

# Fiscal Implications of the 2024 Somalia and Turkey Offshore Petroleum Agreement: Assessment of Government take and Regulatory Gap

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## Abstract

This study examines the fiscal architecture of Somalia's emerging petroleum sector, with a particular focus on the 2024 Somalia-Turkey offshore petroleum agreement and its associated Production Sharing Agreement (PSA). The purpose of the research is to evaluate whether the current fiscal regime can deliver optimal government revenue while maintaining investment attractiveness. The study adopts a qualitative research methodology based on documentary and content analysis of secondary data, including the Somalia Petroleum Law (2020), PSA models, contractual provisions, and comparative petroleum regimes from selected African countries such as Ghana, Uganda, Kenya, and Tanzania. The analysis focuses on key fiscal instruments, including royalties, cost recovery limits, profit oil sharing, and taxation mechanisms. The findings reveal significant fiscal gaps within the agreement, notably the absence of early-stage and recurring revenue instruments such as signature bonuses, surface rentals, and development-related payments. The study further identifies a relatively low royalty rate of **5%** and a high cost recovery ceiling of **90%**, both of which substantially delay government revenue flows and reduce the state's effective share of gross revenue to approximately **11.175%**. Although the profit oil-sharing mechanism appears progressive in relative terms, the overall fiscal structure remains weak due to limited statutory safeguards in the Petroleum Law (2020), allowing excessive reliance on negotiable contractual terms. The study concludes that while the agreement reflects the realities of a high-risk frontier market, its current fiscal design constrains early revenue generation and weakens the government's capacity to maximise long-term economic benefits. Strengthening the legal framework, improving fiscal terms, and enhancing institutional capacity are essential to ensuring a more balanced and sustainable petroleum revenue system.

**Keyword:** PSA, TPOA, Fiscal, Onshore, Offshore

## Introduction

The oil and gas industry has never lacked excitement; however, in the Somali context, developments within the sector evoke particularly strong national interest and anticipation. Any new progress in Somalia's oil and gas sector is received with profound hope, reflecting the country's considerable hydrocarbon potential. (Gundel, 2020).

Somalia is widely regarded as one of the most resource-endowed countries in the region. Among its natural resources, hydrocarbons stand out as especially significant in terms of economic transformation. (Hussein, n.d). Geological indicators strongly suggest that Somalia possesses substantial oil and gas potential, with credible prospects of becoming an oil-producing nation. (Balthasar, 2014).

The oil and gas sector has long been associated with economic transformation in resource-endowed states. Therefore, a responsible exploitation of such resources could generate considerable revenues capable of accelerating socio-economic development and stimulating growth in other, more sustainable sectors of the economy.

In recent years, several East African countries, namely Uganda, Kenya, Tanzania, Madagascar, and Ethiopia, have made major hydrocarbon discoveries, both onshore and offshore. Many observers believe that even larger discoveries can be made in Somalia.

The current energy crisis linked to tensions and conflicts in the Middle East is likely to prompt a global reassessment of energy sources and supply routes. (Patey, 2020). The attention may shift toward emerging and strategically located regions, including East Africa. Somalia, in particular, holds significant potential due to its unique geographic position along major maritime routes, especially near the Gulf of Aden and the Indian Ocean. As a result, the crisis may catalyse increased interest and investment in Somalia's oil and gas sector.

The recent developments in offshore petroleum exploration have revived national expectations of economic regeneration. The arrival of the Turkish deep-sea drillship Cagri Bey in offshore Somalia is the latest development towards the realisation of Somali oil and gas sector development. The vessel's mission is deep offshore drilling in Somali waters exceeding 3,000 meters in depth, and the target reservoir lies approximately 3,500 meters beneath the seabed. These technical and operational factors underscore the high-risk nature of the venture, which represents the first major offshore drilling campaign in Somalia's modern petroleum history. The well, reportedly named **Curad-1**, symbolises national aspirations for realising long-anticipated hydrocarbon potential. (Oxford Analytica, 2024). However, alongside the prevailing public optimism, concerns have emerged regarding the terms of the 2024 Somalia and Turkey intergovernmental agreement and the associated production sharing agreement (PSA) with Turkish Petroleum (TPAO). (Tsamalashvili, n.d.). The number of provisions of the agreement appears to favour the contractor. In particular, attention has been drawn to the fiscal terms, where public dialogue has included claims that Somalia would receive only 5 per cent of the revenue. Such claims, however, reflect a lack of clarity and limited understanding of the technical structure of petroleum fiscal systems, particularly the distinctions between gross revenue, royalty rates, and profit oil shares. (Ahmed, n.d.).

