somali-medics-report-rapid-rise-in-deaths-as-covid-19-fears-grow> (accessed 10 December 2020).

77 Note, however, that the same analyses also tentatively indicate that the health impact of COVID-19 on the African continent may be less severe than elsewhere.

78 Testing facilities were developed in Mogadishu, Hargeisa and Garowe in April 2020 (Radio Dalsan. 2020. 'Somaliland receives aid from UAE To fight coronavirus', *Radio Dalsan*, 8 April 2020, <https://www.radiodalsan.com/en/2020/04/08/somaliland-receives-aid-from-uae-to-fight-coronavirus/> (accessed 11 December 2020); United Nations Population Fund Somalia. 2020. 'UNFPA and WHO partner to strengthen testing capacity for COVID-19 in Somalia', *UNFPA Somalia*, 27 April 2020, <https://somalia.unfpa.org/en/news/unfpa-and-who-partner-strengthen-testing-capacity-covid-19-somalia> (accessed 11 December 2020)). For estimates of the real impact of the pandemic, see: Jama, S. and Abdullahi, A. 2020. 'We are used to a virus called bombs', *Foreign Policy*, 12 May 2020, <https://foreignpolicy.com/2020/05/12/coronavirus-pandemic-somalia-al-shabab/> (accessed 10 December 2020); Ali, A.E. et al. 2020. 'Mogadishu in the time of COVID-19', *Rift Valley Institute Blogs*, 16 April 2020, <http://riftvalley.net/index.php/news/mogadishu-time-covid-19> (accessed 10 December 2020).

young population, yet shared housing and underlying health conditions are relatively common due to poor nutritional standards, working conditions and sanitation.<sup>79</sup> The presence of internally displaced persons (IDPs) located in poor conditions on the periphery of urban centres further aggravates the risks.

**Figure 2 Evolution of COVID-19 pandemic and policy response in Somalia and Somaliland, including relevant measures undertaken by Somalia’s and Somaliland’s main international partners<sup>80</sup>**



79 United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia: COVID-19 Impact Update No. 1*, 12 April 2020.

80 Data on COVID-19 cases and deaths have been retrieved through the World Health Organization database, and they include both Somalia and Somaliland (World Health Organization. 2020. 'WHO Coronavirus Disease (COVID-19) Dashboard – Data Table', <https://covid19.who.int/table> (accessed 12 November 2020)). For a more fine-grained overview of COVID-19 in Somalia, see: Federal Government of Somalia and United Nations Office for the Coordination of Humanitarian Affairs. 2020. 'COVID-19 Response in Somalia', <https://covid19som-ochasom.hub.arcgis.com/> (accessed 12 November 2020). For a comprehensive list of sources on the measures enacted by Somali administration and their main partners, see the section 'Sources on COVID-19 response', which can be found in the 'References' section, 7.1, at the end of this report.

The Federal Government of Somalia, the Somaliland government, local administrations and Al-Shabaab responded to the onset of the pandemic with significant awareness-raising campaigns and some measures to curb the spread of the virus.<sup>81</sup> At both federal and regional levels, Somali administrations established special taskforces, chaired by the respective health ministries, to coordinate the emergency response to the pandemic.<sup>82</sup> The federal taskforce established by the FGS involved representatives from a range of relevant ministries as well as the major corporations and business associations, who contributed not only to the emergency health response but also to the FGS' broader policy response to the pandemic.<sup>83</sup> International and domestic air traffic was restricted (except in Hargeisa), with the exception of humanitarian aid-related flights and later cargo. As a consequence, diaspora travel into the country was significantly reduced. Schools, universities and madrassas were closed, khat imports were banned citing sanitary concerns (which were heavily contested by traders and consumers), and import taxes on several other goods were reduced to ensure access to essential items. Additionally, curfews were established in a number of urban centres and numerous informal shops were demolished as their facilities were not conducive to social distancing.<sup>84</sup> Although the initial enforcement of social distancing measures was relatively strict, most measures were effectively dropped at the start of Ramadan (May 2020) and market places remained mostly busy. Awareness raising on the virus's traits and on prevention has continued through traditional media, social media, music and, notably, private telecoms companies – which added COVID-19 awareness

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- 81 Ali, A.E. et al. 2020. 'Mogadishu in the time of COVID-19', *Rift Valley Institute Blogs*, 16 April 2020, <http://riftvalley.net/index.php/news/mogadishu-time-covid-19> (accessed 10 December 2020). Guled, A. 2020. 'Extremist group al-Shabaab sets up COVID-19 center in Somalia', *Associated Press*, 12 June 2020, <https://apnews.com/article/fc7930ffdf0202de626a8fe043c7fb9b> (accessed 10 December 2020); see also the lecture by Maruf, H. at the Overseas Development Institute (available at <https://www.odi.org/events/17000-armed-groups-responses-covid-19-crisis>).
- 82 Federal Government of Somalia Ministry of Health & Human Services, and World Health Organization Somalia. 2020. *Coronavirus Disease (COVID-19) Situation Report 5*, 4-10 April 2020.
- 83 Phone interview with an employee at the FGS' Prime Minister's Office, Mogadishu, October 2020.
- 84 Maruf, H. 2020. 'Somalia imposes nighttime curfew', *Voice of America News*, 13 April 2020, <https://www.voanews.com/science-health/coronavirus-outbreak/somalia-imposes-nighttime-curfew> (accessed 10 December 2020); Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020.

messages to outgoing phone calls.<sup>85</sup> This may also have been related to societal efforts to further reduce transmission risks.<sup>86</sup>

The onset of the COVID-19 pandemic underlined the poor state of healthcare in Somalia. With FGS expenditures focusing heavily on security provision, a mere 2% of the annual budget was allocated to healthcare.<sup>87</sup> With just 46 intensive care units, 15 ventilators and no oxygenation plant, and one of the lowest doctor-patient ratios in the world, treatment was virtually unavailable in the capital, let alone outside of it.<sup>88</sup> Although efforts were made to introduce screening at ports of entry, additional training for healthcare workers and contact tracing, the severe lack of protective equipment left many in the health sector exposed. The FGS taskforce upgraded two hospitals in the capital to improve their ability to treat COVID-19 patients, one of which was funded by one of the private actors on the task force.<sup>89</sup> In parallel, the FGS increased efforts to procure diagnostic kits and personal and medical equipment, and was met with considerable

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- 85 Ali, A.E. et al. 2020. 'Mogadishu in the time of COVID-19', *Rift Valley Institute Blogs*, 16 April 2020, <http://riftvalley.net/index.php/news/mogadishu-time-covid-19> (accessed 10 December 2020); Majid, N. et al. 2020. 'Puntland and COVID-19: Local responses and economic impact', *LSE Conflict Research Programme Blog*, 5 May 2020, <https://blogs.lse.ac.uk/crp/2020/05/05/puntland-and-covid-19-local-responses-and-economic-impact/> (accessed 10 December 2020); Majid, N. and Musa, A.M. 2020. 'Somaliland and COVID-19: Emerging issues and economic impact', *LSE Conflict Research Programme Blog*, 23 April 2020, <https://blogs.lse.ac.uk/crp/2020/04/23/somaliland-and-covid-19-emerging-issues-and-economic-impact/> (accessed 10 December 2020); Raagsan, 2020. *Socio-Economic Implications of COVID-19 on Micro, Small and Medium Women-Owned Enterprises – A case of Mogadishu*.
- 86 Russel, A. 2020. 'Somalia's Hormuud Telecom records increased mobile money transactions due to the Covid-19 pandemic', *Tech in Africa*, 24 September 2020, <https://www.techinafrica.com/somalias-hormuud-telecom-records-increased-mobile-money-transactions-due-to-the-covid-19-pandemic/> (accessed 10 December 2020).
- 87 Budget allocation to the Somali Ministry was 1.96% of the total budget in 2020, up from 0.44% in 2018 (Jama, S. and Abdullahi, A. 2020. 'We are used to a virus called bombs', *Foreign Policy*, 12 May 2020, <https://foreignpolicy.com/2020/05/12/coronavirus-pandemic-somalia-al-shabab/> (accessed 10 December 2020)).
- 88 See: Jama, S. and Abdullahi, A. 2020. 'We are used to a virus called bombs', *Foreign Policy*, 12 May 2020, <https://foreignpolicy.com/2020/05/12/coronavirus-pandemic-somalia-al-shabab/> (accessed 10 December 2020); Warsame, A.A. 2020. *Somalia's Healthcare System: A baseline study & human capital development strategy*, Heritage Institute for Policy Studies and City University of Mogadishu, Mogadishu: HIPS. According to the estimates provided in these studies, Somalia has 0.02 doctors per 1,000 people (placing the country among the worst of the world) and 0.34 essential workers (physicians, nurses, midwives) per 1,000 people (far short of the WHO's minimum requirement of 4.5).
- 89 For instance, Hormuud financed the COVID-19 treatment centre in Benadir hospital (phone interview with an employee at the FGS' Prime Minister's Office, Mogadishu, October 2020). Details of other donations by Hormuud can be found on the company's website (Hormuud. 2020. 'CSR', <https://www.hormuud.com/corporate/csr.aspx> (accessed 10 December 2020)).

goodwill from international donors.<sup>90</sup> Considerable donations came in from the World Health Organization (WHO), China, the United Arab Emirates, Turkey, Italy and others, contributing medical supplies and personal protective equipment (PPE). A Saudi-sponsored dialysis centre was repurposed as a COVID-19 facility.<sup>91</sup> Additional funding for the COVID-19 response was also made available from the World Bank, while existing facilities such as Baxnaano (cash-transfers for resilience programming, operated by one of the money transfer operators (MTOs) on the task force) and Gargaara (business loans for SMEs) were repurposed to deal with the societal impact of the virus.<sup>92</sup> Nonetheless, virtually no social safety net existed for the majority of the Somali population, forcing them to rely on social connections for support – a practice that in itself could increase transmission risk. With many basic hygiene services and items out of reach for significant parts of the population (e.g. water, sanitation and hygiene facilities for IDPs, and items such as soap seeing significant price spikes), confidence in the ability of government bodies to contain the outbreak was low.<sup>93</sup>

### 3.3 Conclusion

As discussed in this chapter, the Somali economy is weakly governed and private interests frequently intertwine with political processes. The private sector has actively contributed to development in the area. Several businesses have also been able to leverage their resources to establish and entrench their advantaged position, placing smaller enterprises at a disadvantage. Throughout the COVID-19 pandemic, weak governance and service provision has inhibited the health response. Many private enterprises responded in support of the response, however, contributing significant funds, efforts and equipment in tandem with international actors. While some of the major corporate actors were directly involved as part of the FGS taskforce and contributed to the response significantly, large parts of the Somali community were not supported by any formal social safety nets or other support programmes.

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90 Phone interview with an employee at the FGS' Prime Minister's Office, Mogadishu, October 2020.

91 Warsame, A.A. 2020. *Somalia's Healthcare System: A baseline study & human capital development strategy*, Heritage Institute for Policy Studies and City University of Mogadishu, Mogadishu: HIPS; *Al-Khaleeji Today*. 2020. 'Saudi Arabia hands over the dialysis center building to Somalia', 1 November 2020, <https://alkhaleejtoday.co/saudi-arabia/5244280/Saudi-Arabia-hands-over-the-dialysis-center-building-to-Somalia.html> (accessed 10 December 2020).

92 World Bank. 2020. 'World Bank Approves \$137.5 Million for Somalia's Response to COVID-19, Floods, and Drought', *Press Release*, 15 May 2020, <https://www.worldbank.org/en/news/press-release/2020/05/15/world-bank-approves-137-5-million-for-somalias-response-to-covid-19-floods-and-drought> (accessed 10 December 2020).

93 Numerous phone interviews with entrepreneurs and NGO workers active across the regions, Hargeisa, August - November 2020.

## 4 Economic impact of COVID-19

The COVID-19 pandemic has created serious disruptions for the global economy. According to the World Bank the pandemic generated '*the largest economic shock that the world has experienced in decades*'.<sup>94</sup> In an optimistic scenario, global GDP is reportedly set to shrink by 5.2%, but the continued circulation of the virus might further worsen these already bleak predictions. As a result, tens of millions of people are set to be thrown into poverty, with a potentially long-lasting negative impact through a reduction in investments, human capital, and productivity. COVID-19 is likely to have a heavy impact on the economy of the Somali territories, a largely informal economy heavily dependent on access to foreign aid and external capital. Throughout spring 2020, estimates on real growth of Somalia's GDP for 2020 were gradually downgraded, first from 3.2% to 2.3%, and then down to -2.5%.<sup>95</sup> Other forecasts paint an even bleaker picture, with the Economist Intelligence Unit and the FGS itself predicting a downturn of respectively 7% and 11% through 2020.<sup>96</sup>

The aim of this chapter is to investigate in detail how the COVID-19 pandemic has affected the Somali territories' economy so far. The focus here will be on the major issues faced by the economy, notably: disruptions affecting its supply chains, and the consequent problems of availability and affordability of goods; and the turmoil faced by the informal financial sector, with the ensuing troubles in terms of liquidity, access to credit, and demand. Analysis of these issues will serve as a basis to investigate how COVID-19 has affected the environment in which Somali businesses operate, with a specific focus on the challenges faced by SMEs. These considerations, together with an analysis of the pandemic's impact on the governments' budgets, will lay the foundations for the following chapter, which will explore how these shifting dynamics might affect the political economy of Somalia and Somaliland – with important implications for the evolution of conflict dynamics.

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94 World Bank. 2020. *Global Economic Prospects*, Washington DC: The World Bank Group.

95 World Bank. 2020. *Somalia Country Update (April 2020)*, Macro Poverty Outlook, Washington DC; United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia Country Preparedness and Response Plan*, 20.

96 Economist Intelligence Unit. 2020. *Somalia Country Report*, London: The Economist; United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia Country Preparedness and Response Plan*, 3.

