

## **Paper Seven: The Role of Remittance in the Economic Development of Somaliland**

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### **1. INTRODUCTION**

The international remittance markets have grown dramatically in many parts of the world for the past two decades or so. Yet their critical roles in the economic development of least developed countries, particularly in post-conflict and fragile states, are not widely known and acknowledged in the field of economics and development studies. The importance of remittances for the people of Somaliland since the collapse of the Somali state in 1991, engendering the breakdown of all institutions including national and international payment systems (banking), cannot be denied, since it has huge implications not only in the livelihoods of most people in the country but also in the security and the stability of the country.

Remittance services (Hawala) have provided a lifeline for the majority of poor households in Somaliland as they mitigate vulnerability and sustain livelihoods among the population, through timely cash payments. At the same time, remittance has contributed towards trade and investment by allowing traders to import goods without letters of credit and transferring cash from Diaspora communities for construction and investment purposes. This paper has been presented at the SORADI 3<sup>rd</sup> Annual Conference in October 2012 and it seeks to highlight the significance of remittance in the socio-economic situation of the population, particularly by empowering marginalized women as they represent the majority of recipients for most of the small amounts remitted for livelihood security from relatives abroad.

In addition, the paper explores the history, scope, importance, and influence of remittance in the economic development of Somaliland, which has been growing at an estimated rate of 8% to 11% annually for the past 5 years<sup>1</sup>. It also describes the major remittance companies in the country, their estimated share of the transfer market and how they play a vital role in investment

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<sup>1</sup> Dahabshiil Money Transfer Market Research in Somaliland, October 2010 (This research was carried out by Elite Consultancy and Training Agency (ECOTRA

and trade as well as how they provide fast, affordable, and reliable money transfer services. These services reach down to the most isolated rural villages and settlements, in a country where national and international payment systems have completely broken down, and where these remittance companies have filled in that void to work as local depositors<sup>2</sup> (banks). In its conclusion, the paper suggests the urgent need to introduce the enactment of the banking legislation, which will help the formalization of the financial services and confines remittance companies to transfer businesses per se and restore the classical functions of the central bank.

## **2. HISTORY OF REMITTANCE IN SOMALILAND**

Remitting some of their earnings back to their families has always been part of the Somaliland migrants who worked abroad. However, in the old days migrants from Somaliland used to remit money to their relatives either via international bank transfers or via couriers from other migrants, usually, from the same clan or locality. The former method was expensive and took longer but was safer, while the latter was free of charge and quicker but riskier. A third method known as “Hawala” which involved remitting cash was started during the oil boom of the 1970s and 1980s, when large numbers of Somaliland migrant workers in Saudi Arabia and the Gulf countries needed to send remittance to their families back home. Their traders and their agents would collect money from those migrants/workers to deliver to their families. This process equally involved in long delays and was not a risk free at all, however it was this method, which was later improved.

The scope of remittance in Somaliland was transformed after the break-out of civil conflict in Somalia, which resulted in more than quarter of a million Somalilanders fleeing their homes to seek refugee status in Western Europe, North America, and other parts of the world and further half a million became either internally displaced or refugees in neighboring countries (mostly in Ethiopia). Those refugees and immigrants from Somaliland wanted to help relatives they left behind by way of financial assistance (cash). Some of those traders who were involved in the remittance business like Dahabshiil, who was already engaged in the money transfer business,

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<sup>2</sup> *ibid*

albeit in a small scale, realized the urgent need for an organized corporate structure to provide prompt remittance to the people of Somaliland. Thus, the present form of remittance came into being in Somaliland and in other Somali populated regions of the Horn of Africa, and in the absence of banking services in Somaliland; remittance companies have managed to provide some financial services to the population of the country.

### **3. SCOPE OF REMITTANCE**

Aside from the vital small amounts of money sent by relatives from the Diaspora, particularly in Europe and North America, to support their dependants back home, most of whom have been enduring harsh poverty aggravated by civil conflict, the remittance services provided by money transfer companies contribute to investments, commerce and reconstruction projects in the region. In the absence of internationally recognized banks in Somaliland, these remittance companies are considered as reliable and trustworthy “local Banks”. They provide some of the facilities offered by conventional Banks, such as saving and current accounts to individuals, private companies, and international organizations, thus facilitating international payments for imports (Hassan, A.I. 2011). In addition to the key roles that remittance companies play in the economic development of the country in terms of trade, investment and livelihood security they are also considered as one of the biggest private sector employers in Somaliland, employing around 4,000 people directly.

