

# private sector

## Anarchy and Invention

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### How Does Somalia's Private Sector Cope without Government?

**Somalia has lacked a recognized government since 1991—an unusually long time. In extremely difficult conditions the private sector has demonstrated its much-vaunted capability to make do. To cope with the absence of the rule of law, private enterprises have been using foreign jurisdictions or institutions to help with some tasks, operating within networks of trust to strengthen property rights, and simplifying transactions until they require neither. Somalia's private sector experience suggests that it may be easier than is commonly thought for basic systems of finance and some infrastructure services to function where government is extremely weak or absent.**

Somalia is the quintessential failed state. After the autocratic regime of Siad Barre fell in 1991, the country collapsed into civil war. Peace has been established in some regions, but Somalia has only a limited government in the Northwest and no recognized government in the South. In these circumstances the private sector has been surprisingly innovative. Competition thrives in markets where transactions are simple, such as retail and construction. In more complex sectors, such as telecommunications and electricity supply, the private solutions are flawed but impressive: coverage has expanded since the 1980s, and prices are attractive compared with those in other African countries.

Only when it comes to public goods or to private goods with strong spillover effects—roads, monetary stability, a legal system, primary edu-

cation, a cross-border financial system—does the state seem to be sorely missed. But even here the private sector has developed creative approaches that partially substitute for effective government. As a result, Somalia boasts lower rates of extreme poverty and, in some cases, better infrastructure than richer countries in Africa (table 1).

#### Private firms make do

Somali entrepreneurs have used three methods to compensate for the lack of effective government regulation (table 2). First, “importing governance” by relying on foreign institutions—for example, for airline safety, currency stability, and company law. Second, using clans and other local networks of trust to help with contract enforcement, payment, and transmission



Table Selected development indicators for Somalia and comparator economies

Indicator	Somalia	West Africa <sup>a</sup>	Neighboring countries <sup>b</sup>
Per capita household income (US\$), 2002	226	501	438
Gini coefficient, 1997 <sup>c</sup>	40	45	47
Population living on less than PPP\$1 a day (percent), 1998 <sup>d</sup>	43	50	52
Roads (thousands of kilometers per million people), 1997	3	3	3
Telephones (per 1,000 people), 2002	15	9	10
Population with access to safe water (percent), 2000	21	59	60
Adult illiteracy rate (percent), 2003	81	49	35

a. Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Republic of Congo, Democratic Republic of Congo, Côte d'Ivoire, Gabon, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, and Togo.

b. Djibouti, Ethiopia, and Kenya.

c. The Gini coefficient ranges from 0 (perfect equality) to 100 (perfect inequality).

d. PPP dollars are U.S. dollars adjusted for purchasing power parity.

Source: World Bank, World Development Indicators database.

of funds. Third, simplifying transactions until they can be carried out with help from neither the clan nor the international economy.

#### Telecommunications: networks link up

Many local companies have teamed up with international giants such as Sprint (U.S.) and Telenor (Norway), providing mobile phones and building new landlines. Vigorous competition has pushed prices well below typical levels in Africa, and Somalia now has 112,000 fixed lines and 50,000 mobile subscribers, up from 17,000 lines before 1991. Yet not all is well. Calling every phone subscriber in Hargeisa, in the Northwest, would require connections from four telephone firms. But firms in Mogadishu have now agreed on interconnection standards, and those in Hargeisa appear to be following suit. The negotiations were brokered by the Somali Telecom Association, set up with the help of the United Nations and International Telecommunication Union (ITU) and headquartered in Dubai.<sup>1</sup>

#### Electricity: simple solutions yield results

Entrepreneurs have worked around Somalia's lack of a functioning electricity grid, payment systems, and metering. They have divided cities into manageable quarters and provide electricity locally using secondhand generators bought in Dubai. They offer households a menu of choices (daytime, evening, or 24-hour service) and charge per lightbulb.

#### Water: access but not cheap or safe

Public water provision is limited to urban areas, but a private system extends to all parts of the country as entrepreneurs build cement catchments, drill private boreholes, or ship water from public systems in the cities. Prices naturally rise in times of drought. Traditionally, destitute families have not had to pay for water, while the slightly better-off borrow funds from relatives. Nevertheless, after several years of drought the United Nations estimates that many families in the Eastern Sanaag have debts of US\$50–100 for water. Moreover, access to safe water is low even by African standards because neither regulators nor the market have been able to persuade merchants to purify their water.

#### Air travel: outsourcing safety

In 1989 the national carrier (partly owned by Alitalia) operated just one airplane and one international route.<sup>2</sup> Today the sector boasts about 15 firms, more than 60 aircraft, 6 international destinations, more domestic routes, and many more flights. But safety is a concern. Airports lack trained air traffic controllers, fire services, runway lights, and a sealed perimeter against stray animals, and checks on aircraft and crew are inadequate. The makeshift solution: international outsourcing. Somali carriers lease planes, often with crews from Eastern Europe (the largest, Daallo Airlines, leases a Boeing from the United Kingdom, to boost customer confidence). And they operate out of Djibouti, Dubai, and Nairobi, using the facilities there to check aircraft safety.

### Private courts: quick but limited

A recent effort to endow Mogadishu with a functioning court collapsed when the court tried to levy taxes and take over the privately run port of El Ma'an. In any case Somalia lacks contract law, company law, the concept of limited liability, and other key pillars of commercial law. In some cases Somalis have used offshore registration of businesses to import legal concepts and services. More commonly, disputes are settled at the clan level, by traditional systems run by elders and with the clan collecting damages.