## 4.1 Import constraints

The advent of COVID created serious disruptions to international supply chains around the world – due to a mix of production constraints, particularly in the initial phase of the pandemic, and restrictions to international mobility.<sup>97</sup> The Somali territories' economy, characterised by a heavy reliance on imports to satisfy domestic consumption,<sup>98</sup> was particularly prone to suffering the consequences of these disruptions, with the impact to be felt by businesses and consumers alike. Aware of this vulnerability, administrations in both Mogadishu and Hargeisa adopted measures to secure the inflow of essential goods. These measures, however, focused mostly on foodstuffs,<sup>99</sup> leaving the economy at large vulnerable to global supply shocks affecting a range of other important goods and creating an advantage for importers over local producers.

As the pandemic swept across the globe, it became increasingly difficult for Somali businesses to import goods from some of their major trade partners. For instance, China – a key supplier of consumer goods<sup>100</sup> – saw its exports to Africa decrease by more than 10% in January and February 2020 as compared to the previous year.<sup>101</sup> At the same time, measures imposed by the Indian government, including quarantines for seafarers and restrictions to international movement, created significant disruptions for the country's

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97 Seric, A. et al. 2020. 'Managing COVID-19: How the pandemic disrupts global value chains', *World Economic Forum*, 27 April 2020, <https://www.weforum.org/agenda/2020/04/covid-19-pandemic-disrupts-global-value-chains/> (accessed 7 December 2020); World Trade Organization. 2020. *Cross-border mobility, COVID-19 and global trade*, Information Note, Geneva: WTO; Organisation for Economic Co-operation and Development. 2020. *COVID-19 and global value chains: Policy options to build more resilient production networks*, OECD Policy Responses to COVID-19; Meester, J. and Ooijens, M. 2020. *COVID-19 Impact on the Value Chain – Conceptual paper*, CRU Policy Brief, The Hague: Clingendael Institute.

98 It has been estimated that 80% of the Somali economy depends on imports, and in 2019 the value of imports was even higher than the value of the country's GDP (International Monetary Fund. 2020. *Somalia*, IMF Country Report No. 20/85, 26; Phone interview with an official from a large MTO, Hargeisa, August 2020; Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020; Phone interview with a researcher, Nairobi, August 2020).

99 Measures taken by the FGS included a 100% tax exemption on rice and dates, as well as a 50% tax exemption on wheat flour and cooking oil. Measures taken by Somaliland's administration consisted of a 20% tax exemption on the imports of wheat flour, cooking oil, sugar and pasta (Food Security and Nutrition Analysis Unit Somalia. 2020. 'Somalia 2020 Post Gu Food Security and Nutrition Outcomes and Projections', *Briefing for Stakeholders*, <https://www.fsnau.org/publications> (accessed 7 December 2020); Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020).

100 In 2018, imports from China reportedly made up 18-19% of Somalia's overall imports. Of the USD 642 million of imports recorded in that year, almost half were consumer goods (World Bank. 2020. 'World Integrated Trade Solutions – Data', <https://wits.worldbank.org/> (accessed 7 December 2020); elaboration by the authors).

101 Seric, A. et al. 2020. 'Managing COVID-19: How the pandemic disrupts global value chains', *World Economic Forum*, 27 April 2020, <https://www.weforum.org/agenda/2020/04/covid-19-pandemic-disrupts-global-value-chains/> (accessed 7 December 2020).

shipping industry<sup>102</sup> – and hence for Somalis, who rely on India for the supply of food staples such as rice.<sup>103</sup> Similarly, the economic slowdown in Turkey affected Somalia's economy – and especially its construction sector, which relies significantly on materials coming from Turkey and China.<sup>104</sup> To compound the problems faced by Somali businesses in receiving seaborne trade, in mid-March and mid-May respectively Ethiopia and Kenya also decided to shut their land borders to prevent the spread of COVID-19.<sup>105</sup> These measures put a serious strain on the country's capacity to import essential goods – particularly fruit and vegetables, nearly all of which are imported from Ethiopia.<sup>106</sup> To make things even worse, the situation deteriorated throughout the summer, as political unrest in Ethiopia further reduced cross-border trade with Somalia and Somaliland.<sup>107</sup>

As a result of these supply chain disruptions, the value of Somalia's reported imports in the first half of 2020 dropped by 17.6% as compared to the previous year (see Figure 3). This drop was particularly stark in April and May, when the value of imports decreased by more than half over a two-month period. This was likely due to the imposition of restrictive measures, both in Somalia and in neighbouring countries, as well as to the

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102 Mujawar, M. 2020. 'COVID-19 impact: Many Indian sailors eager to board ship; scores of others desperate to return home', *CNBC*, 25 June 2020, <https://www.cnbc18.com/business/covid-19-impact-many-indian-sailors-eager-to-board-ship-scores-of-others-desperate-to-return-home-6204791.htm> (accessed 7 December 2020); respondents for this study suggested in particular that the quarantine for seafarers created delays in Indian supplies to Somalia (Phone interview with a researcher, Nairobi, August 2020). India is Somalia's third largest trading partner and imports from India are mainly staples such as rice and sugar.

103 In 2018, imports from India reportedly made up 12% of Somalia's overall reported imports. Most of these imports consisted of vegetables (30%) and food products (23%) (World Bank. 2020. 'World Integrated Trade Solutions – Data', <https://wits.worldbank.org/> (accessed 7 December 2020); elaboration by the authors). Although the Indian government did not implement any export restrictions in the domain of food, on 3 April 3 Indian rice traders decided to suspend the signing of new export contracts (International Trade Centre. 2020. 'Market Access Map', <https://macmap.org/en/covid19> (accessed 7 December 2020)).

104 Phone interview with a Somali researcher, London, September 2020; Phone interview with an employee at FGS' Prime Minister's Office, Mogadishu, October 2020; World Bank. 2020. 'World Integrated Trade Solutions – Data', <https://wits.worldbank.org/> (accessed 7 December 2020); elaboration by the authors.

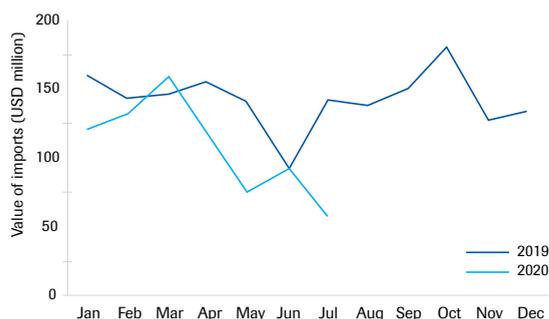
105 Gebre, S. 'Ethiopia closes land border, deploys troops to combat virus', *Bloomberg World*, 23 March 2020, <https://www.bloomberg.com/news/articles/2020-03-23/ethiopia-closes-land-border-deploys-troops-to-combat-virus> (accessed 7 December 2020); Reuters. 2020. 'Kenya closes borders to Tanzania and Somalia over coronavirus', 16 May 2020, <https://www.reuters.com/article/us-health-coronavirus-kenya-idUSKBN22SOKL> (accessed 7 December 2020). The land border closures with Kenya and Ethiopia, with some exceptions for the transit of goods; however, cross-border trade was reportedly affected nevertheless (United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia: COVID-19 Impact Update No. 10*, 22 July 2020).

106 As of 2016, over 95% of the edible vegetables imported by Somalia came from Ethiopia (Gebresenbet, F. 2018. 'Perishable state-making: Vegetable trade between self-governance and ethnic entitlement in Jigjiga, Ethiopia', DIIS Working Paper, No. 2018:1, 9-10).

107 Phone interview with an official from a large MTO, Hargeisa, August 2020; Phone interview with a business trainer, Hargeisa, September 2020.

delayed impact of shipping disruptions.<sup>108</sup> The decline in imports affected Somaliland too, albeit to a lesser extent, with authorities in Hargeisa reporting a reduction in imports' value in the first half of 2020 (-11.9% on the previous six months, and -3.3% on the first half of 2019).<sup>109</sup> Overall, although the reliability of import data for Somalia and Somaliland is questionable, these relative variations suggest that COVID-19 had a marked negative impact on the ability of Somali businesses to import the goods that the country's economy depends on.<sup>110</sup>

**Figure 3** Reported imports into the Somali territories, 2019-2020<sup>111</sup>



108 Large container vessels that had already started their multi-week journey towards Somalia before the implementation of quarantine measures might have completed their shipments. Therefore, it is likely that disruptions in shipping have led to a delay with respect to the imposition of quarantine measures in countries such as China and India (Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020).

109 Data from Somaliland's government (Republic of Somaliland. Ministry of Finance Development. 2020. 'Reports', <http://slmof.org/reports/> (accessed 7 December 2020)); elaboration by the authors.

110 Import/export databases, like Comtrade, suffer from a number of data constraints, which are all the more marked in Somalia's case. First, Somalia does not report any monthly trade data itself, making it necessary to rely on reporting done by Somalia's trade partners. Moreover, and perhaps more importantly, for the years 2019 and 2020 there is little to no trade data available for some of Somalia's major trade partners, namely the UAE, China and Ethiopia – thus making the absolute figures provided by the database extremely incomplete and not reliable. However, if the impact of COVID-19 is to be assessed, it might be possible to gain some relevant insights by looking at the relative variations in the value of Somalia's imports in the first half of 2020. Finally, a last note on the Comtrade database is in order: as data usually gets reported by different countries with variable delays, it is likely that the drop observed in July 2020 largely depends on the fact that not all data is yet available.

111 Data from Comtrade database (United Nations Statistics Division. 'UN Comtrade Database', <https://comtrade.un.org/data/> (accessed 16 November 2020)); elaboration by the authors. The Comtrade database does not make explicit whether data for Somaliland is included. However, the UN generally considers Somaliland as part of Somalia, and hence includes data for Somaliland in its Somalia data (for instance, see: United Nations Office for the Coordination of Humanitarian Affairs and Federal Government of Somalia. 2020. 'COVID-19 Response in Somalia', <https://covid19som-ochasom.hub.arcgis.com/> (accessed 7 December 2020)).

As the pandemic hit the Horn of Africa, sourcing goods abroad became increasingly challenging for Somali businesses. In some cases, goods became temporarily unavailable, forcing importers to find other supply sources or be unable to provide specific goods to their customers.<sup>112</sup> Even when goods were still available, supply times reportedly grew longer, leading to considerable delays as compared to the pre-COVID-19 situation. For instance, a Somali businesswoman indicated that, in the wake of the pandemic, the time needed to import goods from China rose from 6-8 weeks to up to four months.<sup>113</sup> The unpredictability of these delays made things even worse, leading a Somali business owner to comment: *'The flow of goods has stopped. Even big businesses cannot get their goods on time in the country. They cannot give clients a timeline anymore.'*<sup>114</sup> Faced with new challenges in sourcing goods abroad, Somali businesses responded by adopting a range of different strategies. Small retailers active in Hargeisa, for instance, decided to pool their overseas orders in order to save time.<sup>115</sup> At the same time, some airline companies, faced with a sharp reduction in passenger demand, switched their operations from passengers to cargo, responding to increased domestic demand in light of the longer shipping times.<sup>116</sup> In general, respondents seemed to indicate that *'you have to find creative ways to get supplies into Somalia and ways to finance them'*.<sup>117</sup>

It is important to note, however, that supply chain disruptions did not impact all businesses in the same way. Having leaner stockpiles and less possibilities to diversify their sources, small businesses were disproportionately affected.<sup>118</sup> By contrast, increasing scarcity has been a favourable development for larger importers who were able to build significant stocks ahead of COVID-19 slowdowns at major sourcing destinations, allowing traders to charge significantly higher prices when, for instance, shipments of electronics temporarily stopped.<sup>119</sup> Moreover, several larger traders have been able to realign major trade relations, avoiding significant delays (notably in the UAE and China) by sourcing from Turkey, South Korea or trans-shipment in Djibouti.<sup>120</sup> The impact of COVID-induced supply shocks was also different across different sectors of the Somali economy. For instance, the value of

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112 Phone interview with a business trainer, Hargeisa, September 2020. Specific observations pointed to cigarettes of certain brand not being available for a short period of time, or to the time to order goods from retailers increasing dramatically, pointing to supply chain issues gradually having penetrated the entire supply chain.

113 Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020.

114 Phone interview with an official from a large MTO, Hargeisa, August 2020.

115 Phone interview with a business trainer, Hargeisa, September 2020.

116 Phone interview with an entrepreneur in the Somali aviation sector, Dubai, September 2020.

117 Phone interview with a business trainer, Hargeisa, September 2020.

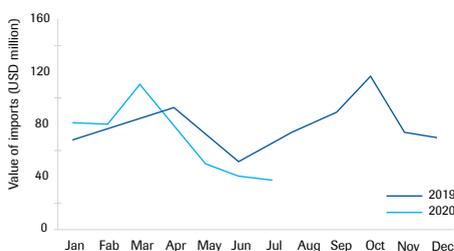
118 Phone interviews with a business trader and an official from a large MTO in Hargeisa, as well as a researcher in Nairobi and another in London, August-September 2020.

119 Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020.

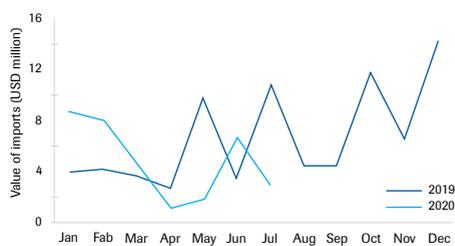
120 Phone interviews with an employee from a large business in the luxury sector in Hargeisa and with a trader in the foodstuffs import sector in Kismayo, September-October 2020.

foodstuff imports briefly rose in March 2020, before witnessing a fall in the second quarter, partly as the result of reduced imports from India (see Figure 4).<sup>121</sup> By contrast, the value of imported luxury items, especially vehicles, followed a markedly different pattern, falling in early 2020 and then picking up after April – thus suggesting that, despite an initial shock, the luxury market has been able to (at least partly) recover (see Figure 5). While many traders in luxury items nevertheless faced declining revenues, for some niche businesses in the luxury sector the COVID-19 pandemic even presented itself as an opportunity.<sup>122</sup> For instance, an importer of cars said that demand significantly rose during the pandemic. As trade and travel restrictions prevented their customers from making purchases abroad themselves, her company effectively became the only way of importing in her segment.<sup>123</sup> However, such examples seem to relate mostly to businesses that serve a small fraction of the Somali market – i.e. affluent Somalis whose purchasing power has not been greatly affected by the COVID crisis.

