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Governance and Labor Market Outcomes in Fragile States: The Impact of Corruption Control on Unemployment Reduction in Somalia

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ABSTRACT

Corruption impedes economic growth, political stability, skill development, and entrepreneurship by diverting resources from critical sectors such as infrastructure, education, and healthcare. It discourages investment and weakens economic institutions. This study examines the impact of corruption control on unemployment reduction in Somalia, a country grappling with prolonged political instability and fragile institutions. Using annual data from 1996 to 2023, the study employs both the Autoregressive Distributed Lag (ARDL) and Fully Modified Least Squares (FMOLS) methodologies to analyze short-run and long-run dynamics. The results indicate that while the coefficient for corruption control (LNCPR) is negative implying that improvements in controlling corruption are associated with reductions in unemployment this relationship is statistically insignificant in the long run but becomes significant in the short run. Similarly, economic growth (LNGDP) significantly reduces unemployment, while government expenditure (LNGEX) and population growth (LNPOP) are associated with rising unemployment. Diagnostic and stability tests affirm the reliability of the model, and FMOLS results corroborate the long-term estimates. The study highlights the urgent need for Somalia to enhance institutional quality, digitalize its economy, and adopt sustainable employment and industrialization strategies to effectively tackle corruption and unemployment. These findings contribute to a deeper understanding of governance-driven labor market challenges in fragile state contexts.

Keywords: Government, Corruption, Economic Growth, Unemployment, Economic System
JEL Classifications: E24, E62, P4

1. INTRODUCTION

Governance is the administration of a nation's economic and social resources, focusing on the ability of governments to plan, create, and implement policies. It encompasses the means, processes, and organizations for citizens to express their interests, exercise their rights, fulfill obligations, and seek resolutions for problems (Abé Ndjié et al., 2019). An anti-corruption body is crucial for national governments as corruption is a national and international issue, especially in developing nations. Reducing corruption is significant as it affects foreign investment inflow and makes high-corruption countries less competitive in attracting international investment, which is essential for these nations (Triatmanto and Bawono, 2023).

In sub-Saharan Africa, Corruption hinders economic growth, affecting political stability, skill acquisition, and entrepreneurial endeavors. It transfers resources from infrastructure, education, and healthcare, creating a negative environment for firms, deterring investment, and erodes public trust, leading to diminished tax compliance and a weakened economic system (Mamo et al., 2024). Five out of the top 10 countries with high corruption levels are located in Africa, affecting young individuals' access to quality education and training, increasing youth unemployment rates and reducing their appeal to employers (Gouider and Haddad, 2024). along with tax evasion and illegal money flows, contributes to a significant portion of Africa's GDP, putting an annual economic burden of around $1.26 trillion on developing nations (Salati et al., 2025).

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Corruption in Somalia is exacerbated by inexperienced institutions, poor law enforcement, chronic poverty, and a clan-based political culture of 4.5. Corruption rewards are substantial, especially in weaker nations (Abdi Mohamed Qasaye and Omar Abdi, 2022). Tribal fighters and warlords have taken control of the ensuing political void, which has impeded the country's political and economic advancement. External involvement and the lack of efficient government mechanisms have exacerbated this unstable backdrop, which has frequently exacerbated local disputes and thwarted peace initiatives (Nor and Raheem, 2025). And the country faced severe political and economic instability due to civil war, governance issues, and state institutional breakdown. This led to a "failed state" status, affecting economic activities, investment, and development. The lack of unified policies and regulatory frameworks intensified socio-economic issues, impacting GDP and unemployment rates (Mohamud et al., 2024).

Additionally, the country faces challenges in meeting labor demand, especially among young people, due to limited access to productive economic resources. With a 73% poverty rate and a per capita income of USD 226, the country ranks among the world's poorest, with 43% experiencing extreme poverty (Mohamed and Abdi, 2024). This issue contributes to socio-economic challenges, including violence, migration, and social deviant behavior (Yasin Gelle et al., 2021). The Somali Federal Government aims to recruit a number of youths by 2030, focusing on primary and secondary school educators and military personnel. This initiative aims to reduce the proportion of youth lacking employment, education, training, or precarious work by 1%/year. With 75% of Somalia's population aged 20-35, this minimal percentage of youth employment will help establish Somalia as a recognized center of excellence (Qase, 2025).

This study addresses a significant gap in the literature on economic development in Somalia. While previous research has explored similar relationships in other national contexts such as Arango and Flórez (2020) in Colombia, Asmara and Saleh (2024) in Indonesia, and Warsame and Mohamed (2024) in Somalia this study uniquely focuses on the impact of corruption control on unemployment reduction within the Somali context. Somalia's prolonged political instability and weak governance structures over the past decades have severely affected key economic indicators, including GDP and unemployment rates. This underscores the need for a contextualized analysis. The research aims to enrich existing knowledge by offering nuanced insights into the corruption control and unemployment nexus in Somalia, considering the country's distinct socio-political and economic challenges. By utilizing both the Autoregressive Distributed Lag (ARDL) and Dynamic Ordinary Least Squares (DOLS) methodologies, the study delivers a comprehensive and robust examination of this relationship in the context of a fragile state.

