

**TRANSITION INFORMAL SECTORS INTO FORMAL SECTORS IN SOMALIA:
ISSUES, CHALLENGES AND OPPORTUNITIES**

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ABSTRACT

The informal sector is a significant driver of Somalia's economy, providing employment and income opportunities to a large portion of the population. However, its unregulated nature presents challenges such as low productivity, lack of financial access, weak social protections, and minimal tax contributions. This policy paper examines the current state of Somalia's informal economy, the challenges faced by informal businesses and workers, and the potential benefits of transitioning to the formal sector. It outlines a strategic framework for formalization, focusing on legal reforms, financial inclusion, labor protections, and institutional coordination to ensure a smooth and sustainable transition. The report highlights a phased approach to formalization, starting with awareness campaigns and stakeholder engagement, followed by simplified business registration processes, financial support mechanisms, and enhanced social protections. The Ministry of Commerce and Industry, in collaboration with financial institutions, private sector actors, and development partners, will play a key role in policy implementation and business support programs. Public-private partnerships (PPPs) will facilitate market integration and provide businesses with the necessary resources to operate within a regulated environment. To ensure the success of the formalization process, a monitoring and evaluation framework has been established, with clear performance indicators, baseline data, and target outcomes. Additionally, risk assessment and mitigation strategies have been developed to address compliance challenges, financial constraints, and enforcement gaps. With a well-coordinated approach, adequate resource mobilization, and stakeholder commitment, Somalia can build a resilient, inclusive, and well-regulated economy, fostering long-term growth, improved worker protections, and enhanced government revenue collection.

1. SOMALIA'S INFORMAL ECONOMY: ISSUES AND CHALLENGES

1.1 Definition and Scope of the Informal Sector

The informal sector in Somalia encompasses all unregistered, unregulated, and unincorporated economic activities that operate outside the formal legal and institutional frameworks. These enterprises often do not comply with labor laws, tax regulations, or business registration requirements. The informal sector is characterized by small-scale operations, a lack of structured employment relationships, and a reliance on cash-based transactions.

Scope of the Informal Sector

The informal sector in Somalia is vast and diverse, covering a wide range of economic activities. Based on the Somalia Integrated Business Establishment Census (SIBEC-2024), informal establishments account for 25% of all recorded business establishments in the country. The sector is particularly dominant in the following areas:

- ❖ **Retail and Trade:** Small shops, kiosks, market vendors, and street hawkers, with 78% of informal businesses operating in wholesale and retail trade.
- ❖ **Agriculture and Livestock:** Unregulated farming, fishing, and pastoral activities that form the backbone of rural livelihoods.
- ❖ **Transport Services:** Informal taxi and motorcycle (bajaj) operators providing essential mobility services in urban and rural areas.
- ❖ **Construction and Handicrafts:** Small-scale builders, masons, and artisans engaged in non-contractual employment arrangements.
- ❖ **Home-Based and Micro Enterprises:** Tailoring, food preparation, and small-scale manufacturing businesses operated from households.
- ❖ **Accommodation and Food Services:** Small restaurants, tea stalls, and food vendors contributing 10% to the informal economy.
- ❖ **Services Sector:** Informal mechanics, barbershops, and freelance workers who lack formal business registration.

Characteristics of the Informal Sector in Somalia

The informal sector in Somalia exhibits the following key characteristics:

- ❖ **Lack of Registration:** Most businesses operate without a Tax Identification Number (TIN) or official business licenses.
- ❖ **Employment Vulnerability:** Workers often have no formal contracts, job security, or social protection benefits.
- ❖ **Cash-Based Transactions:** Business dealings primarily rely on cash payments, limiting access to credit and financial services.
- ❖ **Low Productivity:** Due to limited capital investment, skill training, and access to infrastructure, informal businesses face productivity constraints.
- ❖ **Gender Dynamics:** Women are more active in micro-establishments, accounting for 70% of employees, while men dominate employment in formal and informal businesses.
- ❖ **Resilience to Economic Shocks:** Despite its challenges, the informal sector remains a key driver of employment and survival for vulnerable populations.

The informal sector plays a crucial role in Somalia's economic landscape, providing income opportunities to millions. However, its unregulated nature presents challenges related to taxation, labor rights, and economic development. The transition to a formalized economy requires a

structured approach that balances regulatory enforcement with incentives for small businesses to integrate into the formal system.

1.2 Historical Context and Factors Contributing To the Growth of the Informal Economy

The informal economy in Somalia has deep historical roots, shaped by political instability, weak institutional frameworks, and socio-economic challenges. Before the collapse of the Somali central government in 1991, the formal economy was largely controlled by the state, with key sectors such as banking, telecommunications, and public services under government management. However, with the onset of civil war, the destruction of state institutions led to a breakdown in formal economic structures, pushing many individuals and businesses into the informal sector as a survival strategy (World Bank, 2022). The absence of effective regulatory oversight meant that most economic activities developed outside formal governance, fostering the rapid expansion of informal enterprises.

One of the primary factors contributing to the growth of the informal economy is limited access to financial and regulatory institutions. According to the Somalia Integrated Business Establishment Census (SIBEC-2024), only 28% of businesses operate formally, while the remaining are either informal or micro-establishments. Many entrepreneurs lack the capital to register and sustain formal businesses due to stringent licensing requirements, high fees, and complex bureaucratic processes. Additionally, Somalia's banking sector remains underdeveloped, with a heavy reliance on informal financial systems such as Hawala (money transfer services), making it difficult for small enterprises to access formal credit and financial services (International Labour Organization, 2023).

Another key driver of informality is economic fragility and conflict-driven displacement. Decades of armed conflict have displaced millions, forcing people to engage in informal trade, small-scale manufacturing, and service provision as a means of subsistence. The lack of industrialization and limited employment opportunities in the formal sector have left many individuals reliant on informal income-generating activities. Furthermore, climate-related shocks such as droughts and floods have driven rural populations into urban areas, where they establish small, unregistered businesses as a coping mechanism (United Nations Development Programme, 2023).

Cultural and social factors also play a role in sustaining the informal economy. Many Somali businesses operate within clan-based networks, which provide trust-based credit and support systems that bypass formal regulatory frameworks. This informal trust system enables business owners to trade and invest without official documentation, reinforcing the persistence of unregulated economic activities (African Development Bank, 2022). While these traditional business models have supported resilience, they also hinder efforts to modernize and integrate the economy into formal governance structures. As Somalia continues to rebuild its state institutions, addressing these systemic barriers will be crucial in creating a more structured and sustainable economic environment.

