SOCIAL DEVELOPMENT PAPERS

CONFLICT PREVENTION & RECONSTRUCTION

Paper No. 38 / November 2006

Remittances and Economic Development in Somalia

An Overview

Edited by
Samuel Munzele Maimbo

Summary Findings

This collection of papers examines the role and impact of Somalia's remittance system. After an introduction, Chapter II examines how a dynamic private sector, powered by remittances from abroad, has managed to thrive in a country that is a failed state and among the poorest in the world. Adapting well and even flourishing in a stateless conflict ridden economy, private sector activities have emerged in trade, money transfer services, transport and telecommunications. At the household level, recent studies show that remittances constitute 40 percent at the income of urban households. While recognizing the benefits of remittances, it also cautions that further private sector growth is limited in a country without a functioning government and essential public goods.

Chapter III illustrates the positive impact of remittances by focusing on the collapse of the public education system and mass emigration as two features of the last two troubled decades of Somali history. The remittances received by a substantial minority of city-dwellers improve their economic status and access to education. In Hargeisa, the case explored in this chapter, remittances often play a central role in the livelihoods of those that receive them and help finance education, in some cases allowing the family to choose higher cost forms of education. Children in the households of people receiving remittances have relatively good school attendance rates. Moreover migrants often encourage families to whom they send money to educate their children. Sibling solidarity plays a particularly crucial cultural role in the education and welfare of children and young people.

Chapter IV distinguishes myth from reality regarding Somali Remittance Companies, such as: the remittance businesses are owned by Somalis in Somalia; only the Somalia diaspora transfers money through them; that remittance organizations are not legal or registered and do not pay taxes; and that client funds are not safe. These companies are not as informal as often assumed. Instead, they have the full trust and confidence of their customers, have an extensive network of agents that service all towns and villages in Somalia, as well as all major cities in countries populated by Somali diaspora; run operations that are more efficient than traditional financial services; and most importantly, are well placed to serve rural areas that would be little served by traditional banking institutions.

Remittance companies face severe challenges in setting up and sustaining operations within and outside Somalia. In Chapter V, Shire, an experienced remittance operator, lifts the veil on the complexities of remittance operations in conflict-affected countries. He links these challenges to the dynamic business environment in which companies have to engage with regulators; international, national and local authorities; global and local market competitors, the media and the public. After discussing the threats and opportunities presented by each, he offers recommendations on how remittance companies, banks, regulators and the international development community can ensure the continuation of remittance services, build trust and strengthen mutually beneficial partnerships. To do otherwise, he warns, would result in the disruption of a service that not only provides a lifeline during periods of conflict, but also prevents humanitarian disasters in Somalia (another wave of mass displacement and emigration, instability, and resentment and extremism).

For Somali operators, one audience which requires particular attention is the international and national regulators, whose concerns over money laundering and terrorist financing activities peaked in the aftermath of 9/11, and have heightened yet again in the face of recent escalation of conflict in the country.

In the long run, however, the benefits of the remittance sector need to be complemented by broader financial sector reforms. Like other financial intermediaries, remittance companies are constrained by the absence of a sound legal and regulatory framework, strong property rights culture, enforceable collateral contracts, accessible credit information systems and related financial infrastructure.

The final chapter focuses on the broader financial sector, acknowledging that rebuilding a financial system after a period of sustained conflict is a challenging task. Trying to do so while the political process of nation building is still at its nascent stages makes the task doubly challenging. Managing the expectations of government, the private sector and the public is complicated by the evolving assumptions made about the likely direction of the political process and the resulting state structure. The authors argue that it can be done and offer a primer on rebuilding the financial sector after conflict, including the types of reforms required, some of the necessary pre-conditions, and options to consider over the short to medium term, versus medium to long term.

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Conflict Prevention and Reconstruction

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An Overview

Edited by
Samuel Munzele Maimbo

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Conflict Prevention & Reconstruction
Social Development Department
The World Bank
1818 H Street, NW
Washington, DC 20433
Fax: 202-522-3247

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Contributors

SIBEL KULAKSIZ works for the World Bank as Country Economist for Somalia. Her current interest is development in post-conflict countries and highly-indebted low income countries. In her work for the World Bank since 2001, she has specialized in the development issues of countries in the Horn of Africa. She contributed to the World Bank's lending operations, dialogue and analytical work for the region. She has led dialogue on macroeconomic policy, trade**,** international financial flows and private sector development for Somalia. Her analytical work included trade, tourism, debt, budget execution and macroeconomics. Before joining the World Bank, she worked in the Turkish Government and was appointed as an Advisor to the Undersecretary for Customs in 1998. Her responsibilities included supervision of customs and trade issues with Eastern Europe and Central Asia. She has two Master's degrees in Economics and International Development.

ANNA LINDLEY is interested in how migration connects rich and poor countries. She is currently a doctoral student in the Department of International Development at the University of Oxford. Her research focuses on the dynamics, effects, institutions and politics of remittance transfers in Somali society and the Somali diaspora. Based on one year of ethnographic and survey fieldwork in London, Nairobi and Hargeisa, her thesis investigates the process of remittance transfer, exploring both its social and economic dynamics, as played out in Somali families and communities in the Horn and in their new countries. She has worked on projects with the UK Department for International Development; the European Commission; the Overseas Development Institute and the United Nations Development Programme (UNDP). She has a BA Hons in Modern Languages and an MA with distinction in Development Studies. She is currently affiliated to the Centre on Migration, Policy and Society at the University of Oxford.

WALTER MAHLER is a consultant who retired from the International Monetary Fund. He has worked extensively on Asian and African countries. His main areas of expertise are in tax policy and administration, local government finance and other areas of public finance and macroeconomic policy.

SAMUEL MUNZELE MAIMBO is a Senior Financial Sector Specialist in the World Bank's Africa Finance and Private Sector Unit. He has expertise in a range of financial sector areas, having focused on developing, emerging, and conflict-affected countries since the mid 1990s. Specific areas of focus have included banking and financial sector, formal and informal remittance systems, financial sector reforms in conflict-affected countries, rural finance, micro-finance, housing finance, and private sector development. A Rhodes Scholar, he has a PhD in Public Administration from the Institute for Development Policy and Management at the University of Manchester, England (2001); an MBA (Finance) Degree from the University of Nottingham, England (1998); and a Bachelor of Accountancy Degree (with Distinction) from the Copperbelt University, Zambia (1994). He is also a Fellow of the Association of Chartered Certified Accountants, United Kingdom and a Fellow of the Zambia Institute of Certified Accountants.

MAYANK PATEL is currently the Chief Technical Advisor for the Financial Services Programme in UNDP Somalia. He joined UNDP Somalia in August 2005 after working for 17 years in KPMG. Prior to joining UNDP, he was a partner at KPMG East Africa, where he was the director in charge of the financial sector advisory practice. He is a member of the Institute of Chartered Accountants in England and Wales, and has more than 15 years experience of financial sector experience in the United Kingdom, Eastern Europe and Africa. Prior to joining the KPMG practice in East Africa, he spent 9 years in the specialized Financial Business Unit of KPMG London, gaining extensive experience in the field of banking and finance. At KPMG, he was involved in delivery of advisory services to banking and finance clients in areas such as banking sector policy, strategic planning, bank restructuring, performance improvement, organizational restructuring, mergers and acquisition, and privatization. He also provided consultancy assistance to various central banks in the East African region. In 2003, he led a KPMG team on the financial sector feasibility study and mission for Somalia for UNDP/EC. Since 2003, he has been involved with the Somali money remittance sector, including the facilitation of the first Somali remittance sector conference in the UK.

ANDREA PURDEKOVA works as a consultant for the Eritrea and Somalia Country teams in the PREM II Unit of World Bank's Africa Regional Department. She has provided support in the final drafting stages of the Somalia Country Economic Memorandum, and contributed to the Somalia Joint Needs Assessment. Her research interests include war economies, post-conflict economic recovery, and the nexus between migration and development. She holds a Masters Degree in International Relations with specializations in International Economics and Conflict Management from Johns Hopkins University School of Advanced International Studies (SAIS).

SAAD A. SHIRE is the managing director of Dahabshiil Transfer Services Limited, an international money transfer company based in London, UK. He has expertise in research, operational management, and organisational development. He has specialist knowledge of the Somali Remittance sector where he worked over the past five years, and a keen interest in higher education, having been a founder member of two universities: The University of Hargeisa and the University of Burao in Somaliland. He has also worked for the World Bank, taught at Somali National University and worked both in the private and non-profit making sectors in the UK. He has formal qualifications in agriculture, economics, accounting, and banking.

HUSSEIN SIAD is an independent consultant and a former Vice Minister of Finance, Government of Somalia. He holds a Masters Degree in Economics from George Washington University with specialization in Public Finance, Banking and improvement in economic management of developing countries. He recently contributed to the Somalia Joint Needs Assessment. Other activities include: (i) exploring options for revenue administration and management for the Transitional Federal Government Somalia for UNDP and the Transitional Federal Government of Somalia, Nairobi, Kenya; and (ii) advisor to the Minister of Finance, and Coordinator for Government of Iraq/IMF Programs.

MOHAMED Y. ABSHIR WALDO is the founder and director of the Sandi Consulting Group, a political, business and strategic consulting group whose primary focus is the revival and reconstruction of the Somali nation. Starting out as a radio journalist with the BBC World Service and as Director of the Somali Broadcasting Service in the 1960s, he has been, at various points in his career (and sometimes all at once), a political activist, an entrepreneur and a development consultant. His recent writings on the remittance industry stem from his development work on micro-finance issues as well as his interest in regional rehabilitation through small-business initiatives. Mohamed is a graduate of Columbia University Journalism School (MA in Mass Media, 1968).

KEVIN WEST is a partner with KPMG South Africa, specifically within the forensic division. He specializes in Anti-Money Laundering Regulatory Compliance, with specific focus on the African continent, and the implementation of Money Laundering Control regimes. He has been working with the Somali Financial Services Sector since 2003 and recently completed a comprehensive Guidance for Compliance Manual to be used by the Somali Money Transmitter Companies

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REMITTANCES AND ECONOMIC DEVELOPMENT IN SOMALIA: AN OVERVIEW

I. INTRODUCTION

Samuel Munzele Maimbo[1]

Financial sector development in conflict-affected countries is never an exact science. The opportunistic nature with which entrepreneurs invest in essential financial services is a fascinating art. Somalia typifies the ultimate example of the financial sector's ability to provide a life-line to a people afflicted by sustained conflict. This collection contributes to the literature on the performance of the financial sector during periods of conflict.

1. Remittances in Conflict-affected Countries

We know a few things about the technicalities of formal and informal remittance services—for instance, how informal remittance services are cheaper and often more convenient because of their minimal documentary and infrastructure requirements. But it is less clear how remittance systems—formal and informal—are able to thrive in conflict-affected environments while dealing with the complex regulatory pressures of the post-September 11 environment and while retaining the trust and confidence of their clients in an environment of political mistrust, economic mis-governance and social antagonism.

In light of the many conflict-affected environments in the world today, understanding the role and impact of remittance systems during periods of conflict is of vital importance. Although because conflicts are unique, this is not an area that easily lends itself to typologies and recipes for best practice manuals, there are principles that can be learned. Fundamentally, the story of remittance systems in conflict environments is about entrepreneurs formally or informally moving money into or out of the conflict-affected country between parties that, primarily, are either—collectively or individually—surviving or exploiting the conflict.

- *Survivors* use the remittance system to sustain the livelihoods of friends and family members who remain in the country during the period of conflict. The remittances from those abroad are used to pay for education, medical and other social services that a state in conflict is unable to provide for its citizens. Survivors routinely invest in infrastructure, largely housing and small scale enterprises, to provide an income (often modest) to those directly enduring the conflict.
- *Exploiters* abuse the remittance system to launder the proceeds of crime or finance the conflict for financial gain. The absence of public legal regulatory institutions makes conflict-affected countries attractive for laundering the proceeds of conflict-diamonds, opium production, arms smuggling, and other criminal activities—the proceeds of which are then often invested in more stable countries.

Like other developing countries, Somalia is caught between these two protagonists. On the one hand, as the Chapters by Kulaksiz and Purdekova, and Lindley show, the remittance system has sustained the livelihoods of a people living in one of the poorest countries in the world. On the other hand, the papers by Shire and West remind us that this service comes with some risks and potential for abuse. The benefits

[1] The author wishes to acknowledge the contribution of the Nairobi UNDP office that, together with the World Bank, co-hosted a conference in December 2005 on remittances in Somalia, from which these papers are drawn. All the contributors and participants of that event have enriched the quality of the papers included here. Also, the author wishes to acknowledge the research and administrative assistance of Melina Cholmondeley and Leslie Lang in editing this publication.

of the remittance services can be exploited to facilitate the laundering of criminal proceeds. The challenge, as discussed later in the chapters by Waldo and Maimbo et al., is distinguishing between the myths and realities of the remittance companies, and in the long run, rebuilding a sustainable financial sector that provides a broader range of financial services when peace returns in earnest.

2. The Positive Impact of Remittances

In Chapter II, Kulaksiz and Purdekova detail how Somalia—with a population of 7.3 million in 2004, and an income per capita of $226—has long been a failed state and one of the poorest countries in the world. Today, 47 percent of the economically active population is unemployed in Somalia. Health infrastructure is dilapidated or non-existent, health care is only sparsely provided and school enrollment rates are the lowest in the world.

Chapter II examines how a thriving private sector, powered by remittances from abroad, has managed to thrive in the country. Adapting well and even flourishing in a stateless conflict ridden economy, private sector activities have emerged in trade, money transfer services, transport and telecommunications. At the household level, recent studies show that remittances constitute 40 percent at the income of urban households.

In Chapter III, Lindley further demonstrates the positive impact of remittances by focusing on the collapse of the public education system and mass emigration as two features of the last two troubled decades of Somali history. The remittances received by a substantial minority of city-dwellers improve their economic status and access to education. In Hargeisa, the case explored in this chapter, remittances often play a central role in the livelihoods of those that receive them and help finance education, in some cases allowing the family to choose higher cost forms of education. Children in the households of people receiving remittances have relatively good school attendance rates. Moreover migrants often encourage families to whom they send money to educate their children. Sibling solidarity plays a particularly crucial cultural role in the education and welfare of children and young people.

Yet, while recognizing the benefits of remittances, Kulaksiz and Purdekova also caution that further private sector growth is limited in a state without a functioning government and essential public goods. Remittances, they argue, cannot be a source of long term sustainable growth—remittances can help people survive a conflict, but alone are not sufficient to sustain economic growth. Political stability and credible economic governance institutions are essential pre-requisites to long-term economic growth.

3. The Challenge of Operating Remittance Companies in Somalia

Until Somalia is able to achieve some measure of political stability, its citizens will continue to depend on the resilience of the remittance system to sustain lives and commerce. Unfortunately, operating a remittance company in Somalia is not an easy proposition. In the post-September 11 environment in which informal financial transactions are frowned upon and often associated with terrorist financing, a remittance company is a challenging prospect. Since 2001, Somali remittance companies have been subjected to negative publicity. The positive role that the companies have played for millions of people in the country has largely remained unacknowledged. In their place, allegations of terrorist financing have become common.

In Chapter IV Waldo takes on the challenge of distinguishing myth from reality regarding the ownership, operations and integrity of the Somali Remittance Companies that have, in a mere 15 years, grown from small personal arrangements into a significant industry. Tracing the history and growth of the remittance sector from the early 1990s to the present, he addresses key myths, such as: the remittance businesses are owned by Somalis in Somalia; only Somalia diaspora transfers money through them; remittance organizations are not legal or registered and do not pay taxes; and client funds are not safe.

His conclusions challenge the conventional view of remittance companies working in conflict-affected environments—they are not as informal as often assumed. Instead, he finds companies that have the full trust and confidence of their customers; that have an extensive resource of agents that service all the towns and villages in Somalia, as well as all major cities in countries populated by Somali diaspora; that run operations that are more efficient than traditional financial services; and most importantly, that are well placed to serve some rural areas where the majority of people live but would be little served by traditional banking institutions.

Achieving the operational efficiency and effectiveness referred to by Waldo is no easy task. Remittance companies face real operational challenges in setting up and sustaining their operations within and outside Somalia. In Chapter V, Shire, an experienced remittance operator, lifts the veil on the operational complexities of remittance operations in conflict-affected countries. He reviews the day-to-day technical, regulatory, security, cultural, institutional, logistical and managerial challenges in an environment that is anything but hospitable. He links each to the dynamic business environment in which companies have to engage with regulators; international, national and local authorities; global and local market competitors, the media and the public.

After discussing the threats and opportunities presented by each, he offers recommendations on how remittance companies, banks, regulators and the international development community can ensure the continuation of remittance services, build trust and strengthen mutually beneficial partnerships. To do otherwise, he warns, would result in the disruption of a service that not only provides a lifeline during periods of conflict, but also prevents humanitarian disasters in Somalia (another wave of mass displacement and emigration, instability, and resentment and extremism).

For Somali operators, one audience which requires particular attention is the international and national regulators, whose concerns over money laundering and terrorist financing activities peaked in the aftermath of the September 11 terrorist events, and have heightened yet again in the face of recent escalation of conflict in the country.

Tracing the current regulatory concerns with Somali remittance companies back to the 2001 closure of the then largest Somali remittance company, Al-Burakaat, on allegations of financing terrorist activities, in Chapter VI West outlines the regulatory hurdles that companies are now faced with. He considers how the new requirements for customer due diligence procedures, transaction monitoring and suspicious transactions reporting, record keeping and anti-money laundering compliance requirements, have changed the cost-of-doing business. Somali companies in particular have come under increased scrutiny for compliance to these new standards.

Companies that operate in more than one jurisdiction in particular, as many Somali companies do, face the challenge of complying with different requirements. With no ‘home’ regulatory framework in Somalia, regulators in different countries have adopted especially conservative standards which sometimes restrict if not curtail business activities for remittance companies.

4. Long Term Financial Sector Development

In the long run, however, the benefits of the remittance sector need to be complemented by broader financial sector reforms. Like other financial intermediaries, remittance companies are constrained by the absence of a sound legal and regulatory framework, strong property rights culture, enforceable collateral contracts, accessible credit information systems and related financial infrastructure.

The final chapter by Maimbo, Patel, Mahler and Siad focuses on the broader financial sector. They acknowledge that rebuilding a financial system after a period of sustained conflict is a challenging task. Trying to do so while the political process of nation building is still at its nascent stages makes the task doubly challenging. Managing the expectations of government, the private sector and the public is complicated by the evolving assumptions made about the likely direction of the political process and the resulting state structure. The authors argue that it can be done. Somalia, like other conflict afflicted countries can re-establish the following:

- An autonomous central bank that is fully equipped to carry out its monetary and financial sector regulatory and supervisory responsibilities;
- Banks and non-bank financial institutions which are sound, efficient, and competitive;
- Commercial banks and non-bank financial institutions, instruments, and services that meet the needs of the government, NGOs, businesses, and households in both rural and urban communities; and
- Financial infrastructure that is based on modern information technology and telecommunications.

The task, however, should not be underestimated. Post-conflict financial sector reforms are beset with several challenges, including: the failure of legal and regulatory structures; the complete disruption of international and domestic payments systems; the virtual cessation of all lending activities within the country; significantly reduced deposit taking activities; and a stoppage of most international correspondent banking relationships, particularly in the absence of a unified government structure.