This study clarifies the principal fiscal instruments in petroleum contracts and examines the fiscal architecture of the agreement, comparing its provisions with the terms of the current Somali PSA Model (which formed the basis for other recent agreements), as well as evaluating the contract's implications for government revenue. Particular attention is given to cost recovery limits, royalty rates, and the absence of statutory fiscal safeguards in the Somali Petroleum Law 2020, which allowed the omission of some fiscal instruments that should have been statutory rather than negotiable.

### **Background of the study**

The global oil and gas industry has historically played a pivotal role in shaping the economic trajectories of resource-endowed nations. For developing countries in particular, the discovery and commercialisation of hydrocarbons have often been associated with increased government revenues, infrastructure development, and broader socio-economic transformation. However, these outcomes are not automatic; they depend largely on the strength of institutional frameworks, the design of fiscal regimes, and the governance mechanisms that regulate the sector. In many cases, weak institutions and poorly structured petroleum agreements have limited the benefits accruing to the state, underscoring the importance of sound policy and regulatory systems. (Zuoqian et al., 2023).

In the context of Somalia, the oil and gas sector has re-emerged as a focal point of national interest following decades of political instability that hindered exploration activities. Recent improvements in security, governance, and international engagement have renewed attention toward the country's largely untapped hydrocarbon potential. Geological assessments and historical exploration data indicate that Somalia possesses promising onshore and offshore basins, positioning it as a potential future oil-producing nation in East Africa.

This renewed optimism is further reinforced by significant hydrocarbon discoveries in neighbouring countries such as Uganda, Kenya, and Tanzania, which have demonstrated the region's broader petroleum potential.

Somalia's strategic geographic location along major global shipping routes, particularly near the Gulf of Aden and the Indian Ocean, further enhances its attractiveness to international investors. In light of evolving global energy dynamics, especially supply uncertainties linked to geopolitical tensions in traditional oil-producing regions, emerging frontiers like East Africa are gaining increased attention. Consequently, Somalia is increasingly viewed as a high-potential but high-risk frontier for petroleum exploration and investment. (Kassim & Osman, 2026).

Recent offshore exploration initiatives mark a significant milestone in Somalia's petroleum sector development. The deployment of advanced deep-sea drilling technology, exemplified by the arrival of international drilling operations targeting ultra-deep reservoirs, signals a transition from speculative interest to active exploration. These developments have reignited public expectations that the oil and gas sector could catalyse economic recovery and long-term development. At the same time, they highlight the technical, financial, and operational risks associated with frontier exploration, particularly in deep offshore environments. (Shah et al., 2022).

Despite these promising developments, critical concerns have emerged regarding the governance and fiscal management of Somalia's petroleum resources. The enactment of the Petroleum Law (2020) represented an important step toward establishing a legal framework for the sector. However, gaps remain, particularly in relation to fiscal provisions and the extent to which key revenue-generating instruments are safeguarded by law rather than left to contractual negotiation. The absence of fully operational national institutions, such as a functional national oil company, further complicates the state's ability to effectively manage and monitor petroleum operations. (Vargiolu, 2024).

Moreover, recent petroleum agreements, including intergovernmental arrangements and production sharing agreements (PSAs) with international oil companies, have sparked public debate and scrutiny. Concerns have been raised about the transparency and fairness of fiscal terms, especially regarding royalty rates, cost recovery limits, and the government's share of profit oil. Public discourse has at times been characterised by misunderstandings of how petroleum fiscal systems operate, particularly the distinction between gross revenues and the net revenues ultimately accruing to the state. (Duval et al., 2009)

Against this backdrop, there is a clear need for a systematic examination of Somalia's petroleum fiscal framework and contractual arrangements. Understanding the structure and implications of these agreements is essential to assessing whether they are aligned with national interests and capable of delivering sustainable economic benefits. (Sunny-Hart, 2024). This study, therefore, situates itself within the broader discourse on resource governance, focusing specifically on the fiscal architecture of Somalia's petroleum agreements and their implications for government revenue generation and long-term economic development.

#### *Scope of the Research*

This study analyses the fiscal structure of Somalia's oil and gas sector, focusing on the 2024 Somalia–Turkey agreement and its Production Sharing Agreement (PSA) with TPAO. It examines key fiscal instruments, royalties, cost recovery, and profit oil—and compares them with the Somali PSA Model and international best practices.

The research is limited to offshore developments and the post–Petroleum Law (2020) policy framework. It evaluates how gaps in the law have influenced contract terms and their implications for government revenue and resource governance. The study does not assess resource volumes but focuses on legal and fiscal aspects, while also clarifying common misconceptions about petroleum revenue systems.