1.3 Key Issues and Challenges Faced By Informal Sector Actors

The informal sector in Somalia, while crucial to livelihoods and economic resilience, faces numerous structural and operational challenges that hinder business growth and sustainability. These challenges include limited access to finance, inadequate infrastructure, lack of legal recognition, weak social protection, and vulnerability to economic shocks. The Somalia Integrated Business Establishment Census (SIBEC-2024) highlights that 25% of businesses operate

informally, meaning they lack proper legal recognition and access to state support. This section explores the major constraints affecting informal businesses and workers in Somalia.

1.3.1 Limited Access to Finance

One of the most significant challenges faced by informal businesses is financial exclusion. According to SIBEC-2024, only a small fraction of informal businesses have access to formal credit or banking services due to the absence of collateral, stringent loan requirements, and high interest rates. Many rely on informal financial systems, such as Hawala transfers and rotating savings groups, which offer limited capital for expansion. A 2023 study by the International Labour Organization (ILO) found that more than 70% of informal enterprises in Somalia lack access to formal credit, making it difficult for businesses to scale operations and invest in productivity-enhancing infrastructure.

1.3.2 Inadequate Infrastructure and Market Access

A lack of essential infrastructure such as roads, electricity, and communication networks poses a significant barrier to business growth. Only 30% of informal businesses have access to reliable electricity, forcing many to rely on costly generators or intermittent power supply (World Bank, 2022). Furthermore, poor road networks and insecurity in certain regions restrict access to larger markets, limiting trade opportunities for small businesses. According to SIBEC-2024, the majority of informal enterprises are concentrated in urban centers such as Banadir, Waqooyi Galbeed, and Bari, where infrastructure is relatively better, while rural businesses face severe logistical challenges.

1.3.3 Lack of Legal Recognition and Regulatory Barriers

Many informal businesses operate without proper registration or compliance with taxation laws, leaving them vulnerable to legal uncertainties. The Somalia National Bureau of Statistics (SNBS) reports that only 28% of businesses are formally registered, meaning that the remaining 72% operate without legal protection, making them susceptible to arbitrary taxation, harassment, and eviction. Formalization is often seen as costly and bureaucratic, discouraging many small enterprises from transitioning into the formal economy. Additionally, weak enforcement of business laws results in overlapping regulatory requirements, further complicating the registration process.

1.3.4 Weak Social Protection and Job Insecurity

Informal sector workers in Somalia lack access to social safety nets, such as pensions, health insurance, and unemployment benefits. SIBEC-2024 data reveals that over 66% of workers in informal establishments have no contractual job security or access to health and labor protections, increasing their vulnerability to exploitation. Women, who constitute 70% of employees in micro-establishments, face additional challenges, including gender-based wage gaps and limited maternity protections (African Development Bank, 2022). This absence of social protection makes informal workers highly susceptible to economic shocks, health crises, and sudden job losses.

1.3.5 Vulnerability to Economic and Security Risks

The informal sector is highly sensitive to economic fluctuations, political instability, and climate-related shocks. With Somalia frequently experiencing droughts, floods, and supply chain disruptions, small businesses often struggle to recover from financial losses. Additionally, the absence of business insurance and emergency relief mechanisms exacerbates the risks faced by

informal entrepreneurs. Security concerns, particularly in areas affected by conflict and insurgency, further deter investment in long-term business growth.

Table 1: Statistical Overview of Key Challenges

Challenge	Prevalence	Source
Informal businesses with no access to credit	70%	ILO (2023)
Informal businesses with unreliable electricity	30%	World Bank (2022)
Businesses lacking formal registration	72%	SIBEC-2024
Workers in informal sector without job security	66%	SIBEC-2024
Women employed in micro-businesses (low wages, no maternity protection)	70%	African Development Bank (2022)

The statistics underscore the need for policy interventions to support the informal sector. Addressing these challenges will require improved financial access, regulatory reforms, infrastructure investments, and social protection policies to create a more sustainable and inclusive economic environment in Somalia.

1.4 Economic and social impact of the informal sector on Somalia's development

The informal sector plays a critical role in Somalia’s economic and social landscape, contributing significantly to GDP, employment, and poverty reduction. Despite its challenges, it remains a vital source of livelihood for a majority of the population, especially in urban and rural low-income communities. The chart above compares key economic and social indicators—GDP contribution, employment share, and poverty reduction—between the informal and formal sectors in Somalia.

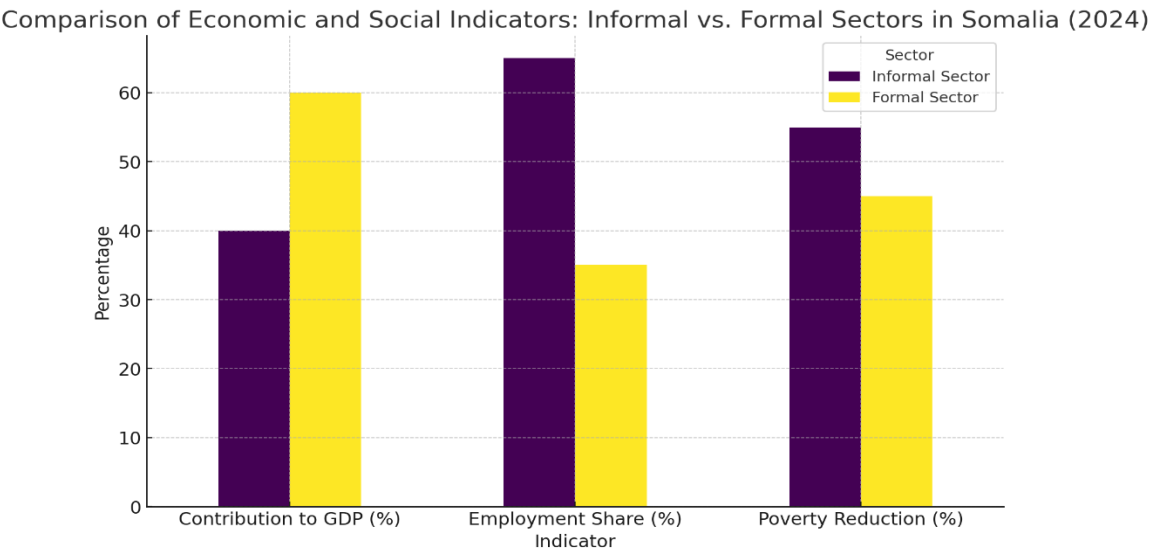


Figure 1: Comparison between Economic and Social Indicators of Informal and Formal Sectors

From Figure 1, the informal sector accounts for approximately 40% of Somalia's GDP, highlighting its substantial contribution to economic activity despite operating outside formal regulatory frameworks (World Bank, 2022). Additionally, the sector employs about 65% of the workforce, making it the dominant employer, particularly for women and youth, who have limited access to formal job opportunities (ILO, 2023). The informal sector also plays a crucial role in poverty reduction, with an estimated 55% of low-income households relying on informal employment and business activities for survival (African Development Bank, 2022). While the formal sector contributes a higher share to GDP (60%), its employment share remains significantly lower (35%), reflecting Somalia's largely informal labor market structure (SIBEC-2024).