The remainder of the paper is organized as follows: Section Two presents the literature review; Section Three outlines the methodology; Section Four discusses the results and analysis; and Section Five provides the conclusion and policy recommendations.

2. LITERATURE REVIEW

Unemployment remains a persistent structural issue in fragile states like Somalia, where weak institutions and prolonged governance deficits hinder labor market efficiency. In such contexts, corruption and political instability are not peripheral but central to labor market outcomes. Hailu Demeke, (2022) demonstrated that youth unemployment exerts a significant influence on political instability within IGAD member states. The study underscores the necessity of comprehensive youth employment policies, both to alleviate the challenges faced by young people and to reduce governments' burdens in addressing recurrent domestic unrest. Its further advocates for harmonized regional strategies among IGAD countries to foster youth employment and mitigate the risk of recurring conflicts.

Corruption undermines the state's ability to deliver employment-promoting services and misalign incentives in both public and private sectors. Uddin and Rahman, (2023) establish a strong statistical link between high corruption levels and reduced employment due to inefficiencies in fiscal management and development planning. Bolatito (2023) further emphasizes how administrative corruption in African countries diverts resources from essential services, erodes public trust, and encourages informal employment practices. Somalia exemplifies this trend: state-led employment interventions often serve as mechanisms of political patronage, where positions are granted based on clan loyalties rather than need or qualification, weakening national cohesion and discouraging private sector confidence.

Political instability complements corruption in its detrimental effect on employment. Aisen and Veiga (2010) argue that political volatility increases economic uncertainty, which inhibits long-term investments in job-creating sectors. Sinha (2023) expands this by showing that political instability correlates with both short-term employment shocks and long-run structural unemployment in developing countries. Somalia's protracted political crises, including electoral delays, constitutional deadlock, and insurgent violence, disrupt both policymaking and market confidence. This leads to widespread underemployment, even in urban areas where infrastructure and education levels are relatively better.

Suleiman (2025) offers empirical insight into Puntland, a semi-autonomous region of Somalia, where ineffective leadership and fragmented governance severely limit job creation. His fieldwork highlights how political elites in Puntland monopolize public employment for rent-seeking, causing mistrust in government among job seekers. This is consistent with the broader findings of Bokhari et al. (2021), who document that political instability reduces FDI inflows and disrupts private-sector labor absorption. In fragile contexts like Somalia, political volatility is not merely background noise it fundamentally impairs the channels through which employment is generated and sustained.

Public expenditure is often used as a tool to stimulate employment, especially in post-conflict and low-income economies. However, its effectiveness depends heavily on institutional quality. Mahmud

(2023), in his study on Somalia, illustrates how donor aid and national budgets intended for development are frequently siphoned off by corrupt intermediaries, resulting in "phantom projects" and negligible job growth. This undermines the intended counter-cyclical role of government spending on unemployment mitigation.

Foreign direct investment (FDI), a commonly emphasized solution for unemployment, is highly sensitive to corruption and political risk. Aloui (2019) and Akçoraoğlu and Kaplan, (2017) independently demonstrate that corruption and instability not only deter FDI but also skew the nature of investment toward capital-intensive or extractive industries with limited employment multipliers. Nor and Raheem, (2025) argue that in Somalia, FDI tends to cluster in sectors controlled by elite political factions, such as telecommunications or security, thereby excluding marginalized populations. This elite capture of investment not only limits employment creation but can reinforce regional disparities.

The quality of governance plays a mediating role in all these variables. Beyene, (2024), using a dynamic panel model across Sub-Saharan Africa, finds that countries with higher governance scores experience more effective conversion of both public spending and FDI into employment. Poor governance not only distorts these inputs but breaks the feedback loop necessary for sustainable labor market growth. In Somalia, low rule-of-law ratings and lack of bureaucratic accountability mean that both domestic and foreign investments are largely disconnected from broad-based employment initiatives.

Education and human capital development critical for meaningful employment are also undermined by corruption and instability. Khan and Farooq (2019) show that weak governance in the education sector leads to skill mismatches and poor employability, especially among youth.

Leadership and institutional coherence are also central to reform. Suleiman (2025) shows that political will and meritocratic governance are essential to translate macroeconomic growth into job creation. In Somalia, fragmented leadership, coupled with frequent changes in administrative personnel, prevents continuity in employment policy. This finding resonates with Okara (2023), who shows that political stability and investment predictability are essential precursors to employment expansion, even in volatile markets. This suggests that reforms focused solely on macroeconomic stability, without improving governance, will have limited labor market impact.