#### *Objectives of the Study*

Despite the long-term nature of oil and gas investment, hydrocarbon revenue is inherently finite as well as being subject to price and production volatility, making it unreliable over the long term. Given these characteristics, the sector development demands a carefully planned approach guided by clear objectives, a robust legal framework, and effective institutional structures. The overarching goal that the host country's institutions responsible for sector development should be mindful of when entering agreements is to maximise the state's economic returns from its resources while ensuring environmental sustainability. Key objectives of the oil and gas sector from the host country's perspective include:

- a) Attracting credible and capable companies through effective resource marketing.
- b) Maximising government revenue through a well-designed fiscal regime.
- c) Enhancing transparency and accountability to build public trust.
- d) Increasing public awareness of the sector and managing public expectations.
- e) Supporting human capacity development to enable national participation in oil and gas operations.
- f) Promoting local content and economic linkages through infrastructure and services.
- g) Facilitating the involvement of state-owned enterprises in resource development.
- h) Establishing legal and regulatory frameworks that prioritise environmental protection in all sector activities.

### **Significance of the research**

This study is significant as it provides a clear and evidence-based analysis of Somalia's emerging petroleum fiscal regime at a critical stage of sector development. By examining the 2024 Somalia and Turkey agreement and its PSA structure, the research contributes to a more informed understanding of how petroleum revenues are actually generated and shared, addressing widespread public misconceptions, particularly the claim that Somalia would receive only a minimal share of revenues.

The study is further important in clarifying the role and function of key oil and gas fiscal instruments. It highlights that petroleum revenues are not derived from a single source, but from a combination of mechanisms, including:

- a. one-off payments such as signature and discovery bonuses;
- b. annual payments like surface rentals and administrative fees;
- c. activity-based payments, mainly taxation; and
- d. Production-based payments, including royalties, profit oil, corporate income tax, and potential windfall taxes.

Among these, production-based instruments are shown to be the most significant contributors to long-term government revenue. By systematically explaining these categories, the study enhances transparency and improves public and policy-level understanding of petroleum contracts.

In addition, the research offers practical policy relevance by identifying gaps in the Petroleum Law (2020), particularly the absence of clearly defined statutory fiscal safeguards. It demonstrates how such gaps may lead to negotiable and potentially less favourable contract terms, thereby affecting the government's ability to maximise resource benefits.

Finally, the study contributes to academic and policy discourse by benchmarking Somalia's fiscal framework against its PSA Model and international best practices. In doing so, it

provides insights that can support better contract negotiation, strengthen institutional capacity, and promote more equitable and sustainable resource governance.



Figure 1. Oil and gas fiscal system instruments

### Literature Review

The literature on this research focuses on how fiscal systems and governance frameworks determine whether oil and gas resources translate into sustainable economic development. Central to this body of work are Production Sharing Agreements (PSAs) and related fiscal instruments such as royalties, cost recovery, taxation, and profit oil sharing, which define how revenues are distributed between governments and investors.

A key theme in the literature is the importance of strong institutions and clear legal frameworks in ensuring fair and efficient resource management. Weak governance and limited negotiation capacity in many developing countries often lead to suboptimal contract outcomes. This is commonly discussed in relation to the Resource Curse, where resource-rich countries fail to achieve expected development gains.

Comparative studies of emerging producers such as Ghana, Uganda, Kenya, and Tanzania provide useful insights into how fiscal design and institutional strength influence petroleum revenue outcomes. Overall, the literature highlights that effective petroleum development depends not only on resource potential but also on robust fiscal regimes, transparent contracts, and strong governance structures.

#### *Comparative Petroleum Governance and Fiscal Regimes*

A substantial body of literature on petroleum governance emphasises that the effectiveness of fiscal systems and institutional frameworks ultimately determines whether hydrocarbon resources translate into sustainable economic development. Comparative experiences from emerging African producers, particularly Ghana, Uganda, Kenya, and Tanzania, provide important lessons on how fiscal design, legal frameworks, and governance capacity shape revenue outcomes.

In Ghana, a hybrid fiscal system applies, combining elements of royalties, taxation, and state participation. The framework is anchored in legislation, particularly the Petroleum Revenue Management Act 2011 and the Petroleum (Exploration and Production) Act 2016, which

clearly define fiscal obligations. (Samanhya & Samanhya, 2016). Key fiscal instruments include:

- ✓ Royalties (typically 5–10% of gross production)
- ✓ Carried state participation (through the national oil company GNPC)
- ✓ Corporate income tax (35%)
- ✓ Additional oil entitlement (windfall/progressive mechanism)
- ✓ Surface rentals and bonuses

One of the major fiscal implications is that Ghana achieves a relatively high and diversified government take compared to many frontier economies.

- ✓ Early revenue comes from royalties and bonuses
- ✓ Mid-stage revenue from profit oil and state participation
- ✓ Long-term revenue from taxation and additional oil entitlement

In Uganda, the fiscal implications of oil and gas are mainly related to how future petroleum revenues will affect government income, debt levels, and economic development. Uganda is expected to earn revenue from royalties, profit from oil under Production Sharing Agreements (PSAs), corporate income tax, and licensing payments. These revenues have strong potential to support national development by financing infrastructure, education, healthcare, and other public services. (Adams, 2020).