These findings emphasize the need for strategic policy interventions to integrate the informal economy into the formal financial and regulatory systems while maintaining its flexibility. Formalization efforts should focus on reducing barriers to business registration, expanding financial inclusion, and improving social protection for informal workers (ILO, 2023). Strengthening the informal sector's contribution to national development can enhance economic stability and foster sustainable job creation and poverty alleviation in Somalia (African Development Bank, 2022)

1.5 Ministry's mandate and role in addressing the informal economy

The Ministry of Commerce and Industry (MoCI) of Somalia plays a crucial role in regulating, supporting, and formalizing the informal economy. As the key government body overseeing business activities, its mandate includes policy formulation, business registration, trade facilitation, and promoting an enabling environment for small enterprises. Given that 72% of businesses in Somalia operate outside formal regulatory structures (SIBEC-2024), the ministry's role in transitioning informal businesses into the formal economy is essential for sustainable economic growth and increased government revenue.

Key Functions of the Ministry in Addressing Informality

1. Business Registration and Formalization Initiatives

- ❖ The Ministry of Commerce and Industry (MoCI) is responsible for issuing business licenses, Tax Identification Numbers (TIN), and Unique Business Identifiers (UBI) to enterprises.
- ❖ To reduce informality, the ministry is working to simplify business registration procedures, lower administrative costs, and promote digital business registration systems.
- ❖ It collaborates with the Somalia National Bureau of Statistics (SNBS) to update the Statistical Business Register (SBR), which helps track informal enterprises and develop strategies for their formalization.

2. Financial Inclusion and Access to Credit

- ❖ Many informal businesses lack access to financial services due to limited documentation and collateral. The ministry partners with financial institutions and development agencies to promote inclusive financial products, such as microfinance programs, SME loans, and digital payment platforms (World Bank, 2022).
- ❖ It also supports the integration of informal businesses into the banking system, enabling access to investment capital and business expansion opportunities.

3. Capacity Building and Skills Development

- ❖ The MoCI collaborates with vocational training centers and business incubators to enhance entrepreneurial skills, financial literacy, and business management among informal sector actors.
- ❖ Training programs focus on improving productivity, product quality, and market competitiveness, particularly for women-led enterprises, which dominate micro-establishments (70%) (African Development Bank, 2022).

4. Market Access and Trade Facilitation

- ❖ The ministry supports informal businesses in gaining access to domestic and international markets by reducing trade barriers and promoting local products.
- ❖ Efforts include market linkage programs, cooperative development, and export facilitation for small-scale producers, artisans, and traders.

5. Policy Advocacy and Legal Frameworks

- ❖ The MoCI plays a pivotal role in formulating policies that protect informal workers, promote decent work conditions, and establish a progressive taxation system that encourages formalization without overburdening small businesses.
- ❖ It collaborates with the Ministry of Finance, tax authorities, and local government bodies to create incentive-based formalization strategies, such as tax exemptions for newly registered businesses and simplified compliance mechanisms (ILO, 2023).

6. Social Protection and Labor Rights

- ❖ Informal sector workers lack social security benefits, including health insurance, pensions, and workplace protections.
- ❖ The ministry works with labor unions, social security agencies, and international organizations to expand social protection schemes and ensure better working conditions for informal sector employees (UNDP, 2023).

2. FORMALIZING THE INFORMAL SECTOR: OPPORTUNITIES AND POLICY FRAMEWORK

The informal sector is a vital component of Somalia's economy, providing livelihoods for millions of people engaged in small-scale trade, services, and production. While it offers flexibility and opportunities for entrepreneurship, its unregulated nature presents barriers to business growth, worker protection, and government revenue collection. Formalizing the informal sector can create a more stable and productive economic environment, ensuring that businesses and workers benefit from legal recognition, financial access, and social protections. However, achieving this transition requires carefully designed policies that balance regulatory enforcement with incentives for compliance. This chapter examines the benefits of formalization and the policy frameworks necessary to support this transformation.

2.1 Potential Benefits and Opportunities of Formalization for Businesses, Workers, and the Economy

Formalizing Somalia's informal sector presents significant economic and social benefits, contributing to higher GDP growth, job creation, increased tax revenues, and poverty reduction. The chart above demonstrates the potential impact of formalization, showing that GDP contribution could rise from 40% to 55%, as businesses gain access to capital, structured markets, and regulatory support. Case studies from Rwanda and Kenya indicate that integrating informal businesses into the formal economy leads to higher productivity, access to financial services, and economic resilience (ILO, 2023). By improving business registration and creating incentives for compliance, Somalia can harness these benefits to enhance national economic stability.

The informal sector currently employs 65% of Somalia's workforce, but formalization could increase employment to 75%, ensuring job security, fair wages, and social protections (SIBEC-2024). In Ethiopia, formalization of micro and small enterprises led to wage growth and expansion of employment opportunities, especially for women and youth. Additionally, tax revenue collection would improve as formalized businesses contribute to national taxation, potentially increasing revenue from 55% to 70% (African Development Bank, 2022). Ghana's tax registration for small enterprises resulted in a 30% increase in government revenues, proving that structured taxation frameworks can boost fiscal sustainability (World Bank, 2023).

Beyond economic benefits, formalization would improve poverty reduction efforts, increasing financial security, access to credit, and social protection for informal workers. In South Africa, extending pension and health insurance schemes to informal workers lowered economic vulnerability (ILO, 2023). Somalia could replicate similar models by developing inclusive social policies that enable informal workers to benefit from healthcare, retirement savings, and legal protections. By addressing the challenges faced by informal businesses and providing incentives for registration, Somalia can create a more inclusive and sustainable economic environment, ensuring long-term stability and prosperity.

