

## Somaliland: Interest-free but not yet Shari'ah-compliant economy

Having survived a civil war and living in international isolation, Somaliland, a de facto independent state in the territory of Somalia, is gradually developing its financial sector. The banking services are interest-free in this entirely Muslim republic. But does it mean they are Shari'ah-compliant? Renat Bekkin, PhD in Law, senior researcher at the Institute for African Studies of the Russian Academy of Sciences, reports.



Sarraffs (money changers) at work, Somaliland

In 1991, the unified country of Somalia de facto ceased to exist. The civil war, which had broken out three years earlier, had led to the break up of the state into three separate areas: Somaliland, Puntland and Somalia.

At the time one could hardly call the former British colony and then province of Somalia – Somaliland – a country. It was virtually a bare territory with its infrastructure completely destroyed by the war.

The world community did not rush to recognise the new state and hardly anyone would have predicted that the country would survive. But 16 years on, Somaliland continues to exist as a state despite international political isolation and weak central government.

The main source of welfare for Somaliland's citizens is not international aid, but money sent by their relatives from abroad. Because of the underdevelopment of the financial sector, money transfer operators have practically taken on the role of banks.

The situation within the country's banking sector presents a paradox. Officially, there are two banks in Somaliland – Bank of Somaliland and Commercial Bank of Somaliland. The paradox is that the first bank, which is nominally a central bank, plays the role of a commercial financial institution, while the latter is more of a state treasury than a fully-fledged commercial bank.

The main task of the Bank of Somaliland is to support the national currency and fight inflation. In order to do so, the bank carries out currency interventions, buying considerable sums in local currency (shillings) for US dollars.

The US dollar is the main currency in Somaliland, while the shilling is used mostly for small purchases. The state does not obstruct the activity of private traders – sarraffs (money changers) – and considers them to be of assistance rather than competition at this stage in the development of the country's currency market.

Apart from supporting the national currency, the Bank of Somaliland acts mainly as a commercial bank. It offers current and deposit accounts, both of which are interest-free. But this does not mean that the bank operates according to Shari'ah – the real reason for the operations appearing to be halal is that the bank just doesn't have enough capital to open and maintain accounts that accrue interest.

The main problem for the country's banking sector is the absence of sufficient capital and guarantees. If banks require capital, the Bank of Somaliland is not able to provide it. The ineffectiveness of the regulation of the banking system is manifested first of all in the absence of relevant legislation. The government is currently drawing up a Banking Act and it is hoped that this will attract foreign banks into the country's banking market.

Meanwhile, there are no fully-fledged commercial banks in Somaliland. The main bulk of banking services is provided by money transfer operators (hawaladars), chiefly by Dahabshiil, the largest provider of money transfer services in the country.

Dahabshiil was created in 1970 and today it is the richest financial structure, not only in Somaliland but throughout the entire Somali territory. Officially, Dahabshiil is a money transfer organisation with the majority of its customers being representatives of the Somali community living abroad (the senders) and Somalis living at

home (the recipients). In fact, it is Dahabshiil and not the Bank of Somaliland which functions as a central bank in the country.

Today, Dahabshiil is more than just the engine of Somaliland's financial sector; it also drives the country's economy as a whole. Dahabshiil does not limit its

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activities to providing banking services (interest-free current accounts), but also participates in projects such as creating new banks. A few years ago, it was involved in an attempt to set up the first Islamic bank in the country. Yemen-based Saba Islamic Bank was Dahabshiil's partner. The new entity was to be called Dahab Saba – to reflect the involvement of both founders. But the government decided that establishing an Islamic bank in the country was not expedient at that time and the project was moved to Djibouti, where it was supported by the government and personally by that country's president.

However, Somaliland did succeed in cooperating with Islamic Development Bank (IDB). IDB supports a number of projects connected with land improvement and public health services in the country, but there is no talk as yet of creating a Shari'ah-compliant banking system in the country. IDB offers assistance with projects that are supported by the government. But as Somaliland's government is not keen on the development of Islamic banking in the country, the collaboration with IDB does not involve issues of developing a Shari'ah-compliant financial sector in Somaliland. Abdourahman Dualeh Mohamoud, governor of the Bank of Somaliland, thinks that at the moment the bank does not support the development of Islamic banking within the country. It is believed that the introduction of this type of bank would

undermine the existing balance – people would withdraw their accounts from banks and quasi-banks that don't pay interest and take their money to the Islamic banks, which offer profit, albeit not guaranteed. In effect, the Bank of Somaliland and its governor consider Islamic financial institutions to be competitors at present. In this respect, the Bank of Somaliland is

acting like a commercial bank rather than a central bank.

In addition to the two banks and a number of hawaladars operating in the country, the population's financial services requirements are also met by cooperatives.

Consumer loans on a cooperative basis have profound roots in the country. People who do not have enough money for large purchases form a group and regularly make contributions into a mutual fund. The group elects a treasurer who manages the fund. When the required sum has accumulated, it is given to a member of the cooperative who needs it. This goes on until all the members' needs are met.

Another source of loans, mostly for small and medium-sized enterprises (SME), are microfinance organisations. Strictly speaking, there is only one company that specialises purely in SME – Amaah Kalkaal (translated as Loan Helper from the Somali language). Other organisations treat microfinance as a sideline business.