However, in the early stages of production, government revenue remains limited because oil companies recover their investment costs first. This delays significant fiscal returns to the state. At the same time, large investments in oil infrastructure, such as pipelines and refineries, have increased borrowing, which raises public debt pressure and fiscal risk.

Uganda's oil revenues are also expected to fluctuate depending on global oil prices and production levels. To manage this, the government has introduced petroleum revenue management systems, including savings and investment funds aimed at stabilising income and ensuring long-term benefits. (Lydia, 2022).

A useful comparison is Ghana, which uses a more structured and diversified fiscal system that combines royalties, taxes, and state participation. This system helps Ghana achieve a more balanced and predictable flow of oil revenues over time. (Harriet, 2023).

- ✓ **Royalty Rate:** Typically **5% – 10% of gross production**, paid regardless of costs
- ✓ **Corporate Income Tax:** **35%** on petroleum company profits
- ✓ **State Participation (GNPC):** The government participates through its national oil company
- ✓ **Additional Oil Entitlement:** Progressive mechanism capturing windfall profits when prices rise
- ✓ **Surface Rentals & Bonuses:** Payments made for access to acreage and during contract signing

**In Kenya**, the fiscal implications of oil and gas relate to how future petroleum development will influence government revenue, public investment, debt management, and economic planning. Kenya has discovered commercially viable oil in the Turkana Basin, but full-scale production has been delayed due to infrastructure, financing, and export challenges. (Wanyagathi Maina, 2019).

At present, Kenya does not yet receive significant oil revenues. However, the government has already developed a fiscal and legal framework to regulate future petroleum income. The

main expected sources of revenue will include royalties, profit oil under Production Sharing Contracts (PSCs), corporate income tax, and signature bonuses. (Harriet, 2023).

Like Uganda, Kenya's system is based on Production Sharing Contracts, meaning oil companies recover their costs before the government earns substantial income. This delays fiscal benefits but reduces upfront government investment requirements.

A major fiscal challenge for Kenya is the high infrastructure cost required to commercialise oil production, especially pipeline development under the LAPSET corridor. These investments may increase public borrowing and fiscal pressure before oil revenues are realised.

- ✓ **Royalty Rate:** Typically around **10% – 12.5% of gross production** (varies by contract and field)
- ✓ **Corporate Income Tax:** Around **30% – 37.5%**, depending on petroleum taxation rules
- ✓ **Production Sharing Contracts (PSCs):** The main fiscal framework used instead of full state participation
- ✓ **Cost Recovery Limit:** Oil companies recover exploration and development costs before profit sharing
- ✓ **State Take:** Government receives revenue through royalties, profit oil share, and taxes
- ✓ **Signature Bonuses:** Upfront payments made when contracts are signed (less significant in Kenya compared to mature producers)

**In Tanzania**, the fiscal implications of oil and gas in Tanzania relate to how natural gas development influences government revenue, taxation, public investment, and long-term economic planning. Tanzania has substantial natural gas reserves, but the full fiscal potential from LNG exports has not yet been realised due to delayed final investment decisions on major projects. At present, Tanzania earns revenue from domestic gas production used for electricity generation, industrial supply, and small-scale exports. However, the most significant fiscal gains are expected once LNG export projects become fully operational. (Mgaya, 2014).

The fiscal system in Tanzania is based on Production Sharing Agreements (PSAs) combined with state participation through the Tanzania Petroleum Development Corporation (TPDC). This means the government shares production after cost recovery by investors, similar to Uganda and Kenya. (Wright et al., 2016).

- ✓ **Royalty Rate:** Typically around **12.5% of gross production** for petroleum resources
- ✓ **Corporate Income Tax:** Around **30%** on petroleum company profits
- ✓ **State Participation (TPDC):** Government participates through its national oil company (TPDC)
- ✓ **Production Sharing Agreements (PSAs):** Main contractual framework for oil and gas development
- ✓ **Cost Recovery Limit:** Companies recover exploration and development costs before profit sharing
- ✓ **Withholding Tax & Bonuses:** Includes signature bonuses, training fees, and other contractual payments.

### Research Methodology

This study adopts a qualitative research design, which is appropriate for examining legal, fiscal, and institutional frameworks governing Somalia's petroleum sector. The qualitative approach allows for an in-depth analysis of contractual provisions, policy documents, and

governance structures, particularly in understanding how fiscal regimes influence government revenue outcomes. (Goundar, 2012).

The study primarily employs qualitative content analysis, focusing on interpreting and evaluating the fiscal terms embedded in petroleum agreements, especially the 2024 Somalia and Turkey agreement and its associated Production Sharing Agreement (PSA). (Davidavičienė, 2018).