**Figure 4** Reported imports of foodstuffs in the Somali territories<sup>124</sup>



**Figure 5** Reported imports of luxury goods in the Somali territories<sup>125</sup>



Given the Somali territories' heavy reliance on imports for a wide range of consumer goods, the disruptions described above could reverberate down to retail levels, showing up eventually in the form of price hikes for consumers. In order to prevent such price hikes, in mid-April administrations in both Mogadishu and Hargeisa implemented significant tax exemptions on foodstuffs, fully or partially waiving import taxes on staples such as rice,

121 The Q2 fall reported by the Comtrade data also depends on the sudden fall to zero of foodstuff imports from Turkey in May 2020. This latter drop, however, is likely due to delays in Turkey's reporting of trade data. At the same time, it is also worth noting that vegetable imports in Q2 are likely to have fallen more than what is reported by Comtrade, due to reduced imports from Ethiopia (Phone interview with an official from a large MTO, Hargeisa, August 2020; Phone interview with a business trainer, Hargeisa, September 2020) that are not captured in the Comtrade database.

122 Phone interviews with an employee from a large business in the luxury sector and with a business trainer in Hargeisa, September 2020.

123 Phone interview with an employee from a large business in the luxury sector, Hargeisa, September 2020.

124 United Nations Statistics Division. 'UN Comtrade Database', <https://comtrade.un.org/data/> (accessed 16 November 2020); elaboration by the authors.

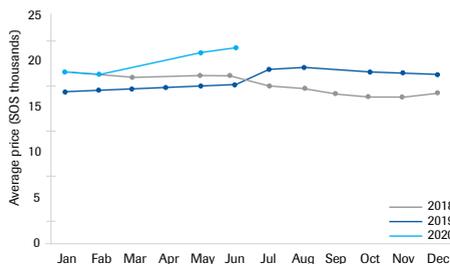
125 Ibid.

dates, wheat flour, cooking oil, sugar and pasta.<sup>126</sup> Moreover, the FGS sought to strike deals with FMSs to eliminate taxation on internal transport, and it attempted to tighten its control on businesses to prevent price gouging.<sup>127</sup> These measures did reportedly prevent – or at least limit – price hikes for some products in specific areas, as exemplified by the rather stable price of rice in Mogadishu.<sup>128</sup> However, as the pandemic spread throughout the Somali territories, the price of cereal products – both locally sourced (sorghum, maize, pasta) and imported (rice, wheat flour) – did rise across most regions (see Figures 6 and 7).<sup>129</sup> In addition, weakening trade flows with Ethiopia (the main

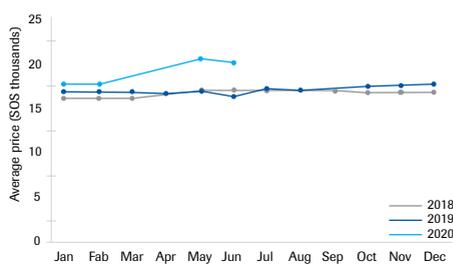
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- 126 Measures taken by the FGS included a 100% tax exemption on rice and dates (since the period leading up to Ramadhan), as well as a 50% tax exemption on wheat flour and cooking oil. Measures taken by Somaliland's administration consisted of a 20% tax exemption on the imports of wheat flour, cooking oil, sugar and pasta. Sources: Food Security and Nutrition Analysis Unit Somalia. 2020. 'Somalia 2020 Post Gu Food Security and Nutrition Outcomes and Projections', *Briefing for Stakeholders*, <https://www.fsnau.org/publications> (accessed 7 December 2020); Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020.
- 127 Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020; Phone interview with an employee at FGS' Prime Minister Office, Mogadishu, October 2020.
- 128 Rice and wheat prices in Benadir region were rather stable throughout spring 2020 (World Food Programme. 2020. 'Somalia – Food Prices', *Humanitarian Data Exchange*, <https://data.humdata.org/dataset/wfp-food-prices-for-somalia> (accessed 17 November 2020); Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020). As for Somaliland, it is impossible to assess the effectiveness of the measures implemented in Somaliland due to lack of available data.
- 129 See: World Food Programme. 2020. 'Somalia – Food Prices', *Humanitarian Data Exchange*, <https://data.humdata.org/dataset/wfp-food-prices-for-somalia> (accessed 17 November 2020); United Nations Office for the Coordination of Humanitarian Affairs. 2020. 'COVID-19 Impact Updates', *ReliefWeb*, [https://reliefweb.int/updates?search=title%3A%22COVID%22&advanced-search=%28PC216%29\\_%28F10\\_S1503%29](https://reliefweb.int/updates?search=title%3A%22COVID%22&advanced-search=%28PC216%29_%28F10_S1503%29) (accessed 8 December 2020); Phone interview with an official from a large MTO, Hargeisa, August 2020; Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020; Phone interview with a Somali researcher, London, September 2020. However, some respondents stressed that the price hikes did not last long and that prices have since come back to normal levels (Phone interview with an employee from a large business in the luxury sector, Hargeisa, September 2020; Phone interview with an employee at FGS' Prime Minister's Office, Mogadishu, October 2020; Phone interview with a business manager in the foodstuffs import sector, Bosaso, October 2020). While the scarcity of available data makes it difficult to quantify the price hikes, it is possible to outline some figures concerning the price of a number of products in 15 markets across most of Somalia (see methodology in footnote to Figure 6). In May and June 2020, the price of the selected staple cereal products in the regions analysed was significantly higher than in the previous year (+23%) – both for locally sourced items such as sorghum, white maize and pasta, and for imported ones like rice and wheat flour (World Food Programme. 2020. 'Somalia – Food Prices', *Humanitarian Data Exchange*, <https://data.humdata.org/dataset/wfp-food-prices-for-somalia> (accessed 17 November 2020); elaboration by the authors). While WFP data is unavailable for Somaliland after March 2020, FSNAU data suggest that the price of cereals in this region witnessed similar dynamics – i.e. an increase of around 15% as compared to the previous year's levels, with high prices persisting until September 2020, although with signs of a decline in October (Food Security and Nutrition Analysis Unit Somalia. 2020. 'Market Update – October 2020', <https://www.fsnau.org/publications> (accessed 7 December 2020)).

supplier of fruit and vegetables) – due both to the spread of COVID-19 in the region and to the growing political unrest in Ethiopia – resulted in large temporary price hikes for fruit and vegetables, as exemplified by the temporary tripling of the price of tomatoes in Hargeisa’s markets.<sup>130</sup>

**Figure 6 Average price of selected domestic cereal products<sup>131</sup>**



**Figure 7 Average price of selected imported cereal products<sup>132</sup>**



Besides foodstuffs, price hikes were also noted in other sectors, where price gouging was reportedly more widespread than for food.<sup>133</sup> Most evidently, prices of hand sanitisers, soap and protective equipment such as face masks skyrocketed, as the COVID-19 outbreak drove up demand.<sup>134</sup> Moreover, prices also increased in the electronics sector – according to some reports, due to the decision of a few big

130 Phone interview with an official from a large MTO, Hargeisa, August 2020; Phone interview with a business trainer, Hargeisa, September 2020; Phone interview with an employee from a large business in the luxury sector, Hargeisa, September 2020.

131 Data source: World Food Programme. 2020. ‘Somalia – Food Prices’, Humanitarian Data Exchange, <https://data.humdata.org/dataset/wfp-food-prices-for-somalia> (accessed 17 November 2020). This data relies on weekly monitoring of 29 markets across all the 18 administrative regions of Somalia. Due to the limited availability of data, in order to be consistent, the analysis had to be limited to 15 of the 29 markets. Somaliland was excluded altogether due to the lack of available data after March 2020. FSNAU reports, however, suggest that a similar rise in cereal price levels have taken place in Somaliland too (Food Security and Nutrition Analysis Unit Somalia. 2020. ‘Market Update – October 2020’, <https://www.fsnau.org/publications> (accessed 7 December 2020)). The products considered in this analysis are: red and white sorghum, white maize and pasta (domestic), as well as rice and wheat flour (imported). The absence of dots in the graph for certain months (April 2018, September 2019, March and April 2020) signifies a lack of sufficient data for that month.

132 Ibid.

133 Phone interview with a civil servant at the FGS’ Ministry of Finance, Mogadishu, September 2020.

134 A few examples of reported price hikes for protective equipment: +318% in Somaliland; +223% in Puntland; +153% in Galmudug (United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia: Update 2 – Overview of COVID-19 directives*).

companies to keep large volumes of goods in storage until prices rose.<sup>135</sup> The most – if not the only – notable exception to the general rise in prices was fuel, the price of which did not vary significantly throughout the crisis. This, however, was due to the exceptional circumstances faced by global oil and gas markets, with extremely low prices throughout spring 2020.<sup>136</sup>

Although it is possible to observe a general rise in price levels since the outbreak of COVID-19, it is important to note that price dynamics in the Somali territories, especially in the domain of food, have displayed a large degree of cross-regional variability. The price of homegrown food staples, for instance, has varied according to region-specific factors such as climatic conditions, security issues, and carryovers from previous harvests.<sup>137</sup> Similarly, price dynamics for imported goods have been different in each region, due to differences in transport costs across regions (i.e. checkpoint fees levied by governmental authorities or by Al-Shabaab),<sup>138</sup> as well as to the specific measures enacted by different levels of administration.<sup>139</sup> Examples of the ensuing price variability can be seen in Figures 8 and 9, which show price levels over time for two food staples – homegrown sorghum and imported rice – across three different regions.<sup>140</sup> Given this variability, broad trends across the Somali territories might be interesting

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135 Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020.

136 According to the Comtrade database, between March and May 2020 the value of Somalia's reported trade in mineral products, including petroleum, surged dramatically – by more than 400% in a 2-month period (United Nations Statistics Division. 'UN Comtrade Database', <https://comtrade.un.org/data/> (accessed 16 November 2020)); elaboration by the authors). According to a respondent for this study, this was due to increased purchases by Somali businesses eager to exploit the extremely low global oil prices (Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020; for an overview of oil prices, see: OilPrice. 2020. 'Oil Price Charts', <https://oilprice.com/oil-price-charts/> (accessed 8 December 2020)).

137 Food Security and Nutrition Analysis Unit Somalia. 2020. 'Market Updates', <https://www.fsnau.org/publications> (accessed 7 December 2020).

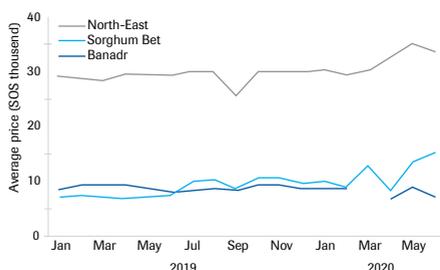
138 Respondents pointed to the fact that food prices tend to be higher in regions that are far away from key ports where food is imported, most notably due to transport costs (Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020; Phone interview with an employee at FGS' Prime Minister Office, Mogadishu, October 2020).

139 For instance, the tax breaks on the import of food staples implemented by the FGS had an effect only in the Benadir region. This can be observed in the World Food Programme database (see above), and has been confirmed both by some respondents to this study (Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020) and by UN OCHA reports (United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia: Update 2 – Overview of COVID-19 directives*).

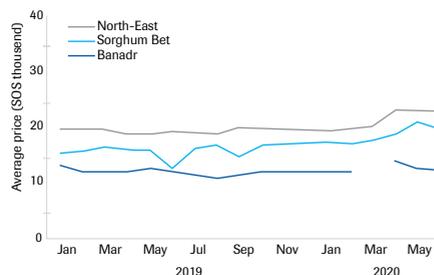
140 Three regions have been chosen here: North-East (Bari, Nugaal, Sool, Sanaag), Sorghum Belt (Hiraan, Bakool, Bay, Gedo), and Benadir (classification adopted by FSNAU). The choice of these three regions has been motivated by the fact that they expose different features that allow for interesting comparisons. The Sorghum Belt region relies more on its own agricultural production (sorghum), which is by contrast scarcer in the North-East. Benadir is an interesting case not only because it is very reliant on food imports, but also because it is the region of the capital Mogadishu, where the FGS has at least a degree of control.

to observe to gain a more comprehensive overview, but caution should be used when drawing general conclusions about processes taking place in the territories as a whole.

**Figure 8 Price of sorghum (homegrown) in selected Somali regions<sup>141</sup>**



**Figure 9 Price of rice (imported) in selected Somali regions<sup>142</sup>**



## 4.2 Remittances and liquidity

Besides the disruption of supply chains and the consequent alterations in the price of goods, the advent of COVID-19 has also had an impact on liquidity in the Somali territories. In the absence of fully functioning central banks and well-developed formal banking systems,<sup>143</sup> over the past decades an informal system has guaranteed the smooth functioning of the economy in the Somali territories. A major pillar standing at the base of this informal architecture is the value of remittances sent by the Somali diaspora worldwide. Remittance inflows into the Somali territories are estimated to be

141 Data source: World Food Programme. 2020. 'Somalia – Food Prices', Humanitarian Data Exchange, <https://data.humdata.org/dataset/wfp-food-prices-for-somalia> (accessed 17 November 2020); elaboration by the authors. It is important to note that the high prices in Puntland might be partly explained by the peculiar dynamics of this region, where local authorities have printed a new currency note that has not been recognised by other regions. FSNAU reports suggest that this issue – together with the reduced supply of dollars in the wake of the COVID-19 pandemic – has caused a depreciation of the Somali Shilling in the region (Food Security and Nutrition Analysis Unit Somalia. 2020. Somalia Food Security Outlook - June 2020 to January 2021, FEWS NET Report, 5).