Demographic pressures and digital transformation are increasingly recognized as critical variables influencing unemployment dynamics. While many nations continue to grapple with structural labor market challenges, youth unemployment remains particularly acute. Shaped by factors such as rapid technological advancement, limited access to education, domestic responsibilities, health constraints, and insufficient job creation, youth unemployment poses a significant risk of evolving into a persistent economic challenge if not addressed through timely and targeted interventions (Başol et al., 2023).

Terrorism and structural violence add an additional burden on labor markets. Kefait et al. (2025) confirm that terrorist activity depresses employment by destroying infrastructure, increasing capital risk, and forcing labor mobility. In Somalia, Al-Shabaab attacks not only reduce physical security but redirect public spending toward military rather than employment-generating sectors. These attacks also impair logistical networks critical for agriculture and retail sectors both major informal employment channels thereby reinforcing urban unemployment and deepening regional inequalities.

The literature converges on a consensus: corruption and political instability are not peripheral concerns but core institutional variables that interact with government expenditure, FDI, and governance to shape unemployment. When these institutional pathologies persist, even well-intended employment policies are rendered ineffective. Sustainable job creation in Somalia will require more than technical reforms it necessitates deep political transformation, institutional accountability, and a recalibration of governance priorities toward inclusivity, transparency, and service delivery.

3. METHODOLOGY

This study utilizes the Autoregressive Distributed Lag (ARDL) model, originally introduced by (Pesaran et al., 2001), to examine the short-term and long-term relationship between corruption control and unemployment reduction in Somalia. The model's functional form is derived using the following standard methodological approach:

$$UE = f\,(CRP, GEX, GDP, POP) \tag{1}$$

Where:

- UE_t: Represents unemployment.
- CRP_t: Represents corruption control.
- GEX_t: Represents government expenditure.
- GDP_t: Represents economic development.
- POP_t: Represents population growth.

The variables in the initial functional form (Equation 1) have been transformed into their log-linear (LN) forms. This logarithmic transformation allows for the interpretation of both short-run and long-run elasticities. Converting all variables into logarithmic form enhances the model's robustness by addressing potential issues such as non-normality, heteroskedasticity, and incorrect functional specification.

$$lnUE = \beta_0 + \beta_1 lnCRP_t + \beta_2 lnGEX_t + \beta_3 lnGDP_t + \beta_4 lnPOP_t + \varepsilon_t \tag{2}$$

Therefore, the RDL model is specified as follows:

$$\Delta lnUE_t = \alpha_0 + \beta_1 lnUE_t + \beta_2 lnCRP_t + \beta_3 lnGEX_t + \beta_4 lnGDP_t + \beta_5 lnPOP_t + \sum_t^q \Delta\alpha_1 + lnUE_t + \sum_t^\rho \Delta\alpha_2 lnCRP_t + \sum_t^\rho \Delta\alpha_3 lnGEX_t + \sum_t^\rho \Delta\alpha_4 lnGDP_t + \sum_t^\rho \Delta\alpha_5 lnPOP_t + \varepsilon_t \tag{3}$$

The symbol Δ represents the first-difference operator, where β indicates the optimal lag length for the independent variables, and α represents the optimal lag length for the dependent variable. To determine whether a long run cointegration relationship exists among the variables, the study applies the bounds testing approach. The null hypothesis is defined as:
H_0: $\beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = 0$,

This implies that there is no long run cointegration among the variables.

The alternative hypothesis is:
H_1: $\beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 \neq \beta_5 \neq 0$,

This suggests the existence of a long-term cointegrated relationship between the variables.

To evaluate these hypotheses, the F-Wald test is conducted. The calculated F-statistics are compared to the critical values at the 5% significance level. If the F-statistics exceed the upper bound of the critical values, the null hypothesis is rejected, confirming the existence of cointegration. If it falls below the lower bound, the null cannot be rejected.

Furthermore, the study utilizes the error correction model (ECM) to analyze both the long-run equilibrium relationships and the short-run dynamics among the variables. The corresponding model specification is presented as follows:

$$\Delta lnUE_t = \sum_t^q \Delta\beta_1 lnUE_t + \sum_t^\rho \Delta\beta_2 lnCRP_t + \sum_t^\rho \Delta\beta_3 lnGEX_t + \sum_t^\rho \Delta\beta_4 lnGDP_t + \sum_t^\rho \Delta\beta_5 lnPOP_t + \ddot{o}ECT_t + \varepsilon_t \quad (4)$$

This study utilizes annual data covering the period from 1996 to 2023. A summary of the variables and their respective data sources is presented in Table 1.