In the absence of a functioning formal banking system, a large and vibrant informal market develops to either sustain the conflict or to provide relief to those unable to leave the country, or indeed, as is often the case, both. Where present, in most conflict affected countries, the informal financial market is largely organized around the money exchange dealers and their ability to transfer funds into and outside the country through informal networks. In many countries these informal firms grow to become mainstream registered non-bank financial service providers. Although impressive, these service providers do not provide the full range of financial services required for dynamic private sector-led growth after the end of active conflict. Consequently, private sector-led growth remains highly constrained unless a functioning banking system is developed to provide financial resources and other supporting banking services to underpin these investments.

Somalia faces each of the challenges listed above, if not much more. In rebuilding a market-oriented, private-sector-owned financial system, reformers need to adopt a multidimensional approach. While ensuring the implementation of medium- and long-term goals, financial sector reforms must address urgent short-term needs, particularly the restoration of a functioning central bank and the provision of basic retail financial services. Experience in other post-conflict countries shows that the focus of reforms must include:

- Drafting a new or substantially updating the legal and regulatory framework of the entire financial system and building regulatory capacity to enforce that framework;
- Re-establishing corporate governance mechanisms and technical capacity in the banking system and the financial sector infrastructure as a whole;
- Developing creative systems for facilitating access to financial services for small and medium enterprises and rural communities, and;
- Broadening and deepening the financial sector.

In contributing their chapters to this publication, the authors hope that this collection will facilitate the commencement of substantive reforms when Somalia begins to experience enduring peace.

II. Somali Remittance Sector: A Macroeconomic Perspective

Sibel Kulaksiz and Andrea Purdekova

There is a glimmer of hope for an otherwise dismal failed state of Somalia. This hope is the emergence of a thriving private sector fuelled by worker remittance inflows. If the nascent private sector is nurtured and protected with an enabling macroeconomic management structure under a functioning state, the opportunity for a turnaround can be seized.

With a population of 7.3 million in 2004, and an income per capita of $226 less than half the regional average, Somalia is one of the poorest countries in the world. During the 1970s and 1980s, Somalia's per capita output declined, physical infrastructure and the quality of public services deteriorated, and severe macroeconomic imbalances emerged, culminating in negative growth during 1988-90. During this period, significant aid inflows helped to prop up essential government social services, but much of this spending was wasted and did not reach the poor because of the weak capacity and corruption in the civil service, and the poor quality of the leadership of the country.

High inflation and financial collapse devastated Somalis in the 1980s. Inflation remained high throughout the 1980s because of rapid rise in credit expansion by the state-run commercial bank to un-creditworthy public enterprises and individuals favored by the ruling regime. Money creation and bank financing of the domestic budget deficits also contributed to the high inflation which increased at an annual average rate of 107.3 percent in 1988-90. The eventual collapse of the commercial bank, and the loss of depositor's money, led to a lack of public confidence in government and banks. The tax system was distortionary and cumbersome, and the tax administration was weak. The revenue to GDP ratio at 5 to 7 percent, between 1984 and 1990, remained among the lowest in Africa.

Despite the absence of a state, a thriving private sector emerged in the 1990s. Powered by worker remittances from abroad, some private sector activity is thriving in Somalia since the 1990s. To nurture the nascent private sector, broaden private sector activities and avoid the perils of sudden collapse, it is imperative to construct a macroeconomic management structure. It is important to understand current motivations and incentives of the private sector, to build a sound and trusted macroeconomic management structure for the future in an economy incorporating a state.

1. Successes and Failures in a Conflict Economy Supported by Worker Remittances

Somali entrepreneurs have adapted well and even flourished in a stateless conflict-ridden economy. Since 1991, the economy has suffered from droughts and the devastating civil war. Unlike the 1970s and 1980s when most of the output of the small industrial sector and many services were provided by the public sector, there has been significant private investment, which has not been measured due to the absence of statistical institutions. Private activities have emerged in trade, money transfer services, transport and telecommunications, funded by remittances from the diaspora. Remittances amount to at least $1 billion today, 71.4 percent of GNP, compared to an average of $370 million in the 1980s and 1990s. There has been little foreign investment in recent years.

Most of the economy remains stunted by weak governance systems. In real sector activity, agriculture, specifically agro-pastoralism and crop production, dominate GDP. Because of lack of GDP data by sectoral breakdowns, the share of the productive sectors in the Somali economy now is not known. However, some assessment can be made using information available for 1990 and earlier. In 1990, the agricultural sector accounted for about 64 percent of total GDP. About 52 percent of this share was generated by the livestock sub-sector and some 37 percent by agricultural crops including fruits. The most prominent sub-sectors in services were trade and hotels, and transport and communications. Although shares might remain similar to the pre-1991 period, agricultural production is well under its peaks in the mid-1980s, mainly because of continued insecurity, destruction of irrigation systems, and absent or weak government. The contribution of manufacturing to GDP in the late 1980s was no more than 5 percent and it still remains low today.

A post-conflict economy without restrictions helped the private sector and cross-border trade in a profound way. Although reliable data are not available, cross-border trade has been growing steadily over past six years. Data on total exports and imports through major ports are collected in physical quantities, but not reliable. More reliable aggregate trade data reported by partner countries to the IMF show that imports have almost doubled, reaching a historical record of $461 million in 2004. The largest recorded imports through Berbera and Bosasso ports are food (sugar, wheat and wheat flour, rice and cooking oil), building materials, and fuel. Khat, a mild narcotic, is the second top import product after sugar.[2] Exports have almost tripled during the past six years, by reaching $266 million in 2004. Livestock continues to dominate exports, despite the Saudi ban on Somali livestock imports, followed by charcoal, fish, and hides and skins.

The absence of a monetary control is stoking inflation hurting the poor and endangering private sector growth. Inflation rose throughout the country due to the substantial injection of foreign-printed currency.[3] In addition to the monetary expansion, prices rose because of higher world fuel prices and food insecurity. In South-Central Somalia, the CPI index suggests inflation went up from 14.4 percent in 2002 to 16.4 percent in 2003. Recent inflation data based on Mogadishu consumer prices suggest average inflation of 5 percent for the first quarter and 2.4 percent for the second quarter of 2005 measured across 102 consumer goods. In Somaliland, based on the price of 115 consumer goods in the Gobanoimo market in Hargeisa, average inflation for the period of January to July 2005 stood at 3.9 percent. Price developments at the Shiraaqle market in Hargeisa for the same goods and the same period show average inflation of 8 percent. In 2006, cereal and sorghum prices in local markets continued to rise because of drought, and two consecutive seasons of below normal and failed crop production.

Absent a central bank, strong inflationary pressures could precipitate an exchange rate crisis. Money exchangers operate freely in the country and the system is becoming increasingly dollarized. Despite the political uncertainties, the Somali and Somaliland Shilling have remained stable since October 2004, at 14,500-15,600 SoSh/US$ for Somali Shilling, and at 5,900-6,400 SlSh/US$ for Somaliland Shilling. The rise in livestock exports to the Middle East (excluding Saudi Arabia) has kept the currency stable in recent years, but significant depreciation of the Somali Shilling is likely because of the recent shipment of newly printed Somali currency.

Essential government services are hampered by inadequate revenue resources. Since 1991, only meager information exists on fiscal flows for Somaliland and Puntland, and no fiscal estimates are available for the South-Central region. Fiscal management in the two northern regions suffers from low revenue collections, spending mostly for security and general administration, and poor planning and coordination of development projects. Trade taxes have been the source of more than 80 percent of annual revenue. Budget allocations have been least for infrastructure and social services. Deficit financing is limited to loans from major business people that are repaid through tax exemptions.

Worker remittances are the lifeline for ordinary Somalis. Somalia’s financial relations with international creditors were frozen in late 1980s when financial policies slipped out of control. From 1990 to 2006,

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[2] According to Kenya's National Agency for the Campaign Against Drug Abuse, Kenya’s annual khat exports to Somalia amounts to $110 million.

[3] The first shipment of newly printed Somali currency, worth SoSh500bn ($352m), arrived in Puntland on May 3, 2006. The order, placed with an Indonesian company, was made through a Somali businessman.

because of significant arrears on past debt-servicing obligations, the lack of a fully functional national government, and the unstable security situation, Somalia neither borrowed nor serviced its public debt. After 2004, Somalia's external debt was estimated at $3.2 billion, of which $2.5 billion was in arrears. In the absence of new lending, official development assistance (ODA) to Somalia has been rising steadily, reaching $119 million in 2000 and $272 million in 2003. Per-capita aid to Somalia, had reached $41 in 2003. Remittances, roughly four times official development assistance, clearly show that the major inflow of "aid" has come from Somalis themselves.

2. The Remittance Sector: Effects on Poverty and Growth

The cost of civil conflict and absence of a state in economic and social development has been extremely high. The World Bank Country Economic Memorandum 2006 found that at a steady growth rate of 2 percent—the same as that experienced during the mid and late 1980s—economic real per capita output and income (assuming pre-1990 remittance flows) in 2002 could have been about a third higher than it was before the civil war (1988-90). Today, 47 percent of the economically active population is unemployed in Somalia. Health infrastructure is dilapidated or non-existent, health care only sparsely provided and enrollment rates in schools are the lowest in the world.

Remittance companies, in the absence of commercial banks, are the main mechanism to transfer money in and out of Somalia. Remittances have been a significant contributor to family income and investment, with subsequent effects on poverty and inequality. Especially in times of economic depressions and external shocks, remittances have been extremely important to the Somali economy because they tend to smooth consumption and thus create a "buffer" against shocks. Remittance inflows have risen during times of drought, the Saudi livestock ban and inter-clan warfare.

Most Somali remittances, which range between $50-100, are used for direct consumption by the household, including education and health. It is widely accepted that most remittances are spent on consumption, followed by investment (on a much smaller scale). Consumption accounts for at least half of remittance spending, most likely up to two thirds. Studies on remittances in Somaliland show that increasingly remittances are also used to fund new organizations and development projects (Hansen 2003).

Whether invested or consumed, remittances have important macroeconomic impacts. They generate positive multiplier effects, while stimulating various sectors of the economy. Adelman and Taylor found that for every dollar Mexico received from migrants working abroad, the GNP rose by $ 2.69 to 3.17 depending on whether remittances were received by urban or rural households (Rathe 2003). Recent studies analyzing links between remittances and poverty in Ghana (2005) suggest that raising remittance by 10 percent decreases the share of those in poverty by 3.5 percent and has a negligible impact on income inequality, as measured by the GINI coefficient (Adams 2005). An earlier study (2003) of 74 low and middle-income countries suggests that the impact of remittance flows on the poverty headcount might be smaller on average (Adams and Page 2003). The point estimates for the poverty headcount measure using survey mean income suggest that a 10 percent rise in share of remittances in GDP will cause a 1.6 percent decline in the poverty headcount ratio (people living on less than $1/day). The point estimate for the poverty gap and severity of poverty (poverty gap squared) suggest that on average, a 10 percent rise in share of remittances in GDP will cause a 2 percent decline in depth and severity of poverty. The effects of remittances on poverty might be underestimated in the last study because in measuring remittances, the large (and unknown) amount remitted through private, unofficial channels is not included.

Remittances have strong positive impacts on the current account balance of Somalia but could also have less desirable outcomes such as the Dutch disease effect. Although remittances as foreign savings allow Somalia, a country without access to international capital markets, to consume outside its production frontier, these inflows might also draw resources from tradable to non-tradable sector, worsening the welfare of families that do not benefit from remittances.

Studies of remittances in Hargeisa, Burco and Bosasso calculated that remittances constitute nearly 40 percent of the income of urban households, which would leave roughly 14 percent for average rural consumption (Gundel 2002). Besides direct re-distributions, there are also spill-over effects. A study in Hargeisa found that usually those, who earn less than $2/day, have no direct access to remittances from abroad but have to rely on gifts from family members or neighbors. One negative impact is that remittances might discourage job-seeking and keep unemployment high.

3. Conclusion

Somalia's private sector has done surprisingly well, as it is not only surviving, but growing in conditions of a free market supported by steady remittance flows. Even so, there are pitfalls to a conflict economy without a state, the most important being failure to provide public goods and failure to correct negative externalities. Although it is true that the private sector and the NGOs picked up provision of key services after the "exit" of the state from this arena, this provision has been extremely narrow in scope.

While remittances play an important role in the Somali economy, they cannot become a source of long-term sustainable growth. In the medium term, if there is an improvement in the political and security situation, it is expected that part of former remittance will turn into domestically-sourced investment as Somalis start returning home. In the longer term, regulations need to be put in place to promote investment, which is a crucial precondition for long-term growth.

III. The Influence of Migration, Remittances and Diaspora Donations on Education in Somali Society

Anna Lindley[4]

Literacy and primary school enrolment levels in Somalia are among the worst in the world.[5] This is partly an outcome of the political upheaval of the last two decades. Another outcome of this political upheaval is mass emigration—the Somali diaspora is estimated at over one million people or roughly one sixth of the population of Somalia (UNDP 2001). As this collection underlines, many of these people retain contact with family members and home communities. Emigration and migrants' remittances have complex effects in the country of origin. Exploratory research presented in this chapter suggests that the diaspora is one of the important social forces shaping education in Somali society today.

The issue of education emerges in analyses of international migration in several respects. Well-educated migrants tend to travel more internationally, where less educated migrants more often move within their country or region. Much research has focused on the effects of the emigration of well-educated people. The migration of highly skilled workers may be seen as a loss of human capital—'brain drain' or even 'brain desertification'—and a loss of any public investment in their education (Ouaked 2002). Where professional working conditions in the country of origin are really poor, sometimes high-skilled people migrate to take up low-skilled jobs in the destination country—'brain waste' (Ouaked 2002). The return of well-educated migrants with valuable skills, international networks and capital is usually beneficial—'brain circulation', 'brain exchange' or 'brain gain' (Pellegrino 2001). Even while remaining abroad, migrants may engage in trade or community development with their place of origin—'brain retrieval' (Meyer 2001; AFFORD 2004).

Researchers have examined the links between education and the motivations and determinants of remittances. Some studies suggest that by sending remittances, migrants repay their families for their education and upbringing (Poirine 1997). In studies of the remittance behavior of Latin Americans in the United States, years of education usually correspond with higher income levels, but may not correspond to higher levels of remitting—more educated migrants may come from families less in need of support, or their education may afford them more rapid economic integration in the host country and the relinquishing of connections with their country of origin (Massey and Basem 1992; DeSipio 2000). Most studies of remittances, however, focus on how this income affects the livelihood of recipients. Where earlier research judged the impact of remittances in terms of whether or not they were used for productive investment, research in the last decade has recognized that using available resources—including remittances—to ensure that household members are fed, sheltered, educated and healthy is not only important in itself to people's well-being, but also represents a investment in a household's human capital that can lead to economic benefits for the household and wider society (Goldring 2004). However, there is little research that traces in detail the impact of remittances on education. A rare example of such a study found that in El Salvador the key determinant of school retention was parental schooling, and that remittances had a much larger impact on the hazard of leaving school than other income streams (Cox and Ureta 2003).

Of course, the influence of international migration on education will vary according to the specific national educational context. The mobile pastoral livelihoods of the majority of Somali people have always challenged the spread of conventional formal education, but Siad Barre's regime had achieved

[4] The author would like to thank the Africa Educational Trust and the University of Oxford for logistical and financial assistance, and conference participants for their useful comments.

[5] The term 'Somalia' is used to specify the territory of the Republic of Somalia as of the 1960s, and 'Somaliland' to denote the self-declared Republic of Somaliland as of 1991.

considerable advances (Ahmed 1988; Laitin and Samatar 1988). However, in 1988 civil war broke out in the northwest and spread to other regions; the regime and the state collapsed in 1991. The public education system was left in tatters—teachers no longer paid, families fleeing their homes, schools looted and occupied by displaced people.

Since the state collapsed, Somali primary and secondary schools and colleges have been funded and run by a variety of actors: local communities and parents, private individuals, religious organizations, international and local NGOs and local authorities, or the government in parts of Somaliland, and as we shall see, diaspora groups. There has been substantial progress in many communities in rebuilding schools and getting children back into school. There were around 196,000 children in primary school in 1985, compared with 286,000 in 2004. There were nearly as many primary schools (1,172) and teachers (9,088) in Somalia in 2004 as in 1985, (when there were 1,224 primary schools with 10,338 teachers). However, the story so far is one of only partial recovery, compared with pre-war standards—overall primary school enrolment rate is similar to the 1980s, at just under 20 percent, and for those in school, student-teacher ratios have increased by 65 percent.[6] The contemporary educational situation varies across Somali areas, with primary school enrolment much higher in the more stable Somaliland (37 percent), less in Puntland (18 percent) and lowest in the Central/Southern Zone (13 percent) (UNICEF 2004). Neighboring countries Djibouti, Ethiopia, and Kenya had gross primary school enrolment rates of 32 percent, 35 percent and 65 percent respectively in 2000 (UNDP 2001).

This chapter focuses on the influence of the diaspora, particularly those in the Middle East and the West, on formal education at primary, secondary and tertiary levels, in terms of how it affects local people's access to, choices about, and the provision of education. Access to formal education depends on being able to afford the direct and indirect costs of education, and the existence of local education provision. Direct costs of education may include fees, educational materials, transport, stationery, etc. Most Somali primary schools charge fees or ask for parental contributions of less than $3 per month—schooling more often costs nothing or under $1 in Puntland and the Central/Southern Zone (UNICEF 2004). Indirect costs of education include the opportunity costs of the student not working, in the home or outside, to contribute to family welfare or livelihood. As women's economic role increases, elder girls are often given roles in the household that prevent them from attending school. Girls make up about one third of the primary school population, but fewer at secondary school (UNICEF 2004). Many young people do not have the choice of being educated. For those that do, choices can include: whether to participate in education or not, what type or which institution to attend; and what course of education to follow. Quality of education varies depending on teacher availability and training and the availability of funds to pay teachers a living wage, maintain buildings and provide learning materials.

This analysis is based on research in 2004-05 in Hargeisa and London.[7] In Hargeisa, the research involved interviews with Somaliland government officials, NGO workers, teachers, parents and students and a survey of a non-random sample of 130 tertiary and secondary students. A larger survey of a random sample of over 500 people collecting remittances from money transfer outlets in the city was carried out in August-September 2005.[8] While not precisely representative, the survey findings may be taken as painting a broadly indicative picture of the situation of people who receive remittances in Hargeisa, how much they receive, from where and how the money is used. In London, the research involved informal consultations and formal interviews with people originating from various Somali areas and clans, and a survey of 175 remittance senders. The chapter focuses on their effects in Hargeisa, the capital of the self-

[6] This comparison draws on UNICEF's Survey of Primary Schools (2004), pre-war UNESCO data available on www.uis.unesco.org and UNDP (2001)
[7] This research was conducted as part of the author's doctoral project which investigated the dynamics and effects of Somali remittances in general.
[8] This was conducted in co-operation with Dahabshiil, a money transfer company.

declared Republic of Somaliland. The situation in other Somali cities and in rural areas is considerably different and therefore these results cannot be generalized, in particular because of the relative stability of Hargeisa during the last decade. However, all evidence suggests that the conclusion of these investigations in Hargeisa—that the diaspora is playing a considerable role in shaping education—holds true across Somali society. The process of migration influences education in three main ways: through outward and return migration, family remittances, and diaspora donations to educational institutions. While the extent of the diaspora contribution is difficult to gauge based on available data, this chapter traces the mechanisms of influence and explores the relationships involved.