2.2 Guiding principles and objectives of the formalization policy

A well-structured formalization policy is essential for transitioning informal enterprises into the regulated economy while preserving their dynamism and accessibility. The policy must balance economic incentives, regulatory reforms, and institutional support to encourage businesses and workers to register and comply with formal structures. The guiding principles and objectives

outlined in this section ensure that formalization is inclusive, sustainable, and beneficial for all stakeholders.

Guiding Principles of the Formalization Policy

1. Simplicity and Accessibility

- ❖ The formalization process should be easy to navigate, affordable, and digitally accessible, ensuring that small businesses can register with minimal bureaucracy.
- ❖ Streamlining business registration, taxation, and licensing procedures will remove administrative barriers that discourage compliance.

2. Inclusivity and Social Protection

- ❖ The policy should consider the needs of vulnerable groups, including women, youth, and marginalized communities, who dominate the informal sector.
- ❖ Formalization efforts must integrate social protection measures, such as health insurance, pensions, and worker rights, to enhance job security.

3. Incentive-Based Transition

- ❖ Businesses should be encouraged, not forced, into formalization through tax incentives, reduced licensing fees, and access to financial support.
- ❖ Offering low-cost registration schemes and temporary tax relief for newly formalized enterprises can encourage participation.

4. Public-Private Collaboration

- ❖ The government should partner with business associations, financial institutions, and development agencies to support formalization efforts.
- ❖ Providing training programs, access to markets, and financial literacy initiatives will help businesses thrive in the formal economy.

5. Progressive Regulation and Enforcement

- ❖ The policy should gradually introduce regulatory measures, allowing businesses to transition without excessive penalties or financial burdens.
- ❖ A phased approach to taxation and compliance can help businesses adapt to formal requirements over time.

Objectives of the Formalization Policy

1. Increase Business Registration and Compliance

- ❖ Expand the number of registered businesses by making formalization simpler and more affordable.
- ❖ Develop a one-stop digital registration platform to facilitate easy compliance.

2. Enhance Financial Inclusion and Market Access

- ❖ Provide microfinance programs, small business loans, and grants for newly formalized enterprises.
- ❖ Improve access to domestic and international markets through business development initiatives.

3. Strengthen Employment Protections and Social Security

- ❖ Extend social protection programs to informal workers, including pensions, health insurance, and maternity benefits.
- ❖ Encourage businesses to adopt fair wages, contract-based employment, and improved working conditions.

4. Boost Government Revenue and Economic Growth

- ❖ Increase tax revenue collection through a gradual and fair taxation system that does not overburden small businesses.
- ❖ Use tax revenues from formalized businesses to fund public infrastructure and social programs.

5. Promote Innovation and Productivity

- ❖ Support entrepreneurship and innovation by offering training programs and business incubation services.
- ❖ Facilitate access to technology, digital payments, and e-commerce platforms to improve business efficiency.

2.3 Legal and regulatory reforms to facilitate formalization

To successfully transition informal businesses into the formal economy, Somalia must implement comprehensive legal and regulatory reforms that simplify business registration, taxation, labor rights, and financial access. These reforms should aim to reduce bureaucratic barriers, encourage compliance, and protect both businesses and workers. An effective legal framework should balance enforcement with incentives, ensuring that businesses see tangible benefits in formalization while maintaining economic flexibility.

Key Legal and Regulatory Reforms for Formalization

1. Simplification of Business Registration and Licensing

- ❖ Establish a one-stop digital business registration platform that allows businesses to register online with minimal paperwork and costs.
- ❖ Develop a tiered registration system that differentiates micro, small, and medium enterprises (MSMEs), ensuring that small businesses face fewer compliance burdens.
- ❖ Reduce or eliminate registration fees for businesses below a certain revenue threshold to encourage voluntary compliance.

2. Tax Reforms for Small Enterprises

- ❖ Introduce progressive taxation where newly formalized businesses receive tax breaks or lower rates in their first 3–5 years of operation.
- ❖ Implement a simplified tax system for micro and small enterprises, such as a flat-rate tax model, reducing the complexity of compliance.
- ❖ Strengthen taxpayer education programs to help businesses understand and comply with tax requirements.

3. Labor Law Reforms for Informal Workers

- ❖ Expand worker protections, ensuring that employees in formalized enterprises receive fair wages, social security benefits, and job security.
- ❖ Introduce flexible employment contracts that allow informal workers to transition into legal employment without excessive restrictions.
- ❖ Strengthen enforcement against exploitative labor practices, ensuring that workers in newly formalized businesses receive adequate protections.

4. Access to Financial Services and Credit

- ❖ Amend financial regulations to allow informal businesses easier access to bank loans, microfinance programs, and digital banking services.
- ❖ Create a credit guarantee scheme where the government or development banks partially back loans for newly formalized businesses, reducing risk for lenders.
- ❖ Encourage the use of mobile banking and digital payment platforms, making financial transactions more secure and traceable.

5. Protection of Small Enterprises from Overregulation

- ❖ Ensure that formalization does not lead to excessive regulatory burdens, such as costly audits, strict labor laws, or high penalties.
- ❖ Allow gradual compliance, where businesses formalize over time, with incentives for early registration and compliance.
- ❖ Establish business support centers that provide legal and advisory services to help businesses navigate regulatory processes.

6. Decentralization of Business Registration and Support

- ❖ Allow regional and local governments to issue business licenses and permits, making registration more accessible in rural and underserved areas.
- ❖ Strengthen collaboration between national and municipal authorities to ensure uniform implementation of formalization policies.
- ❖ Partner with business associations and trade unions to inform and support informal businesses through the transition process.

7. Incentives for Compliance and Growth

- ❖ Provide grants, subsidized training, and market access opportunities for newly formalized businesses.
- ❖ Offer preferential procurement opportunities, where government contracts are reserved for registered MSMEs.
- ❖ Establish a formalization tracking system to measure the effectiveness of legal reforms and business compliance rates.

Expected Impact of Legal and Regulatory Reforms

By simplifying regulations, reducing taxation burdens, and improving access to finance, these reforms will make formalization more attractive and feasible for businesses. Countries like Ghana, Kenya, and Rwanda have successfully implemented tax incentives, digital registration, and financial inclusion strategies, leading to a significant increase in business formalization rates. With clear legal frameworks and supportive policies, Somalia can enhance economic growth, expand government revenues, and improve the working conditions of millions of informal workers.