Such measures are free—and fast by international standards. In a case involving the oppression of minority shareholders in a large livestock company, out-of-court talks were preferred, the company continued to operate successfully, and the dispute was settled amicably. But clan-based systems deal poorly with disputes outside the clan. In a dispute involving the telecommunications company Aerolite, the interclan committee of elders awarded the plaintiff from a weaker clan an unfairly small settlement, and since it was not enforced, he received nothing.

### Currency: perfect competition for dollars

Sharp inflation in 1994–96 and 2000–01 destroyed confidence in three local currencies.

U.S. dollars are harder to forge, do not need to be carried around in large fragile bundles, and, most important, retain their value. The feeble capabilities of the central bank have allowed free entry into the currency exchange business, which is as close to perfectly competitive as is ever likely to be possible.

### International fund transfers: *hawala* system

The *hawala* system, a trust-based money transfer system used in many Muslim countries, moves US\$0.5–1 billion into Somalia every year. A person in New York wishing to send money to his family in Tog-waajale gives the *hawala* agent in New York the sum in cash, paying a 5 percent commission. The agent deposits the cash in a local bank account to be transferred to the company bank account in Djibouti or Dubai, then alerts the clearinghouse in Hargeisa, which passes details on to Tog-waajale. When the recipient shows up, the local agent quizzes him about his clan lineage using questions provided by the relative overseas as security against fraud. The transaction is usually completed within 24 hours. *Hawala* networks are unregulated and do not always keep records of transactions, but they are coming under pressure from efforts to combat money laundering.<sup>3</sup>

Table Private sector coping strategies in Somalia

2 Strategy and application	Example
<b>Importing governance</b>	
Telecommunications	Somali Telecom Association, set up with help of United Nations and ITU and headquartered in Dubai, supports interconnection.
Finance	<i>Hawala</i> system uses financial infrastructure outside Somalia for money transfers. <i>Haji</i> traveler's checks written with Saudi banks.
Air safety	Planes operate out of foreign airports and are checked there. Planes and crews are leased from international suppliers.
Legal system	Companies are often registered offshore.
Monetary stability	Economy is de facto dollarized.
<b>Using clan systems</b>	
Savings and insurance	Rotating credit associations use clan links to convene and enforce.
Social insurance	By tradition, destitute families do not pay for water. Families and clans extend credit to others to pay for water during droughts.
Legal system	Clan elders arbitrate disputes. System is less effective in cross-clan disputes but still used.
<b>Simplifying transactions</b>	
Electricity and telecommunications	Entrepreneurs divide up cities into manageable chunks and use flat tariffs (such as per light-bulb) for electricity.
Finance	Quiz on clan relationships used in place of sophisticated security.

### Savings accounts and traveler's checks

Somalia has adopted the widespread African institution of rotating credit associations, which rely on clan links for enforcement and provide a safe haven for savings. More innovative is the system of traveler's checks for the pilgrimage to Mecca, or *hajj*. Nobody would accept Somali checks, so Somali firms set up accounts in Saudi banks and write checks to pilgrims that can be cashed in any branch.

### Gaps in private sector provision

In some areas the private sector has made little progress. The Somali road system, for example, is limited and in poor condition. For a private supplier to build a road and collect fees to cover the costs is apparently too hard, partly because of prohibitive transaction costs and partly because fee-paying users are not the only ones who benefit from roads.

Primary education is another disappointing story. Some 71 percent of primary schools are privately owned (typically by parents or communities), but enrollment is just 17 percent. By contrast, it is 82 percent in West Africa, where countries are richer and more stable and the government is much more heavily involved in the economy.

Ideally, benevolent government would sort out both problems. But government that is merely stronger might not help. Where municipal governments along the Berbera–Hargeisa road have the power to collect tolls, they do not spend them on maintenance. The failings of the education system are partly because half of Somalis are nomads. It is not clear that government would do much better, especially since the private schools are locally acknowledged to be superior to those run by local government. Rather than try to create a government system from scratch, a better policy would be to improve the network of higher-quality private schools.

### Conclusion

The achievements of the Somali private sector form a surprisingly long list. Where the private sector has failed—the list is long here too—there is a clear role for government interventions. But most such interventions appear to be

failing. Government schools are of lower quality than private schools. Subsidized power is being supplied not to the rural areas that need it but to urban areas, hurting a well-functioning private industry. Road tolls are not spent on roads. Judges seem more interested in grabbing power than in developing laws and courts.

A more productive role for government would be to build on the strengths of the private sector. Given Somali reliance on clan and reputation, any measures allowing these mechanisms to function more broadly would be welcome; credit and land registries would be a good start. And since Somali businesses rely heavily on institutions outside the economy, international and domestic policies supporting such connections would help.

For governments and aid agencies, the capability of some business sectors to cope under the most difficult conditions should give hope and guidance in other reconstruction efforts. It may take less encouragement than is commonly thought for stripped-down systems of finance, electricity, and telecommunications to grow.

### Notes

1. "Somalia Telecoms Boom without Government," *Somaliland Times*, July 22, 2004.
2. United States Institute for Peace, *Removing Barricades in Somalia: Prospects for Peace* (Washington, D.C., 1998).
3. Abdusalam Omer, "Supporting System and Procedures for the Effective Regulation and Monitoring of Somali Remittance Companies (*Hawala*)" (United Nations Development Programme, Nairobi, 2003).

## viewpoint

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