1. Migration

Migration in both directions is intertwined in complex ways with education. First, migration patterns are socio-economically differentiated, one factor being education. It is reported that 80 percent of the country's skilled population has left since the conflict began (EC 2002). Those who were better educated were often better-off and better able to mobilize the financial resources and social networks required to rebuild their lives in the diaspora, and indeed to choose where to live. The consequent brain flight sapped the capacity to provide education—as some Somali communities became more stable, and rehabilitated schools, they struggled to find and attract qualified teachers.

Box 3.1: Blooming Primary School

The Blooming Primary School was founded in 1999 by a Somali Canadian family which returned to Hargeisa and identified an unmet demand for English language primary education for the children of families returning from the West. Today, the school has about 580 4-15 year old pupils. There are 23 classes of 18-25 pupils, and 31 teachers. It is expanding into a secondary school as the eldest cohort progresses, and land has been purchased to develop a new site. The school follows the Somaliland curriculum in Islamic Studies, Arabic, Somali and Social Studies. For other subjects—Math, English, and Science—they use an international syllabus taken from India. Teacher salaries range from $100-300, considerably more than in the public sector. The school fees are expensive—$25 per month per child, $30 including transport. If a family has more than two children at the school they get a discount. 150 pupils are exempt from paying fees, of which around 60 children come from Hargeisa Orphanage.

The students were born in Somaliland, Canada, US, UK, Norway, Finland, Sweden and other countries. Nearly all of the approximately 430 fee-paying students have lived abroad. Their families decided that the children should go to Hargeisa to become better acquainted with Somali language and culture and to get to know their relatives. The length of their stay in Hargeisa depends among other factors on the family's immigration situation in the host country, and on their plane tickets. Among the fee-paying students, fewer than ten families have stayed in Hargeisa for more than five years - many children stay just one year. The main cause of children leaving the school is that the child's family moves abroad again. Around 80 per cent of the students coming from abroad moved to Hargeisa with both parents, or with their mother while their father remains working abroad. Around 20 percent live with other relatives and their parents live abroad, usually sending money for the child's fees. The teachers have found that students who live with their mothers do the best in school because their mothers check that they are working well—in contrast, students living with other relatives tend to have less support at home. The children who have been living abroad quickly fluent in Somali, but some have difficulties learning in English (the teaching language). Children coming from the UK are fluent in spoken English but often have poor reading and writing skills.

Source: Interviews with parents, children and principal, March 2005.

Second, education is one of several motivations for people leaving today. Even young residents of the relatively stable Hargeisa still often seek to go abroad, prompted by limited educational facilities, material insecurity and high unemployment, and the hope of better economic opportunities. Young people with relatives abroad often appeal to them for assistance, and emigration beyond neighboring countries is often, if not usually, financed and facilitated by relatives living in rich countries. As eligible close relatives have been reunited in the diaspora under family reunion provisions, and as asylum and immigration to the West becomes more restricted, migration is sponsored by relatives in Europe and

North America to other destinations. Increasing numbers of Somali university students study in Arab and Asian countries, particularly Yemen, Pakistan, India, and Malaysia.

Third, return can affect demand for education. The relative stability of Somaliland since 1997 has prompted the return of many migrants to Hargeisa, the majority from Ethiopia on UNHCR voluntary repatriations but also people from the Middle East and further afield (Ministry of National Planning and Coordination 2005). Those returning from the Middle East and the West are better-off. Some return with a nest-egg and start small businesses. Their return may be gradual, with ever longer visits. Hansen (2003) has highlighted the fact that some people who return to Somaliland become 'revolving returnees'—finding themselves not quite able to earn a living locally, they return to Europe to work, men sometimes leaving wives and children in Somaliland. Parents send young people to get to know the culture, language and relatives, and to keep 'out of trouble'. The return of relatively monied diaspora families to Hargeisa has further stimulated demand for private education, encouraging providers to offer smaller class sizes and English or Arabic medium teaching. A particular example of this growing trend is given in Box 3.1.

2. Remittances

Beyond going and returning, migrants also influence education in Hargeisa by sending remittances to family members. A substantial minority of people in Hargesa receive remittances—it has been estimated that nearly 40 percent of households receive remittances and for nearly one quarter, remittances are their main source of income (these figures exclude people in several poverty-stricken settlements on the outskirts of the city, where fewer people receive remittances) (Medani 2000). The Academy for Peace and Development estimated that remittances represent perhaps 20 percent of household income in urban Somaliland (Academy for Peace and Development 2004). These remittances mean that some Hargeisa families are better able to afford the direct costs (Table 3.1) and indirect costs of education:

Table 3.1: Fees Charged by Educational Institutions in Hargeisa

Level	**Public**	**Private**
Primary schools	Around $1 per month	Up to $30 per month
Secondary schools	Around $2 per month	$15 or more
Tertiary institutions	$270-360 per year (more for certain subjects)	

Source*:* Interviews, March and August 2005.

The research conducted is exploratory—it does not allow us to reach firm conclusions about the impact of remittances on education versus other potential factors (e.g., birth order, gender, other income sources, parental schooling)—but several correlations and comparisons are worth noting. Recipients surveyed in money transfer outlets across Hargeisa at the end of August 2005 received an average of around $200 per month in during the previous year. Even before counting other sources of income, regular remittance recipients tend to be among the better-off or average segments of the population—annual per capita income is estimated at $491 for urban Somaliland and $291 for urban Somalia (Ahmed 2000; UNDP 2001; King 2003; Academy for Peace and Development 2004).

Thus remittances play a central role in the livelihoods and welfare, including education, of many families in Hargeisa. Around half the recipients surveyed lived in households with no other source of income apart from remittances—the rest had some other source of income, from employment, a business, or other assets. Nearly two thirds of recipients surveyed said that remittances were used for education. An average of 7.7 people lived in the households of survey respondents, and about half the households with children aged 6-15 years old had all their children in school. Of the more than 1,000 children in this age group in respondents' households, over 80 percent were in school. This is substantially higher than average primary school enrolment rate of 37 percent in towns in Somaliland (UNICEF 2004).

This is corroborated by teachers at all levels who notice the impact of remittances in their institutions. The principal of a public primary school commented: "Remittances have had a good influence on education as many children get a chance to learn as they receive money from their relatives in other countries, they can also buy books and pens." The principal of a public secondary school pointed out that: "There are some who pay their contribution on the 28th of the month, in advance; they won't look at the calendar they just pay as soon as they receive the money from outside!"

At the other end of the educational scale, according to the Vice-Chancellor of the University of Hargeisa, remittances are one of the main sources of income in students' households, the other main source of income being women's business or employment. Of 80 tertiary education students surveyed in clasSRComs and libraries, around a quarter said that their families received remittances regularly, half said they did not receive remittances and the rest received money sometimes. Those whose families did receive support from abroad commented on the questionnaire that they play an important role in the household budget: *"Saameyn ayay noloshayada ku leedahay. Waxa ay dabooshaa baahiyahayaga nolol-maalmeedka, waxbarashada iyo ganacsi in aan ku kordhisanno."*(It has an impact on our life, it covers our daily needs, education and to build up the business.) *"Lacagtu is-beddel way sameysaa maxaa yeelay waxbarashada ayay kuu fududaynaysaa."* (The money makes a difference because it makes education easier for you.) *"Dhaqaalaha, amaba dakhliga soo gala qoyskayaga aad ayuu u hooseeyaa, Nolosha dadkiina waxay ku xidhantahay lacagaha dibedda looga soo diro."* (The economy, or the income of our family, is very low. The livelihood of the people depends [very much] on the money sent from abroad.)

Conversely, teachers notice that when such students do not pay their fees, and it is usually because the remittances have not arrived. In public schools, teachers keep a close eye on this as the wages of staff may depend in part on parental contributions. Administrators at the University of Hargeisa also noticed that of the 30 percent of tuition fees paid on time in 2004-05, most came from students who were supported by relatives in the diaspora and that sometimes students drop out because the remittances that their family receives have decreased or stopped, perhaps because their relative abroad lost a job or got married and had children.

Although teachers consulted in public and private primary, secondary and tertiary institutions were unanimous that remittances played a part in the household livelihoods and education of some of their students, the proportion of students affected varies depending on the type of institution. In the words of a public secondary student: "Only the rich students who are depending on abroad can go [to private schools]. Also if you have a large family, it is not possible to go to private school." Private schools are able to attract the well-trained teachers with higher wages, are better resourced and have more modest class sizes than public schools. Regular remittance income is more common among families of students in higher cost education at private and tertiary institutions.

A variety of relatives transfer money to people in Hargeisa. Sixteen percent of the remittances recorded in the survey came from the husbands of recipients. In this traditional pattern, the migrant husband sends money for the upkeep of his wife and children, as illustrated in Box 3.2. However around 40 percent of the remittances came from siblings—17 percent from sisters and 22 percent from brothers. Migrants in the West in many cases managed to reunite with their spouse and children as their first priority, under family reunion or asylum measures (or only got married after emigrating). Thus, their relatives that remain tend to be parents and siblings. Supporting siblings is consistent with cultural tradition, whereby townspeople take in young rural relatives, often younger brothers, and give them an education. Nieces and nephews also benefited, with special cultural expectations attached to the role of uncle on the father's (*abti*) and mother's (*adeer*) sides. Many educated emigrants have grateful memories of assistance given to them by older siblings before the war, and feel that they should repay them, and/or in turn support younger siblings or nephews and nieces in their education. In Hargeisa, interviewees often spoke in particularly glowing terms of specific elder brothers and sisters, or aunts or uncles, who have constantly encouraged and financially supported their education.

Box 3.2: Yusuf[9]

Yusuf is 19 years old and attends a public secondary school in Hargeisa. He was born in Djibouti and moved with his family to Hargeisa in the mid 1990s. He lives with his mother and seven siblings. All of the siblings are in public schools, the eldest is at University. The family's main expenses are rent ($60 per month for three rooms), school fees, transport to school, food, electricity and water. He thinks that his family is doing OK. His father is in Djibouti most of the time, he works in shipping and sends Yusuf's mother around $200 each month. This is the only source of regular income for the family. Sometimes an uncle who lives in Sweden also sends some money.

Source: Interview, March 2005.

It is clear that the role of the diaspora does not stop at simply transferring money. People are often in regular telephone contact and migrants sending money often encourage relatives to invest in education. An NGO worker sums up the attitude of many in Hargeisa and in the Somali diaspora: "For some reason, if a child is out of school it has a big effect on the relatives abroad. People have a strong reaction to want to help… Other needs are not taken so seriously for some reason. Especially educated people outside think education is very important and encourage people to send their children to school." There is a general perception in Hargeisa that the diaspora is keen to ensure that their families invest in education. According to another NGO worker: "Their families abroad who send money give advice to their family and they ask have you sent the children to school?"

Their encouragement is motivated by concern for the families' welfare and economic prospects, which are better if the children are educated. Many migrants in the West are conscious that their own children get free primary and secondary education. Remitters are often keen to try to ensure that their hard-earned remittances are used productively, and that their young male relatives will not end up unemployed, spending much of their time chewing khat. In other, unstable Somali cities, families have other concerns, as one British citizen from Mogadishu commented: "The children, if they don't go to school, they become militia, simple! How can we reduce that militia? You should send to your family… neighbor [and clans people]... If someone called me today and says my child cannot go to school because I don't have fee money, I should feel guilty, if I have got money and someone told me that story." Moreover, in this kind of situation, pressure often builds on diaspora relatives to help unemployed young relatives to leave the country. Often this is expensive and risky, and many migrants may prefer to support their young relative's education locally instead.

Thus, remittance amounts to the family in question are sometimes fixed or increased to accommodate educational needs of family members. Sometimes the emigrant begins to remit directly to older students. Some remitters take an active interest in the educational 'product' they are directly or indirectly buying for their young relatives in Hargeisa, as the Principal of Mercy Academy found (Box 3.3). As with Blooming Primary School (Box 3.1), this is the high end of the educational market in Hargeisa, and indicates only part of the transformations underway. Many of those receiving remittances are just able to cover the family's essential needs, but as evidenced by the survey data above, keeping the children in school is often considered foremost among these needs.

[9] Names have been changed and some details altered to preserve anonymity

Box 3.3: Mercy Academy

Mercy Academy was established in 2004 by two Finnish citizens, who left Somalia because of the war. The Principal took a year's career break from his job with an international IT company in order to set up the Academy. The course offered is an advanced diploma in Business and IT, accredited by the UK-based Association of Business Executives. Fees, course material and examination fees total around $700 per year. The teachers are from various countries around the world. The fees are high for Hargeisa, but the fact that the qualification is internationally accredited and the course progresses faster than other higher education qualifications is attractive for students. Large numbers of the students receive assistance from family members abroad. From the beginning the role of the diaspora was obvious. Prospective students enquiring about enrolment often said that they would send the brochure and advertising materials to family members abroad whom they were planning to ask for help. When students are late paying it is often because remittances have been delayed. In some cases, someone abroad pays for their education by transferring money directly into the Academy's account.

Source: Interviews with principal and conversations with students and teachers, March 2005.

3. Donations

The third way that the diaspora influences education in Somalia is through establishing and making donations to educational initiatives. Emigrants and businesspeople have provided the impetus and, crucially, considerable finance for initiatives to establish or improve schools and colleges in many Somali communities. Of the 175 remitters surveyed in London, half had made donations for educational purposes in Somalia in the last 12 months, an average of around $150.

These funds were destined for institutions from village schools to universities, throughout Somalia. Most primary schools in Puntland and the central and southern zones are owned and managed by the local community and parents, and in Somaliland, most are owned and managed by the Somaliland government (UNICEF). In the great majority of Somali primary schools, teachers receive support (mainly cash) from the local community and parents; in many schools international and local NGOs also support teachers and in Somaliland, the local authorities play an important role (UNICEF 2004). From Borama to Las Caanood to Afmadow to Mogadishu, diaspora donations, as yet unquantifiable, channeled informally through the local community and parents or through a local NGO, contribute to the funding of schools.

Educational funding initiatives can be more or less institutionalized—from ad hoc personal donations to fund-raising campaigns to small NGOs. Members of a sub-clan in a particular area may come together over long distances, by phone and internet, to mobilize donations. In one of numerous examples, a group of people scattered across Australia, New Zealand, North America, Europe, the Middle East and Africa, held together by family and clan connections, make regular contributions to Irro Primary School in Bursalah in Puntland for 400 5-16 year-old children. It is registered as a charitable organization in the UK, and draws entirely on diaspora funds. People are persuaded to donate to such initiatives through a variety of methods, from visits by friends and clan members, email lists and groups, advertising at Mosques and community centers, distribution of leaflets, public meetings, to advertising on internet news and through websites. Sometimes there is a one-off fund-raising campaign to raise a large sum, while elsewhere people make regular contributions over time to support running costs. People in London usually give their donations to a responsible individual, organizer or fund-raiser, but sometimes send the money direct to the school's account at a remittance company, which often offer discounted commissions on transfers to charitable projects. At the other end, the funds are used to pay for repairing or building schools, paying teacher salaries, providing scholarships, or paying for the shipping of learning materials and equipment. One NGO worker commented that this can have interesting consequences at local level, for example, if a Yemeni diaspora group is supporting a school they send Yemeni textbooks and if a British diaspora group is supporting a school they want to use British materials, thus shaping what the students learn.

People describe various motivations in making these contributions. Connected with remittance motivations, there are practical considerations, for example, if you want your sister's children to go to school and there is none in her small village, apart from arranging for them to stay away from home, your only option is to help to build a school. There is the religious duty to give *sako* (alms) to needy people. There is empathy with the community that you come from, a feeling of guilt or thankfulness for one's own good fortune in escaping the civil war and the aftermath. There is also a symbolic value to having a school, a sense of putting a place on the map, a sense of clan pride, and in some towns, civic pride. In Somaliland, this fund-raising for the public good is termed *Jaaliyaad* which roughly translates as community. In the past, the Ministry of Education in Somaliland noted considerable competition between different villages to start a primary school, and now, increasingly, for towns to start secondary schools and colleges.

Interaction between these diaspora donations and political authorities and NGOs is as yet limited, but developing in interesting directions. The Somaliland government encourages and welcomes the diaspora funding of educational initiatives. Several public schools established with diaspora funds by the local community have been transferred to the management of the Ministry of Education. The Ministry of Finance often waives import taxes for school projects. However, the Somaliland government, while recognizing and encouraging of diaspora transfers, does not systematically promote or monitor contributions.

Some diaspora funding initiatives would be best defined as informal solidarity networks; others are more complex organizations, with offices staffed by employees or volunteers, forging contacts with international NGOs and donors. There is a blurry line between many diaspora funding initiatives and local NGOs, depending on how institutionalized the enterprise is.

Box 3.4: Buhodle School and Africa Educational Trust

The director of the Africa Educational Trust (AET) was approached by a group of people in London with connections to Buhodle. They were planning to raise funds to establish a school and get an NGO to help. AET staff visited Buhodle, and they agreed to match the funds that the London group raised. The group later came to the London office with $1,000 in cash that they had raised from contacts in the UK. AET in Hargeisa handed over a total of $2,000 to a man delegated by the town to receive it, and later visited to see the results, also receiving a very full account of exactly how the money was spent. According to the Director: "AET was very pleased with the idea - as they obviously did use the funds for what we had agreed and there was a lot more done with it than if UNHCR / UNESCO or some of the other bigger organizations had been involved. It was clear that they were asking us to help and not that it was an AET project that we were trying to get them to implement."

Source: Personal correspondence, November 2005.

Regarding international NGOs, some migrant-funded projects are more comfortable than others with relying on diaspora contributions. As a member of one migrant-funded project put it: We thought—why ask for help from other people when you can do it yourself." Ruunki Development Initiatives (known as 'Ruudi') established by Somali community development workers in London, began under the same principle, and much of the organization's funds so far have been raised by Somalis in London and Dubai. Now an umbrella organization supporting seven community initiatives including a school in Western Hiiraan, it came to the conclusion that fundraising in the diaspora alone was not a sustainable method of financing its activities and has begun to undertake projects with international partners, including a QUESTS placement (Qualified Expatriate Somali Technical Support, a UNDP scheme to facilitate the return of diaspora professionals to work in Somalia) and a university scholarship scheme with a Malaysian NGO that funds Somali high school students at university in Kuala Lumpur. Moreover, international NGOs and diaspora initiatives work in parallel in some of the same communities and inevitably affect each others' projects. Since 1998 the Danish Refugee Council (DRC) assisted with the rehabilitation or reconstruction of over 60 schools. Staff are aware that many of these schools have at one time or another also received some assistance from the diaspora, often for teacher salaries. In some cases, the community raised some funds from abroad and then approached DRC to ask for help in building the school. Another example of such cooperation is shown in Box 3.4. Thus, in ad hoc ways, some forward-thinking international NGOs, less mired in bureaucratic procedures and internationalized uniform models of operating, are able to respond to and cooperate with similarly open and enterprising diaspora groups.

4. Conclusions and Recommendations

Any attempt to gauge the precise extent of the impact of migration on education in Somali society is fraught with difficulty. This chapter has traced the contours and modes of influence of international migration on access to education, choices about education and provision of education.

First, past and current emigration and return migration patterns are intertwined in complex ways with the issue of education. Brain flight has decimated educational capacity, and the as yet limited return of trained professionals and new training programs goes only a little way to remedying this. Seeking educational opportunities is one of several motivations for young Somalis to emigrate, although for many there are more pressing physical security concerns. The return of relatively comfortable diaspora families to Hargeisa from the West and the Middle East has increased the demand and supply for certain types of education.