2.4 Institutional arrangements and coordination mechanisms

The successful formalization of Somalia's informal sector requires strong institutional arrangements and coordination mechanisms among key stakeholders, including government

ministries, financial institutions, business associations, and international development partners. A well-structured institutional framework ensures that policies are effectively implemented, resources are optimally allocated, and informal businesses receive the necessary support to transition into the formal economy.

Key Institutions and Their Roles in the Formalization Process

1. Ministry of Commerce and Industry (MoCI)

- Leads policy development and implementation for business formalization.
- Oversees business registration, licensing, and regulation to ensure compliance.
- Develops incentive programs such as tax relief and financial support for newly formalized businesses.
- Works with regional and municipal authorities to decentralize business registration processes.

2. Ministry of Finance and Revenue Authority

- Develops progressive tax policies that encourage formalization while ensuring affordability for small businesses.
- Introduces simplified tax regimes for micro and small enterprises to facilitate compliance.
- Enhances public awareness programs to educate informal business owners about tax obligations and benefits.

3. Somalia National Bureau of Statistics (SNBS)

- Maintains the Statistical Business Register (SBR), ensuring an updated record of both formal and informal businesses

2.5 Capacity building and support programs for informal sector actors

For Somalia's informal sector to successfully transition into the formal economy, capacity-building initiatives and targeted support programs must be implemented. Many informal businesses face limited access to finance, lack of business skills, and restricted market opportunities, which hinder their ability to grow and sustain operations. Providing structured training, financial assistance, and technological support will empower informal entrepreneurs and workers to navigate the formalization process effectively. These programs should focus on enhancing business management skills, improving financial literacy, expanding access to credit, and integrating digital solutions into business operations.

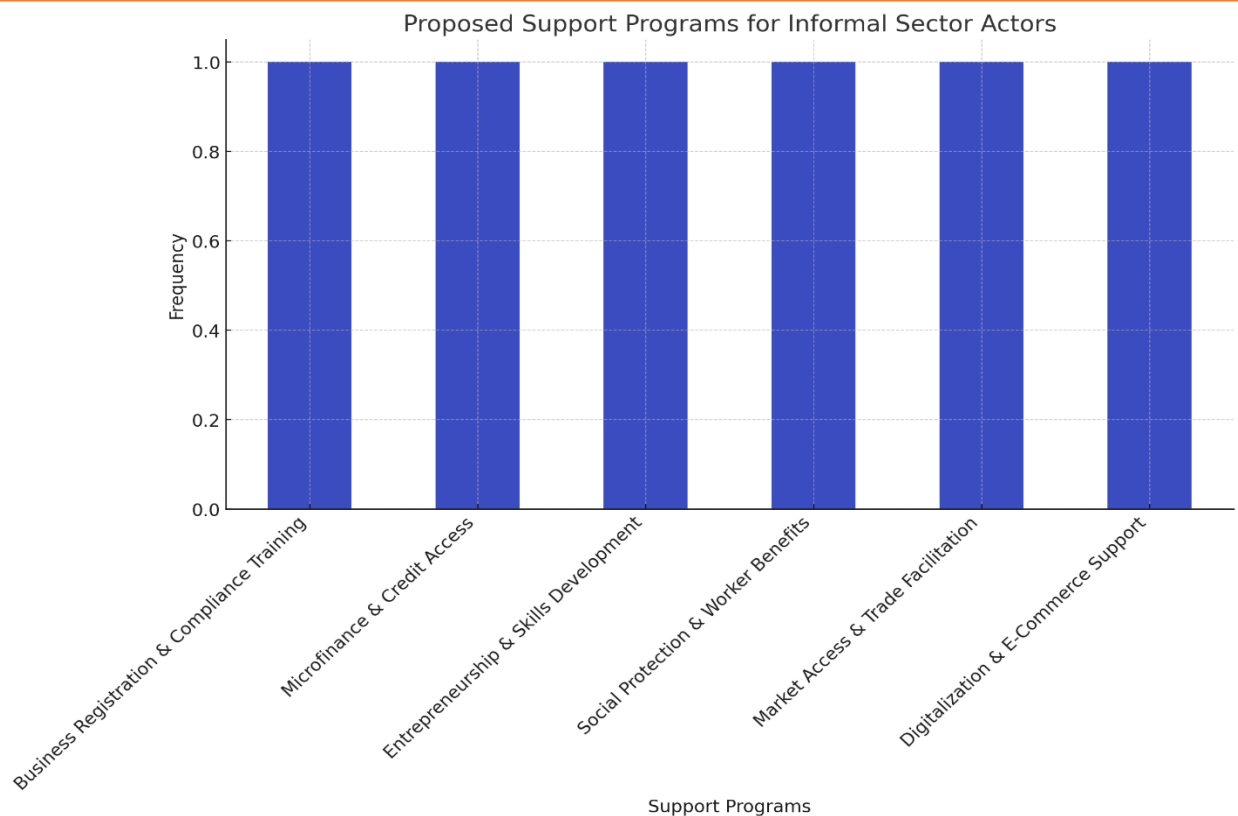


Figure 2: Proposed Support Programs for Informal Sector Actors

The chart above highlights the key support programs designed to assist informal sector actors in their transition to formality. These initiatives include business registration training, microfinance access, skills development, social protection schemes, market linkages, and digitalization support. Each program targets specific groups such as small business owners, youth entrepreneurs, women-led enterprises, and informal workers. The expected impact includes higher business registration rates, increased financial inclusion, improved job security, and expanded trade opportunities. By addressing these critical challenges, these programs create a structured pathway for informal businesses to integrate into the formal economy.

These capacity-building and support programs play a crucial role in reducing barriers to formalization while enhancing economic resilience and productivity. Providing access to affordable credit, government-backed training, and digital business tools will help small businesses scale up, create jobs, and contribute to national economic growth. Lessons from Rwanda, Kenya, and Ghana demonstrate that well-structured financial and educational support significantly improves the success rate of business formalization efforts (ILO, 2023). Somalia can leverage these best practices to develop a robust support system that ensures informal sector actors receive the necessary skills, financial backing, and policy incentives to thrive in the regulated economy.

2.6 Strategies for promoting social protection and decent work conditions

Ensuring social protection and decent work conditions for informal sector workers is essential for a fair and sustainable transition into the formal economy. Informal workers often face job insecurity, low wages, lack of social security, and poor working conditions, which limit their economic mobility and financial stability. Expanding access to health insurance, pension schemes,

fair wages, and workplace protections can significantly improve their livelihoods and economic security. Implementing inclusive social protection mechanisms and enforcing labor regulations will enhance the well-being of informal workers while strengthening national economic resilience.