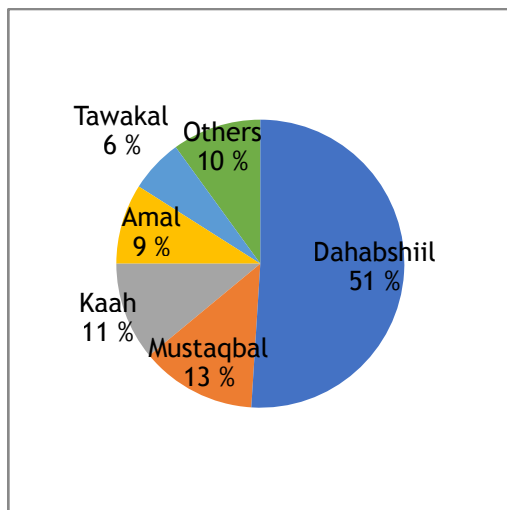
Remittance money constitutes an important sector of the Somaliland economy, but there is little accurate information about the actual volume of the cash flow passing through money transfer companies. However, the closest estimate of remittance that flows into the country could be in the region of US\$1315 Million, annually. About 41.84% (US\$550 Million) comes in as household maintenance (received by families and individuals as small money between US\$100 and US\$500); 30.43% (US\$400 Million) as capital or financial investments; 16.73% (US\$220 Million) and the remaining 11% (US\$145 Million) as domestic transfers, mainly via mobile transfers (ZAAD). Given this fact it would be true to argue that today in Somaliland remittance is

by far the biggest contributor to the national economy - 54% of the country's GDP (ECOTRA, 2010).

The successful growth of remittance companies in Somaliland is almost completely dependent on social capital – namely the cohesiveness and trust within communities (clans). Had it not been for the existence of this social capital and the safe “*Hawala*” system of financial transfers across continents, people from Somaliland would have not have had access to assistance from the Diaspora and would have suffered much greater deprivation during and after the civil conflict, and perhaps the large scale and rapid growth in capital investment, commerce and trade would not have happened at all.

Today, there are more than 17 money transfer companies working including the international giant (Western Union) who has just opened its first few branches in Somaliland. Some of the main remittances and financial service provider companies that are active in Somaliland include, *Dahabshiil, Mustaqbal, Kaah, Amal, and Tawakal etc.* The table below describes the market share among remittance companies operating in Somaliland.

#### Market share chart



*Source: Dahabshiil Money Transfer Services Market Research, November 2010*

The main advantage of the money transfer operations is that it is simple, convenient, basic, cheap and reliable. These financial service providers are keen in developing their businesses not only as

remittances but also as local banks in the future (commercial banks), and may include offering loans to small businesses. However, the possibility of financial intermediation from these remittance companies is hindered by lack of legal and regulatory framework as there is no Banking Law in Somaliland yet, something that is continuing to have a big “opportunity cost” for the country’s economic development (Jama, Hassan 2010).

In other words, some money transfer companies now offer a wider range of “Bank-like” services such as savings and deposits (non-interest bearing deposits) and they may also provide consumer lending in the form of small loans. However, this may require some sort of a “guarantor”, which could be based either on kinship and clan affiliation or through social capital and trust. In most cases, the source of financial assistance in the form of small credit is obtained from relatives and friends, who lend cash to those who want to set up businesses, in return for future goodwill. Business lending by remittance companies seems unviable even with collateral, both for religious reasons, and due to business preferences for direct involvement of an investor/lender in the operations they are financing. Limited short-term trade credit (against security such as fixed assets) is sometimes available from main remittance companies. But, even in those circumstances there are some risks involved in lending, due to lack of legal obligations and regulatory framework from the part of the government, which makes the need to re-establish conventional banks imperative (PFM&FPU, 2010).

#### **4. CHARACTERSITICS OF FINANCIAL SECTOR IN SOMALILAND**

In order to comprehend fully the current status of the financial sector in Somaliland, which can be best described as a post-conflict “cash economy” situation, it is important to assess the financial sector of Somaliland, where despite relative peace, security, stability, functioning administration, and parliamentary democracy the country is regarded as a risk zone by the international lenders and investors. The situation is compounded by the lack of government legislation on banking and public finance management resulting in the sector being generally characterized by the following:

- Lack of legal and regulatory banking structures;

- Absence of classical central bank role;
- None-existent international and domestic payment systems;
- Cessation of most lending activities within the country;
- Almost non-existent deposit taking activities by the bank;
- Stoppage of international correspondent banking relationships;
- Unstable exchange rate;

In addition to the above, it will be correct to argue that, today, Somaliland is essentially a cash society where there is no common platform for international or domestic payments between existing financial institutions. This means that cash and payment orders are the only meaningful payment instruments widely used in the economy and no clearing and settlement system is in operation inside the country (ECOTRA, 2010). Thus, it is important to note here that normally in a country like Somaliland, where international and domestic payment systems have ceased to function twenty years ago, after the collapse of the Somali state, followed by break down of all state institutions including banking sector, and created the above cited financial sector problems, re-establishing banks to facilitate international and domestic payment systems should be a priority for Somaliland. In other words the re-establishment of conventional banks in Somaliland would contribute towards the economic development of the country in terms of trade and investment, something that has been currently done via remittance albeit partially.