#### *Data Sources*

The research relies exclusively on secondary data, given the sensitivity and limited accessibility of primary data in the petroleum sector. (Johnston, 2014). The data sources include:

- ✓ Official government documents (Somalia Petroleum Law 2020)
- ✓ Production Sharing Agreements (PSAs) and model contracts
- ✓ Reports from international organisations and policy institutions
- ✓ Academic literature on petroleum fiscal systems and governance
- ✓ Industry reports and geophysical data published by exploration companies (TPOA)

#### *Data Collection Methods*

Data are collected through a documentary review, which involves the systematic identification, selection, and examination of relevant legal, policy, and contractual materials. (Mazhar et al., 2021). Particular attention is given to:

- ✓ Fiscal provisions (royalties, cost recovery, profit oil, taxation)
- ✓ Institutional and regulatory frameworks
- ✓ Comparative fiscal regimes in countries such as Ghana, Uganda, Kenya, and Tanzania

#### **Findings of the Research**

This study examined key thematic areas relating to the fiscal implications of the 2024 Somalia–Turkey offshore petroleum agreement. In particular, it focused on the design and structure of fiscal instruments, the adequacy of the legal and regulatory framework, and the broader implications for government revenue generation and resource governance.

Accordingly, this section presents the principal findings derived from the analysis of Somalia’s petroleum fiscal framework, with specific emphasis on the 2024 Somalia and Turkey agreement and its associated Production Sharing Agreement (PSA). The findings are organised into four main areas:

- a. The structure and effectiveness of fiscal instruments, including royalties, cost recovery limits, and profit oil;
- b. gaps within the Petroleum Law (2020) and their impact on contractual outcomes;
- c. comparative assessment with selected African petroleum-producing countries; and
- d. The overall implications of the current fiscal architecture for government revenue mobilisation and long-term economic development.

#### *Fiscal Gaps in the Somalia and Turkey Offshore Petroleum Agreement*

The agreement is distinguished by the absence of early-stage and recurring financial obligations typically embedded in petroleum fiscal regimes. Notably, it excludes key instruments such as signature bonuses, discovery and development bonuses, surface rental fees, and administrative charges. In addition, provisions relating to training funds and local

community development funds are either absent or insufficiently articulated. While such mechanisms generally constitute a modest share of total petroleum revenues over the project lifecycle, they play a critical role in generating early-stage government income and fostering social legitimacy among host communities and subnational authorities.

The omission of these instruments carries measurable fiscal implications. For instance, applying a standard surface rental rate of USD 100 per km<sup>2</sup> consistent with the existing Somali Production Sharing Agreement (PSA) framework to the contract area of 15,000 km<sup>2</sup> would yield approximately USD 1.5 million annually. This represents a stable and predictable non-production revenue stream that is particularly valuable during the exploration phase, when production-based revenues have yet to materialise.

Similarly, the agreed signature bonus of USD 1 million per contract, irrespective of the number of blocks covered, falls at the lower bound of international benchmarks. Although Somalia's frontier exploration status and associated geological and commercial risks justify comparatively modest fiscal demands, the complete exclusion or minimisation of such upfront payments limits the government's ability to capture early economic rent. Comparative evidence demonstrates that in more mature petroleum provinces, signature bonuses can reach substantially higher levels, as exemplified by the USD 1.1 billion paid in 2006 for offshore blocks in Angola. While Somalia cannot reasonably command such premiums, a more calibrated approach aligned with its risk profile would be fiscally prudent. Moreover, the absence of success-based fiscal instruments, such as discovery, production, or price-linked bonuses, represents a missed opportunity to enhance progressivity within the fiscal regime. These mechanisms enable the state to capture additional value in scenarios of commercial success, particularly in light of geological data suggesting significant hydrocarbon potential. Incorporating such contingent payments would better align government revenue with project performance, thereby improving the overall fiscal balance.