Key Strategies for Strengthening Social Protection and Work Conditions

1. Extending Social Security Coverage to Informal Workers

- Introduce voluntary pension and health insurance schemes tailored for informal sector workers.
- Develop low-cost, flexible social security plans to encourage participation from small business owners and self-employed individuals.
- Implement government-subsidized insurance programs to support vulnerable groups, such as women and low-income workers.

2. Improving Occupational Safety and Health Standards

- Establish workplace safety guidelines to protect informal sector workers, especially in hazardous sectors like construction and manufacturing.
- Conduct awareness campaigns and training on occupational safety, particularly for small-scale traders and artisans.
- Encourage compliance with health and safety regulations by providing incentives for businesses that implement proper workplace conditions.

3. Introducing a Minimum Wage and Fair Employment Practices

- Develop sector-specific minimum wage policies to protect informal workers from exploitation and unfair wages.
- Encourage formalized employment contracts for workers in semi-formal businesses to ensure job stability.
- Promote collective bargaining through informal worker associations, enabling workers to advocate for fair pay and better working conditions.

4. Expanding Access to Affordable Childcare and Maternity Support

- Establish community-based childcare programs to support working parents in the informal sector.
- Provide maternity benefits and job security measures for women engaged in informal work.
- Strengthen public-private partnerships to create affordable and accessible daycare facilities for informal workers.

5. Strengthening Legal Protections for Informal Workers

- Amend labor laws to include informal sector workers, ensuring they are protected under employment regulations.
- Develop a legal framework for dispute resolution, allowing informal workers to seek legal recourse in cases of unfair treatment.

- Enforce anti-discrimination policies that safeguard women and marginalized groups from workplace exploitation.

6. Promoting Financial Inclusion for Informal Workers

- Expand access to microfinance, savings programs, and digital banking to enable workers to build financial security.
- Offer financial literacy programs to help informal workers manage savings, investments, and retirement planning.
- Strengthen mobile money platforms and cooperative savings groups, allowing informal workers to participate in structured financial systems.

Building a Fair and Secure Informal Workforce

By implementing these strategies for social protection and decent work conditions, Somalia can ensure that informal workers are protected, empowered, and financially secure. Expanding social security, legal protections, and financial access will not only improve worker livelihoods but also encourage greater participation in the formal economy. With strong government support, business collaboration, and international partnerships, Somalia could create a more inclusive and equitable labor market where all workers benefit from fair wages, stable employment, and long-term economic security.

3. IMPLEMENTING THE FORMALIZATION POLICY: STRATEGIES, MONITORING, AND EVALUATION

Effective implementation of formalization policies requires a coordinated approach that ensures businesses and workers can transition smoothly into the formal economy. This process involves clear policy strategies, institutional collaboration, financial support, and regulatory enforcement to create an enabling environment for businesses to comply with formal structures. Additionally, monitoring and evaluation mechanisms are crucial to assessing the effectiveness of formalization efforts, identifying challenges, and making necessary adjustments. This chapter outlines key implementation strategies, mechanisms for monitoring progress, and evaluation frameworks to ensure the long-term success and sustainability of the formalization process in Somalia.

3.1 Phased approach to implementing the formalization policy

A phased approach to formalization ensures a smooth and structured transition for informal businesses, minimizing disruption while encouraging compliance. Implementing formalization policies in gradual stages allows businesses to adapt to new regulations, access necessary support services, and integrate into the formal economy without financial or bureaucratic burdens. A well-planned phased approach also provides time for stakeholders, including government agencies, financial institutions, and business associations, to develop effective support systems and refine policies based on real-time feedback.

Phased Approach to Implementing the Formalization Policy

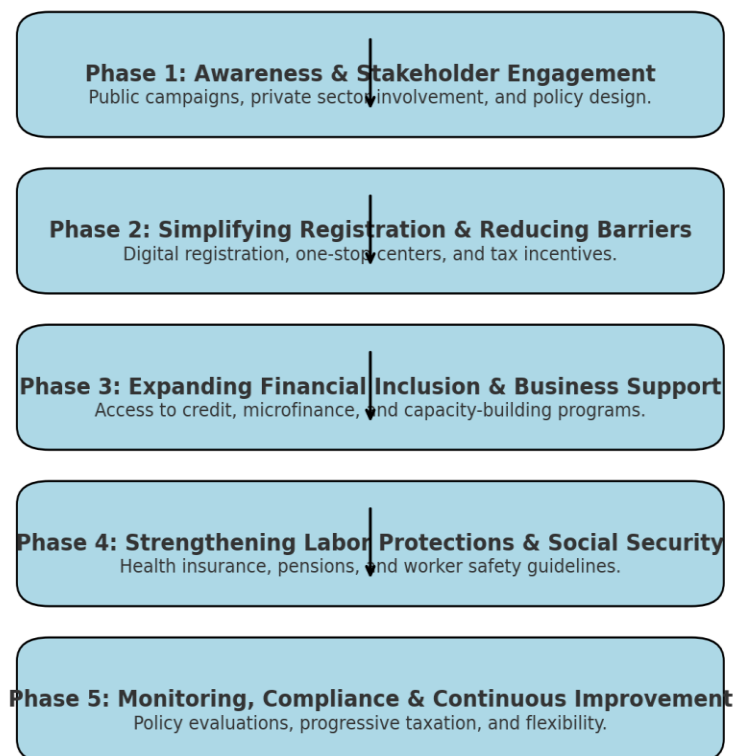


Figure 3: Phased Approach to Implementing the Formalization Policy

Phase 1: Awareness and Stakeholder Engagement

- Conduct nationwide awareness campaigns on the benefits of formalization, targeting informal business owners, workers, and trade associations.
- Engage local governments, financial institutions, and private sector representatives in designing policies that meet the needs of informal businesses.
- Develop public-private partnerships to establish support programs for businesses transitioning into the formal sector.

Phase 2: Simplifying Registration and Reducing Barriers

- Launch a simplified business registration process, including digital platforms and one-stop registration centers to minimize bureaucracy.
- Provide temporary tax exemptions or reduced fees for newly formalized businesses to ease the financial burden of compliance.
- Strengthen regional and local business registration offices to improve accessibility, particularly in underserved areas.

Phase 3: Expanding Financial Inclusion and Business Support

- Facilitate access to credit, microfinance, and financial literacy programs to help businesses grow after registration.
- Establish government-backed credit guarantee schemes for newly formalized businesses, ensuring they can secure financing.
- Develop capacity-building programs in entrepreneurship, digital business tools, and market access to enhance business competitiveness.