142 Ibid.

143 In the case of Somalia, for instance, while the Central Bank of Somalia was re-established in 2012, it still faces numerous challenges such as control over the exchange rate and the supply of Somali shillings, as well as fragmentation throughout the different Somali territories (El Taraboulsi-McCarthy, S. 2018. 'The challenge of informality: Counter-terrorism, bank de-risking and financial access for humanitarian organisations in Somalia', HPG Working Paper, 5). For a broader overview of the banking sector in the Somali territories, see: Owuor, V. 2013. *Somalia Banking: Transfers, Challenges and Opportunities*, Shuraako.

worth between 1.3 and 2 billion US dollars each year.<sup>144</sup> This large amount of money, which surpasses the value of formal direct investment (FDI) inflows and amounts to around a third of Somalia's USD 4.9 billion GDP, is important for the economy in three main ways. First and foremost, remittances function as a safety net for many Somalis who depend on this extra source of income, and in many cases are able to improve their access to food and other basic needs based on it.<sup>145</sup> Overall, remittances have been credited for having a stabilising role in past crises in the country.<sup>146</sup> In addition, the Somali territories' economy is dollarized and heavily dependent on remittances to buy goods abroad in foreign currency; in this context, remittances are crucial in ensuring the flow of goods into the import-dependent Somali economy, which is in constant need of hard currency.<sup>147</sup> Lastly, remittances can also be important for recipients due to their role in improving access to credit. On some occasions SMEs have used remittances as investments for their business.<sup>148</sup>

While remittances are extremely important for the functioning of the economy in the Somali territories, transferring funds into Somalia and Somaliland is not a straightforward enterprise. To get such large amounts of financial flows into the country in the absence of a strong formal banking system connected to the international banking system, Somalis tend to rely on MTOs and the *hawala* system.<sup>149</sup> MTOs facilitate money transfers through their affiliated agents in Somalia to recipients inside Somalia. Inflows to recipients are offset by an outflow where MTOs finance traders' imports

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144 International Organization for Migration. 2020. 'Expected 40 percent Drop in Remittances Threatens Somalia's Most Vulnerable', *Medium*, 15 June 2020, <https://medium.com/@UNmigration/covid-19-cuts-remittances-for-vulnerable-somalis-d3b6fdbba04a3> (accessed 8 December 2020); Majid, N. et al. 2020. 'How will remittances affect the Somali COVID-19 response?', *LSE Conflict Research Programme Blog*, 7 April 2020, <https://blogs.lse.ac.uk/crp/2020/04/07/remittances-affect-the-somali-covid-19-response/> (accessed 8 December 2020); Phone interview with a researcher, Nairobi, August 2020.

145 Majid, N., Abdirahman, K. and Hassan, S. 2018. *Remittances and Vulnerability in Somalia*, RVI Briefing, Nairobi: Rift Valley Institute, 3.

146 El Taraboulsi-McCarthy, S. 2018. 'The challenge of informality: Counter-terrorism, bank de-risking and financial access for humanitarian organisations in Somalia', HPG Working Paper, 6.

147 This is notwithstanding the fact that the Somali Shilling has appreciated enormously against the dollar since a decades-long inflationary spiral ended in the late 2000s.

148 Majid, N., Abdirahman, K. and Hassan, S. 2017. *Remittances and Vulnerability in Somalia; Assessing sources, uses and delivery mechanisms*, RVI Report, Nairobi: Rift Valley Institute, 6, 26-28. For instance, a respondent to this study said: 'I get 300 dollars every month from my brother, but he is no longer able to send that money now. Therefore, I can't run the business that I was running' (Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020).

149 El Taraboulsi-McCarthy, S. 2018. 'The challenge of informality: Counter-terrorism, bank de-risking and financial access for humanitarian organisations in Somalia', HPG Working Paper, 5-8.

from third countries through what is known as the franco valuta system.<sup>150</sup> In this way, the transfers of Somali companies purchasing goods abroad (outflow) are offset by remittances (inflow). If imbalances between branches arise, they have to be rebalanced by transferring cash physically to keep the system functioning. As one interviewed researcher put it: *'The money is often transported in bags. To reduce cash transport in bags, what is usually done is this: When I send money to Somalia, this money does not necessarily go there. Agencies try to find a business who buys in dollars and use that money.'*

As the COVID-19 pandemic spread across the globe, however, the franco valuta system used by Somalis to ensure the functioning of their economy started to experience significant difficulties. First of all, the pandemic ravaged the economies of wealthy states hosting large numbers of the Somali diaspora, most notably the United States and the United Kingdom. As a result, diaspora members suddenly found themselves in difficult economic conditions. This drastically reduced their capacity to send remittances, thus exacerbating the crisis faced by recipient households and businesses in Somalia and Somaliland. Remittance recipients, in urban and rural settings alike, reported a 10-30% drop in the value of remittances received as compared to before the pandemic.<sup>151</sup> Other estimates paint an even bleaker picture, with reports of remittances declining by up to 50-60% in certain corridors.<sup>152</sup> To add to the problem, the pandemic also disrupted the logistical arrangements used to rebalance flows. When international flights came to an abrupt stop at the beginning of the COVID 19 pandemic, this impacted airlines' ability to fly cash into Somali territory, a vital component for the informal payments system to work. It also disrupted the ability of Somali businesses to purchase goods in business

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150 The franco valuta system had emerged in Somalia even before the collapse of the Somali state in 1991 (Musa, A.M. 2019 'From trust to oligopoly: Institutional change in livestock trade in Somaliland after 1991', DIIS Working Paper, 13). However, while at the time the system was predominantly managed by individual senders of remittances or groups of them, now it seems that the same mechanism is used by MTOs.

151 Food Security and Nutrition Analysis Unit Somalia. 2020. 'Somalia 2020 Post Gu Food Security and Nutrition Outcomes and Projections', *Briefing for Stakeholders*, <https://www.fsnao.org/publications> (accessed 7 December 2020).

152 Majid, N. et al. 2020. 'How will remittances affect the Somali COVID-19 response?', *LSE Conflict Research Programme Blog*, 7 April 2020, <https://blogs.lse.ac.uk/crp/2020/04/07/remittances-affect-the-somali-covid-19-response/> (accessed 8 December 2020); United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia Country Preparedness and Response Plan*, 3; Anti-Tribalism Movement. 2020. *COVID-19: Impact on remittances from UK to Somalia*, Briefing for UK Government; Ibrahim, A. 2020. 'State-building and COVID-19 in Somalia: Impact on government revenues', *LSE Conflict Research Programme Blog*, 2 September 2020, <https://blogs.lse.ac.uk/crp/2020/09/02/state-building-and-covid-19-in-somalia-impact-on-government-revenues> (accessed 8 December 2020); International Organization for Migration - Somalia. 2020. *COVID Preparedness and Response: Mission Update #28*, 22 November - 5 December 2020; Phone interview with an official from a large MTO, Hargeisa, August 2020.

hubs abroad. As a result, restrictions on transferring funds tightened, which put further downward pressure on the amount of money available at the end of the financial transfer.<sup>153</sup> *'With the COVID crisis, the system broke: [] the company was not getting enough liquidity. [Recipients] could not get the money out.'*<sup>154</sup> These dynamics meant that it was harder for recipients to cash out on the funds that were being sent to them. While it is beyond the scope of this report to quantify the changes in remittance flows in the wake of the COVID-19 pandemic, the available estimates suggest that the impact has been marked.

This drop in remittances led to serious liquidity problems for the economy of the Somali territories, with a heavy impact on the ability of SMEs to gain much-needed access to credit. Under financial pressure due to the overall economic effects of the pandemic, SMEs sought to access working capital to keep their business running. However, as remittances fell and liquidity dried up, lenders increasingly focused their operations on a restricted number of clients. As an employee of a large multinational money transfer company said: *'Existing clients with good historical relations are ring-fenced. Even these clients do not get as much as before. The others – new or recent clients – won't get loans, and there aren't other sources where businesses can get finance.'* As a result, SMEs – which already faced difficulties in securing formal access to credit prior to the COVID-19 outbreak – found themselves under further pressure. This situation lays bare a pre-existing issue of access to finance that plagues SMEs in the Somali territories, but equally in other fragile and conflict-affected settings around the world.

The importance of social capital in such contexts, in order to either secure a loan through connections or to be able to fall back on an informal way to access capital, has been widely documented by literature.<sup>155</sup> The formal and informal sides of access to credit can be intertwined in the Somali territories, as one Somali researcher explained: *'If you want loan from banks, you need to give collateral. Banks here don't trust collateral, but rather they accept guarantees (that are obtained through social networks). It varies from bank to bank. If you need a loan you need a guarantor, which makes you need a social network and you have to be trusted. Some banks only trust guarantors that are shareholders in a sister company. You then need to look for someone who has a share in a company, talk to them. You need access, you need trust. Not everybody has that access.'* The need for a guarantor with sufficient social status, or the practice of collateralizing assets held by trusted acquaintances, leads to the financial exclusion of certain groups

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153 Phone interview with a Somali researcher, London; Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020.

154 Phone interview with a Somali researcher, London.

155 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.

(especially women, young people and the lesser clans) with potentially viable businesses but weaker social ties.<sup>156</sup>

In response to the shrinking space for getting formal credit, many SMEs turned to the informal credit system, which is based on one's personal network and on trust relations that an entrepreneur has established within that network. Several business owners indicated, however, that such avenues for financing their business have also become extremely hard to access, with more wealthy members of their networks reducing their exposure to what they see as risky investments in a potentially worsening economic environment in which their other investments are underperforming.<sup>157</sup> This signals that the difficulty of obtaining credit was not only impacting new businesses – a situation that existed prior to the pandemic – but also impacted the access to working capital for thriving businesses.

Besides liquidity and credit issues, the drop in remittances has also had an impact on demand in the Somali territories, since households that were dependent on those remittances suddenly found their buying power reduced. This, coupled with a reduction of income due to the overall economic slowdown and the restrictions imposed by the governments, significantly affected demand for goods and services. This is reflected in the estimates of the FGS, which as of June 2020 reported a 25% drop in private consumption expenditure in Somalia.<sup>158</sup> Respondents interviewed for this study point out that the most affected sectors were (air) transport services and the hospitality sector – an assessment largely confirmed by a business survey report published by Somaliland's government.<sup>159</sup> In addition, businesses selling electrical and electronic appliances were also particularly badly hit, with postponed spending and a decline in demand disproportionately affecting these sectors.<sup>160</sup>

A particular dynamic is observed in the livestock sector. Annual livestock exports to Saudi Arabia during the Hajj represent the second biggest source of hard currency for Somalis

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156 Phone interview with a business consultant, Hargeisa, November 2020.

157 Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020; Phone interview with a researcher, Nairobi, August 2020.

158 Ibrahim, A. 2020. 'State-building and COVID-19 in Somalia: Impact on government revenues', *LSE Conflict Research Programme Blog*, 2 September 2020, <https://blogs.lse.ac.uk/crp/2020/09/02/state-building-and-covid-19-in-somalia-impact-on-government-revenues> (accessed 8 December 2020).

159 Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020; Phone interview with a business trainer, Hargeisa, September 2020; Republic of Somaliland. Ministry of Finance and Development. 2020. *Business Impact of COVID-19 Survey*, Central Statistics Department Report.

160 Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020; Phone interview with a business trainer, Hargeisa, September 2020.

after remittances, playing an even more important role in Somaliland and Puntland.<sup>161</sup> Livestock exports are estimated to account for 50% to 75% of the total value of exports and typically peak in the run-up to the Hajj due to increased demand.<sup>162</sup> The limitation of this year's Hajj to 1,000 pilgrims instead of the usual 2.5 million, however, threatened to generate a demand drop from Somalia's main export destination for livestock.<sup>163</sup> This threatened the pastoral economy. Pastoralists depend on the informal credit systems through which they buy food and other necessities in urban hubs, and risked facing difficulties in paying back wholesalers, thus affecting other sectors as well.<sup>164</sup> For pastoralists who depend on yearly exports to the Gulf for most of their income, the cancellation of the majority of livestock exports could have had catastrophic consequences and saddled them with significant debt. Data on price levels suggests, however, that demand, including external demand, was sustained at normal price levels.<sup>165</sup> Diversification in order to satisfy increased demand from Oman and other Gulf countries during Ramadhan, as well as Saudi Arabia's decision to temporarily lift its ban on Somali livestock in April 2020, appear to have made up for part of the decline in Hajj-related exports.<sup>166</sup>

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161 For Somaliland, see: Musa, A.M., Wasonga, O.V. and Mtimet, N. 2020. 'Factors influencing livestock export in Somaliland's terminal markets', *Pastoralism* 10(1), 1-13. For Puntland, see: Majid, N. 2010. *Livestock Trade in the Djibouti, Somali and Ethiopian Borderlands*, Chatham House Africa Programme Briefing Paper, 18.

162 Observatory of Economic Complexity. 2020. 'Somalia', <https://oec.world/en/profile/country/som> (accessed 8 December 2020); World Bank and United Nations Food and Agriculture Organization. 2018. *Rebuilding Resilient and Sustainable Agriculture in Somalia*, Somalia Country Economic Memorandum Volume I, 45-78.

163 Faruk, O. and Bearak, M. 2020. 'With drastically smaller hajj, Somalia's livestock industry goes from "boom to doom"', *The Washington Post*, 28 July 2020, [https://www.washingtonpost.com/world/africa/hajj-somalia-livestock-exports/2020/07/28/10c984e6-d03a-11ea-826b-cc394d824e35\\_story.html](https://www.washingtonpost.com/world/africa/hajj-somalia-livestock-exports/2020/07/28/10c984e6-d03a-11ea-826b-cc394d824e35_story.html) (accessed 8 December 2020).