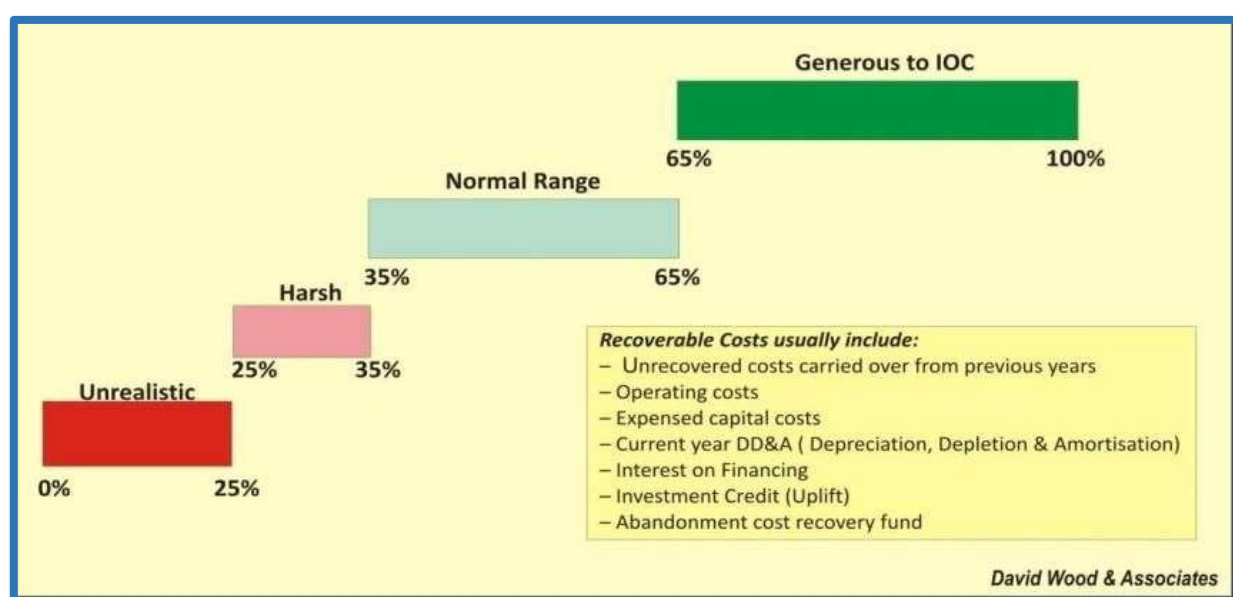
In terms of taxation, the agreement reportedly defers to the applicable legal frameworks of both contracting parties. However, the lack of explicit provisions within the PSA regarding key fiscal elements such as withholding taxes, capital gains tax, and corporate income tax introduces potential ambiguity and weakens fiscal certainty. Best practice in petroleum contracting typically requires these elements to be clearly codified within the agreement to ensure transparency, predictability, and enforceability.

The royalty rate, set at 5 per cent, is below the global average range of approximately 8 to 20 per cent. While this lower rate may be justified by Somalia's frontier status and the high costs and risks associated with deep offshore exploration, it nonetheless reduces the government's guaranteed share of gross production. A more balanced approach could involve the adoption of a progressive royalty structure, whereby rates increase in response to higher production volumes or improved project economics, thereby preserving investment incentives while enhancing state revenue capture.

Although not explicitly detailed in the agreement, secondary sources indicate that production sharing follows a progressive, production-based sliding scale, beginning with an equal 50–50 split between the contractor and the government. Corporate income tax is reportedly set at 30 per cent, consistent with international norms. Taken together, these elements suggest the

presence of some progressive features within the fiscal regime; however, the absence of complementary instruments, particularly those targeting early-stage revenue generation and windfall gains, limits the overall robustness and responsiveness of the framework.

Most critically, the agreement provides for a cost recovery ceiling of 90 per cent, which is substantially above prevailing international benchmarks. In most petroleum fiscal regimes, cost recovery limits typically range between 35 per cent and 65 per cent. A ceiling of this magnitude materially weakens the host government's fiscal position by significantly reducing the share of profit oil available in the early years of production. Consequently, it delays the timing of government revenue flows and shifts a greater proportion of project risk and reward in favour of the contractor.



**Figure 2.** Cost recoverable allocations in oil and gas production sharing agreements

Such a provision is particularly disadvantageous for host countries and is especially consequential in the context of Somalia, where early revenue mobilisation is critical to broader economic development. Timely fiscal inflows are essential not only for general budgetary support but also for advancing the petroleum sector itself, including the development of infrastructure, strengthening of institutional frameworks, enhancement of technical and regulatory capacity among stakeholders, improvement of security conditions, and the promotion of effective resource governance. By deferring government revenue, an elevated cost recovery ceiling constrains the state's ability to finance these foundational priorities.

In addition to the implications of the high cost recovery limit, a further concern arises from the institutional and technical constraints commonly faced by emerging hydrocarbon-producing countries in auditing and verifying petroleum costs. The oil and gas sector is inherently complex, technologically demanding, and capital-intensive, which creates significant information asymmetries between host governments and International Oil

Companies (IOCs). Within this context, there is a risk that reported costs may be overstated, thereby reducing taxable income and delaying the transition to profit oil. Many developing countries lack adequately trained petroleum cost auditors and specialists capable of rigorously assessing whether reported expenditures are justified, efficiently incurred, and aligned with industry standards. This includes evaluating the competitiveness of procurement processes and ensuring that transactions with affiliated entities are conducted on an arm's length basis. In the absence of strong oversight mechanisms, these challenges can further erode the host government's revenue base and undermine the overall integrity of the fiscal regime. Elevated costs prolong the cost recovery period, thereby delaying the government's share of profits.