Phase 4: Strengthening Labor Protections and Social Security

- Implement voluntary social security schemes, including health insurance and pension plans, tailored for informal workers.
- Introduce labor protections and workplace safety guidelines to ensure decent working conditions in newly formalized enterprises.
- Partner with trade unions and labor organizations to educate workers on their rights and benefits.

Phase 5: Monitoring, Compliance, and Continuous Improvement

- Establish regular monitoring and evaluation frameworks to assess progress and address implementation challenges.
- Introduce progressive taxation models, where small businesses gradually transition to standard tax rates.
- Maintain flexibility in policies, allowing businesses to provide feedback and adapt to evolving economic conditions.

Ensuring a Sustainable Transition

A phased implementation strategy provides a realistic and inclusive approach to formalizing the informal sector in Somalia. By gradually introducing policies, offering incentives, and providing ongoing support, businesses and workers can integrate into the formal economy with minimal disruption. This structured approach will contribute to higher compliance rates, improved economic stability, and sustainable growth in Somalia's business landscape.

3.2 Resource mobilization and budgetary allocations

Effective formalization of the informal sector requires sufficient financial resources and well-structured budgetary allocations to support businesses and workers during the transition. Resource mobilization must involve contributions from government funding, private sector partnerships, international donors, and financial institutions to ensure that policy implementation is adequately financed and sustainable. A clear budgetary framework will help allocate resources efficiently across registration incentives, capacity-building programs, financial support mechanisms, and monitoring systems.

Key Strategies for Resource Mobilization

1. Government Funding and Fiscal Policies

- Allocate a dedicated budget line for business formalization under the Ministry of Commerce and Industry.
- Introduce progressive taxation models where formalized businesses contribute over time, ensuring sustainability.
- Establish a Business Formalization Fund to support SMEs and informal enterprises through grants and subsidized registration costs.

2. Public-Private Partnerships (PPPs)

- Collaborate with banks, microfinance institutions, and corporate stakeholders to co-fund business support programs.
- Encourage large companies to integrate informal suppliers into formal value chains, providing financial and logistical support.
- Offer tax incentives for private entities that invest in training and capacity-building initiatives for informal businesses.

3. International Development Assistance

- Seek funding from international organizations such as the World Bank, ILO, UNDP, and AfDB to support formalization programs.
- Align formalization efforts with regional and global economic inclusion initiatives to attract grants and technical assistance.
- Develop co-financing models where donor funding complements domestic budget allocations for sustainable impact.

4. Financial Inclusion and Credit Schemes

- Partner with banks and microfinance institutions to create low-interest credit programs for newly formalized businesses.
- Expand access to digital finance solutions to improve financial literacy and promote banking adoption among informal entrepreneurs.
- Establish a Credit Guarantee Fund to reduce lending risks for small enterprises transitioning into the formal sector.

Table 2: Budgetary Allocations for Key Implementation Areas

Program Area	Proposed Allocation (%)	Funding Sources
Business Registration & Licensing	20%	Government, World Bank, Private Sector
Financial Inclusion & Credit Support	25%	Banks, Microfinance Institutions, AfDB
Capacity Building & Training Programs	15%	Government, Private Sector, Donor Agencies
Social Protection & Worker Benefits	20%	UNDP, ILO, Government
Monitoring & Evaluation Frameworks	10%	Government, Development Partners
Digitalization & Market Access	10%	Tech Companies, PPPs, International Investors

Ensuring Financial Sustainability

A well-structured resource mobilization plan ensures that formalization policies are adequately funded and remain sustainable in the long run. By leveraging government resources, private sector investments, and international funding, Somalia can effectively implement business registration reforms, expand financial inclusion, and provide critical social protections for informal workers. A balanced budgetary allocation will support long-term economic growth while fostering a thriving, inclusive formal sector.

3.3 Stakeholder engagement and public-private partnerships

Successful formalization of the informal sector requires a collaborative approach involving government institutions, private sector actors, financial institutions, development partners, and informal business representatives. Stakeholder engagement ensures that policies are practical, inclusive, and widely accepted, while public-private partnerships (PPPs) provide the necessary resources, expertise, and infrastructure to support the transition process. A well-coordinated effort among stakeholders will strengthen policy implementation, create incentives for businesses to formalize, and build trust between informal sector actors and regulatory authorities.

Key Stakeholders and Their Roles

1. Government Institutions

- Ministry of Commerce and Industry (MoCI): Leads policy design, business registration, and compliance enforcement.
- Ministry of Finance & Revenue Authority: Develops tax incentives and supports financial inclusion for newly formalized businesses.

- Local Governments & Municipal Authorities: Facilitate business registration and zoning policies to support SMEs.

2. Private Sector & Business Associations

- Somalia Chamber of Commerce and Industry (SCCI): Represents businesses in policy discussions and promotes investment in formalization efforts.
- Large Corporations & Supply Chain Partners: Integrate informal businesses into formal supply chains, providing training and financial support.
- Trade Unions & Informal Sector Associations: Advocate for worker protections, fair wages, and social security programs.

3. Financial Institutions & Development Partners

- Banks & Microfinance Institutions: Provide tailored credit facilities, savings programs, and financial literacy training for informal businesses.
- International Organizations (World Bank, ILO, UNDP, AfDB): Offer funding, technical assistance, and capacity-building programs to support formalization.

Public-Private Partnership (PPP) Strategies

1. Collaborative Policy Design & Implementation

- Establish a Public-Private Consultative Forum to engage stakeholders in drafting formalization policies.
- Use feedback mechanisms from informal business owners to ensure policies are practical and inclusive.

2. Financial Incentives & Business Support

- Partner with banks and fintech companies to offer low-interest credit and digital payment solutions.
- Develop PPP-driven training programs to equip informal entrepreneurs with business management and financial literacy skills.

3. Market Integration & Supply Chain Linkages

- Encourage corporate partnerships where formal businesses source goods and services from newly formalized enterprises.
- Create government-backed procurement programs to prioritize SMEs in public contracts and tenders.

4. Awareness Campaigns & Advocacy

- Launch joint government-private sector awareness campaigns on the benefits of formalization.
- Leverage trade unions and business networks to educate informal sector actors on available incentives.