164 Phone interview with a researcher, Nairobi, August 2020.

165 Food Security and Nutrition Analysis Unit Somalia. 2020. 'Somalia 2020 Post Gu Food Security and Nutrition Outcomes and Projections', *Briefing for Stakeholders*, <https://www.fsnau.org/publications> (accessed 7 December 2020), slide 6; Food Security and Nutrition Analysis Unit Somalia. 2020. 'Market Update – September 2020', <https://www.fsnau.org/publications> (accessed 7 December 2020). In August and September 2020, livestock prices were reported to be higher than the average for the same period in 2015-2019 (between +3 and +46% across almost all regions of Somalia, with the only exception being Somaliland, where camel prices declined slightly). The sustained price levels have reportedly depended on a wide range of factors, including good water and pasture availability, good livestock body conditions, and sustained demand, both locally and in terms of exports. While export data from Berbera is not available as of the time of writing, export data from Bosaso suggests that by September 2020 livestock exports (measured by heads) had already reached the figures of the whole year of 2019.

166 Phone interview with a researcher, Nairobi, August 2020; Phone interview with a trader in the livestock export sector, Kismayo, October 2020; Duale, M. 2020. 'Saudi Arabia lifts ban on Somalia's livestock imports', *The Horn Diplomat*, 19 April 2020, <https://www.horndiplomat.com/2020/04/19/saudi-arabia-lifts-ban-on-somalias-livestock-imports-2/> (accessed 8 December 2020).

### 4.3 Impact on government revenues

Besides taking a serious toll on the economy of the Somali territories and its SMEs, COVID-19 has also significantly affected the budget of the administrations in Mogadishu and Hargeisa. Traditionally, both administrations have been heavily dependent on Somalia's connections with the outside world. As for the FGS, around 30% of the government's 2019 revenue came from taxes on international trade (mostly imports), and a further 15% came from budget lines depending on Somalia's links with the outside world (e.g. visa and passport charges, concession fees for Mogadishu's port and airport, overflight fees).<sup>167</sup> A similar situation can be seen in Somaliland, whose government planned to collect over 50% of its 2020 revenues through taxes on international trade and (to a much lesser extent) port fees.<sup>168</sup>

As the pandemic put a halt to the cross-border flows of goods and people, the ability of Somali administrations to mobilise resources thus came under strain. Throughout the first half of 2020, the FGS' income from taxes on international trade dropped by approximately a third, picking up only very slightly in the third quarter.<sup>169</sup> The sudden disappearance of revenues from the import of khat, which was banned by the government to prevent the spread of COVID-19, contributed to the decrease in revenues since March.<sup>170</sup> Adding to this strain, the tax relief measures implemented by the FGS to ensure the affordability of foodstuffs put further pressure on the government's coffers. While the FGS tried to make up for the losses by raising taxes on other goods, such as plastic bags, cosmetics and tobacco products,<sup>171</sup> the net effect of COVID-19

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167 Federal Government of Somalia. Ministry of Finance. 2020. 'Financial Statements 2019' and 'Financial Statements 2020', <https://mof.gov.so/publication/> (accessed 16 November 2020); elaboration by the authors.

168 Republic of Somaliland. Ministry of Finance Development. 2019. *Citizen's Budget 2020*; Republic of Somaliland. Ministry of Finance Development. 2020. *Macroeconomic and Fiscal Framework*.

169 Federal Government of Somalia. Ministry of Finance. 2020. 'Financial Statements 2019' and 'Financial Statements 2020', <https://mof.gov.so/publication/> (accessed 16 November 2020); elaboration by the authors. As seen above, taxes on international trade are particularly important because they make up a large share of the FGS' revenues (in 2019, almost a third of the government's overall revenue, including both domestic and foreign sources).

170 The import of khat reportedly continued through illegal channels, especially from Ethiopia (Koshin, S.A. 2020. *Khat and COVID-19: Somalia's cross-border economy in the time of coronavirus*, RVI Briefing Paper, Nairobi: Rift Valley Institute, 2). However, this illegal trade did not generate tax revenues for the FGS. According to FGS data, revenues from taxes on khat imports give a significant contribution to the FGS budget (in 2019, USD 16.7 million, i.e. almost 5% of Somalia's overall revenues) (Federal Government of Somalia. Ministry of Finance. 2020. 'Financial Statements 2019' and 'Financial Statements 2020', <https://mof.gov.so/publication/> (accessed 16 November 2020); elaboration by the authors).

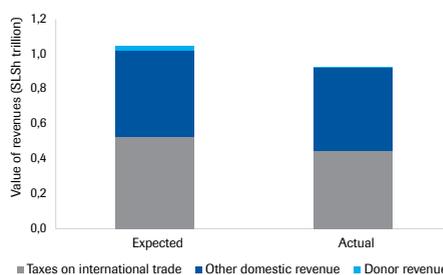
171 Phone interview with a civil servant at the FGS' Ministry of Finance, Mogadishu, September 2020.

on the FGS' tax revenues has proved to be negative.<sup>172</sup> As a result, the amount of overall domestic revenues collected by the FGS since the advent of COVID-19 was 10.6% below the previous year's level (see Figure 10).<sup>173</sup> Albeit to a lesser extent, the coffers of Somaliland's government also felt the impact of COVID-19. As of June 2020, the actual value of taxes collected on international trade fell short of expectations by SLSH 77 trillion (i.e. 7.6% of the administration's overall budget). This drove down the administration's overall revenues, which as of June 2020 were 9.6% below their expected value (see Figure 11).<sup>174</sup>

**Figure 10 FGS revenues in 2019-2020, by source, by quarter<sup>175</sup>**



**Figure 11 Somaliland revenues in 2020, by source, expected vs. actual<sup>176</sup>**



While COVID-19 imposed similar challenges to both the FGS and Somaliland's government, most notably in terms of reduced revenues and increased expenditure needs, the way in which the two administrations handled these financial constraints was markedly different. In Hargeisa, the administration adopted a rather prudent approach to expenditure, which reportedly even fell short of the budget target for the

172 The amount of tax revenues collected by the FGS between January and September 2020 was 10% lower than the amount collected in the same period of 2019.

173 Federal Government of Somalia. Ministry of Finance. 2020. 'Financial Statements 2019' and 'Financial Statements 2020', <https://mof.gov.so/publication/> (accessed 16 November 2020); elaboration by the authors. The period of reference for this calculation is between March (when COVID-19 arrived in Somalia) and September (the last month for which data is available). A much more marked fall can be seen if one considers the trend of overall domestic revenues between January and September 2020 (-33.4%). However, the extent of this fall largely depends on the extraordinary high value of non-tax revenues in Q4 of 2019. This is a result of an unprecedented inflow of USD 12 million in overflight fees, whose absence in 2020 is not related to the effect of COVID-19. Therefore, the year-on-year variation used in the text (-10.6%) is likely to be more representative of the pandemic's impact on FGS revenues.

174 Republic of Somaliland. Ministry of Finance Development. 2020. *Macroeconomic and Fiscal Framework*.

175 Federal Government of Somalia. Ministry of Finance. 2020. 'Financial Statements 2019' and 'Financial Statements 2020', <https://mof.gov.so/publication/> (accessed 16 November 2020); elaboration by the authors.

176 Republic of Somaliland. Ministry of Finance Development. 2020. *Macroeconomic and Fiscal Framework*.

first half of the year.<sup>177</sup> The response to COVID in Somaliland was financed through a mix of public funds and support from the local business community – as exemplified by the Somaliland Fundraising Committee for COVID-19, which sought to combine a government contribution of USD 1 million with an additional 2 million to be raised from Somaliland’s business community.<sup>178</sup> Similar synergies between the public and the private sector could also be seen in Mogadishu, where the FGS closely interacted with major businesses in order to coordinate the response to COVID-19.<sup>179</sup> However, in addition to domestic sources of revenue, the government in Mogadishu was able to also rely on a major increase in financial support from the international community, and especially from multilateral donors such as the World Bank.<sup>180</sup> Over the first nine months of 2020, the FGS’ donor revenues increased by more than 160% as compared to the previous year, bringing into the government coffers USD 190 million (i.e. 56% of the FGS’ overall revenues in the same period).<sup>181</sup> This major increase in foreign financial support, however, came at a time when – with increased logistical constraints and less international presence on the ground due to the COVID-19 pandemic – oversight mechanisms on donor funds had come under serious strain.<sup>182</sup> This reportedly created

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177 Expenditure was reportedly 16% below target for the first half of 2020 (Republic of Somaliland. Ministry of Finance Development. 2020. *Macroeconomic and Fiscal Framework*).

178 United Nations Office for the Coordination of Humanitarian Affairs. 2020. *Somalia: COVID-19 Impact Update No. 5*, 12 May 2020.

179 Major business conglomerates like Hormuud and Dahabshiil, as well as the Somali Chamber of Commerce, worked alongside Somali administrations to develop a response to the crisis (Phone interview with an employee at FGS’ Prime Minister’s Office, Mogadishu, October 2020).

180 Multilateral donors (and especially the World Bank) provided 97% of the FGS’ 2020 donor revenues. While it is the norm for Somalia to receive more multilateral than bilateral support, multilateral donors’ share of the FGS’ donor revenues in 2020 was particularly high. In 2018 and 2019, for instance, the equivalent shares were respectively of 39.1% and 66.5%. The 97.1% of 2020 is largely due to a stark increase in multilateral support in the face of COVID-19. As for bilateral support, in 2020 Turkey was the only country to contribute to the FGS’ budget, with a grant of USD 7.5 million in the second quarter. Source: Federal Government of Somalia. Ministry of Finance. 2020. ‘Financial Statements 2019’ and ‘Financial Statements 2020’, <https://mof.gov.so/publication/> (accessed 16 November 2020); elaboration by the authors.

181 Interestingly, the FGS’ revised 2020 budget had foreseen an even higher increase in donor revenues, hoping to raise USD 410 million over the whole of 2020. This clearly indicates the extent to which the FGS had planned to rely on its international partners in order to face the pandemic. Source: Federal Government of Somalia. Ministry of Finance. 2020. ‘Financial Statements 2019’ and ‘Financial Statements 2020’, <https://mof.gov.so/publication/> (accessed 16 November 2020); elaboration by the authors.

182 Some respondents clearly pointed to an increase in corruption since the advent of COVID-19, which was blamed on the fact that the crisis has diverted attention away from oversight mechanisms. One of the respondents clearly stated: ‘*Transparency has gone down; corruption has gone up. Attention is elsewhere. Donors and the private sector are not paying attention to what is going wrong.*’ (Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020; Phone interview with a business trainer, Hargeisa, September 2020).

openings for misappropriation of funds, which has the potential to affect the complex political economy of Somalia's aid sector.<sup>183</sup>

#### 4.4 Conclusion

The advent of COVID-19 has taken a serious toll on the economy of the Somali territories. First, the disruptions in supply chains across the world – and especially in countries such as China, India, Turkey and Ethiopia – have made it increasingly difficult for Somali businesses, especially smaller ones, to source the imports that the economy relies on. As a result, consumers at the end of the supply chain have witnessed an rise in prices for most goods, which were especially pronounced in COVID-related protective gear, electronics and (to a lesser, but still significant, extent) foodstuffs.

At the same time, the pandemic has disrupted the complex, informal financial system that Somalis rely on. Due to a combination of economic distress in the Somali diaspora and restrictions on international mobility, remittance flows declined and the Somali informal financial system temporarily broke down. As a result, the economy of the Somali territories experienced a liquidity crisis, and businesses – especially, once again, smaller ones – faced even more challenges than usual in accessing credit. To compound the problem, government restrictions, declining remittances and reduced income due to the overall economic slowdown drove down demand, further exacerbating the troubles faced by Somali businesses.

Government coffers were not spared by COVID-19. As the cross-border flow of goods and people to and from Somalia came to a halt, the domestic revenues of administrations in both Mogadishu and Hargeisa decreased significantly in the first half of 2020. Both the FGS and Somaliland's government acted in coordination with local business communities to implement their responses to COVID-19. In addition to this local cooperation, the FGS also addressed its fiscal challenges by markedly increasing its reliance on external donors – an option not available to the administration in Hargeisa. While this foreign support might have provided some fiscal relief in the short run, this large inflow of donor revenues has come at a time of reduced oversight on the use of such resources, thus potentially opening the door to misappropriations.

Overall, therefore, the pandemic has the potential to significantly change the complex political economy of Somalia and Somaliland, with important implications for their

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183 On the dangers arising from a massive influx of money into Somalia in these times of crisis, see for instance: Elder, C. 2020. 'The humanitarian response to COVID-19 in Somalia will increase capital flight and violent conflict', *LSE Africa Blog*, 30 April 2020, <https://blogs.lse.ac.uk/africaatlse/2020/04/30/humanitarian-response-covid-19-somalia-capital-flight-debt-relief-violence/> (accessed 8 December 2020).

stability. The economic crisis brought about by COVID-19 is taking a much larger toll on smaller and newer businesses, likely reinforcing the (already dominant) position of the big players in the Somali market. At the same time, the FGS' increasing reliance on external support, coupled with a particularly low level of oversight on donor projects and the upcoming electoral cycle, has the potential to affect the complex mechanisms of Somalia's aid sector. The next chapter will thus investigate how these shifting economic and political dynamics might affect the conflict dynamics in the Somali territories.

## 5 Political-economic impact

As noted in Chapter 2, SMEs are acknowledged as significant drivers of socioeconomic development due to their important role in GDP growth, job creation and stimulating increasing entrepreneurship. However, in fragile state contexts, the legacy of violent conflict often imposes constraints on economic and private sector growth, including: damaged commercial networks; loss of trust; weakening of market institutions; and political uncertainty.<sup>184</sup> These fragile contexts include political instability and economic activity influenced by general risk aversion, planning along short time horizons, and distorted political and economic incentives. The effects of pervasive insecurity, governance inefficiency and inadequate infrastructure (both hard and soft) on private sector development are well known.<sup>185</sup> In particular, SMEs suffer from inadequate access to finance,<sup>186</sup> technology<sup>187</sup> and markets.<sup>188</sup> They therefore have low capacity to compete with larger firms, are disproportionately affected by disruptions in the regulatory environment,<sup>189</sup> and lack entrepreneurial human capital.<sup>190</sup>

Research has shown that, in such an environment, development assistance to SMEs *'carries the risk of reinforcing the same structures that prevent small businesses from*

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184 Brück, T., Fitzgerald, V. and Grigsby, A. 2000. *Enhancing the Private Sector Contribution to Post-War Recovery in Poor Countries: A Report to the Department for International Development*, University of Oxford, Finance and Trade Policy Research Center.