Second, the remittances received by a substantial minority of city-dwellers improve their economic status and access to education. In Hargeisa, the case explored in this chapter, remittances often play a central role in the livelihoods of those that receive them and help finance education, in some cases allowing the family to choose higher cost forms of education. Children in the households of people receiving remittances have relatively good school attendance rates. Moreover migrants often encourage families to whom they send money to educate their children. Sibling solidarity plays a particularly crucial cultural role in the education and welfare of children and young people.

Third, there is a plethora of diaspora funding initiatives that support education provision by building or rehabilitating and contributing to the running costs of schools and colleges. These initiatives vary in levels of institutionalization, methods of fund-raising and the extent to which they seek and create other key actors such as political authorities and international NGOs.

There is a familiar danger that as migrants help to fund education for individuals and communities, political actors are made less accountable for providing basic services. The same applies to international aid—on the one hand it can reduce political accountability and on the other hand diaspora donations in some ways compensate for lack of aid. This should be seen as a tricky triangle to negotiate, but not a vicious circle to avoid completely. Somali society is beset by deep deprivation on the worst global scale and a limited political capacity, even in Somaliland, to raise public revenues. Totally free and accessible public education is not coming soon to any part of Somali society. Meanwhile, generations of children are disadvantaged, with severe labor market, political and personal consequences. Through remittances and donations, the often financially overstretched diaspora is giving children and young people in Somali communities a better chance at life. Remittances and donations are private and voluntary transfers; but there are several ways that might help to ensure that they are allowed to continue and to make the diaspora's money go further in encouraging education.

The following suggestions involve a range of actors—Somali communities, the diaspora, responsible political actors, international aid agencies, educationalists, foreign governments, private sector, financial services sector, and researchers. They are presented as a tentative agenda for discussion among these people. There are some initiatives already working toward these goals.

- Safeguard the ability of migrants to continue to transfer money to family members at reasonable cost—an issue addressed in other chapters in this collection.
- Encourage financial service innovation and development. The Somali financial sector already performs some banking functions in Somalia and might explore possibilities of offering insurance, savings, business loans or microfinance schemes, possibly in ways that interact with remittances, which might have positive consequences for household livelihoods and local communities.
- Support employment and income-generation initiatives as complementary to education—training and education are crucial to the future of Somali society, but must meet labor market demands.
- Experiment with forms of educational funding. What role for Somali and foreign employers, particularly businesses and NGOs, in the training of the future workforce? How might remittance companies further facilitate through their services or support through corporate sponsorship the funding of community education? What models do diaspora charitable initiatives take, what strengths do these initiatives have and what problems have they encountered? Bearing in mind Johnson and Sedaca's (2004) advice to donors and international organizations to "meet [diaspora initiatives] where they are not where you want them to be," much might be gained from partnerships between different groups, from the ad-hoc to the carefully coordinated, to fund and deliver education to Somali children and young people.

IV. SOMALIA REMITTANCES: MYTH AND REALITY

Mohamed Abshir Waldo

To create awareness of and about the Somali remittance sector and to develop a roadmap for the future to address its challenges, it is necessary to first understand the history of the sector. It is equally important to demystify the topic. It is a fact that there are great deal of myths surrounding the ownership, operations and integrity of Somali Remittance Companies (SRCs) that have, in a mere 15 years, grown from small personal arrangements into a significant industry. These myths need to be challenged with the realities.

1. The History of Migration in Somalia

As traditional rural pastoralists, Somalis have long been involved in moving from one place to another, and since the advent of borders, from one country to another. The nomadic traditions have been overtaken in the last 35 years of military dictatorship and civil war, by pressures of political repression, insecurity and the search for peace and economic opportunity.

Somali migration is widely spread among various countries and continents and has not necessarily followed former colonial links and cultural and linguistic affinities. Italy, a major colonial power in Somalia, attracted the least number of migrants among the major European countries. While Somali migration and remittances date back many decades, there have been several distinctive periods of these movements, dating from the 1940s to the present.

The first distinctive period of migration included numerous seafarers from the 19th to the 20th centuries, many of whom took residence in Arabia; Second World War soldiers and merchant seamen settling in the West; and students who remained abroad after their studies from the 1960s to the late 1980s. The second distinctive period was characterized by the exodus of refugees fleeing the Siad Barre regime persecutions in the 1970s to the late 1980s. Many of the latter migrants settled in the Eastern and Central African countries of Kenya, Ethiopia, Djibouti, Tanzania and Zambia as well as in the Middle East.

The most recent period of migration followed the collapse of the government and the start of the civil war in 1991. This period saw the largest wave of migration to the Gulf States, Eastern Africa, North America and Western Europe with migrants in search of political asylum, employment and a better quality of life. The period 1991-93 also saw the largest war-related international displacement of nearly a million people from Central and Southern Somalia. As the conflict in the South and Central regions of Somalia continues, there has been increasing recent migration to the Central and Southern African countries of Zambia, Mozambique, Namibia and South Africa where there are now over 35,000 Somali migrants who are mostly engaged in small enterprises and provide employment for the Somali migrants.

2. The Growth of the Somali Remittance Sector

Two reports present an excellent account of the history of the money transfer development in Somalia and Africa. The first is the UNDP report Establishing Systems and Procedures for the Effective Regulation and Monitoring of Somali Remittance Companies (Hawala) by Abdusalam Omer, and the second is the World Bank report Migrant Labor Remittances in Africa: Reducing Obstacles to Developmental Contributions by Sam Maimbo and Cerstin Sander. These reports thoroughly discuss the historical development of “Hawala,” the vital roles it plays in society and the constraints faced in the respective areas they cover—Somalia and Africa.

The inflow of remittance started with the first migrants who often sent money with traveling friends and relatives. Remittances progressively increased as the number of migrants increased and their earning power improved. Before the collapse of the military regime, another common means of remittance was the 'Franco Valuate' system. Under this system, Somali laborers working in the Gulf States purchased high-value consumer goods and shipped them back to their families or simply transferred a portion of their earnings via Somali traders. In the first case the traders then took the proceeds of the sale of the goods and paid the laborers' relatives in local currency.

What started as a way for an émigré to send cash back to their extended families has in many cases blossomed into full-blown financial operations. In the first half of the 1990s, the system of sending remittances was highly informal and personalized. It typically relied on trust relations with a known broker based in Nairobi or elsewhere who would insure that funds were delivered (either by carriers who flew to cities with cash on daily khat flights or via local high frequency [HF] radio operators) to family members inside Somalia or in refugee camps in the Horn of Africa. Initially, poor communications inside Somalia hindered the delivery capacity of this form of remittances. Individuals operating private HF radio communication services, the only type of communication available at that time, locally handled most remittances. In this way, local HF radio operators became the first, small-scale remittance sector. Their lack of capital prevented them from expanding the service beyond very modest levels. Though some operators in small towns and villages continue to play a role in remitting money since 1995 most HF radio operators have been absorbed into larger remittance companies as local agents, operating on commission. This gives the companies the ability to reach virtually every community in the country.

Somalia's failed economy and heavy dependence on its diaspora for economic survival in the 1990s coincided with revolutionary advances in the telecommunications sector. These advances made remittance transfers from great distances much easier. The rise of the remittance companies specializing in global money transfers into and out of Somalia corresponded concurrently with the introduction of the first private satellite phone companies in 1994-95. Consequently, there are three major factors that have influenced the growth of remittance companies in Somalia: migration, telecommunications, and the emerging trade sector. The financial services and telecommunications industry are currently among the most innovative and dynamic sectors in Somalia.

3. The Dominance of Somali Remittance Companies in the Horn of Africa

At present, the Somali financial sector is comprised wholly of the SRCs as they are the only financial services providers in the country for the majority of households and for the whole of the private sector. While in general the Somali private sector suffered considerably from the combination of a protracted civil war, the collapse of the public sector, the absence of a functioning national government for over a decade and the destruction of the economic infrastructure, the remittance business grew exponentially in the vacuum of statelessness. It did so because of the evident need for urgent, personalized and unique financial services to deliver money to communities suffering from the effects of living in conflict zones, and in distant and remote rural areas.

Against this backdrop, the remittance industry is the country's driving socio-economic force. There are about one million Somalis in the diaspora and they remit over $1 billion annually. These remittances provide a lifeline to at least a third of the country's population, making remittances the backbone of the economy. SRCs provide significant employment at home and in the diaspora. In addition, they encourage investment—remittance companies, while providing limited informal banking services including savings and checking accounts to individuals, businesses and local and international agencies, also serve as a conduit for trade and investment. The diaspora are not only senders of money but also operators and investors; they established the overseas hawalas and manage them.

4. Myths and Suspicions Associated with Somali Remittance Companies

Having successfully grown into 'branded' hawalas (for lack of a better word), the Somali remittance sector is surrounded by perceptions and myths. As the title of this chapter may suggest, there also seems to be an assumption that all SRCs are actually owned by Somalis in Somalia and that all transfers occur in one direction—from the West to Somalia. This is a myth and as a result of it, the Somali or associated remittance organizations feel that they are singled out for exceptional scrutiny by regulatory authorities and discriminated against by most Western banks that either close their accounts or refuse to provide them with banking services without credible justifications. Why then is this particular scrutiny and suspicion reserved for SRCs?

Listed below are some of the assumptions that are the cause of the myths and suspicions and the reality associated with each:

- *These remittance businesses are owned by Somalis in Somalia*: almost all the remittance organizations currently operating outside Somalia are, in fact, owned and operated by citizens of the respective countries in which they operate—the owners/operators are US, Canadian, UK, French, Swedish, Kenyan, and Ethiopian citizens. There are less than 15 effective national Somali hawala owners (i.e., owners/operators of Somali citizenship) while the overseas-owned remittance companies could be in the hundreds. That said, what is important and often overlooked is the close partnership and networking of the overseas hawalas and the local Somali hawalas, which gives the impression that they are one and the same.
- *Only the Somali Diaspora transfers money through them:* although most SRC diaspora clients are of Somali ethnicity, the client base does include a variety of African nationalities—Kenyans, Ethiopians, Sudanese, etc. SRC clients also include UN Agencies and international NGOs operating in Somalia. Further, while most money transfer destinations are within Somalia, SRCs do transfer money in every other direction—within North America, Western Europe, Arabia and Africa.
- *SRCs, are not legal or registered and do not pay taxes:* SRCs are legally registered or in the process of legalizing their status and they pay taxes in every country in which they operate, including Somalia.
- *SRC operations are not transparent and Anti-Money Laundering (AML) compliant because of their association with Somalia*: SRC remittance operations are transparent and have been open to the inspection of regulators and banks whenever required, and despite ominous reports from Somalia regarding security and terrorist threats, the SRCs know better than to associate with undesirables and are traditionally wary of fanaticism. Although Al-Barakaat was closed down soon after September 11 on allegations of terrorist financing, it has not been proven guilty of any crime by a court of law as far as we know and it should be considered innocent until proven guilty. Al-Barakaat was the biggest Somali hawala and its closure bankrupted thousands of Somalis and severely damaged the reputation of the Somali remittance institutions with regulators, banks and governments worldwide. Also, though there may not be formal regulatory mechanisms in Somalia (as there is no functioning Central Bank), each and every SRC practices self-regulation of some kind. This is expected to be further strengthened when the Somali Financial Services Association (SFSA) acquires full operational capacity.
- *Clients' money is not safe and the SRCs are not providing efficient and ethical service for their clients*; SRCs are reputed to provide the safest, fastest, most reliable and efficient service for their clients. Can any traditional financial institution claim or can it offer to make a transfer from Alaska or Japan or New Zealand to a remote village or water well in Somalia in 24 hours? SRCs can and do. It would also be interesting to know if U.S. or European banks and regulators had any complaint from clients of SRC on fraud or shoddy service.

Thus, although there are two distinct ownerships and definite decentralization of what is general termed the Somali remittance organization, the perception has persisted (in international circles) that Somali remittance operations are secretly conducted between Somalis only and that all the transfers are pouring into that murky and anonymous country called Somalia. This is not the case. While it is true that the bulk of the remittances go to Somalia, substantial transfers are also sent from the country for trade purposes. Transfers to and from other parts of Africa, Arabia, Europe, North America and other countries or continents do take place. Perhaps, a noteworthy example of financial business cooperation should be highlighted—this is the cooperation between SRCs and the international agencies and NGOs working in Somalia but based in neighboring African countries for security reasons. These international organizations, including UN Agencies, make money transfers for their operations in the country through SRCs.

5. Constraints and Opportunities for Somali Remittance Companies

Principal Constraints in the industry include the following:

- New and weak industry association for the promotion, advocacy and defense of the industry;
- Limited technical and organization capacity to keep up with the pace of rapid and sophisticated developments taking place in this sector;
- Different and complex US State regulations and bond sizes ranging from $30,000 to over $500,000;
- Different regulatory regimes ranging from the liberal systems in the UK and Sweden to complicated requirements in Holland, Norway, Germany, Italy, among others;
- Bond sizes again ranging from a few thousand dollars to millions;
- Hawkish scrutiny and discrimination by banks; and
- Crippling competition with the Somalia hawala on rates of transfer.

6. Conclusions and Recommendations

One of the significant results of the civil war in Somalia was that remittances have clearly played the role of a social safety net, preventing total economic collapse in the face of all the calamities that have befallen Somalia in the last 35 years. It has also been shown that remittances have been far more important for livelihoods and survival in Somalia than all the international development and humanitarian aid put together.

Particular efforts should, thus, be made to further involve the large, globalized Somali diaspora linked to Somalia as they are in a position to forge global economic networks for investment and development. A professionalized and formalized remittance sector is the key to sustainable stability and governance, effective reconstruction and improved livelihoods in Somalia. Robust, practical and early international development partners' support is essential for the realization of these critical objectives. More specifically, the following are recommended:

- Further development of Somali remittance companies into formal financial institutions—banks, MFIs, insurance, etc.;
- Strengthening of the SFSA to a level where it can properly guide the industry in the right direction and establish effective and fruitful relations with national and international stakeholders;
- Continue the corporate restructuring in line with national and international business and regulatory requirements, especially as the new national government and a central bank begin to take control of the affairs of the country;
- Further develop and strengthen working relations with banks, regulators and donors; and

- Work closely with central and regional Somali authorities with the view to contributing to the promotion of the financial sector and the preparation of investment and regulatory laws.

Finally, as has been argued by Omar Abdulsalam, “regardless of the establishment of a strong central government and/or a central bank in Somalia, the remittance/hawala system will remain an integral part of the Somali economy and monetary system for the foreseeable future.” He correctly gives the reasons for this as follows:

- Remittance companies have the trust and confidence of their customers;
- Remittance companies have an extensive network of agents that service almost all the towns and villages in Somalia; as well as all major cities and towns in other countries populated by Somali Diaspora;
- Remittance operations are far more efficient than other financial services institutions; and
- No other financial system is comparatively so well designed to serve the rural areas where the majority of the people live but are little served by communication and transport infrastructures.

V. SOMALI REMITTANCE COMPANIES AND THEIR CLIENTS

Saad A. Shire

1. Remittance Organization Clients

Remittances to Somalia constitute a lifeline without which dependence on international food aid or starvation on large scale would have been inevitable. This has been particularly the case since the ban of livestock exports to the Middle East, which was the main source of foreign currency. In 1997 over two million heads were exported to Saudi Arabia alone.

No one knows exactly how much Somalis in the diaspora remit. Figures in the literature vary widely. UNDP put the total for 2000 between $800 million and $1 billion. The figure is, probably, not off the mark by much, when considering the fact that remittances pay for practically all imports and investment in the country. Other developing countries have normally access to various sources for external financing including: export earnings, official aid, direct investment, and indirect investment through capital markets. Under the current situation all these channels are not available to Somalis. Apart from remittance, the only other source is limited humanitarian aid provided by the UN, the EU and international charities.

1.1 The Sender

Almost every one in the diaspora, particularly in high-income countries, the West and the Middle East, is expected to send money. Fathers, mothers, husbands, wives, sons, daughters, uncles, aunts, nieces and nephews, are expected to support their families back home or wherever they are. They constantly receive pleas for help, and those who can usually respond by sending money. It is a matter of duty, a cultural and humanitarian obligation. Table 5.1 shows that men and women are equally likely to send money. The general perception is that more women than men send money back home. But that perception is not supported by the data. We took a sample of 1,206 transactions from the June (2004) records of one of our branches in London. It is possible that women are far more sensitive to the needs of others, and in the early days were the main benefactors, but as more and more men went into employment, their ability to remit has probably compensated for what they lack in sensitivity.

Table 5.1: Remittance Senders by Gender

Gender	Percent
Men	53.2
Women	46.8

Source: Dahabshiil (2004).

Apparently all ages in the adult population participate in remittance. But the working middle age group between 30 and 50 are more likely to send money according to the results of a sample survey we carried out (Table 5.2). Young people are more likely to be in education and less engaged emotionally with people left behind, while older people, who rely mainly on income support and pension allowance are financially less able to help.

Table 5.2: Remittance Senders by Age

Age group (years)	Percent
Less than 30	23.3
30-50	55.8
Above 50	20.9

Source: Dahabshiil (2004).

Most of remittance transactions consist of relatively small amounts sent regularly to provide for family or personal basic needs. This is demonstrated by the mode and the median of the data we used in this study, which are respectively $100, and $132.5 (Table 5.3). Thirty one percent of the senders remitted $100, which is the typical amount for a family monthly living allowance. On average half of the transfers are less than $100, and 90 percent of the people send less than $200 at a time (Tables 5.4 and 5.5). It is important to note that some of the remitters send money to more than one person at a time. According to the sample used every two individuals send money to two people, which means the average amount sent by person is 50 percent higher than the mean per transaction. There are also few large transfers mainly for investment in housing. There appears to be a construction boom going on in the stable regions. Prime land has become prohibitively expensive. This is fuelled by investment in housing by the diaspora.

Table 5.3: Remittances: Mode, Median and Average

Parameter	Value ($)
Mode	100.0
Median	132.5
Average for 90% of transactions	174.5

Source: Dahabshiil (2004).

Table 5.4: Remittances: Average Amounts by Percent of Transaction

Percent of transaction	Average $/transaction
10	44.8
20	55.9
30	70.6
40	78.0
50	82.9
60	96.6
70	111.3
80	130.7
90	174.5

Source: Dahabshiil (2004).

1.2 The Recipient

The great majority of the beneficiaries live in urban areas. This is supported by analysis of the destinations provided in the data we used. Ninety-two percent of the transfers went to people in the main towns (Table 5.5). Only 8 percent were destined to rural villages, even though about 50 percent of the population still lives in rural areas. That may be because most of the people in the diaspora are of urban background, and it is the urban residents who have to pay rent, purchase food, buy water and charcoal for cooking, pay school fees etc. who cannot do without external assistance. Rural people are more self-sufficient. It is also likely that the proportion of remittance that goes to rural communities is much higher than the 8 percent suggested by the data, during the dry winter season and in draught situations when their need for support is much greater.

Table 5.5: Remittance Recipients by Destination

Destination	Proportion (%)
Urban	92
Rural	8

Source: Dahabshiil (2004)

The recipients are evenly divided between men and women (Table 5.6). This could be a sign of Somali egalitarianism, or a sign of changing times where men and women are equally likely to head a household. It is also likely that women seek help as much as men with the same outcome. However, these results should be interpreted with caution, because the person named as the recipient in the transaction could be just a care taker, and the money could be meant actually for another person of a different gender and area of residence.