#### *Legal gap in the Somali Petroleum Law 2020*

A robust petroleum fiscal regime is ordinarily grounded in primary legislation that clearly defines the core fiscal instruments governing the sector. In the case of the Somali Petroleum Law 2020, the absence of a comprehensive statutory framework outlining key fiscal elements such as bonuses, surface rental fees, royalties, payment terms, and penalties for late payment represents a significant structural gap. In well-established petroleum jurisdictions, such parameters are codified in sector-specific legislation, thereby constraining excessive contractual discretion and ensuring consistency, transparency, and predictability in fiscal outcomes.

The lack of such statutory safeguards in Somalia introduces a high degree of variability in negotiations and may weaken the government's bargaining position. Consequently, essential fiscal provisions are left to be determined at the contractual level, increasing the likelihood of omission or dilution. This dynamic is reflected in the 2024 Somalia–Turkey Offshore Petroleum Agreement, where several standard fiscal instruments appear to have been excluded.

Furthermore, while the Production Sharing Agreement (PSA) Model serves as a useful reference framework, it does not possess the binding authority of legislation. Its provisions are inherently flexible and subject to alteration during negotiations. As such, reliance on a model contract in the absence of enforceable legislative backing may lead to significant deviations from optimal fiscal terms, potentially undermining the state's long-term revenue interests.

<p><b>Uganda Petroleum Act 2013</b></p> <p>PART XIV—PAYMENTS</p> <p>154. Royalty on petroleum.                  155. Annual fees.                  156. Signature bonus.                  157. Payment terms.                  158. Penalty for late payments.                  159. Recovery of payments under this Act.</p>	<p><b>Ghana Petroleum Act 2016</b></p> <p>Fiscal Provisions</p> <p>85. Payment of royalties                  86. Annual fee in respect of acreage                  87. Tax                  88. Bonus payments                  89. Additional oil entitlement</p>
<p><b>Tanzania Petroleum Act 2015</b></p> <p>Sub-Part VII                  Petroleum Fiscal Regime</p> <p>113. Royalty on petroleum                  114. Annual fees                  115. Bonus Payments                  116. Payment of Tax                  117. Ring fencing on recoverable cost of exploration and development licence                  118. Payment terms                  119. Penalty for late payments                  120. Recovery of payments under this Act                  121. Security for compliance</p>	<p><b>Kenya Petroleum Act 2019</b></p> <p>PART VII—PAYMENTS AND REVENUES</p> <p>53—Contractor to comply with financial and fiscal obligations in agreement.                  54—Annual fees.                  55—Signature bonus.                  56—Payment terms.                  57—Petroleum revenue.                  58—Sharing of petroleum resource.</p>

The hierarchy of the petroleum legal framework is illustrated in Figure 4. Constitution principles on oil and gas are usually limited to provisions on the state’s ownership of subsoil resources, government structure and checks & balance within the political system, as well as establishing several civil rights that are linked to oil and gas sector operations, such as the right to information, labour rights, etc.



The sectoral law should constitute a primary source of regulatory authority governing the industry, including the establishment of financial obligations. Such statutory provisions should not be subject to alteration or override through contractual arrangements. Therefore, in oil and gas legal arrangements, from the perspective of host countries, it is important to have as many details as possible in the sectoral legislation rather than leaving it for the contract drafting and being subject to extensive negotiation. Somalia, due to its frontier status, is determined to attract investors and does not have the luxury of dramatically shifting provisions to the legislation. However, the transfer should be progressively implemented as sector development matures, hence significantly narrowing down the negotiation margin over time.



Figure 4: Hierachy of the petroleum legal

Embedding most sectoral details within primary legislation promotes the development of a standardised Production Sharing Agreement (PSA) model that aligns with both sector-specific and broader legal and regulatory frameworks. This approach reduces the complexity and variability associated with project-by-project negotiations, facilitates more consistent and coherent project implementation procedures, and strengthens the effectiveness of monitoring and enforcement mechanisms.

Moreover, it enhances transparency and accountability by enabling greater public participation in the regulatory process, as the formulation of legislation typically involves broader consultation and stakeholder engagement compared to contractual negotiations. Having most of the details in the sector legislation will result in a standard PSA model that is in line with sectoral and other wider laws & regulations. This reduces the challenges of the negotiation of each project, allowing a coherent procedure for implementing projects as well as effective monitoring & enforcement of the rules. Furthermore, this brings about more public input into the sector regulation, as establishing laws usually includes public consultation and participation more than contract negotiation.

 Investor share	<b>Total income</b> <b>100.00 USD = 1 barrel</b>	 Host country share
—	Royalty 5%	5.00 USD
	Net after royalty 95.00 USD	
85.50 USD	Cost recovery (90%)	—
4.75 USD	Profit share = 9.5 USD (50/50)	4.75 USD
- 1.425 USD	Corporate income tax (30%)	1.425 USD
88.825	Gross revenue percentage	11.175
3.325 USD	Distribution of profit (14.5 USD)	11.175 USD
23% (3.325 x 100)/14.5	Profit share percentage	77% (11.175 x 100)/14.5

#### *Illustrative Production-Based Revenue Analysis*

Production-based revenue reflects the actual distribution of value under a Production Sharing Agreement (PSA) once production begins. Table 2 illustrates the allocation of petroleum revenue between the Government of Somalia and the Turkish Petroleum Corporation under the 2024 Somalia–Turkey offshore agreement for Blocks **142**, **152**, and **153**. For simplicity, the model assumes one barrel at **USD 100**.