Building Sustainable Partnerships for Formalization

By fostering strong stakeholder collaboration and leveraging public-private partnerships, Somalia can create an inclusive, well-supported pathway for informal businesses to transition into the formal economy. Through coordinated policy efforts, financial incentives, and business development programs, these partnerships will accelerate formalization efforts while ensuring economic stability and social inclusion.

3.4 Monitoring and evaluation framework

A well-defined monitoring and evaluation (M&E) framework is essential for tracking the progress, impact, and effectiveness of Somalia's formalization policy. By establishing clear performance indicators, baseline measurements, and measurable targets, policymakers can assess whether formalization efforts are yielding the expected economic and social benefits. The M&E framework ensures data-driven decision-making, allowing for adjustments to policies and programs as needed. It also facilitates accountability among stakeholders, ensuring that government agencies, financial institutions, and private sector actors work collaboratively to achieve set targets.

The table 3 presents key performance indicators (KPIs) for evaluating the success of the formalization process. It includes baseline data (2024), target outcomes (2028), and evaluation methods to measure progress in business registration, tax compliance, financial inclusion, job creation, social protection, and informal employment reduction.

Table 3: Monitoring and Evaluation Framework for the Formalization Policy

Key Performance Indicator (KPI)	Baseline (2024)	Target (2028)	Evaluation Method
Increase in Business Registrations	28% of businesses registered	50% of businesses registered	Business registration records, surveys
Growth in Tax Compliance among SMEs	Low SME tax compliance (approx. 30%)	SME tax compliance reaches 60%	Tax authority reports, SME compliance audits
Expansion of Financial Inclusion (Loans to SMEs)	Limited SME access to loans (25%)	SME loan access increases to 50%	Banking & microfinance institution reports
Job Creation in Formal Sector	Formal sector employs 35% of workforce	Formal sector employment rises to 50%	Labor force surveys, employment statistics
Increase in Social Protection Coverage	Low social protection coverage (15%)	Social protection coverage reaches 40%	Social security enrollment data
Reduction in Informal Employment Rate	65% of workforce in informal sector	Informal employment rate reduced to 45%	National employment surveys
Awareness Campaigns & Training Sessions Conducted	Minimal engagement in formalization training	Nationwide training and outreach programs established	Event tracking, participation reports

The structured table outlines the KPI benchmarks, expected targets, and methods of assessment. The framework highlights key areas that require continuous monitoring to ensure successful policy implementation and long-term sustainability of the formal sector. Tracking progress in business registrations, tax compliance rates, and financial access will determine how effectively informal businesses are integrating into the formal economy. Similarly, improvements in job creation, social protection coverage, and employment transition rates will measure the policy's impact on economic inclusion and worker welfare.

Ensuring Policy Success through Continuous Evaluation

A robust monitoring and evaluation system will help Somalia adapt formalization strategies based on real-time data, ensuring that businesses and workers benefit from an inclusive and sustainable transition. Regular policy reviews, stakeholder engagement, and data-driven adjustments will be critical to achieving long-term economic growth and social protection goals. By using this structured approach, Somalia can effectively track formalization progress, identify challenges, and refine interventions to maximize the impact of the policy.

3.5 Risk Assessment and Mitigation Strategies

The implementation of a formalization policy for Somalia's informal sector presents several risks and challenges that could hinder its success. These risks include low compliance rates, resistance from informal business owners, financial constraints, administrative bottlenecks, and inadequate enforcement mechanisms. If not properly addressed, these challenges could slow down the formalization process, discourage participation, and limit the intended economic and social benefits. A comprehensive risk assessment and strategic mitigation plan are necessary to ensure that formalization efforts remain effective, inclusive, and sustainable.

Table 4: Key Risks and Mitigation Strategies

Risk Factor	Potential Impact	Mitigation Strategy
Low Business Compliance & Resistance	Informal businesses may avoid formalization due to costs and complexity.	Introduce simplified registration, tax incentives, and awareness campaigns.
Financial Constraints & Limited Credit Access	Lack of financial resources may prevent businesses from formalizing.	Expand microfinance, government-backed credit schemes, and subsidized registration fees.
Administrative Bottlenecks & Bureaucracy	Lengthy registration processes and inefficient public systems may discourage businesses.	Implement digital registration platforms and one-stop service centers to simplify processes.
Weak Law Enforcement & Regulatory Gaps	Businesses may continue operating informally if regulations are not enforced effectively.	Strengthen inspection systems, compliance monitoring, and penalties for non-compliance.
Market Disruptions & Unfair Competition	Newly formalized businesses may struggle to compete with remaining informal enterprises.	Provide market access programs, business training, and preferential procurement policies.
Lack of Social Protection for Informal Workers	Informal workers may remain unprotected even after formalization.	Extend social security schemes, health insurance, and labor protections for workers.
Political & Institutional Instability	Changes in government priorities could disrupt formalization efforts.	Establish multi-stakeholder governance structures and long-term policy frameworks.

Building a Resilient and Inclusive Formalization Process

To minimize risks and ensure sustainable formalization, Somalia must adopt a flexible and adaptive approach that allows for continuous policy evaluation and refinement. Strengthening institutional capacity, financial support mechanisms, legal enforcement, and business incentives will increase compliance and participation rates. Additionally, collaborating with private sector stakeholders, financial institutions, and development partners will provide the necessary resources and expertise to mitigate risks effectively. By proactively identifying potential risks and implementing targeted mitigation strategies, Somalia can ensure a smoother transition for informal businesses and workers, fostering a more resilient and dynamic formal economy.

4. CONCLUSION

The formalization of Somalia's informal sector presents a transformative opportunity to enhance economic stability, business growth, job security, and government revenue collection. While the informal sector remains a crucial driver of employment and entrepreneurship, its unregulated nature limits financial inclusion, tax contributions, and worker protections. A well-structured formalization policy can bridge these gaps, creating a more resilient and inclusive economy that benefits both businesses and workers.

The success of formalization depends on clear policy implementation, institutional coordination, financial support, and public-private partnerships. A phased approach, combined with business registration incentives, financial access programs, and labor protections, will ensure a smooth transition for informal businesses. Additionally, a robust monitoring and evaluation framework will help track progress, address challenges, and refine policies over time.

While challenges such as low compliance rates, administrative inefficiencies, and financial constraints may arise, proactive risk management and targeted mitigation strategies can enhance policy effectiveness. By fostering strong stakeholder collaboration, Somalia can build a sustainable, well-regulated, and inclusive economy where businesses thrive, workers are protected, and economic development is accelerated. Through dedicated efforts and strategic interventions, formalization can drive long-term prosperity and economic resilience for Somalia.

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