Table 5.6: Remittance Recipients by Gender

Gender	Proportion (%)
Men	49.8
Women	50.2

Source: Dahabshiil (2004).

2. Key Factors

There are three developments, which have contributed significantly to the strong link between the diaspora and the home country: telecommunication technology (telephones, the internet and satellite television), air travel and money transfer companies

The telephone has practically rendered physical distance irrelevant. When the phone rings it could be a call from a colleague next door or from a cousin from the other side of the globe. He does not have to be calling from home or telephone booth, either; he could be calling from his mobile in the middle of nowhere. He can also be reached at any time. Of course, it costs to call and that remains a barrier for many, but e-mail, which costs much less, is fast making communication affordable.

Nowadays the inbox is likely to contain one or two e-mails from a young relative back home. With so many websites and links on the internet, and now, satellite television offering up-to-date information on political, cultural and social fronts, a Somali migrant in Minneapolis is likely to know more about what is happening back home than the man on the street in his home town. With these new technologies the migrant, in a way, lives in two countries at the same time, or in one virtual global country without boundaries. The impact and the importance of this new development are mirrored in the businesses of Somali entrepreneurs in the diaspora. A survey of 48 of our agents in London revealed that more than half of them are internet cafes and call shops (Table 5.7).

Table 5.7: Dahabshiil London Agents by Type of Business

Business	Frequency	Percent
General store (shop)	13	27.1
Call shop	4	8.3
Internet Cafe	23	47.9
Office	7	14.6
Other	1	2.1
	48	100.0

Source: Dahabshiil (2004)

Airlines have also played a major role in bringing the migrant closer to home. More than half a dozen airlines compete to fly people from around the world. The main carriers are: African Express, Daallo Airlines, Damal Airlines, Ethiopian Airlines, Jubba Airlines, and Star Airlines. All of them have regular scheduled flights. It is possible to take a Daallo Airline from Gatwick Airport, London, to Hargeisa, Bossaso or Mogadisho twice a week, or to fly from New York to Hargeisa on Ethiopian Airlines, and from there, to other destinations.

Money transfer companies constitute the third development that changed the relationship between the migrant and his country of origin. There are more than 20 of them in operation. They have an international network, which offers cheap, fast, and reliable financial services, perhaps unparalleled in the world. They provide a vital link. Following a distress call, it is possible for someone in London or Minneapolis or Melbourne to get help to some one, even in a remote village, by next day, and sometimes on the same day. Within the country, they provide some basic banking services for businesses, and facilitate trade, as well as investment by the migrant community. They are also the biggest employers in the private sector and contribute to social and economic development in a major way.

3. Process and Challenges

The maintenance of this life-line by the Somali Remittance Companies (SRCs) is critical, but not easy. To outsiders it may seem a simple process of transferring value from A to B, and to the ill-informed it may look like a murky system where money changes hands secretly under the table or in an alleyway, and messages are passed on orally without leaving any trace. In fact it is a very sophisticated business, which has to overcome day-in day-out technical, regulatory, security, cultural, institutional, logistical and managerial challenges, in an environment, which is anything but hospitable.

The remittance process consists basically of two flows: an information flow and a value flow, each with its own challenges.

3.1 Process

The information flow process consists of six stages:

- Receiving information from the sender including personal details, identity, amount and destination;
- Transmitting information electronically;
- Organizing, sorting, and filtering information at a central processing unit;
- Notifying the paying agent and the beneficiary of value;
- Taking the personal details and the identity of the beneficiary;
- Informing the sender and/or the send-agent of payment made; and
- Keeping and updating records.

3.2 Challenges

The process involves several challenges:

- *Cultural:* There are three elements prominent in the Somali culture which come into play in the information flow process: trust, privacy, and tribal or clan identity. Somalis are by tradition trusting and private people. Asking for personal information beyond what they consider to be absolutely necessary in any transaction or relationship is interpreted as questioning one's integrity, which is offensive. Hence SRC agents have sometimes to do some convincing to persuade a customer to provide his or her personal details or identity. They have to deal with the question, 'You know me, why do you need my address or ID?' The tribal or clan identity is on the other hand a very useful aspect of the Somali culture in this process. Every individual has a unique set of lineal names. Each name in the line is like a chromosome in a DNA helix. Thus one's tribal identity is like a biological tag, which people are willing to reveal. This makes it easy to identify and pay beneficiaries in places where there are neither addresses nor IDs.
- *Regulatory:* Regulations require know your customer (KYC) at both send and payment points. Other rules govern the flow of information across borders and the revelation of personal information to third parties. The law also establishes the period in which data should be kept and stored before it can be destroyed. Compliance with these regulations is neither easy nor cheap. Nevertheless, this is a process to which SRCs are by and large committed to. Apart from the legal requirement, KYC and record keeping are absolutely essential in the remittance business for customer service, accounting, settlement and protection against fraud. Hence, the allegation that the so called Informal Remittance Operations (IRO) are run with out records has no basis.
- *Technical:* The remittance business like the rest of the financial sector is information intensive. At the beginning information was handled mainly manually. But as transactions grew, the application of modern information and telecommunication technology became imperative. This has evolved over time from reliance on radio communication, to fax, telephone, and the internet; and from the use of simple spreadsheets, and databases to sophisticated platforms. In a way, the SRCs have been the driving force in ushering the information age to the country.
- *Managerial:* The management of hundreds of thousands of transactions and the maintenance of advanced software and hardware are challenges which all SRCs have to contend with. All of them engage IT engineers in one form or another, some in well-staffed IT departments.

4. Value Flow

4.1 Stages

This process consists of seven stages:

- Receiving money from the sender over the counter at the send point;
- Depositing money into a bank account;
- Transferring money to a central account;
- Transporting money to the paying point;
- Safe keeping money; and
- Paying the beneficiary.

4.2 Challenges

Challenges relate to security, institutional aspects, managerial and technical:

- *Security:* Like all cash businesses, security is a major concern for SRCs. It is a challenge they have to deal with from the receiving point to the paying point. This is a serious problem particularly in

Somalia where law and order and government authority is either week or non existent in large areas. SRCs have been very resourceful in minimizing this risk by minimizing the physical transportation of cash. This is achieved by operating as banks, whereby local beneficiaries are paid using money received from local traders who want to be paid in a major commercial centre or in another country where they import or buy their stock. There are of course occasions when one location has more cash than it needs and another needs more to fulfill its obligation to pay customers, and cash has to be transported. On these occasions they do resort to armed escorts. Tradition also plays a major role in providing protection. That is because the tribe provides a sort of an insurance cover to the members with means, who are expected to pay their dues by helping out other members when in need.

- *Institutional*: Access to banking services is absolutely essential to the transfer of value. Before September 11 this was not a problem, but since then, it has become the greatest challenge which SRCs face. The closure of Barakat and the allegation by the media and in political circles that the so called informal money transfer operations or hawalas, assist or are vulnerable to terrorists moving money around has given an unwarranted bad image to the industry. This had the unfortunate effect of scaring off banks who, perhaps, do not want to attract bad publicity by association. It has now become extremely difficult for SRCs to open a new account and an uphill struggle to keep existing ones, even though there has not been a single proven serious case of wrong doing against them.
- *Managerial*: Managing to pay $100 sent from Minnesota today to someone in a remote small village in Somalia tomorrow is quite challenging. Getting money from where it is collected to where it is needed on time, across continents and countries is no easy task. It requires a sophisticated logistical operation, especially in a country like Somalia, where there are no banks and infrastructure is extremely poor. Managing accounts, exchange rates and foreign currency deals to minimize losses and maximize returns are some of the challenges SRCs face on daily basis, just like the dealers in money markets in New York.
- *Technical:* Maintaining up to date accounts, keeping track of transfers, monitoring foreign exchange and money markets, and affecting transfers securely and conveniently are all essential to the flow of value, and require the adoption of modern technology. This has been embraced to a lesser or greater extent by the SRCs who are usually keen on new technology.

5. Business Environment

SRCs do not operate in isolation. They work in an environment in which there are many actors and elements that have a bearing on all aspects of their activities directly or indirectly (Figure 5.1), including: regulators, financial institutions, law-makers , national and local authorities, law enforcement agencies, international and regional organizations, local markets and competitors, global markets and competitors, the media, terrorism, the public, academics and technology. These environmental factors present threats as well as opportunities which SRCs have to deal with, guide against or take advantage of. The following paragraphs highlight some of the threats and opportunities.

5.1 Threats

- *Financial institutions:* The most immediate threat is posed by the reluctance of banks to provide banking facilities to SRCs, not because of anything wrong they have done, but because of poor perception. Unfortunately SRCs can not operate without banks.
- *Regulations:* In some of the countries where there are Somali communities, regulations allow only banks to carry out money transfer transactions. Others require significant capital investment or deposits, which are beyond the means of SRCs, or which can not be justified economically given the size of the market. Communities in these countries or states face the risk of being excluded from

SRC services. The diversity and fragmentation of the regulations within the US and in the EU, where every state and every country has its own regulations and a license in anyone is not valid in any other, present constant difficulties to SRCs. Another challenge comes from the published list of blacklisted individuals. The only information provided is their names. By and large these are Muslim names, and databases, which incorporate such lists some times, hold up to 20-30 percent of the transactions as a result of name matching. The net result is the exclusion of some Somali communities who desperately need SRC services.

- *Low enforcement:* The closure of any SRC operation like Barakat would have a devastating effect on the industry. It is, therefore, important to ensure that any legal action taken is based on established facts and is proportionate to crime committed.
- *Terrorism:* Real or perceived, terrorism presents a threat to SRCs. First the Somali community which they serve is just as likely to fall victim of terrorist atrocities as any of the other communities in the countries in which they reside. Second, every terrorist action tends to result in tighter regulations for the industry. Third, many politicians and opinion makers, instead of focusing on the causes of terrorism, find it easier to talk about funding of terrorism in a way that implicates remittance services and the Muslim community at large.
- *Global competitors*: Ironically SRCs have thus far found a safe haven in an unsafe Somalia where international money transfer operators consider no go area due to perceived risk, lack of internationally recognized government and poor infra-structure. That will change sooner or later, and the likes of Western Union and Money Gram will be keen to get a share of the well published $1 billion market. With their worldwide network, financial muscle, technology and great experience in the development of new markets, they pose a real threat to SRCs. International banks are also likely to set up branches and will be competing with SRCs at least for the international trade business.

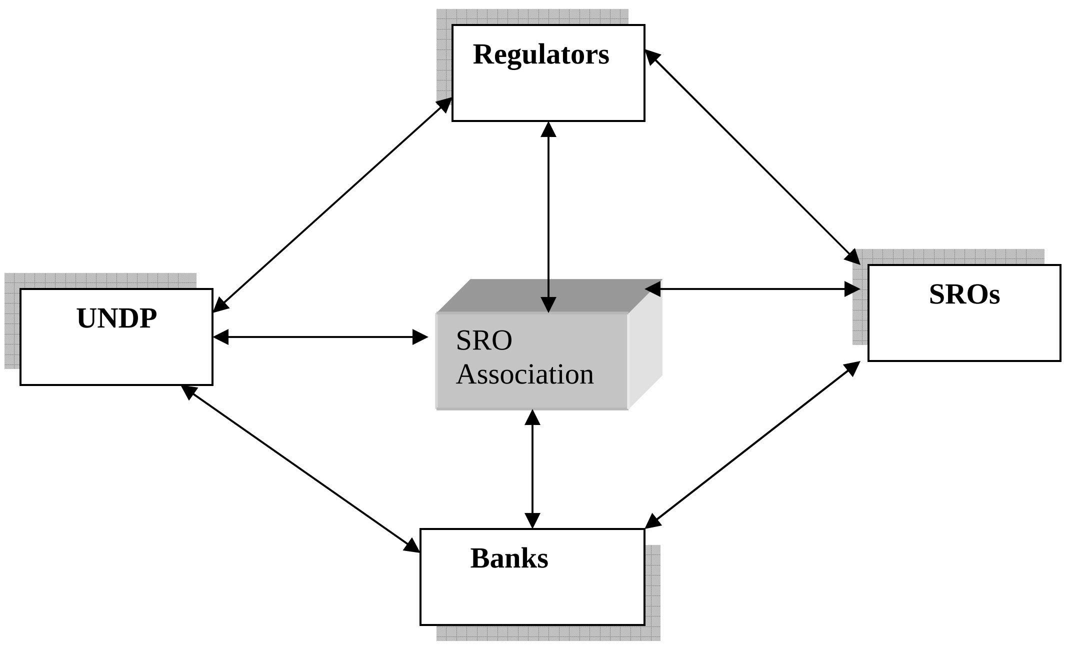
5.2 Opportunities

- *Global markets*: Global markets present a great opportunity for SRCs. So far, SRCs have targeted just the Somali market, but there are developments which are likely to render that unsustainable. First, the Somali market is limited and has probably peaked. Second, compliance with new regulations and the required formalization of operations is costly. To maintain profit margins, this must be spread out over a greater number of transactions, which must come from other markets. Third, the entrance of international money transfer operators and banks is likely to reduce SRCs' share of the Somali market. Fourth, the market is fiercely competitive, and while costs have steadily risen, commission rates have not changed for the last eight years, rendering the remittance business less and less profitable. To address this problem, SRCs will have to either revise their commission rates, or improve their efficiency or go for higher volume to make up for loss in margin. As a result of these developments, SRCs need to look beyond the Somali market and view the global market, which offers them enormous opportunities, as their market. The Mexican market, for instance, is worth more than $11 billion. There is no reason why SRCs in the USA can not take advantage of this enormous market at their door step.
- *Banking:* The absence of banks in Somalia presents a great opportunity for SRCs to convert to proper banks, taking deposits and making loans. It is true that the necessary banking regulations are not still in place, which is why SRCs must lobby hard to ensure their enactment.
- *Technology*: This is the future, which will either make or break the SRCs. The adoption of new transfer technologies is crucial for SRCs in order to improve services, reduce operating costs, go global, and compete effectively with international operators. One of the main comparative advantages of international money transfer companies is technology which allows them to: establish global network of agents, pay in real time, accept credit and debit card payments, process

on line payments, pay into customer bank accounts, issue and pay by debit cards which can be cashed at ATMs, text-message customers, carry out instant analysis and reporting, and comply with regulations.

- *Institutional support:* The support of the UNDP Somalia program for the SRCs is very important. It gives them the backing of a reputable international organization in an unfavorable climate. It also offers them the technical assistance they need to become competitive in the global market. This is a valuable institutional support, which SRCs must take advantage of.

Figure 5.1: Remittances: Framework for Cooperation



6. Meeting the Challenge

The significance of maintaining the flow of remittances and the role of SRCs can not be over emphasized. Any interruption in this vital flow will lead to: a humanitarian disaster, another mass displacement and emigration, instability, resentment and extremism, and the development of underground transfer systems. In order to ensure continuity, build trust, and make the necessary transition, four parties need to work together in partnership: SRCs, banks, regulators and UNDP. Key to this partnership will be the SRCs' Association (Figure 5.1).

- *SRCs:* They must realize the current dynamics of the money transfer market, and the implications of the new regulatory regime. They need to wake up to the opportunities offered by new technologies, and make the necessary changes individually and collectively to be in a stronger position in the increasingly global market. The revival of the professional association initiated two years ago by the UNDP Somalia program will be critical in this process. When fully functional it should be able to support its members, represent the sector, and advance its interests. At the same time it should be able to hold its members accountable to uphold the sector's reputation. A lot can be learned from similar associations.
- *Banks***:** The banks need to be made aware of the key role they play in this important process, and the implications of denying SRC access to their services. Where there is a case to answer, it should be dealt with on its merit in accordance with industry procedures. It should not be a cause for

collective punishment and indiscriminate ban. SRCs want to address their concerns, and build a good working relationship with them. The SRC Association once up and running could provide the right channel of communication between the SRCs and the banking sector to build trust and cooperation.

- *Regulators*: While SRCs must meet the regulations required in each country in which they operate, it is important that regulators are ware of the special circumstances SRCs have to operate in Somalia. They have also the responsibility to ensure that their citizens can exercise their right to support their beloved ones back in their country of origin within the law. It should be the role of the Association to liaise with the regulators in each country.
- *UNDP Somalia*: The UNDP program has two roles to play. The fist role is institutional building. The key to this role is the establishment of a functioning SRC Association. The second role is advocacy. Because of Its knowledge of the situation on the ground, understanding of the working of the SRC sector and at the same time awareness of the concerns of the regulators and the banks, it is in a good position to bring the needs of all parties concerned together.

VI. The Money Laundering Regulatory Challenge Facing Somali Remittance Companies

Kevin West

The aftermath of September 11 saw an international crackdown on terrorists and terrorist financing. This also marked a change in the way traditional money laundering was viewed. Prior to September 11, money laundering definitions focused specifically on the "proceeds of crime" whereas after September 11, money laundering definitions were expanded to include transactions involving the "proceeds for crime" (i.e., terrorist financing). Such transactions could involve the use of legitimate funds being transferred via financial systems with the destination of these funds being the use for illegal purposes such as terrorist financing. This is often referred to as "reverse money laundering".

One of the largest Somali Remittance Companies (SRCs) at the time, Al-Barakaat, was closed down by the US Government in November 2001, claiming it had proof that the Al-Barakaat company was providing as much as $25 million a year in financial aid to Osama bin Laden. Al-Barakaat was the largest private sector employer in Somalia and had also ventured into fixed and mobile telephone services and started the first locally based Internet service. It operated in 40 countries and handled about $140 million a year from the diaspora. The closure of Al-Barakaat created a confidence crisis in Somali remittance operations and a negative humanitarian impact in Somalia as many Somalis depended on the remittances sent by Al-Barakaat.

During October 2001, the Norwegian Government closed down the operations of Somali Remittance Companies in Norway due to allegations that these companies were associated with terrorism (Omer 2003). Indications are that the Norwegian Government is addressing the issue of regulating the operations of remittance companies.[10] During 2002, the Wells Fargo Bank in the US said it would close down the accounts of one of the largest remaining SRCs. The bank, however, postponed the decision following an intervention by the UNDP. These examples provide an indication that there is concern among the international community regarding the services provided by Somali Remittance Companies.

At an extraordinary meeting held in Washington D.C. on October 29-30, 2001, the Financial Action Task Force (FATF) agreed a set of eight Special Recommendations on Terrorist Financing. Special Recommendation VI (Alternative Remittance) commits members to take measures to ensure that persons or legal entities that provide a service for the transmission of money, including transmission through an informal money transfer system or network, should be licensed or registered and subject to all the FATF anti-money laundering requirements that apply to banks and non-bank financial institutions.[11]

Remittance companies that are not licensed or registered to operate in host countries, and which also do not implement effective anti-money laundering regimes, are specifically vulnerable to possible money laundering and terrorist financing sanctions. Remittance companies are at risk due to the fact that they are often not aware of the risks associated with not implementing customer due diligence procedures, understanding the business of their clients, recognizing money laundering/terrorist financing activity and poor record-keeping. Compliance in this regard does come at a cost, and this is one of the challenges facing SRCs at present.[12]

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[10] Field notes – discussion with a member of the FSA in Norway

[11] FATF Special Recommendation VI – Alternative Remittance

[12] The recent FATF Report on Money Laundering and Terrorist Financing Typologies (2004-5) provide a number of examples where remittance companies have been used by criminals to transfer funds.