## **5. ROLE OF REMITTANCE**

The role of remittance in Somaliland is extremely important towards the economic regeneration of the country by helping drive the economic engine through cash circulation and large transfers that are used for goods importation, investment and reconstruction, on the one hand, and through small amounts of remittance for families and individuals sent by refugees and migrant relatives from developed and rich countries for livelihood security and maintenance, on the other. Both of these types of transfer services provided by various remittance companies have been

indispensable for family survival or household maintenance, acquisition of basic social services and small businesses that all depend on speedy and reliable transfers in and out of the country for import/export payments.

This means that remittance money in Somaliland has not only played a positive role towards economic development and livelihood improvements but also in conflict reduction and stability by allowing poor households to receive vital maintenance money, sent by their relatives from the Diaspora, (it is estimated that nearly 48% of all households in major towns get monthly maintenance from their relatives abroad), without a delay (instant cash within few hours, in most cases), thereby allowing enterprise and trade to grow, enabling authorities from Somaliland to collect import taxations and other tariffs, which are in turn spent on security to sustain peace and stability and on social development and reconstruction programs (ECOTRA, 2010).

In the current situation in Somaliland, the banking legislation has just been recently passed by the parliament after a long delay due to some resistance coming from the part of the remittance companies. These companies enjoy extensive influence over the financial sector of the country as they have filled in the void and acted as a substitute to conventional banks and created their informal ways of contributing to trade, investment, commerce, cash movements and reconstruction efforts through:

- In/out flow of capital;
- Trade facilitation;
- Internal or local transfers;
- International payments for aid agencies;
- Financial intermediation;
- Reconstruction projects;

As already explained elsewhere in this article, in addition to providing the above mentioned financial services, Somali-owned remittance services have got comparative advantage over other multi-national money transfer companies, such as Western Union and Money Gram by virtue of

their faster, simpler, hassle-free, more convenient, and low operational cost services, as they can easily reach right to the smallest rural village to deliver their services. Indeed, in a post conflict situation, where there has been an absence of internationally recognized or conventional banks, in Somaliland money transfer companies are considered to be “local Banks” as they not only provide reliable and trust-worthy money transfer services but also basic banking provisions, including deposit and saving accounts etc. Another recent remittance phenomenon in Somaliland is the “mobile transfers” known as ZAAD which was started at the end of 2008 and has been growing at a spectacular rate and has totally dominated the local transfers over such a short period of time (research shows that more than 95% of small local transfers are now done through ZAAD (Hassan, A.I. 2011).

## **6. DOWNSIDE OF REMITTANCE**

Although the paramount importance of remittance and its role both on the economic development and livelihood security in Somaliland and the phenomenal success of remittance companies during the past two decades cannot be denied as explained in this article, there are, nevertheless, some people who believe that remittance money has caused a great deal of damage including: creating a remittance dependency culture; rendering “dollarization” of the economy; increasing inflation and money laundering; encouraging human trafficking as well as fuelling clan and religious tensions through instant cash supplies etc. However, regardless of the pros and cons of the subject there is no doubt that remittance companies would face certain challenges in the future and some of these challenges would include:

- Stiffer competition from conventional banks;
- Economic slowdown in those affluent countries, where most of the money is remitted from;
- Stringent regulations by individual countries and regional bodies intended to counter fraud, money laundering and provision of funds to global terror networks;
- Demographic and attitudinal change amongst the children of migrants and refugees who might feel less obliged to send cash to their relatives back home;



In this regard, it would mean that the outcome of these challenges could negatively impact upon the performance and efficiency of remittance companies in the future thereby threatening their economic viability and long-term sustainability. Despite these challenges, however, it is expected that international remittance industry has got a brighter future and had already made appropriate measures to adjust to some of those challenges.

## **7. CONCLUSION**

By way of conclusion there is no doubt that the remittance sector is a thriving and important financial sector in Somaliland not only in terms of trade and investment but also in reconstruction, development and livelihood security. Hence, remittance industry can no longer be left in the fringes of financial sectors or the periphery of microeconomic level and its informal economic dynamics. In fact, today, Somaliland like in many least developed countries, with large migrant populations in the Diaspora, income from remittances is the largest contributor to the economy of the country. However, it must be taken into account that the sector faces both challenges and opportunities. The effects of these challenges could negatively impact upon the performance and efficiency of the remittance industry, thereby threatening its economic viability and long-term sustainability.

Despite these challenges, this article argues that remittance services have got a brighter future, provided they make appropriate measures to adjust to some of the challenges cited in this article. In this regard it is hoped that Somali-owned remittance companies will rise up to these challenges and put their houses in order. This involves adopting robust and rigorous anti-money laundering policies and procedures to allay fears raised by some foreign banks<sup>3</sup>, and assist the government towards the implementation of the banking regulations that have been recently enacted by the Somaliland Parliament. This will unchain the country's financial services for the benefit of everyone in the country and contribute towards more economic recovery and growth through international investment and trade. The result will be a better future for the citizens of the country and further support the government to strengthen its institutions.

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<sup>3</sup> Sunrise Community Banks in Minnesota (USA) have announced at the beginning of 2012 that they will stop processing remittances to Somalia/Somaliland.

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