A royalty of **5%** is first applied to gross revenue, ensuring immediate government income. The remaining **USD 95** is then subject to cost recovery, with **90%** allocated to the contractor. The balance (**USD 9.5**) constitutes profit oil, which is shared equally between the parties. The contractor's share is further taxed at **30%**, generating additional government revenue. This structure demonstrates how royalty, cost recovery, profit sharing, and taxation collectively determine revenue distribution.

As illustrated in the table, the distribution of gross revenue allocates approximately **88.825%** to the contractor and **11.175%** to the Government of Somalia. However, when assessed at the level of profit oil, the government's share rises significantly to approximately **77%**, compared to **23%** for the Turkish Petroleum Corporation.

Notwithstanding this seemingly favourable profit split, the government's absolute share of gross revenue remains modest, amounting to only USD **11.175** out of USD **100**. This disparity is primarily attributable to the high cost recovery ceiling of 90%, which substantially reduces the volume of profit oil available for distribution. Consequently, even with a relatively balanced profit-sharing mechanism, early fiscal flows to the host government are significantly constrained.

Moreover, the relatively low royalty rate of **5%** further limits the overall government take. A more balanced fiscal arrangement, such as a **10%** royalty combined with a **70%** cost-recovery ceiling, would enhance revenue generation and provide a more equitable return for the exploitation of the country's petroleum resources.

### **Conclusion**

Somalia possesses significant hydrocarbon potential, and recent offshore exploration activities have revived strong public expectations that the sector could contribute substantially to national economic transformation.

The 2024 Somalia–Turkey offshore petroleum agreement represents a historic step in Somalia's resource development path. The deployment of deep offshore drilling signals confidence in Somalia's geological potential and may catalyse broader regional investment. However, concerns have emerged regarding the terms of the agreement, many of which appear to favour the contractor. Fiscal design choices, particularly the high cost recovery ceiling (90%) and low royalty rate (5%), delay government revenue realisation and reduce the effective share of gross revenue accruing to the state, which, according to the calculation above, comes to **11.175%**. While the low royalty rate may be considered defensible in high-risk frontier environments, the overall fiscal design choices highlight structural weaknesses in Somalia's petroleum legal framework, coupled with a poor negotiation strategy.

The agreement also omits several fiscal instruments commonly found in petroleum contracts, including signature bonuses, development bonuses, surface rental fees, and possibly training and community development funds. This reduces early-stage financial benefits to the government and regional administration. The Somalia Petroleum Law 2020 does not comprehensively define key fiscal instruments such as bonuses, royalties, payment obligations, or penalties for late payment. This allows fiscal terms to be negotiated at the contractual level, potentially weakening the state's bargaining position.

Many developing countries, including Somalia, face challenges in auditing and verifying petroleum costs reported by International Oil Companies. Weak capacity increases the risk of inflated or non-transparent cost reporting.

### **Recommendations**

- ✓ The Somali Petroleum Law 2020 is to be amended to incorporate comprehensive fiscal

provisions. Key fiscal instruments such as royalties, bonuses, surface rents, taxation provisions, and payment obligations should be clearly defined in the petroleum law, rather than being left to contract negotiations.

- ✓ Contracts should be allocated through transparent bidding rounds to the greatest extent possible, rather than a direct bilateral approach.
- ✓ The 2024 intergovernmental hydrocarbon agreement between Somalia and Turkey requires amendment to ensure greater equity, or, at a minimum, its application should be restricted to the currently contracted blocks and not extended to future agreements.
- ✓ For future contracts, the cost recovery limit should be reduced to a level closer to international practice (for example, 60–70%) to allow earlier profit oil generation and increase government revenue.
- ✓ A moderate increase in royalty (e.g., 8–10 per cent) or at least a progressive royalty rate linked to production levels or profitability should be adopted as it would provide a more balanced fiscal framework that protects government interests while still attracting investment.
- ✓ Institutional capacity to be strengthened for petroleum cost auditing by investing in developing technical expertise and systems to audit petroleum costs effectively and prevent cost inflation by contractors.
- ✓ Transparency and public communication to be enhanced. Clear disclosure of fiscal terms and revenue structures would improve public understanding and manage expectations regarding the benefits of oil and gas development.
- ✓ Somalia should gradually move toward a more consistent petroleum fiscal regime where contractual terms closely reflect the provisions of sector legislation.

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