1. The Challenge of Regulating the Remittance Sector

The challenge of regulation in the remittance sector is two-fold: the challenge of regulating the remittance sector by regulators, and compliance to regulations by remittance companies, specifically those remittance companies who operate in more than one jurisdiction.

The challenge facing regulators is one of implementing a regulatory regime that will balance preventative measures without unnecessarily restricting the flow of remittances. Over-regulation could result in remittance companies going underground to conduct their business, while under-regulation will provide an avenue for criminals to utilize the remittance system to move their illicitly obtained proceeds, or to finance criminal activity.

Remittance companies who operate in more than one jurisdiction face the challenge of complying with the various requirements (both general requirements and AML/CFT requirements) of the jurisdictions they operate in. Furthermore, Somali Remittance Companies operating in Somalia are not regulated and need to apply other procedures in the area of Customer Due Diligence. Countries in which the Somali Remittance Companies operate require various levels of disclosure about ownership and organizational structure.

1.1 International Prescripts and Responses to Money Laundering/Terrorist Financing

Many of the host countries in which the Somali Remittance Companies operate are FATF member countries, thus subscribing to the FATF 40 Recommendations and 9 Special Recommendation to combat Terrorist Financing. The FATF 40 Recommendations sets out the basic framework for anti-money laundering efforts, and this is supported by a number of other important directives and/or papers that have contributed to the anti-money laundering frameworks developed across the world. These are:

- Basel Committee on Bank Supervision – Customer Due Diligence for Banks;
- Basel Committee – Core Principles for Effective Banking Supervision;
- The Wolfsberg Anti-Money Laundering Guidelines for Private Banking; and
- European Communities Directive 2001/97/EC.

In addition to the above, many banking associations of various countries have issued their own guidelines on issues such as Customer Identification and Verification[13] and the implementation of a risk-based approach to Customer Identification.[14]

The events of September 11, led to the passing of the "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act ("USA Patriot Act"). Often cited as being somewhat draconian, this piece of legislation significantly revised and expanded anti-money laundering measures for financial institutions, including Money Service Businesses, and also has extraterritorial reach. Section 312 of this Act requires enhanced due diligence procedures to be conducted on accounts while Section 316 sets out the minimum requirements for Customer Identification and Verification. Greater transparency in respect of ownership is also required.

I believe that, due to this Act's extraterritorial reach, as well as mounting international pressure to combat terrorist financing, many jurisdictions have responded requiring financial institutions, and those involved in the provision of Money Service Businesses, to design anti-money laundering policies and procedures which include: Customer Due Diligence Procedures; Transaction Monitoring and Suspicious Transaction

[13] American Bankers' Association – Industry Resource Guide.
[14] Financial Intelligence Centre (South Africa) – Guidance Notes 1 and 3.

Reporting; Record keeping requirements; and the provision of anti-money laundering training. Indeed, as many Somali Remittance Companies will testify, since the closure of Al-Barakaat, they have been under increased scrutiny when it comes to anti-money laundering compliance.

1.2 Responses to the Risk of Abuse of Remittance Systems

Remittance systems that are not regulated are particularly vulnerable to abuse by criminals and/or terrorists. FATF Special Recommendation VI (Alternative Remittances) recommends that:[15]

- Countries either license or register informal remittance systems;
- Ensure that they are subjected to all the applicable FATF 40 Recommendations; and
- Impose sanctions on those that fail to license/register or implement the applicable FATF 40 Recommendations.

FATF Special Recommendation VII (Wire Transfers) recommends that countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain. Annexes 1 and 2 put into perspective the recommendations made by FATF Special Recommendations VI (Alternative Remittance) and VII (Wire Transfers) and their implications on Remittance Companies.

The author of this article has performed research on a number of countries regarding their requirements for regulating Money Remittance Companies in respect of both general compliance and anti-money laundering compliance.

2. Responsibilities by SRCs to the Challenge of Regulation

2.1 Current Responses

There are a number of remittance companies operating in Somalia which also have operations in a number of European and other countries. These countries include, but are not limited to:

- United Kingdom
- United States of America
- The Netherlands
- Norway
- Sweden
- Finland
- Denmark
- Italy
- Qatar
- United Arab Emirates
- Kenya
- Australia
- Canada
- Saudi Arabia
- Switzerland

While the Somali Remittance Companies are not regulated in Somalia, most of the above-mentioned countries have regulatory regimes governing the provision of remittances by remittance companies.

Regarding the regulation of remittance companies in Somalia, the Somali Remittance Sector has established the Somali Financial Services Association (SFSA) with one of its objectives being to provide a self-regulatory system. The SFSA has embarked on a number of initiatives such as compiling an Anti-Money Laundering Compliance Guide which is to be used by member SRCs to establish their own Anti-Money Laundering Internal Rules/Compliance Manuals in the various jurisdictions in which they operate.

[15] FATF Special Recommendation VI.

The SFSA has also provided training in this regard, but the self-regulatory regime has yet to be established and implemented. This can only be effectively done with the buy-in of all SFSA members.

In most of the host countries where the Somali Remittance Companies operate, strict Anti-Money Laundering/Counter Financing of Terrorism regulations are applicable. Although many Somali Remittance Companies may have compiled Anti-Money Laundering Compliance Manuals, appointed Money Laundering Compliance Officers and provided Anti-Money Laundering training, they need to ensure that their procedures adhere to the local legislative requirements of those jurisdictions in which they operate. In this regard, the various host countries have differing requirements for know your customer (KYC), record keeping, reporting and the appointment of Money Laundering Reporting Officers.

Complying with the AML requirements of the various host countries is just one challenge. The other more difficult challenge is complying with the general compliance requirements applicable in the host countries. In this regard, regulation varies from host countries having no specific compliance requirements for money transmitters (such as Canada), countries having strict registration and/or licensing and capital requirements (The Netherlands, Italy and Switzerland), and countries having legislation which makes it virtually impossible to conduct business due to the level of compliance required (Norway and South Africa).

Complying with the general compliance requirements is most probably the biggest challenge facing Somalia Remittance Companies today. Conducting business in such a manner that they comply with the various host country regulations regarding the licensing and/or registration of money remitters, incorporation of companies/partnerships where these are required, appointment of auditors and adherence to capital requirements all come at a cost. This cost of compliance clashes directly with the business model of the Somali Remittance Companies, providing a quick and affordable money remittance service. Indeed, the capital requirements in a number of American states are very high.

Table 6.8: Summary of Registration and Licensing Requirements

General Supervisory Requirements	**Registration**	**Licensing**
Background checks	To identify providers, no consequences attached	Full fit-and-proper test
Internal procedures	Basic AML/CFT preventive measures	Detailed business plan, including AML/CFT preventive procedures
Monitoring	Basic reporting requirements and risk-based inspections	Basic reporting requirements and regular onsite inspections
Sanctions	Ranging from informal warnings to fines	Ranging from warnings to withdrawal of license
AML/CFT Requirements		
Customer identification	Required	Required
Record keeping	Required	Required
Suspicious transactions reporting	Required	Required

Source: International Monetary Fund (2005).

2.2 Thoughts for the Future

Current regulation, specifically in the field of anti-money laundering, is most likely going to increase. Closely aligned to Anti-Money Laundering requirements are general compliance requirements. Countries are not likely to opt for a "no regulation" approach, but will look at implementing some form of regulation or licensing regime. Based on current international developments in the field of anti-money laundering, many countries will review their current regulatory approaches to the remittance sector. The FATF recommendations and special recommendations indicate that either registration or licensing regimes are acceptable as a regulatory approach. The table below compares typical supervisory and AML/CFT requirements of the registration and licensing regimes.

No matter which approach is used, the above table indicates that, in respect of any Anti-Money Laundering regime, there are three major elements which need to be complied with: customer due diligence (KYC), record keeping, and reporting of suspicious transactions. SRCs will need to implement internal procedures and controls to address these three elements if they have not already done so. In addition to this, they will need to gain an understanding of what general compliance requirements are to be adhered to (i.e., registration/licensing, appointment of auditors, capital requirements etc.).

3. Conclusions

SRCs have a role to play in restoring confidence in a sector that was hit by a confidence-crisis after the closure of Al-Barakaat. This will include complying with host country compliance regulations, having transparent operations and implementing corporate governance structures within the remittance companies.

The challenge facing SRCs is to become totally compliant with host country regulations. SRCs will have to determine the remittance corridors in which they operate, and then determine if the cost of operating in some jurisdictions may not make it worth while for smaller remittance companies to continue operating. A possibility exists that, should a number of smaller remittance companies be operating in a country where the cost of operating is high, consideration be given to amalgamating operations.

The SFSA will need to start playing far more of an active advocacy role for SRCs across the world, specifically in the banking, regulatory and legislative sectors. They need to, first of all, become the voice of SRCs, and secondly, be recognized as such by the rest of the industry.

While SRCs have been making progress in respect of implementing Anti-Money Laundering regimes in their companies, training employees and appointing Compliance Officers, the question arises as to what development has been occurring within Somalia itself in this regard, and also what progress has been made in becoming compliant with host country requirements. Many of the countries in which the SRCs have operations have begun making public lists of those Money Transmitters who have obtained licenses or have registered as required by their regulations. A review of these lists indicates that very few SRCs appear on them.

Finally, SRCs will not disappear in the near future. Over-regulation, or even banning them, will drive remittance operations underground. A challenge for both the SRC sector and the various countries' regulatory sector will be to develop licensing/regulatory regimes that will take into consideration compliance obligations, without unnecessarily hindering the flow of remittances. This in itself may be a mammoth task, but one which will possibly need to be embarked upon.

VII. Financial Sector Development in Somalia: Central Banking and Financial Services in an Uncertain Environment

Samuel Munzele Maimbo, Mayank Patel, Walter Mahler, and Hussein Siad

Rebuilding a financial system after a period of sustained conflict is a challenging task. Trying to do so while the political process of nation building is still at its nascent stages makes the task doubly challenging. Managing the expectations of government, the private sector and the public is complicated by the evolving assumptions made about the likely direction of the political process and the resulting state structure. But it can be done. Somalia, like other conflict afflicted countries can re-establish the following:

- An autonomous central bank that is fully equipped to carry out its monetary and financial sector regulatory and supervisory responsibilities;
- Commercial banks and non-bank financial institutions which are sound, efficient, and competitive;
- Commercial banks and non-bank financial institutions, instruments, and services that meet the needs of the government, NGOs, businesses, and households in both rural and urban communities, and;
- Financial infrastructure that is based on modern information technology and telecommunications;

The task, however, should not be underestimated. Post-conflict financial sector reforms are beset with several challenges, including: the failure of legal and regulatory structures; the complete disruption of international and domestic payments systems; the virtual cessation of all lending activities within the country; significantly reduced deposit taking activities; and a stoppage of most international correspondent banking relationships, particularly in the absence of a unified government structure.

In the absence of a functioning formal banking system, a large and vibrant informal market develops to either sustain the conflict or to provide relief to those unable to leave the country, or indeed, as is often the case, both. Where present, in most conflict affected countries, the informal financial market is largely organized around the money exchange dealers and their ability to transfer funds into and outside the country through informal networks. In many countries these informal firms grow to become mainstream registered non-bank financial service providers. Although impressive, these service providers do not provide the full range of financial services required for dynamic private sector-led growth after the end of active conflict. Consequently, private sector-led growth remains highly constrained unless a functioning banking system is developed to provide financial resources and other supporting banking services to underpin these investments.

Somalia faces each of the challenges listed above, if not much more. In January 1991, all state institutions that provided services and regulated the economy collapsed, including the Central Bank of Somalia and the entire banking system. The commercial bank liabilities that had survived the 1989 bankruptcy of the only commercial bank in the country disappeared. Some semblance of a central banking authority has evolved in North-West region (Somaliland) and North-East region (Puntland) of Somalia. The two regional banks established in both northern regions have several branches and offer very limited commercial banking services in deposit accounts and trade finance. However, their primary function remains that of treasurer of their respective regional governments. In the South/Central region, no banking institutions currently exist.

Since the collapse of the only commercial bank in 1989, the mistrust in government-owned banks runs deep. Private citizens use their accounts in the two regional banks primarily for accumulating taxes they owe to the regional governments. Overall, in all Somali regions, the economy functions without commercial banks, with most small transactions conducted on cash basis and only the remittance companies providing some form of payment services. Given the current state of the financial sector, Somalia will fail to attract the level of private sector investment that is necessary to alleviate poverty, create economic opportunities, generate employment and contribute towards overall economic growth. Hence, the reestablishment of a strong central bank function and the reentry of full fledged commercial banking activities, is a high priority. Reinvigorating the financial sector is a critical step toward setting Somalia on the road to sustained self-sufficiency, the creation of economic opportunities, and ultimately the reduction of poverty in the country.

In rebuilding a market-oriented, private-sector-owned financial system, the Transitional Federal Government of Somalia (TFGS) needs to adopt a multidimensional approach. While ensuring the implementation of medium- and long-term goals, financial sector reforms must address urgent short-term needs, particularly the restoration of a functioning central bank and the provision of basic retail financial services. Experience in other post-conflict countries shows that the focus of reforms must include:

- Drafting new or substantially updating the legal and regulatory framework of the entire financial system and building regulatory capacity to enforce that framework;
- Re-establishing corporate governance mechanisms and technical capacity in the banking system and the financial sector infrastructure as a whole;
- Developing creative systems for facilitating access to financial services for small and medium enterprises and rural communities; and
- Broadening and deepening the financial sector.

In Somalia's case, the challenge of implementing such reforms is uniquely daunting because of the following special circumstances that prevail:

- Efforts to re-establish a unitary governing structure for the whole country are at a nascent stage, and are still on-going. The Somali National Reconciliation Conference that began in October 2002 in Kenya led to representatives of 22 Somali groups establishing a 275-member Transitional Federal Parliament in August 2004, largely based on clan affiliation. In October 2004, the parliament elected Abdullahi Yussuf Ahmed, the former president of Puntland, as the interim president of the TFGS. The following month, Mr. Abdullahi selected Ali Mohammed Ghedi as Prime Minister, who in turn obtained approval of his cabinet in January 2005. The establishment of a broad-based TFGS is a positive but only a first step in the long road of rebuilding the Somali nation, ensuring continued peace and stability, and moving the country onto the path to sustainable development.
- The proposed governing federal structure has been agreed to in principle, but yet to be defined and agreed in specific administrative terms by all political entities**.** Despite the length of the negotiations in Kenya leading to an agreement over power sharing under a transitional charter and over the principle of federalism among regions for the future, reconciliation among clans, warlords, and political leaders remains a challenge.
- Somaliland's determined but thus far failed efforts to secure international recognition as an independent state by the international community, which continues to uphold the territorial integrity of Somalia. Although it was twice affected by civil strife (1992 and 1994-96), Somaliland has managed to establish a parliament, judiciary, police force, and municipal structures and to hold a locally-financed referendum on a constitution in May 2001, local elections in December 2002 and presidential elections in April 2003. Relative security has revitalized the economy, private activity, remittance flows, and an active NGO sector. In partnership with the private sector and other civil society organizations, Somaliland also has succeeded in restoring basic public services and in attracting reconstruction and development assistance, though at modest levels.
- The extremely low levels of private sector and public confidence in public institutions, including public financial establishments. Before the civil war, general public management was characterized

by frequent policy reversals, weaknesses in fiscal management, slippages on the monetary side, poor governance, inadequate maintenance expenditures, and security problems that discouraged the private sector from investing in long-term production-oriented activities and that generated low or negative returns for public investment. Further, banking sector closures, primarily due to mismanagement further eroded confidence in publicly owned financial institutions. Overall, Somali people still harbor suspicion and ambivalence toward things associated with public authorities.

- An extremely poor investment climate. In a post-conflict environment, attracting new foreign and domestic firms is central to private sector development. New decisions about investment, especially financial institutions, usually depend on the availability of five basic factors: political and economic stability and security; clear unambiguous regulations; reasonable tax rates that are equitably enforced; access to finance and infrastructure; and an appropriately skilled workforce. In Somalia, these conditions are lacking. The challenges facing the TFGS in addressing these constraints and in turn attracting foreign and domestic investment cannot be underestimated.

The absence of a functioning central government has implications on the nature of financial sector legislation and regulatory framework and the financial services infrastructure proposed for the financial sector reform process. The remaining sections of this chapter examine each of the required reforms typical in post conflict counties—central banking, commercial banking, and access to finance—and makes specific efforts to accommodate Somalia's unique circumstances without compromising on the minimum international standards of transparency, efficiency, safety and soundness of a conventional modern day financial system, albeit a basic one.

1. Central Banking

A strong legal and regulatory framework enforced by an equally strong central bank is a priority for effective financial sector reforms. Weaknesses in the legal and judicial framework governing commercial contracts and their enforcement, and the slow and biased court system, are common in conflict-affected countries where years of conflict erode basic civil rights. But these weaknesses urgently need to be addressed as sustainable financial sector growth and stability requires a framework based on strong creditor rights. Developing an appropriate legal environment for financial sector development, particularly in the short term will require attention at a minimum to the following:

- *Licensing criteria for new commercial banks*: The entry of new banks in a conflict-affected environment can provide an expedient impetus to rebuilding a financial system. The injection of new capital into the country can spur the resumption of basic lending activities and financial transactions with the rest of the world. In encouraging new banks, it is important to establish strong entry criteria and procedures for bank licensing to ensure that only credible banks are allowed into the nascent environment. The risk of money laundering inspired banks is high.
- *Central bank regulatory and supervisory capacity*: The central bank needs to rebuild its regulatory and supervisory monitoring and enforcement capability. Considering the challenging task for banking supervision, the creation of a dedicated supervision function in the central bank with sufficient qualified staff assigned to this function is essential. Banking supervision needs to constantly assess the health of the banking sector and the ability of the managers to run the banks in accordance with international best practice. Where problems are identified, banking supervision has to have the skills to design and enforce remedial strategies before they spread to the rest of the banking sector.
- *Prudential regulations for commercial banking institutions*: Regulators need to promptly elaborate and introduce a modern legal foundation for effective banking supervision. In addition to a new licensing regulation, other priority regulations should cover prudential norms, including capital adequacy, loan classification, liquidity, transactions with concerned persons, foreign exchange

exposure. Outdated central bank and commercial banking laws need to be updated or replaced and augmented with specific prudential regulations for monitoring bank performance with respect to capital adequacy, asset quality, liquidity, and loan classification.

- *Prudential regulations of formal and informal non-bank financial institutions*: Although regulators in post-conflict countries often lack the capacity to regulate formal financial institutions, let alone informal financial service providers, they need to recognize the role that these institutions play in providing financial services in communities where commercial banks are not commercially viable. Efforts to strengthen legal and regulatory frameworks for the financial sector must also include engaging the owners of these institutions as doing so will help regulators to implement measures that address potential vulnerabilities without inadvertently affecting the operational characteristics of these institutions that make them efficient in difficult circumstances. Further, conflict affected environments are often characterized by a large number of NGOs that provide microfinance services. Often running small programs, these NGOs provide an important financial service that needs to be nurtured within the parameters of an accommodating legislative and regulatory structure. Reforms must focus on establishing a basic but effective system for NGO and microfinance registration and monitoring. A legal framework that is too detailed may stifle rather than develop the sector.