185 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute, p. 24-40. For further details, see Chapter 2 of this report.

186 Harvie, C., Narjoko, D. and Oum, S. 2013. 'Small and Medium Enterprises' Access to Finance: Evidence from Selected Asian Economies', ERIA Discussion Paper No. 23/2013; Chittithaworn, C. et al. 2011. 'Factors affecting business success of small & medium enterprises (SMEs) in Thailand', *Asian Social Science* 7(5), 180-190.

187 Vandenberg, P., Chantapacdepong, P. and Yoshino, N. 2016. *SMEs in Developing Asia: New approaches to overcoming market failures*, Asian Development Bank Report, Tokyo: ADB.

188 Rogerson, C.V. 2013. 'Improving market access opportunities for urban small, medium and micro-enterprises in South Africa', *Urbani Izziv* 24(2), 133-143.

189 Stein, P., Ardic, O.P. and Hommes, M. 2013. *Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises*, International Finance Corporation Advisory Services; Tewari, P.S. et al. 2013. 'Competitive Small and Medium Enterprises: A diagnostic to help design smart SME policy', World Bank Draft 82516; Saleem, Q. 2013. *Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance*, IFC Advisory Service in the MENA.

190 Vandenberg, P., Chantapacdepong, P. and Yoshino, N. 2016. *SMEs in Developing Asia: New approaches to overcoming market failures*, Asian Development Bank Report, Tokyo: ADB.

*growing and fragile situations from stabilizing*.<sup>191</sup> The success of many SMEs in fragile and conflict settings hinges on their ability to rely on personal and social networks, as well as on arrangements with non-state governance actors (e.g. traditional leaders or insurgent groups) or through informal relations with governments or armed groups.<sup>192</sup> In cases of armed conflict, risks of criminal violence or expropriation of property, firms seek protection through their connections to armed groups (if such armed groups are not already heavily involved in the business venture itself). Governance providers in FCAS have been considered as political entrepreneurs managing a market exchanging loyalty and economic rents, through their ability to grant favours to potential spoilers.<sup>193</sup> Although SME development assistance runs through central governance mechanisms, its implementation is highly discretionary, leaving the success of SMEs heavily reliant on local elites and their access to social capital. Yet, compared to large corporations, they pay more tax on average, boosting the revenue of governance providers, and play a more consistent role in day-to-day security and social service provision (including employment).

To date, development efforts targeting Somali SMEs have often inadequately accounted for Somalia's political-economy structure – at both national and local levels – failing consider the informal norms, regulatory authority and practices that govern the private sphere. This chapter explores what COVID-19 and the associated economic constraints may reveal about Somalia's political-economic dynamics. It starts by setting out the impacted dynamics of the Somali business environment. Subsequently it explores how the unequal relationship between various market players evolved, and how this has affected these actors' relationship with governance providers.

## 5.1 Business' coping with fragility

In most conflict-affected countries the private sector has a missing middle – instead of a range of medium enterprises, there is a small number of large companies (often preferentially owned by members of the elite) and a large number of small ones.<sup>194</sup> As such, large areas of the private sector in fragile and conflict-affected countries are not really competitive, as they are controlled by conglomerates and elite groups.

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191 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute, 52.

192 Hoffmann, A. and Lange, P. 2016. *Growing or Coping? Evidence from small and medium sized enterprises in fragile settings*, CRU Report, The Hague: Clingendael Institute.

193 de Waal, A. 2015. *The Real Politics of the Horn of Africa: Money, war and the business of power*, Cambridge: Polity Press.

194 Davis, P., Spearing, M. and Thorpe, J. 2018. *Private Sector Development in Countries Progressing to Peace and Prosperity*, HEART Report, Oxford: HEART.

These large companies derive their profits from rents extracted due to their size and power, as well as a distortionary policy environment. In Somalia many of these conglomerates emerged out of the civil war through technological innovation and by trading in foreign exchange. The major traders and businessmen in Somalia have a strong hold on political power, frequently using their access to external capital (and threats of relocation, whether to Somaliland, Turkey, Djibouti, etc) to influence policy choices. These conglomerates are characterised by expansive operations and significant diversification that has historically placed a chokehold on competition, as they have come to dominate crucial sectors of Somalia's service industry (including telecommunications, electricity, finance and import/export).<sup>195</sup> Outside of these sectors, however, there is relatively more space for SMEs to conduct their business: in addition to small shops, many SMEs run services (such as hotels and restaurants) and small-scale exports (e.g. fish).

In the Somali context, which features high uncertainty, high risk, lack of access to formal financial markets and monopolisation, many SMEs deliberately deploy coping strategies that are 'survivalist' rather than growth oriented. They aim to solidify the existing connections that grant them access to contracts, licences, tax cuts and other forms of protection, rather than develop new initiatives in an attempt to grow. Somali companies are notoriously risk averse, avoiding illiquid investments and requiring immediate payment to avoid debt. SMEs cope with conflict by containing cost and risk through the use of organisational and transactional measures, also avoiding growth in order to circumvent the attention of governance providers and armed actors, who may wish to extract or assume a stake in an expanding business.<sup>196</sup> This is critical, as it contributes to a landscape of financial opacity, illiquidity and capital flight, as 'being successful' increases demands from society and the state.<sup>197</sup> These entrepreneurs who are strongly reliant on social capital to access finance and opportunities maintain the methods they used successfully during wartime, creating conflict and debt overhang, but also forming a highly flexible business model that allows companies to move rapidly across sectors, regions and value-added activities. This business model is informed by the structures of Somali trade corridors, as dynamic spaces under the jurisdiction of multiple *de facto* and *de jure* public authorities, which make a range of varying tax-claims on trade and livestock activities.<sup>198</sup>

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195 Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*, CRU Report, The Hague: Clingendael Institute.

196 Phone interviews with a trader in Garowe and a hotel owner in Mogadishu, October and November 2020.

197 Elder, Claire. Forthcoming. 'Powerbrokers and Somalia's violent political economy: theorising about the logistics industry, reigning "tenderpreneurs" and protracted state collapse', *African Affairs*.

198 Musa, A.M., Steputat, F. and Hagmann, T. 2020. 'Revenues on the hoof: livestock trade, taxation and state-making in the Somali territories', *Journal of Eastern African Studies* 13(3), 1-20.

It has been argued that, in such an environment, a government is unlikely to be a facilitator of business activities, and instead may view businesses as opponents.<sup>199</sup> In Somalia, the FGS' laissez faire attitude towards business has been substituted with a recognition that private companies (including SMEs) play an important role in realising the country's development objectives, including in qualifying for debt relief. Both national and regional governance providers have thus been attempting to bestow favours while increasing their domestic revenues, establishing overlapping tax regimes with varying success. However, Somali businesses have been able to maintain a high degree of autonomy from the state given their control over access to foreign exchange, with the capacity to block key legislation around banking and telecommunications. Yet, it is not an 'economy without a state' per se, as political entrepreneurs, conglomerates and technocrats are entangled in a web of political clientelism, and redistribution, as well as debt relations specifically linked to new state finance structures (often linked to prospective oil rents and debt relief).<sup>200</sup> For instance, a number of logistics contractors that led the Islamic Courts Union (ICU) have since run for elected office to recoup debts from the civil war and to protect business interests, instrumentalising socioeconomic grievances to agitate against state intervention in the economy and society.<sup>201</sup> Other clan-connected powerbrokers exercise their influence through dense social networks and capital, also agitating against state intervention in the private sector.

These economic practices are ultimately not conducive to economic growth and development, but rather cement patterns of elite capture and short planning horizons. While regulatory measures have been consistently on the agenda since 2012 (including anti-trust laws and increased taxation) they have so far delivered mixed results as the state also relies on businesses to resolve conflicts and to provide social and public services.<sup>202</sup> Understanding the unique multidimensional pressures that SMEs experience within Somalia's political economy is critical, as the challenges faced by these businesses are not always improved through capital injections. As is evident elsewhere, the impact of capital injection, FDI or microfinance relief may even reinforce hierarchies of power and may lead to an upsurge in imports and a 'crowding out' of domestic investment, thus negatively affecting SMEs' growth.<sup>203</sup> An influx of aid and investment may also adversely affect SMEs by creating incentives for entrepreneurs to focus on

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199 McKenchie, A., Lightner, A. and te Velde, D.W. 2018. *Economic development in fragile contexts: Learning from success and failure*, Supporting Economic Transformation, 20.

200 Elder, C. Forthcoming. 'Powerbrokers and Somalia's violent political economy: theorising about the logistics industry, reigning "tenderpreneurs" and protracted state collapse', *African Affairs*.

201 *Ibid.*

202 Meester, J., Uzelac, A. and Elder, C. 2019. *Transnational capital in Somalia: Blue desert strategy*. CRU Report, The Hague: Clingendael Institute.

203 Farole, T. and Winkler, D. (Eds). 2014. *Making Foreign Direct Investment Work for Sub-Saharan Africa: Local spillovers and competitiveness in global value chains*, Washington DC: World Bank.

rent-seeking over business creation. Those that also hold parliamentary or government positions may also influence flows of aid in ways that create a new class of ‘oligarchs’ tied to aid-based contracts, won through lobbying, and market and regulatory capture, as well as through political influence.<sup>204</sup>

## 5.2 Impact on businesses and SMEs

As many respondents explain, the impact of COVID-19 has been decidedly different than that of past crises, including previous droughts, famines and civil war. As one business owner reported, *‘Civil war, famine and drought often impact the poor. COVID-19 crisis has hit the middle class and rich. We lost money and the government doesn’t seem to care because we are investors.’*<sup>205</sup> This was a commonly held opinion – that the business community writ large had been disproportionately affected by the crisis, and was receiving insufficient assistance from the state or international donors. Making the comparison to the civil war, SMEs explained how during the warlord era business was simpler: *‘Taxes were in a form of negotiation. You only had to have tribal protection for your business. You knew who you were dealing with and how to handle them; but today on top of COVID, businessmen are paying taxes to two different governments as well as Al-Shabaab and dealing with unconventional price competition. It’s unsustainable.’*<sup>206</sup> His statement challenges some of the preconceptions about how business benefits from conflict, and may even encourage it, indicating instead that the complexities of COVID had created a series of interconnected social, financial and political effects. The largest issues for SMEs were disruptions to transport corridors and trade links and hampered access to credit and liquidity. For instance, SMEs engaged in overland trade reported disruptions due to border closures that resulted in the increased number of militia checkpoints as different authorities were squeezed for cash.<sup>207</sup> SMEs have fewer protections through government and personal security and additionally face inconsistent tax policies by local and national authorities. The provision of tax breaks only to food and oil importers fed narratives of the FGS’s urban bias, benefitting elite firms and neglecting small farmers and fishermen. No support was provided to help local producers or export-focused companies (for instance in agriculture) to help reduce prices and overcome bottlenecks and facilitate access to key markets, nor was there support for manufacturing to maintain employment levels.

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204 Naudé, W. 2007. ‘Peace, Prosperity, and Pro-Growth Entrepreneurship’, UNU-WIDER Working Paper No. 2007/02.

205 Phone interview with a hotel owner in Mogadishu, November 2020.

206 Phone interview with a trader in the foodstuffs import sector, Kismayo, October 2020.

207 Phone interviews, local transporters of commodities from Mogadishu to regions, Mogadishu, August 2020.

As explained in Chapter 4, COVID-19 has affected logistics, not only for remittances but all aspects of trade, as quarantine measures in major ports caused delays and unpredictable shipping. Such developments opened up some opportunities for domestic airlines, which were not affected by international shocks. Yet, SMEs still faced longer cycle times without being able to negotiate rapid clearance, and requiring more working capital to cover for longer transit times. Additionally, increasingly unpredictable trans-shipment periods and increases in import taxes on selected goods have disproportionately hurt small traders and brokers.<sup>208</sup> According to a business owner in the fishing sector in Garowe, COVID-19 has had substantial adverse effects on the industry at all levels, in terms of export, import, labour and finances. This has largely been due to the Yemen-Saudi border closure, as well as to the decline of activity in the hospitality sector and restrictions on flights and travel. The entrepreneur reported a loss of 50% in local market businesses (mainly hotels and restaurants), and a complete drop in export business. Moreover, the entrepreneur reported that *'COVID affected local fishermen the worst, and cash flow injections aren't going to reach them, even though they remain destitute. During the last four months they have had no work.'*

The major MTOs have fared better in comparison to SMEs. Several of the major MTOs have been able to offset losses and capital shortages through their role in delivering COVID-19 related development aid and cash voucher schemes, as well as through the significant funds that they maintain abroad (in foreign currencies).<sup>209</sup> While MTOs faced social pressures to impose repayment holidays on loans and price reductions on telecommunications and other services, many have been able to continue introducing new services and major promotions to compete for customers.<sup>210</sup> Throughout the crisis MTOs have continued to provide loans to major importers to some degree, considering them as lower-risk clients due to their ability to put up collateral and the fact that under Somali Islamic trade financing imported goods are owned and imported by the financier

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208 Phone interviews with a business trader and an official from a large MTO in Hargeisa, as well as a researcher in Nairobi and another in London, August-September 2020.

209 See, for instance, the role of MTOs in delivering electronic vouchers for the FAO (Food and Agriculture Organization of the United Nations). 2020. 'Mobile money transfers give Somali farmers a one-up on the climate', *FAO Stories*, 22 October 2020, <http://www.fao.org/fao-stories/article/en/c/1316503/> (accessed 24 December 2020).