Amaah Kalkaal was created in 1998 thanks to a grant from the European Union. It has the status of a non-commercial organisation and therefore does not pay any taxes. The organisation is located in Hargeisa and there are 76 groups, comprising 2300 customers (including those who have taken repeated loans) registered with the

company. Until recently, Amaah Kalkaal offered two types of loan: individual and group. Both types have been given for further development of already existing businesses but not for starting up new ones. Individual loans are now no longer available, but the organisation continues to work with borrowers who already have them. There are only a handful of individual loan takers (just 30), less than one per cent of the total number of borrowers. The main reason for such a low rate is the strict requirement of property ownership (a car, house etc) in order for the applicants to prove their solvency.

Amaah Kalkaal's customers have to pay a fixed charge on the loans they take out. The company claims that this is not riba, which is forbidden according to Shari'ah, but rather a fixed commission for services provided. For example, the first group loan, which is limited to \$500, has a nine per cent commission for six months (or 18 per cent per annum). If the debt is paid off in full and on time, a borrower can then apply for \$1000, then \$1500 and so on. If the borrower cannot pay off a loan in time, there is no fine or penalty. The individual

loan sum varies from \$1000 to \$11,000, with a 16 per cent commission. As in the case of group loans, there are no extra charges for delayed payments.

Still, not everybody is willing to take out a loan from Amaah Kalkaal. Many prefer to turn to their relatives, clan members and friends for financial support. The fact that the company makes a fixed charge for its services concerns greatly the 100 per cent Muslim population of Somaliland. In its defence, the company refers to the view of some scholars that a fixed commission for financial services is not considered to be riba. Such an argument clearly doesn't withstand critical examination; nor does the statement of Amaah Kalkaal's representatives that the activity of the organisation is somewhere in the middle between halal and haram.

It is fair to say, however, that in order to expand its customer base, Amaah Kalkaal did attempt to lay a Shari'ah-compliant foundation to its financing activities. The company invited Shari'ah scholars from Kenya to develop its Islamic loan scheme. The scheme proposed by the scholars did

not suit Amaah Kalkaal though, as it disrupted the main principle of the company (a simplified loan granting system without any excessive paperwork involved), as Islamic methods of financing require a more rigid attitude towards checking the applicant's solvency.

A new group of Shari'ah scholars is currently working at Amaah Kalkaal in order to develop SME products based on murabaha and mudarabah. The company has plans to move to purely Islamic financing in due course.

All in all, despite the underdevelopment of the banking sector in Somaliland, some financial institutions do exist and operate in the country's banking market. Insurance companies are a completely different matter though.

There are no insurance providers in Somaliland at the moment. The role of insurer rests with the clan, tribe, well-off relatives and friends. Thus, a member of a clan can claim compensation without paying regular insurance contributions. Later, he/she has to repay the sum to the insurer (whether this is a group or an individual), although repayment is subject to availability. Mutual insurance exists in Somaliland, although in its primordial form. People form groups and each participant contributes a sum; a member of the group receives compensation when he/she needs it.

In its current form, Somaliland's financial sector is far from being the country's main source of revenue. Its key income comes from customs duties and harbour dues, as well as entry and exit taxes. Tax collection of other types of duties is considerably hampered by the weakness of the fiscal system and the lack of an established method of taxation. For example, income tax, the rate of which is frequently stated at will, can be lowered based on an oral agreement between a tax-payer and the government. The absence of a common inland revenue system affects the collection and distribution of taxes; even the collection of zakat (an obligation on Muslims to pay a prescribed percentage of their wealth to



specified categories in society when their wealth exceeds a certain limit) is affected due to the lack of a proper collection mechanism. Zakat is not an official tax in Somaliland and is often combined with the lump sum charity payment – sadaqah. In addition to paying zakat and sadaqah, well-to-do Somalis also donate land and funds for the building of mosques in the country, although officially this type of endowment – waqf – is absent in Somaliland. At the moment, the waqf institution in the country is being used only for building mosques and not as yet being applied for resolving other important social and economical tasks.

An analysis of the country’s current economic situation draws the conclusion that the absence of Islamic financial institutions in the country is the result of the underdevelopment and weakness of the country’s financial sector. Absence of a legislative base and the position of the central bank brought attempts to introduce the first Islamic bank in Somaliland to nothing.

At the same time, the experience of existing financial institutions has shown that the population tries to avoid operations involving riba (interest). So much so that the major microfinance organisation in the country, Amaah Kalkaal, had to turn to Shari’ah scholars for assistance in developing Shari’ah-compliant products. It is important to emphasise that the majority of the population of Somaliland does not have enough knowledge to understand the particulars of whether a certain banking product or service complies with the Shari’ah. Almost certainly this is an area that requires assistance from IDB – the development of specific educational programmes to explain the advantages of Shari’ah-compliant economy to the country’s population. At the moment, this function rests with Amaah Kalkaal, which specialises in microfinancing, although the experience of Amaah Kalkaal shows that this organisation does not itself always interpret correctly the issue of riba prohibition by Islamic law. The development and introduction of Shari’ah-



Mosque,  
Somaliland

compliant methods of financing at Amaah Kalkaal inspires hope of unfolding the principles of Islamic finance among wider sections of the population in Somaliland.

Today, the banking system of Somaliland is not yet ready for the appearance of fully-fledged commercial banks. Passing the relevant legislation is an important, but not the only, necessary step towards creating a fully-fledged banking system. The ending of international isolation will also surely be a breakthrough in establishing a stable financial sector in Somaliland. This, however, is still a long way off.

Meanwhile, money transfer operators take on the role of more than just mediators of providing Somaliland with financial means from abroad – they substitute for the country’s underdeveloped banking sector. 🌱