Somalia's legal and regulatory framework is virtually non-existent. Although the TFGS has appointed a governor, the central bank has not yet been established and the banking supervision function will need to be developed from scratch. The current banking law and supervision regulations are inadequate. A new banking law setting the foundation for an autonomous central bank has been drafted, but it is yet to be enacted into law by the recently established parliament. Bank supervisors, once identified, will need to be trained in basic banking supervision and risk management skills. Further, in addition to the problems listed here which are common in other conflict affected countries, and those listed above (which are not common to post-conflict countries), Somalia also suffers the unique complication of having within its borders, entities operating as central banks for specific regions.

- There are two banks performing both central and commercial banking functions on a limited almost defunct level. Both the Bank of Somaliland and the State Bank of Puntland provide limited commercial banking services—primarily deposit-taking facilities. However, the lack of trust and confidence in the public financial services has generally resulted in a limited use of the services offered by both institutions. Private citizens use their accounts in the regional banks primarily for accumulating taxes they owe to the regional governments. Their primary function remains as the treasurer of these governments. Still, by offering banking services they are in an undesirable conflict of interest with their central bank and banking supervisory activities.
- The two banks do not perform many of the typical central bank functions. For instance, they do not conduct monetary policy, do not, in effect, supervise banks, nor do they provide or supervise an efficient payment system. Furthermore, the central banks would not even be in a position to offer lender-of-last resort facilities for illiquid but solvent banks had there been any. Significantly, there is no evidence to suggest that either bank has the wherewithal to act autonomously against clear rules of public accountability. There is an absence of well-defined operational objectives such as achieving and maintaining price stability. Addressing these weaknesses is crucial to any meaningful reform of the financial sector.

In this regard, there are political decisions that must precede the commencement of financial sector reforms.

- There needs to be agreement on the location of the proposed central bank. Rebuilding the physical infrastructure of a central bank is an expensive proposition. The required infrastructure for banking supervision, payment systems, and monetary policy alone is substantial. In a resource constrained environment, it is not ideal to work with a temporary location, in the belief that a decision to relocate the capital can easily be matched with a like transfer of the central bank to that city.

- There needs to be agreement on the desired and expected strength of the federal regulatory structure of the central bank. With two regional central banks already in existence, the role of national and regional central banks and the degree of capacity building to take place at the proposed national central bank needs to be discussed and agreed with all political entities.

Once there is agreement on the two issues listed above, then the following technical assistance program for legal and regulatory reforms can commence in earnest. If there is no immediate agreement on these issues, especially the second issue, then suboptimal transitional reform options need to be considered. Essentially this would entail parallel reforms in each region aimed at achieving technical harmony or financial legislation, policies and procedures prior to attaining political harmony of state independence—a more expensive, but still achievable prospect. For example, officials from Somaliland, Puntland and the TFGS Central Bank can agree in principle to harmonize their respective prudential regulations since the expected applicants are likely to serve the same markets. This done, it would be possible in the interim to proceed with capacity building programs before discussions on the final political structures are concluded. The bank in Puntland has in principle agreed to operate as branch of the national central bank.

2. Commercial Banking

As soon as the process of building a strong legal and regulatory framework and central bank allows, the priority of the Government should be attracting sound and credible commercial banks. It is essential that public awareness is raised on the licensing and prudential requirements in order to attract desirable private investors.

Soon after the reform process commences, financial regulators need to take stock of the existing state-owned financial institutions and quickly make a decision on which institutions or branches of institutions will be liquidated or disposed off. The assets of banks earmarked for liquidation need to be accounted for and systems put in place for their transparent disposal. However, it is unlikely that there will be immediate interest in purchasing such assets. In Somalia, the only state-owned commercial banking services are those owned and operated by the Bank of Somaliland and the State Bank of Puntland. Best corporate governance practice recommends that the commercial banking operations should be separated from the central banking functions (supervision and regulatory oversight) of the central bank. This should be considered as part of restructuring the central bank. The commercial banking assets can be liquidated, privatized or temporarily, can be corporatised into a separate viable state-owned financial institution.

State participation in the commercial banking sector should only be seriously considered if:

- Appropriate changes are made at the board and management levels with qualified and experienced personnel;
- The organization and corporate governance structures are well structured;
- The operating systems, management tools, responsibilities, and scope of authority at all levels of management and staff are well-defined; and
- Recapitalization is effected only after a full diligence, and financial, management and operational unites have been performed on the bank being restructured.

Until the commercial activities are separated from the central banking functions, the Government should focus on strengthening corporate governance structures through a variety of options including: guidelines for the appointment and dismissal of managers and board members, new organizational structures, revised credit policy and controls, new procedures for credit-risk evaluation, and enhanced asset/liability and treasury-management techniques.

3. Access to Financial Services

Fundamentally, the urgency for financial sector reforms in Somalia is driven by the commonplace complaint about the inability of the private sector to access formal financial services. Cost is not even an issue, as there are simply no formal services available at the moment.

Unfortunately, providing access to financial services in post-conflict environments is constrained by several factors which complicate further the usual problems often found in developing economies even in the absence of conflict, notably:

- The breakdown of the credit and contract enforcement culture;
- A large number of internally dispersed populations with little or no documentation;
- The absence of physical collateral and land-tenure systems (often devastated by years of conflict) that minimize the value and use of land as collateral;
- The credit information infrastructure;
- High risks associated with rain-fed agriculture; and
- Past history of state involvement and subsidized lending, leading to low recovery rates.

These problems, some of which may affect urban access to finance, tend to be more acute in rural areas. In Somalia, each of these problems is manifested to some degree, especially in areas where there is an absence of a unified governing authority.

The pressure for government intervention is therefore often acute in the aftermath of conflict. Yet, the old model of directed lending to groups of interest through publicly owned and managed development finance institutions or specialized banks has become redundant and outdated. Universal experience shows that a strong, market-based, competitive financial system comprising banks serves these needs in a much more efficient and cost effective manner. In Somalia, as is the case in many developing countries, the provision of funds through directed and subsidized credits by development finance institutions has contributed to the failure of many financial sector programs, even before the commencement of conflict. Still the pressure for government directed credit will be immense.

At the same time, market failure, particularly in post conflict countries, justifies public policy intervention on behalf of underserved SMEs and rural communities. Research shows that demand for financial services exists, and the capacity to save, borrow and pay for financial services can grow. The key lies in defining public policy intervention carefully and ensuring that it focuses on facilitating rather than displacing private sector involvement. It is therefore important that financial sector reforms encourage banks and other formal financial institutions to enter the market and to develop creative systems for facilitating access to financial services despite the challenges present in a conflict environment. Non-collateralized lending, for example, will be a premium in conflict affected Somalia. Only in Somalia's case, the real challenge lies first in attracting credible banks to enter the market in the first place. To this end, initially introducing modest criteria for entry of banks in terms of capital and 'fit and proper' requirements should help. Furthermore, accommodating some of the Somali money transmitters as 'narrow' banks could be considered. While commercial banks are likely to serve the upper segments of the population and private sector, developing a sustainable microfinance sector would ensure that a more inclusive financial sector is built for the long run.

While the banking sector is likely to remain the largest component of the financial system for some time after the end of sustained conflict, there is also a need to develop alternative financial institutions that broaden and deepen the financial sector including microfinance institutions, leasing companies, commercial credit companies, credit unions, factoring companies, insurance companies, and pension and provident funds, and, in the longer term, to develop debt and equity markets. Banks are notoriously inept at expanding services to rural communities, particularly those afflicted by conflict. The establishment of a broad range of instruments into which savers can deposit their funds and through which companies and consumers can obtain access to capital and credit, will spur economic recovery.

4. Conclusion and Recommendations

Restoring a financial system in a country afflicted by conflict is a challenging task. Recognizing that financial sectors in post-conflict countries have varying levels of development and capacity for reform, and that each conflict has unique characteristics and circumstances, reformers need to bear in mind that sustainable financial reforms have a long maturity period. Enacting legislation, improving governance structures, developing competitive financial practices, building financial infrastructure, and encouraging international and domestic confidence in financial institutions require patience and determination. In a complex post-conflict country like Somalia, the need for persistence is even greater. The chosen strategy will by necessity have to be opportunistically evolutionary and reactionary. The changing dynamics in Somalia preclude a rigid ex-ante financial sector strategy.

4.1 Central Banking

Given the interdependencies of post-conflict problems, the program proposed below must be seen as an integral part of the overall public sector reform program. What is proposed below must be read as efforts towards a minimal structure of monetary and exchange arrangements, key financial legislation, organizational structures, instruments, and information systems in a post-crisis situation. Such a minimal system should support the start of broader private sector development by providing the following basic conditions:

- Reasonably stable prices, resulting from firm monetary control;
- Effective financial services to execute the government budget (means to collect revenue, make payments, finance deficits, etc.).
- Efficient utilization of foreign aid and foreign exchange resources;
- Efficient mobilization and allocation of savings (credit); and
- Credible external and internal means of payment.

Because Somalia no longer has a functioning central bank, it is recommended that a graduated approach for reestablishing key functions in areas where a central bank typically has responsibilities is pursued. The overall objectives would be to rebuild capacity for formulating and implementing monetary and exchange rate policies, and to restore a functioning banking and payment systems within an appropriate institutional framework. Through these actions, the foundations will have been laid for a sound monetary and financial system, which is critical for promoting economic recovery.

The primary steps to be taken toward re-establishing a central bank and a rudimentary financial system in a post-conflict economy are usefully grouped into four phases. The timeframe for these time periods will vary depending on local circumstances; however, due to the linkages and sequencing requirements, the need to preserve the momentum of the reform process is imperative, arguing in favor of implementation over a period of up to five years.

4.2 Commercial Banking

Initial discussions have begun in connection with the establishment of a full fledged commercial banking operation in Somalia. Many of the remittance companies have expressed an interest investing in such a bank. However, they have equally expressed concern about their lack of operational capacity and experience in venturing into commercial banking. And indeed, in addition to the lack of capacity there are other risks associated with the entry of commercial banks into Somalia. Some of these include the following:

Capital

Opening a commercial bank requires adequate capital. Given the adverse economic and political circumstances with which Somalia struggles, it is unlikely that a single investor will invest their hard earned resources into a bank on their own. The business rationale for doing so, given the potential opportunity cost is high. The initial capital for a serious private banking operation will likely have to be arranged by multi-investors. It is unlikely that investment will be forthcoming from a single investor. Potential sources of capital include:

- *Diaspora*: The diaspora is reputedly remitting at least $1 billion annually to Somalia. Much of these remittances have been invested into property in various cities in Somalia. Potentially, some of them may be enticed to invest in a Bank in the same way that they have invested in educational and health institutions and kept the economy running.
- *Bilateral and multilateral institutions*: While the present country circumstances may dictate this unlikely option, there are models upon which bank promoters have managed to attract the interest of multi- and bilateral institutions. In 2004, the First Microfinance Bank of Afghanistan (FMBA) was sponsored by the Aga Khan Fund for Economic Development, AKFED, and the IFC with additional sponsorship taken by other bilateral shareholders and institutional microfinance investors. The Asian Development Bank is an equity investor in the Afghanistan Investment Bank which was formed during the same period.
- *Remittance companies*: The largest remittances companies have indicated that they have the financial wherewithal to invest in commercial banking operations. Having operated remittance companies, they are probably best placed to understand the financial sector in Somalia. They have provided money transfer services and basic banking products for a number of years. The public has some measure of confidence in their operations.

The challenge for the new central bank supervisory authority will be that of defining uniform capital requirements. Presently, there are none. How should bank capital be defined? What level of capital is adequate for banks to remain safe and sound? What criteria should be used to assess that the adequacy of capital? Most developing countries have adopted the Basle capital recommendations as a local standard for domestic and foreign banks operating within their jurisdiction. The minimum capital required to open a bank is thus the higher of 8 percent of total risk weighted capital or an absolute amount, whose determination varies across different countries. Afghanistan recommended a minimum of $5 million, which is a useful benchmark (together with other requirements) to prevent unsavory characters from opening banks. Somalia will need to agree on an appropriate level for its environment, but a level similar to Afghanistan is recommended for full-scale commercial banking.

The Profitability of Banking Business in Somalia

Standard practice dictates that banking applications are accompanied by business plans which typically include the applicant's planned banking policies, projected earnings, cash flows and expected rates of return. There are, however, a few exceptions to this practice. The Bank of Botswana, for example, does not attempt to examine the commercial viability of the proposed banks in the belief that the market judgment must be made by the investors whose capital is at risk and not by the licensing authorities.

The evaluation of a bank applicant's business plan raises interesting questions for prudential regulatory policy. Is it possible to prescribe detailed regulations on what is an acceptable business plan? Who is better placed to analyze projected bank performance, the central bank, or market participants?

In Somalia, there is concern that the lack of trust in banks will make it hard to attract deposits; the lack of a functioning legal framework will make it difficult to lend; and that generally the political uncertainty will make it difficult to engage in profitably sustainable banking business. It is likely that the promoters seeking to establish banks in Somalia may resort to insider lending—lending only to related companies and firms of family and close associates. Experience shows that the possibility of collapse is higher when such practices exist than when business is conducted at arms length.

Political Interference in the Licensing Process

Political interference in the evaluation of license applications hinders the regulator's ability to exercise independent judgment in evaluating applications. In many developing countries licenses were granted by government agencies and not those directly responsible for supervising banks. In some countries, the central bank shares responsibility for licensing with the Ministry of Finance or takes licensing decisions in consultation with, or with the approval of the Minister of Finance. These arrangements make accountability difficult, increase the risk of subjective judgments and encourage "rent seeking behavior" in the process.

In Somalia presently, the regional governing authority has a role in the issuance of bank licenses. Often political considerations influence the granting and renewal of banking licenses even when the applicants have not fulfilled the necessary minimum requirements. Instead, the politicians grant exemptions from some of the legal requirements. Top avoid such influences, the authority to license banks should rest with the Central Bank of Somalia.

4.3 Access to Financial Services

Establishing the bank is only one half of the story. Realistically speaking, newly licensed banks might not be able or willing to extend services, particularly lending services, outside major urban centers. For commercial reasons, the banks may initially focus primarily on trade financing, foreign direct investments, and currency exchange operations, or service the wealthier communities and expatriates in the post-conflict territory. It would, therefore, be essential to promote the establishment also of non-bank financial institutions, as a means of channeling financial services to rural or deprived areas or lower income segments and women. No license from the central bank should be necessary for non-bank financial institutions as long as they only operate below a given threshold (say, $100,000 of public deposits). The central bank should not be in charge of regulating and supervising small financial institutions; this task should be assigned to an appropriate meta-institution (for example, an association of microfinance institutions) that the central bank would liaise with.

Achieving the high rates of growth necessary to reduce poverty significantly will require increased mobilization of domestic and foreign savings to support higher rates of private sector investment. Mobilizing savings implies a broadening and deepening of financial markets, institutions, and products, particularly long-term project finance. It also means supporting the creation of banks and non-bank financial institutions offering a range of products and services that compete with or complement those traditionally provided by banks.

Microfinance

Somalia's development needs would demand building of an inclusive financial system so that savings and credit facilities are available to the lower income segments of the population and micro and small businesses. Experience shows that if built in line with international acceptable best practices, microfinance has the potential to have a lasting impact on poverty reduction.

The microfinance sector in Somalia is perhaps comparable to the situation in other post-conflict countries, only that there are two microfinance institutions (MFIs) that have been in operation for more than seven years now, albeit not on commercial basis. Otherwise, most microfinance activity is focused on relief and reintegration through a number of NGO microfinance programs or projects. In total, these organizations probably account for less than 10,000 active clients with an outstanding credit portfolio of under $1million. Obviously, the sector is very small, and generally speaking, characterized by very poor outreach, unacceptable repayment rates, and unsustainable operations. Moreover, the long period of conflict in Somalia has led to people's reliance on grants. More positively, more than half of the active clients at the two MFIs are women. In fact, based on loans granted at one of the MFIs recently, more than two-thirds of the borrowers were women.

Even if one were to assume demand for microfinance services from 5 percent of the Somali households as potential active borrowers in Somalia, this would equate to an active loan portfolio of $5-10 million. This is more than conceivable given that Somalia's economy is dominated by micro and small businesses, with a significant economically active population comprising many households that are headed by women. While estimations may indicate a large unmet demand for microfinance, there are numerous challenges that need to be addressed. To successfully develop the microfinance sector on a sustainable basis, the needs of the economically active poor must be well understood (particularly, in relation to products conforming to Islamic principles), and demand-driven products need to be developed to increase customer base. Moreover, the interest rates (or service charges) of 10-16 percent currently charged by the two MFIs need to be reviewed to reflect more commercial rates of return. The increased outreach must be matched by improved delivery systems to improve efficiency and reduce costs. To complement these, it is imperative that people's attitude is shifted from grants to self-reliance, and business and credit management skills are improved. Appropriate business support services should be made available to micro and small entrepreneurs and vulnerable segments (i.e., IDPs, demobilized militia) of the population.

In the early stages of developing the microfinance sector, the essential need for capacity building of both individuals and new or existing MFIs is massive. So is the need for donor funding to support the capacity building and infrastructure requirements to enable MFIs to grow profitably and achieve sustainability. Perhaps, efforts could be focused on developing one or two sustainable MFIs with private sector management and capital supported by technical assistance from donors. In the short to medium term, the Government should look to introduce a national microfinance policy to facilitate the development of the microfinance industry. As mentioned already, initially, the institutions involved with microfinance activities below a certain threshold do not need to be regulated by the Central Bank. Later, however, the introduction of prudential and licensing requirements for the microfinance industry is recommended.

In addition to microfinance, over the short and medium term, the following options may be considered:

- *Short term (up to 18 months)*: Creating channels for the delivery of sustainable credit programs in post-crisis areas is challenging as recipients will expect grants from the government and the international donor community. It is therefore essential that a clear distinction is made between emergency grant based programs aimed at restoring basic living conditions, and longer term financial resources aimed at restoring income generating livelihoods. In the short term public finance might be used to bridge the gaps in financing. Public financial assistance programs must complement rather than compete with private financing that could be available on commercial terms from other sources. While in the immediate aftermath of establishing a functioning government, grants, not loans, may be provided to entrepreneurs, later in the recovery period funds to entrepreneurs should shift to mainly loan-based products. However, it is recommended that grant programs are applied for the short term enterprise development needs of vulnerable groups or for non-economic purposes while loans are extended to entrepreneurs for general enterprise development. Subsidized credit programs are unsustainable and often unnecessary. New financial products and liquidity vehicles would allow them to better serve small and medium enterprises with tailored lending and savings products. Institutionally, efforts should focus on using the new banks to direct resources rather than creating dedicated state agencies, which have demonstrated for too long their inability to channel funds themselves. A mapping of both banks and non-banking institutions from which small grant and later credit programs can be managed would be a useful exercise in the state rebuilding process.