210 Phone interviews with a business trainer in Hargeisa and with a senior consultant for an international development organisation active in Somalia, September-November 2020. See for instance Telesom's new data plan (Itaqile, A. 2020. 'Somaliland: Telesom launches kafiye monthly prepaid recharge plan with unlimited calls & SMS', *Somaliland Sun*, 31 July 2020, <https://www.somalilandsun.com/somaliland-telesom-launches-kafiye-monthly-prepaid-recharge-plan-with-unlimited-calls-sms/> (accessed 24 December 2020)) or Somtel's 'Giveaway extravaganza' (Goth, M.G. 2020. 'Somaliland: SOMTEL unveils major promotion giveaway extravaganza', *Somaliland Current*, 12 July 2020, <https://www.somalilandcurrent.com/2020/07/12/somaliland-somtel-unveils-major-promotion-giveaway-extravaganza-ever/> (accessed 24 December 2020)).

(allowing banks to divert shipments and sell elsewhere in case of client default).<sup>211</sup> It emphasises a larger trend in the importance of social capital, networks and access in navigating contracted government and financial operations. For instance, disruptions to supply chains have created opportunities for racketeering around port clearance (especially in light of the unpredictable transit-period to offload and load Somali shipments to smaller ships) and taking advantage of import taxation cuts reportedly driven by elites. When all cafes and restaurants were reported to close at the onset of the conflict, many of the larger chain cafes and restaurants remained open, able to take advantage of a workaround.

As such, the effects of COVID-19 are highly unequal and SMEs remain hardest hit by the contraction of lending activities (loans, remittances, credit and working capital) and disruptions to global value chains and social networks.<sup>212</sup> Newer entrants to the business industry in particular are even worse hit, as they frequently have not been able to establish other assets that could serve as collateral, nor do they have access to the political connections that larger enterprises thrive on.<sup>213</sup> Additionally, small and medium enterprises also faced a reduction in buying power following declining remittances. The impact of such shocks was, for many SMEs, compounded by long-term weak financial and cashflow management and the dominance of mobile money.<sup>214</sup> As petty trade is mostly conducted in Somali(land) shillings, retailers, importers and producers of low-value items have been especially affected by the unstable exchange rate and parallel foreign exchange systems, as well as high inflation.

Retailers and petty traders have faced declining demand, forcing many to close either temporarily or permanently. In a recent IOM study surveying 320 women-led businesses, over 300 reported reduced revenues and sales. About half reported having to put their operation on hold, and about the same number said they faced difficulty paying back loans or rent. Almost 60% said they had been forced to shut down during the pandemic,

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211 Phone interview with a senior consultant for an international development organisation active in Somalia, November 2020.

212 Phone interviews with a business trader and an official from a large MTO in Hargeisa, as well as a researcher in Nairobi and another in London, August–September 2020. For more information on COVID's impact on global value chains see: Meester, J., Bisson, L. and Dekker, B. 2020. *Streamlining the value chain in times of COVID-19*, CRU Alert, The Hague: Clingendael Institute. For some examples of Somalia's informal credit system, see: Majid, N., Abdurahman, K. and Hassan, S. 2018. *Remittances and Vulnerability in Somalia*, RVI Briefing, Nairobi: Rift Valley Institute; Nor, M.I. and Masron, T.A. 2019. 'Investigating the informal mode of financing utilized for construction financing in Somalia: Some evidence', *African Journal of Science, Technology, Innovation and Development* 11(2), 223-233.

213 Note that the situation may differ in certain sectors, notably digital financial services. See Norman, J. and Kleist, N. 'Tech and trust challenges: Emerging trends in Somaliland diaspora response to Covid-19', <https://www.diiis.dk/en/research/tech-and-trust-challenges> (visited 15 January 2021).

214 Phone interview with a business trainer, Hargeisa, September 2020.

with about one-third of that group closing permanently.<sup>215</sup> These findings are consistent with evidence from across Africa which shows that many SMEs are not receiving any government support to combat the economic downturn.<sup>216</sup> The issues cited include existing debt, lack of access to relief funding, lack of cash reserves, inability to operate during lockdown and inadequate or outdated access to financial information.

Other SMEs reported shifts in lifestyle that have affected certain luxury services – for instance, industrial dry cleaning facilities in Mogadishu indicate a loss in revenue as people turn to more traditional laundry businesses that are cheaper. Travel companies (particularly those operating around the Hajj) reported that they had to close down but continued to pay 50% with the expectation that employees ‘will pay it back gradually once the business returns’.<sup>217</sup> Despite the many negative reports, there are also positive stories of SME resilience, grounded in the experience of prolonged conflict that include trust-based shareholder schemes, family support and the importance of reputational capital that long-enduring SMEs appreciate. A few SMEs also offer a more optimistic outlook:

*‘Somali businesses are always resilient. Despite the losses, few have actually shut down their businesses. Our partners still imported essential goods even though they weren’t given a tax break. You can still rely on our social capital and credit systems: when my customers could no longer afford the price of the hotel, we had to offer major discounts. Several diaspora customers who were stranded were given two rent-free months because they ran out of money.’<sup>218</sup>*

### 5.3 Inequality, competition and governance

As COVID-19 spread in the Horn of Africa towards the end of March, rumours started to circulate regarding trade restrictions in India and China, causing panic buying and food shortages. Prices of several staple goods such as sugar, rice and cooking oil rose by about 20% within a two-week period. However, as traders in Puntland and Mogadishu

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215 International Organization for Migration. 2020. ‘IOM empowers women business owners in Somalia to recover from COVID-19 impact’, *IOM Press Releases*, 12 August 2020, <https://www.iom.int/news/iom-empowers-women-business-owners-somalia-recover-covid-19-impact> (accessed 24 December 2020).

216 APO Group. 2020. ‘Survey reveals 95 percent of African small and medium-sized enterprises (SMEs) did not receive government aid during COVID-19 pandemic’, *APO Group Africa Newsroom*, 9 December 2020, <https://www.africa-newsroom.com/press/survey-reveals-95-percent-of-african-small-and-mediumsized-enterprises-smes-did-not-receive-government-aid-during-covid19-pandemic> (accessed 24 December 2020).

217 Phone interview, travel service company for Hajj, October 2020.

218 Phone interview with a hotel owner, Mogadishu, October 2020.

reported, this turned out to be a deliberate act by a number of brokers who initiated the rumours, buying up stock and raising prices. By the end of April prices had largely come down again for rice and sugar, although modest price increases have persisted for rice, sugar, flour and spaghetti.<sup>219</sup> Aiming to counter speculators in the market jeopardising the affordability of key consumption goods, the FGS appealed to business people not to take advantage of this crisis by overcharging consumers. This was arranged by applying a 50% import tax cut on many foodstuffs in order to stabilise prices – a policy that has kept the prices of these items the same (not lower) and benefited importers over local producers. Tax breaks for essential items were heavily negotiated in ways that likely benefited the larger corporations. For instance, as one large importer explained, *'We lobbied for the government to give us a tax break because we were experiencing heavy demands to bring cooking oil and pressure to use alternative more expensive shipping methods. The government finally agreed.'*<sup>220</sup> Other importers in pasta, cement and khat engaged in lobbying efforts for these items to be categorised as 'essential', which many other business actors interpreted as a way of exchanging favours ahead of elections.

Reports confirm that as taxes on imported foodstuffs fell, new rent-seeking actors – including politicians – entered the market in an attempt to take advantage of the tax cuts and the unfulfilled demand, which led to a significant surplus of these foodstuffs, further destabilising prices.<sup>221</sup> These newcomers imported large amounts of flour, rice, dates and other items, selling at significantly lower prices than market prices. Stores across Mogadishu were hence full, although buying power had plummeted due to reductions and delays in remittances, and SMEs that required a stabilisation of market prices were disadvantaged. Some SME businesses explained the food market as simply the latest avenue for political finance – i.e. the need to clean and move cash abroad – especially as the normal channels of construction and government contracting had dried up. As one businessman recounts, *'Leaders and politicians launder the money by investing in a successful healthy company. Basically, doing a capital injection with a condition to get back at least 70% of his money clean.'*<sup>222</sup> Although there were widespread perceptions that construction had dried up, the effects were actually mixed, demonstrating the considerable resilience of the construction industry in fragile contexts. There was, however, evidence of a consolidation of market opportunities by large conglomerates. Large cement importers explained that they remained unaffected and offered critical credit to other importers of oil and food, but also noted that smaller companies that could not cope with disruptions to supply chains and government security clearance

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219 Phone interview with a business manager in the foodstuffs import sector, Bosaso, October 2020.

220 Phone interview with a trader in Mogadishu, December 2020.

221 Phone interview with a business manager in the foodstuffs import sector, Bosaso, October 2020.

222 Phone interview with a business manager in the foodstuffs import sector, Bosaso, October 2020.

had closed down.<sup>223</sup> More broadly, the construction industry faced an initial spike in prices for materials and large construction projects (e.g. building of major roads, and construction around the airport and for government premises) but these prices levelled off as importers found new routes and suppliers. New expected projects funded by the international community largely came to a halt due to reduced aid expenditures, leaving many contracted companies at a loss, although projects already underway and other civilian projects were unaffected.<sup>224</sup>

Diaspora entrepreneurs, e.g. investors, start-up leaders and traders between the West and Somalia, were also heavily affected. For instance, as traders and importers reported relative ease in resuming trade in the Gulf and Asia, import/export companies that had strong trade relations with countries in the Western hemisphere (Canada and UK) indicated that they faced closure, mass unemployment and being forced to sell assets.<sup>225</sup> More broadly, they are some indications of a deteriorating business relationship with Saudi Arabia and UAE, and a strengthening of trade ties with Turkey, Qatar, Bahrain and Oman, '*who are working with Somali businessmen to come up with a faster way to deliver goods into Somalia*'.<sup>226</sup> The stability of these economic relations are tied to broader political dynamics and shifting alliances but also highlight the importance of long-standing networks and relations or 'cosmopolitan capital' that disproportionately benefit certain groups of business people and capital above others. At the same time, national forms of capital decline in importance and are differentiated increasingly into national and international fractions.<sup>227</sup> Somalia's economy is one of entanglements but also differentiations that have not been properly explored.

The disparity between the ability of SMEs and larger conglomerates to navigate the crisis is directly evident in the crisis response, as most major companies were part of the government's COVID-taskforce, whereas SMEs have had little representation and few ways to lobby for their interests. As part of the COVID taskforce, large corporations provided what businesses called 'informal grants' to the government to provide for medical supplies, ventilators, etc. Such informal grants are frequently paid back either in full or in kind through tax cuts.<sup>228</sup> The perception was that the taxation burden still

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223 Phone interviews with two cement importers and construction agencies, Mogadishu, August 2020.

224 Phone interviews with construction company, Mogadishu and Garowe, September 2020.

225 Phone interview with diaspora trader in luxury goods, Mogadishu, October 2020.

226 Phone interview with a trader in the foodstuffs import sector, Kismayo, October 2020.

227 Bühlmann F, David T, Mach A. 'Cosmopolitan capital and the internationalization of the field of business elites: Evidence from the Swiss case'. *Cultural Sociology*. 2013;7(2):211-229.

228 Phone interviews, importer/exporter and manager in the foodstuffs sector as well as a diaspora businessman, Garowe, Mogadishu and Hargeisa, November 2019. See also Elder, C. Forthcoming. 'Powerbrokers and Somalia's violent political economy: theorising about the logistics industry, reigning "tenderpreneurs" and protracted state collapse', *African Affairs*.

fell on small traders, retailers and other SMEs that generally lack the bargaining power of conglomerates.<sup>229</sup> There are also fears that, as strongly diversified companies, conglomerates have expanded operations into farming and livestock, buying up devalued land as titleholders go bankrupt or are in urgent need of funds, as agricultural land can later serve as a valuable productive asset and has an important role as collateral.<sup>230</sup> This has been reported as driving land evictions in Kismayo and Hobyso throughout the crisis.<sup>231</sup> Additionally, there have been criticisms of entities that hold significant public assets (including land and property) but make no contribution to public works in these areas.

SMEs also raised concerns about increases in corruption in relation to the COVID-19 response and ahead of the elections. Following the replacement of the minister, a substantial corruption scandal unfolded at the Ministry of Health, paving the way for the COVID-19 response to be moved to the Office of the Prime Minister.<sup>232</sup> The investigation uncovered substantial embezzlement of COVID-19 earmarked funds. It should be noted, however, that a substantial part of COVID-19 support was provided in kind as well, in the form of personal protective equipment (PPE) and other medical supplies. Throughout the response to COVID-19, supplies (often donor-branded) reportedly continued to find their way to the marketplace, as actors involved in the response diverted supplies in order to resell them.<sup>233</sup> While such practices may facilitate a range of political financing needs, they are also likely to undercut private vendors attempting to supply the surging demand for PPE.

By contrast, small traders, retailers and other SMEs who generally lack the bargaining power of conglomerates have continued to make tax contributions (with multiple taxation systems in place from Al-Shabaab, regional governments and central government). Initial promises of tax relief and postponements were rarely implemented or seized upon by SMEs. Some have blamed this on a lack of awareness of formal regulations among petty traders, suspicious of governments offering tax breaks (while informal shops were being demolished). Others explained how they made arrangements

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229 Phone interviews with a livestock trader and an export trader in Kismayo and Mogadishu, November 2020.

230 Jaspars, S., Adan, G.M. and Majid, N. 2020. *Food and Power in Somalia: Business as usual?*, London: LSE Conflict Research Programme.

231 Phone interviews with a livestock trader and an export trader in Kismayo and Mogadishu, November 2020.

232 Khalif, A. 2020. 'Somalia jails four government officials for stealing Covid-19 funds', *The East African*, 25 August 2020, <https://www.theeastafrican.co.ke/tea/news/east-africa/somalia-jails-four-government-officials-for-stealing-covid-funds-1925460> (accessed 24 December 2020).