- *Medium to long term (18 months to 5 years)*: In the absence of data on the financial requirements of the Somali business community, it is recommended that in the medium to long term a multiple-client approach is adopted. The chosen financial program(s), for example, venture capital and microfinance must be ones that are applicable to banks and non-bank financial institutions to ensure maximum geographical coverage. Options for providing financial resources to firms include:
    - a *Business Development Fund*: This may be useful as a model in an environment in which there is pressure on the government to provide the private sector with working capital finance in the absence of commercial banks as an interim measure. In addition to government resources, funds may come from diaspora business networks, nascent venture capitalists, equity funds or other types of firms or groups of individuals, who are committed to developing the private sector in the region. Access to these funds can embed the entrepreneur in professional networks that use common standards for evaluating applicants. To the extent that access to these networks is formalized through a dedicated fund, even entrepreneurs who are poor can receive financing. The long-term goal should be to have private financial institutions supporting small and medium enterprises—and to encourage basic but well-functioning financing markets. This will require putting into place and developing basic credit reference mechanisms to provide credit references without elaborate credit evaluation systems found and used in normal circumstances.
    - *Long Term Development Fund*: This may be useful for extending long term finance to new business ventures or those seeking to expand since it is highly unlikely that efficient maturity transformation in the financial system will take place for several years. Even if banks were able to mobilize longer term funds, the additional risks attached to new ventures and longer term financing would deter them from lending for such purposes. Again, the longer term goal should be to have private financial institutions, venture capital funds, or equity funds provide long term financing.
    - *SME Risk Fund*: This may be appropriate for an interim period to address the typical constraints facing SMEs, including lack of collateral and higher processing costs of financing. Such a Fund, managed privately, could provide structured investments without necessarily requiring collateral.
    - *Credit lines and guarantee schemes*: As commercial banks enter the Somali financial sector and commence operations, and should demand from SMEs and larger firms increase—for new credit to expand and purchase working capital, a credit facility through

commercial banks to business can be established to promote investment and accelerate the rebuilding process.

- *Remittance companies*: Somali remittance companies will continue to represent an important and often necessary element of Somalia's financial architecture. The market's simplicity, cost-effectiveness, and convenience will ensure its survival for many years to come. However, as the sector grows, the profitability of the sector will decline and companies will be forced to either consolidate or expand into new financial products. Money transmitters generally have three direct sources of income—profit on the exchange rate, fees paid by the remitter and sometimes by the recipient, and the interest earned on remitted funds before they are paid out to the recipient. However, Somali money transmitters' profits are earned only from transfer fees. Competition between transfer agents has pushed down commissions and fees, and pressure to make payments within 24 hours has minimized the potential for gains on cash float. Given the extensive branch network throughout the country and large customer base, the Somali money transmitters could be offered incentives to develop new innovative financial products.
- *Microfinance*: is effective at meeting the needs of the smallest businesses. However, in Somalia microfinance has not yet proved successful. In part because of the perception of funds being 'free donor funds' and also because of the general apprehension with interest rates in this largely Muslim country. The repayment rates for the two institutions funded have been around 50 percent in recent years and only increased to 80 percent in recent months. To improve performance and to be considered a viable option for increasing financial services, microfinance institutions will need to re-think their business model.

As these products are introduced into the financial sector, the private sector require business development guidance in identifying acceptable financing needs and connect them to relevant finance providers. A clear strategy needs to be designed, developed and implemented that connects enterprises to relevant business linkage promotion and linkages to finance and financial services. Instead of establishing a formal government institution, efforts should be made to build or partner with internal and external entrepreneurial networks and associations. There is significant interest from international diaspora individuals and companies to assist in the economic recovery in Somalia.

Resources and know how that might be provided from linkages with firms outside the country need to be identified and formalized while the will to assist remains strong. The challenge lies in how to institutionalize these efforts to ensure long term commitment of the private sector and the ability of the TFGS to create an enabling environment for that to happen. Networks can create an entrepreneurial climate for providing financial resources and coaching, mentoring and learning and strengthen links between companies. Networks support indigenous and private systems of learning, so that entrepreneurs can be encouraged to learn from their peers.

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Annex 1: Special Recommendation VI – Alternative Remittance – International Best Practice

Recommendation	Implications for Remittance Companies
SR VI (Alternative Remittances) International Best Practice, paragraph 11: Jurisdictions should require licensing or registration of persons providing informal money value transfer services.	Jurisdictions will implement either licensing or registration requirements with the objective of being aware of its existence. In this regard, remittance companies will need to be transparent in respect of ownership and business address details. Licensing regimes will have more onerous requirements than those of registration regimes. Remittance companies will be required to either register or obtain a license before being allowed to provide money transfer services.
SR VI (Alternative Remittances) International Best Practice, paragraph 19: The principle of know your customer (KYC) should be introduced into money value transfer systems.	Various jurisdictions will have their own specific KYC requirements which must be adhered to. These involve mainly identifying the customer, obtaining his/her address and verifying both the identity and address. Somali Remittance Companies will need to design and implement KYC procedures for customers in, not only in the host countries in which they operate, but also in Somalia. In respect of implementing KYC in Somalia, remittance companies will need to consider that no formal identity system exists and providing residential addresses may pose problems as well. Alternative procedures will have to be developed.
SR VI (Alternative Remittances) International Best Practice, paragraph 20: Money value transfer systems should maintain records for at least 5 years.	Jurisdictions have various requirements in respect of record keeping. Remittance companies will need to obtain customer identification documentation and keep such records for at least 5 years (or for such time period as determined by the jurisdiction) as well as keep records for all transactions for the same period.
SR VI (Alternative Remittances) International Best Practice, paragraph 21: Jurisdictions should introduce transaction reporting obligations in line with their current obligations required by Financial Institutions.	Remittance companies will need to develop internal rules in respect of reporting obligations as required by the jurisdiction in which they have operations. In this regard, the employees will need to be trained in order to identify suspicious transactions. Structures will also have to be implemented to ensure that reporting is effected within the required time-frames as set out in the various host country regulations.
SR VI (Alternative Remittances) International Best Practice, paragraph 22: Regulatory authorities need to monitor the sector with a view to identifying illegal operators and use of these facilities by criminal and terrorist groups.	Regulatory authorities may check the operations of remittance companies and such visits may be unexpected. Remittance companies will need to ensure that they always comply with KYC, reporting and record keeping requirements.
SR VI (Alternative Remittances) International Best Practice, paragraph 23: Jurisdictions should set up a system to employ civil, criminal or administrative sanctions depending on the severity of the offence.	Persons providing money/value transfer services without a license or registration will be subject to appropriate administrative, civil or criminal sanctions as is prevalent in the jurisdiction of operation. Licensed or registered money/value transfer services which fail to comply fully with the relevant measures called for in the FATF 40 Recommendations or the 9 Special Recommendations will also be subject to appropriate sanctions

Annex 2: Revised Interpretive Note to Special Recommendation VII – Wire Transfer

Recommendation	Implications for Remittance Companies
Revised Interpretive Note to SR VII (Wire Transfer), paragraph 4: Cross-border wire transfers should be accompanied by accurate and meaningful originator information. However, countries may adopt a *de minimus* threshold (no higher than USD or EUR 1,000).	Remittance companies will have to obtain identification detail of all originators of remittances. Each jurisdiction will have its own threshold in respect of applying KYC procedures. The Interpretive Note has recommended a threshold of no higher than USD 1,000 or EUR 1,000 per transaction for instituting KYC procedures. Remittance companies will have to determine any threshold applicable in the jurisdiction/s in which they operate.
Revised Interpretive Note to SR VII (Wire Transfer), paragraph 5: Information accompanying qualifying cross-border wire transfers (transfers above the threshold as set by the specific jurisdiction) must always contain the name of the originator and where an account exists, the number of that account. In the absence of an account, a unique reference number must be included.	KYC information regarding all remittances sent by originators/customers must be obtained. This is only applicable for transactions above the requisite threshold set by each jurisdiction in respect of obtaining and verifying KYC information.
Revised Interpretive Note to SR VII (Wire Transfer), paragraph 6: Information accompanying qualifying wire transfers should also contain the address of the originator. However, countries may permit financial institutions to substitute the address with a national identity number, customer identification number, or date and place of birth.	KYC information to be obtained in respect of paragraph 5 as indicated above should include the address of the originator. This may, in certain jurisdictions, be substituted with a national identity number, customer identification number, or date and place of birth. Remittance companies will need to develop procedures around the aspect of obtaining and verifying customer identification information (i.e., Customer Due Diligence).
Revised Interpretive Note to SR VII (Wire Transfer), paragraph 8: Information accompanying domestic wire transfers must also include originator information as indicated for cross-border wire transfers, unless full originator information can be made available to the beneficiary financial institution and appropriate authorities by other means. In this latter case, financial institutions need only include the account number or a unique identifier provided that this number or identifier will permit the transaction to be traced back to the originator.	Somali Remittance Companies will have to develop appropriate KYC procedures which can be used for domestic remittances within Somalia. The Somalia Financial Services Association has developed an Anti-Money Laundering Compliance Guide which provides guidelines on the procedures that could be followed in respect of applying KYC in Somalia.
Revised Interpretive Note to SR VII (Wire Transfer), paragraph 11: The ordering financial institution must ensure that qualifying wire transfers contain complete originator information. The ordering financial institution must also verify this information for accuracy and maintain this information in accordance with the standards set out in the FATF 40 Recommendations (2003).	Remittance companies from which funds are remitted will be required to keep record of all KYC information relating to its customer. Such information will need to be kept in a format and manner that makes it easy to retrieve should this information be required by the authorities. Such information should be kept for a minimum of at least 5 years after the transaction was effected, or if the customer is a regular one, for 5 years after the relationship is terminated.
Revised Interpretive Note to SR VII (Wire Transfer), paragraph 14: Beneficiary financial institutions should have effective risk-based procedures in place to identify wire transfers lacking complete originator information. The lack of complete originator information may be considered as a factor in assessing whether a wire transfer or related transactions are suspicious and, as appropriate, whether they are thus required to be reported to the financial intelligence unit or other competent authorities. In some cases, the beneficiary financial institution should consider restricting or even terminating its business relationship with financial institutions that fail to meet SRVII standards.	Remittance companies receiving domestic or international remittances will need to implement procedures in respect of reporting suspicious transactions. This will include procedures where information from the originator of remittances is incomplete. In Somalia, this aspect will be difficult to implement given the fact that no authority presently exists to receive suspicious transactions. The challenge for the remittance sector inside of Somalia is how to give sensible effect to this recommendation.

Annex 3: Summary of Country Requirements for Money Transmitters

Money Remittance Services

General Compliance Requirements for Money Transmitters

Country	Reference to Money Transmitters	Legal form of Money Remitter	Regulatory Body for Money Remitters	Licensing/Registration requirements for Money Remitters	Authority to receive license/registration application	Cost for Licensing/ Registration	Fit & Proper criteria	Business/Policy Plan	General Reporting obligations	Capital requirements for Money Remitters
Australia	Cash Dealers	Natural persons, bodies' corporate and unincorporated bodies	AUSTRAC	Application to be declared an approved Cash Dealer	AUSTRAC	None specified	None	None	- International Funds Transfer Instruction (IFTI) reports; - Instructions to remit overseas is reportable	None
Canada	Money Service Business	Person or entity that is engaged in the business of remitting funds	OSFI/BSIF	No registration/licensing obligation	N/A	N/A	None	None	None	None
Denmark	Money Transmission Service	No specific requirements	Danish Commerce and Companies Agency *	Apply to be listed in Register of Companies	Danish Commerce and Companies Agency *	DKK2 000	Listed	Written guidelines on the most significant areas of activity	Annual Report	None
Finland	Yes	Natural and Legal persons	Financial Supervisory Authority of Norway	Registered	State Provincial Office of Southern Finland	EUR 80	No prohibition orders to do business	Description of the nature and scope of the operations required	All changes in the business must be reported to the State Provincial Office	No
Italy	Yes*	Natural persons and persons other than natural persons *	Bank of Italy	Registered*	Italian Foreign Exchange Office	Specified by the Italian Foreign Exchange Office (UIC) *	Conditions*	Record of administrative and accounting procedures and internal controls	Periodic returns and other figures or documents as requested *	EUR600 000
Kenya	No term mentioned as Money Remittance is not specifically legislated	Registered companies Registered as a Bank or Forex Bureau	The Central Bank of Kenya *	Licensed	The Central Bank of Kenya *	Application fees of Kshs 5 000 Fees for a bank: Ksh 40 000 Fees for a forex bureau: Ksh 50 000	Listed	A feasibility study of the future operations and development of business for a minimum period of three years from the period of the application	Various currency transaction reports	US$ 25 000
Netherlands	Money Transaction Office	Natural person or Legal Entity or Partnership	De Nederlandsche Bank *	Registration and preceding permission	De Nederlandsche Bank *	EUR 3 100	Listed: test to be completed	Manual of Procedures	Annual audited accounts Report concerning management and	Annual fee of EUR 3 300 Bank Guarantee to cover total some of cash made available
Norway	Finance Company (which is allowed to conduct money transmission)	Company	Financial Supervisory Authority of Norway	Licensed	Financial Supervisory Authority of Norway	None specified	Listed	Operating Schedule	Unknown	EUR 5 million
Qatar	Money changing business/Exchange houses	Any company or establishment licensed to conduct Money Changing	Qatar Central Bank	Licensed	Qatar Central Bank	Registration fees: QR5 000 for Head Office and QR2 000 for every branch	Unknown	Unknown	Accounting records	Bank Guarantee for 25% of capital
Saudi Arabia	Money Changing Business	Natural person or partnership	Saudi Arabian Monetary Agency	Licensed	Saudi Arabian Monetary Agency	None specified	Good conduct and behaviour	No specific requirements	Certified copy of balance sheet annually	Rls 500,000
South Africa	Banks / authorized dealers	Registered company	SARB	Registered	SARB	Minimum R3 000 and a maximum of R150 000	Listed	Compliance Manual	Every foreign exchange transaction	R 250,000,000
Sweden	Money Remittance Services/Money Remitter/an undertaking	Natural and Legal persons	Finansinspektionen *	Registered	Finansinspektionen *	Natural Persons: SEK 5 400 * Legal Persons: SEK 12 500 *	Listed	Not required	Changes in leading management and ownership	None
Switzerland	Yes	Any legal form	Money Laundering Control Authority *	Licensing - if turnover over CHF 2 million or gross income over CHF 20,000	Money Laundering Control Authority *	Different costs depending on the Self regulating bodies *	No criminal records/good reputation	Yes	Yes	Not required
United Arab Emirates	Hawaladar Money Changing Business	Sole proprietor, company	Central Bank of the United Arab Emirates	Exchange Houses: licensing Hawaladars: voluntary registration	Central Bank of the United Arab Emirates	Unknown. Valid for one year	No criminal record, No bankruptcies, honour liabilities towards banks	For Hawaladars: none. For Exchange Houses: yes	Submit audited accounts yearly	Dhs 1,000,000 - 2,000,000
United Kingdom	Money Service Business	Not specified	Her Majesty's Revenue and Customs	Registered	Her Majesty's Revenue and Customs	Registration GBP 60 per outlet Annual fee	Any convictions of money laundering	Procedures related to internal control and communication	HMR&C need to be notified of certain changes	Not required
United States of America (Federal)	Money Service Business	Owner or controlling person *	FinCEN *	Register and maintain a list of agents *	FinCEN *	None specified	Yes*	AML Compliance Manual	Any transaction in currency of US$10 000 or more	Not required

Anti-Money Laundering Compliance requirements

Country	AML programs	Customer Due Diligence Requirements	Record keeping requirements	Reporting of suspicious transactions	Report to whom?	Currency transaction reports	Report to whom?	Cash Threshold reporting	AML training	Independent Review	AML Compliance Manual	Appointment of AML Compliance Officer	Sanctions for non-compliance
Australia	Yes	All transactions	7 years*	To be submitted after transaction	AUSTRAC	AU$10 000	AUSTRAC	AU$10 000	Yes	Unknown	Yes*	Unknown	Imprisonment
Canada	Yes *	Transaction of C$10 000 or more	5 years*	Within 30 calender days	FINTRAC	None	FINTRAC	C$ 10 000	Yes*	Yes*	Yes*	Yes*	Criminal Charges *
Denmark	Yes	Transactions of EUR 15 000 or more	5 years	Investigate and then report	Public Prosecutor for Serious Economic Crimes	None	N/A	None	Yes	None	Yes	No	Fine
Finland	Yes *	Obligation to identify when entering into a business relationship identity of a non-regular customerestablished when the total value of a single transaction or several related transactions exceeds EUR 15 000	5 years	Yes	Money Laundering Clearing House - situated in the National Bureau of Investigations	No	Money Laundering Clearing House	None	Yes	None	Not clearly defined*	advised	Fines to 6 years of imprisonment *
Italy	Yes	Transactions in excess of Lire 20 million	10 years	Without delay	Italian Foreign Exchange Office	No	Italian Foreign Exchange Office	Cash transactions in excess of Lire 20 million	Yes	Yes	Not specifically requested in writing	No	Fines*
Kenya	Yes	All transactions	7 years	Immediately	The Central Bank of Kenya *	Above US$10 000	Financial Markets of the CBK	US$10 000	Yes*	None	Yes*	Not required	CBK intervention Fines
Netherlands	Yes	EUR 10 000 or more	5 years	Immediately	Meldpunt Ongebruikelijke Transacties	No	N/A	N/A	Yes*	Yes	Yes*	No specific requirement	Administrative fines and penalties
Norway	Yes	NOK 100 000 or more	5 years - will be destroyed within one year after expiration	Investigate and then report	National Authority for Investigation and Prosecution of Economic and Environmental Crime	No	N/A	None	Yes*	No specific requirement	Yes*	Yes*	Administrative action, fines or imprisonment
Qatar	Yes	All transactions	15 years	Inform QCB immediately and relationship with customer ended	QCB	QR 30 000	QCB	Not required	Yes*	Yes	Yes	Yes	Various
Saudi Arabia	Yes	All transactions	10 years	Immediately	Saudi Anti Financial Crimes Unit	Report transactions beyond customer profile	Saudi Anti Financial Crimes Unit	Unknown	Yes	Yes	Yes	Yes	Fines; Revoking of license; imprisonment
South Africa	Yes *	Identify and verify all clients	5 years after conclusion of transaction	ML - within 15 days TF - within 5 days	FIC	No	N/A	No threshold in South Africa as yet although provisions in FICA	Yes	No	Yes	Yes	Fines and imprisonment
Sweden	Yes *	For all customers and occassional customers transacting above EUR15 000	5 years	Immediately	Swedish FIU	Cross-border transactions exceeding SEK 150 000	National Tax Authority	None	Yes*	Yes	Yes	Yes	Suspension of business
Switzerland	Yes	Identification of contractual partner * Establishing the identity of the material beneficiary * Repetition of identification or of the establishing of the material beneficiary * Special duty to clarify *	10 years	Without delay	Swiss FIU	No	Money Laundering Reporting Office	None	Yes	Yes	Yes	No	Warnings, order, withdraw license
United Arab Emirates	Yes	Money Changing: All Customers Non-accountholders who transact in amounts of or in excess of Dhs 2000 Hawaladars: All customers	5 years	Immediately	FIU	Suspicious large transactions	FIU	None	Yes	Unknown	Unknown	Yes	Imprisonment or fines
United Kingdom	Yes	Transaction equal to or in excess of €15 000	5 years	As soon as practical	Director General of the national Criminal Intelligence Committee	No	Director General of the National Criminal Intelligence Service	None	Yes	Yes	Unknown	Yes	Fines/ Imprisonment *
United States of America (Federal)	Yes *	Obtain and verify customer identity *	5 years	Within 30 calender days	FinCEN *	Yes - within 15 days *	FinCEN *	Cash purchases: US$3,000-US$10,000 * Money transfers of US$3,000 or more * Currency exchanges of more than US$1,000 *	Yes*	Yes*	Yes*	Yes*	Civil and criminal penalties

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SOCIAL DEVELOPMENT DEPARTMENT
Conflict Prevention & Reconstruction

Also Published as Social Development No. 102

The World Bank
1818 H Street, NW
Washington DC 20433
Fax: 202-522-1699
E-mail: cpr@worldbank.org
Web: www.worldbank.org/conflict