233 Garowe Online. 2020. 'Somalia: Former president alleges loss of COVID-19 donations to black market in Mogadishu', *Garowe Online*, 25 May 2020, <https://www.garoweonline.com/en/news/somalia/somalia-former-president-alleges-loss-of-covid-19-donations-to-black-market-in-mogadishu> (accessed 24 December 2020).

to defer tax or to have their tax burden reduced, only to be later harassed by tax authorities.<sup>234</sup>

## 5.4 Conclusion

The COVID-19 pandemic has affected the political economy of the Somali territories in a few key ways. In contrast to previous crisis periods, like drought, famine and civil war, COVID-19 produced both logistical constraints, declining availability of finance and liquidity, and incoherent overlapping tax regimes which have made it hard for many SMEs to make it through the crisis. While some measures were introduced to support companies, such as tax cuts for certain essential imported goods, regulation was not fully developed and created resentment and competition. The larger corporate actors in Somalia faced a distinctly different situation, however. Given their strong hold over the financial system, capital reserves abroad, diversified operations and strong relationships with governance providers, they were generally better able to navigate and even benefit from the economic constraints. Although such actors were under pressure to impose repayment holidays on loans, lower the prices of services, secure employment, and fund significant parts of the COVID-19 response as well as providing other handouts, they were able to benefit from reciprocal relationships with governance providers – allowing them to negotiate tax cuts, benefit from COVID-19 aid and access new market opportunities.

Existing research analysing Somali businesses and political economy has paid insufficient attention to disaggregating among sectors and market levels to discerning business interests, tactics and vulnerabilities. The negotiations around the informal/formal and public/private are heavily negotiated by different regulatory authorities, practical norms and patterns of accumulation. Business are indisputably embedded in society, which informs the important and visible role they provide in terms of social and public services, and their critical access to foreign exchange rivals the authority and legitimacy of the state. Yet businesses are also increasingly reliant on the state in certain critical ways (security, regulation and access to new markets like oil and debt relief). The electoral business cycle is always busy as medium-sized enterprises and corporate actors seek to protect existing arrangements and secure new opportunities that risk overshadowing aid and macro-economic policies to alleviate debt burdens and struggles felt at the lower ends of the market.

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234 Phone interviews with a livestock trader and an export trader in Kismayo and Mogadishu, November 2020.

## 6 Conclusion and recommendations

The global COVID-19 pandemic has had a considerable toll on the Somali economy. Disruptions in the major economies supplying and trans-shipping goods for Somalia's import-based economy have caused significant logistical disruptions, shortages and price fluctuations. Additionally, restrictions on movement have hampered the ability of MTOs to maintain the franco valuta payment system on which the country relies, thereby significantly disrupting people's ability to make payments and reducing the availability of financing. Financial inflows were further affected by the economic setback across Europe and the United States, affecting the welfare of the Somali diaspora and thus reducing remittances and indirectly buying power and small enterprise finance within the Somali territories. As trade declined, government revenues were also affected, given the reliance on taxes and fees related to imports and passenger travel as well as ODA-funded projects. While such shortfalls were to some extent made up through additional COVID-19 related emergency financing, the shift in funding streams required the realignment of political financing patterns and created price instability as political actors sought new ventures through which to move the funds.

Somalia's private sector took a significant hit throughout the crisis. Some of the larger companies and traders aimed to maintain stable affordable prices on key goods in return for an import tax waiver from the FGS while also having to absorb delays in delivery of items. Meanwhile, liquidity constraints within the financial system hampered companies' activities within Somalia, and forced those granting credit to extend significant payment holidays. Although such losses are likely to be substantial, many of these companies have been able to maintain significant reserves, frequently abroad, allowing them to circumvent some of the credit constraints. Additionally, these companies' broad and diversified portfolio, as well as their strong presence in import-export activities, has meant they were perceived as low-risk clients able to maintain access to many credit lines. Reducing buying power in the Somali market severely curtailed the activities of SMEs operating as retailers, petty traders or local service providers. For those that maintained demand, the limited working capital they possess was quickly strained due to poor cash flow management, longer time cycles, limited ability to maintain stocks, and reduced access to financing options. With limited options to diversify and with destabilising market prices, many small and medium enterprises floundered or shut down completely (either temporarily or permanently).

While the economic shock brought about by COVID-19 did not structurally change the Somali political economy, it did exacerbate existing patterns of inequality. Many

SMEs were severely affected or shuttered, and were generally unable to leverage their network to overcome the constraints imposed by the crisis. Meanwhile, many of the larger companies were able to contribute meaningful support to the COVID-19 response while also continuing the launch of new offers and significant price cuts. Although the support the private sector provided to the COVID-19 response is likely to have supported a range of livelihoods throughout the Somali territories, the preferential access to governance and strong competitive position that allowed this also highlights a worrying level of inequality and market concentration, and raises questions regarding government legitimacy. It seems likely that the COVID-induced economic crisis has there reinforced rather than destabilised those dynamics that prevent small businesses from competing on an equal footing and fragile situations from stabilising. Additionally, it has exposed the sizeable vulnerability associated with the Somali territories' import dependence and financing system, creating sizeable risks to the livelihoods of those depending on these systems. Donors seeking to support economic and governance development in the Somali territories should therefore consider the following recommendations:

### **Recommendation 1 – Stimulate technical advances in SME finance**

The limited availability of financing opportunities for SMEs is a common problem across fragile and conflict-affected states, and a known bottleneck for development in both Somalia and Somaliland (both foreign and domestic sources). Although this bottleneck may slow down economic development, the COVID-19 pandemic has additionally highlighted the technical limitations of financial service providers, leading to highly unequal access to the financial means to survive the crisis. Many of the large companies active in the Somali territories have independent access to offshore funds and financial services, or are active predominantly in markets considered low risk by domestic financiers (e.g. import-export trading). SMEs, even those that are relatively well established and operating a viable business model, frequently lack such access. For instance, even at the height of the COVID-19 pandemic in Mogadishu even relatively know entrepreneurs were unable to secure funding to set up a facemask sewing operation, despite soaring demand and prices.<sup>235</sup>

The activities pursued by SMEs frequently involve higher risk or technically more complex financial products, notably the financing of working capital, non-trade direct expenditures or the purchase of capital goods that pay back over a longer term. Lacking such financing opportunities, small and medium-sized companies are disproportionately likely to flounder in the face of trade restrictions or economic shocks. Such shocks are further compounded by many domestic entrepreneurs' limited capacity in the area of cash flow management. Given the strong connections between private sector interests

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235 Phone interview with a Somali entrepreneur in the fisheries sector, London, August 2020.

and the functioning of governance within Somalia, both development and stabilisation efforts might be well served by efforts to develop SME finance and skills training.

## **Recommendation 2 – Inclusion of SME interests in governance**

Government action to stabilise prices in the form of import tariff cuts have had a positive effect in that it prevented an extended period of inflated pricing on staples that could have put severe pressures on lower-income groups. That being said, large traders were able to benefit to a much larger extent than smaller traders by increasing significantly the amount of imports during the period in which tariff cuts were in place (thereby increasing margins on their future sales). More generally, larger companies benefited more from government measures due to their overall proximity to officials and their ability to lobby for their interests. Exacerbating this problem were new market entrants, including political actors, that reaped part of the benefits of imposed tax breaks. Smaller companies rarely made use of available tax breaks, which may be due to a lack of knowledge or their relationship to governance providers. A number of smaller businesses were demolished at the start of the virus outbreak, which may have provided an additional rationale for some to stay below the radar. In an overall context of post-war economic growth, it is important to pay close attention to these dynamics of unequal distribution of bargaining power and unequal competition that shape Somalia's political economy and that is rendered even more visible during a crisis. The lack of an equal playing field may translate into unequal impacts on businesses during a crisis, causing many smaller businesses to shut and reinforcing patterns of inequality.

The poor influence that smaller businesses have on government decisions may thus be detrimental to political stability in the medium term. Small and medium-sized enterprises should be included in policymaking for their sector, for instance through measures increasing their degree of collective organisation and interest articulation. From the government side, it should be remembered that although market share, price impact and tax revenues associated with these enterprises may be limited, the number of livelihoods they support are substantial. As such, crisis response measures aiming to affect selected markets should make use of inclusive consultation procedures. An example can be found in Burkina Faso, where pressure from small traders following the closure of markets in major cities led to their reopening one month later with tighter public health measures. Donors may want to explore opportunities to invest in SME associations able to articulate SME interests and weigh in on key pieces of policy.

### **Recommendation 3 – Building Back Better efforts post-COVID-19 should stimulate the non-trading economy**

Although the substantial efforts involved in establishing Somalia's growing imports-based economy have been highly effective at ensuring the reliable availability of a wide range of goods at a relatively low price and have supported a wide range of livelihoods and consumption for low-income groups, the COVID-19 pandemic has highlighted the limits of this system. Shipping delays on goods from a number of the major overseas trading partners, disruptions at trans-shipment harbours, the civil conflict in Ethiopia hurting cross-border trade, and air traffic disruptions hamstringing MTOs created significant shortages, price instability and payment difficulties. The lack of physical inflows into the Somali economy brought many economic sectors to a standstill, affecting livelihoods as well as the accessibility of various goods and services. Domestically produced goods, to the extent they existed, were rarely able to fill the gaps that occurred nor supplement livelihoods.

As aid portfolios are realigned in response to the pandemic, aiming to address the widened shortfalls towards meeting the Sustainable Development Goals (SDGs), notably SDG 10, along the Building Back Better agenda, the structural bottlenecks exposing the Somali economy to logistical shocks should be addressed. In the short term, Somali traders have likely already initiated efforts to diversify their sourcing and trans-shipment operations, and MTOs are likely to be reassessing their operations as well given the losses incurred over the last few months. In the longer term, however, significant vulnerabilities will remain unless advancements are made in the domestic economy of Somali territories. Besides security constraints and the financing constraints noted above, several key bottlenecks have withheld such developments, notably monopoly practices in several markets, expensive and unreliable electricity, and a shortage of qualified human resources. As a consequence, programming aiming to support Somalia and Somaliland in Building Back Better is unlikely to generate significant results unless the major bottlenecks holding back development of new value chains are tackled.

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# Annex – Methodology

This study has been conducted in accordance with CRU's political-economy analysis framework, thus focusing on power arrangements. By analysing changes in arrangements of power one can understand why decisions are made, what incentives play a role, how alliances form or break, and what narratives dominate. In turn, such understanding is key to identifying feasible approaches to conflict resolution. Examining shifts in arrangements of power enables the simultaneous exploration of the perspectives of those that govern and those that are being governed, as power is always relational. Doing so requires the use of three lenses: 1) the power networks and relationships between conflict actors; 2) the power practices and exchanges between them; and 3) contextual factors, such as institutions and ideology, that affect the power distribution underlying conflict.<sup>236</sup>

This political-economy analysis is further specified to the informal sector, in order to situate the role of the informal sector in the deeper context of the political settlement, in which the most significant power and state connections are understood. The framework combines traditional conflict analysis with elements from social network and power analysis, and draws on recent research across a range of disciplines, namely new political economy, new institutional economics, and conflict studies. It thus brings to the surface the politics and power dynamics that may facilitate or hamper proposed interventions in conflict-affected situations. In this way it uncovers hidden stakeholders, the practices and exchanges that facilitate the main actors' relation to power, and the written and unwritten rules and structures that form the silent backdrop of these relations. This identification of arrangements of power helps to identify potential spoilers and entry points for action by showing the structures which might be amenable to change and those which might be used to the policy maker's advantage.

The report supports conflict-sensitive programming, by recognising that '*[t]he success of most development efforts, including efforts to strengthen the state and build institutions of public accountability, rises or falls according to the degree to which these efforts are aligned with – or at least do not fundamentally threaten – the interests of powerful national and local actors who are in a position to thwart or co-opt those efforts*'.<sup>237</sup> The analysis recognises that 'many times well-intentioned interventions become ineffective because

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236 For further details, see: Clingendael. 2019. *Our methodology for political-economy analysis*, The Hague: Clingendael Institute.

237 Parks, T. and Cole, W. 2010. *Political Settlements: Implications for international development policy and practice*, San Francisco: The Asia Foundation.

they reinforce an equilibrium that sustains the outcome the intervention attempted to change. These situations can arise from interventions that do not take into account the existing power balance.<sup>238</sup>

Research for this report included desk research, and 17 phone interviews (including three female respondents), running between August and November 2020.<sup>239</sup> Desk research included a literature review of academic and grey literature, data from local surveys, government policy documents, supplemented with a variety of news sources. Respondents interviewed for this report represented a range of formal and informal positions, covering governmental and NGO staff, as entrepreneurs and employees of companies in a wide range of sectors, and political actors. The wide range covered allowed the researchers to triangulate information and perspectives through cross-referencing information between different professional backgrounds.

Regardless of the efforts undertaken to cover the breadth and depth of COVID-19's impacts on the Somali economy and politics, the COVID-imposed travel restrictions prevented any fieldwork being conducted, and may have prevented certain groups of potential interviewees from responding. Additionally, it should be remembered that with the elections looming in Somalia, many respondents were reluctant to discuss topics related to political finance. It should therefore be kept in mind that additional research including fieldwork and further depth on business and political actors might provide further insights. Additionally, it should be noted that the impacts of COVID-19 are not homogenous across the Somali regions. While the dynamics covered in this report are likely to be indicative of dynamics around Mogadishu and Hargeisa, they cannot be expected to hold across other areas (particularly not those under AI Shabaab control). Extrapolations from such dynamics without taking into account the local context may thus obscure important differences.

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238 World Bank. 2017. *World Development Report 2017: Governance and the law*, Washington DC: World Bank Group, 27.

239 Interviews covered the Somali public and private sector, as well as the research community and international community, while maintaining a reasonable distribution across regions and the inclusion of female respondents.