4. RESULTS AND DISCUSSIONS

4.1. Unit Root Test

The results of the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests conducted in this study are reported in Table 2. These tests provided crucial insights into the stationarity properties of the variables included in the model. The analysis was performed under four specifications: Intercept, intercept and trend, level, and first difference.

Table 1: Data sources

Code	Variable	PROXY	Source
UE	Unemployment	Total (% of total labor force)	WDI
CRP	Corruption control	Control of corruption: Estimate	WDI
GEX	Government expenditure	(Constant 2015 US$)	WDI
GDP	Economic growth	GDP per capita (constant 2015 US$)	WDI
POP	Population growth	Gross fixed capital formation (constant)	WDI

WDI: World development indicators

Under the intercept specification, the variables LNGEX, LNGDP, and LNPOP exhibited unit roots at level, indicating non-stationarity. Conversely, LNUE and LNCPR were found to be stationary at both level and first difference, suggesting they are not affected by unit roots. When applying the intercept and trend specification, all variables achieved stationarity at first difference, confirming that differencing effectively eliminated the unit roots. These findings indicate that the dataset includes a combination of stationary and non-stationary variables, justifying the use of the ARDL (Autoregressive Distributed Lag) model for cointegration analysis.

4.2. Cointegration Analysis

To verify the presence of a long-run relationship within the ARDL framework, a cointegration test based on the F-statistics was performed. As presented in Table 3, the bounds test yielded an F-statistic value of 9.110275, which is statistically significant at the 1% level. This indicates strong evidence of a long-run association among the variables, leading to the rejection of the null hypothesis in favor of the alternative.

4.3. Diagnostic Test

Following the estimation, several diagnostic tests were performed to ensure the robustness of the model. Table 4 confirms that the model does not suffer from serial correlation, non-normality, or heteroscedasticity. All diagnostic test P-values exceed the 10% significance threshold, supporting the adequacy of the model specification.

4.4. ARDL Long Run and Short Run Analysis

The key findings are summarized in Table 5, which outlines both the long-term and short-term elasticities of the explanatory variables and their influence on unemployment in Somalia. The long-run analysis indicates that LNGEX, LNGDP, and LNPOP have statistically significant impacts on unemployment, whereas LNCPR does not.

More specifically, the results reveal a statistically insignificant yet negative relationship between corruption control (LNCPR) and unemployment (LNUE) in Somalia, where a 1% improvement in LNCPR is associated with a 0.035% reduction in unemployment. This finding reflects the broader relationship between governance quality and labor market outcomes. Previous studies such as (2023) Triatmanto and Bawono (2023), Oueghlissi and Derbali (2024), and Bello et al. (2024) support this interpretation. Triatmanto and Bawono, (2023) demonstrated that corruption adversely affects employment and human capital in Indonesia, calling for institutional reforms and investment in human resources. Likewise, Oueghlissi and Derbali, (2024) emphasized that the effectiveness of democratization in combating corruption is amplified when unemployment is low. Bello et al. (2024) also identified a positive association between corruption and unemployment in Nigeria, highlighting how misallocation of public resources undermines labor market efficiency. While the Somalia-specific result lacks statistical significance, its

Table 2: Unit root test

Variable	ADF unit root test			
	Intercept		Intercept+Trend	
	Level	1st difference	Level	1st difference
LNUE	−2.947390*	−4.366218***	−2.968372	−3.674932**
LNCPR	−9.599665***	−5.396593***	−8.373299***	−4.944210***
LNGEX	0.505022	−0.524069	−0.595979	−22.09763***
LNGDP	−1.591841	−2.715696*	−2.668617	−3.301624*
LNPOP	−0.570020	−2.515495	−3.110710	−1.425527*
Variable	ADF unit root test			
	Intercept		Intercept+Trend	
	Level	1st difference	Level	1st difference
LNUE	−3.069785**	−4.352379***	−2.842353	−4.168347**
LNCPR	−9.587628***	−16.74322***	−8.364158***	−14.07822***
LNGEX	4.722242	−9.338150***	−0.871776	−4.501439***
LNGDP	−0.828900	−3.423784**	−1.303762	−3.553244*
LNPOP	−0.691929	−4.085939***	−10.83146***	−3.974587**

***, **, and * refer to the significant level at 1%, 5% and 10% respectively

Table 3: Bound F-test for cointegration

Model	Lag order	F-Statistics
UEM=f (CPR, GEX, GDP, POP)	(2,1,1,2,2)	9.110275
Critical value for F statistics	Lower I (0)	Upper I (1)
10%	1.9	3.01
5%	2.26	3.48
1%	3.07	4.44

Table 4: Diagnostic test

Diagnostic test	F-statistics	Probability
Breusch-Godfrey serial correlation	4.947886	0.1122
Heteroskedasticity	1.103285	0.5092
Jarque-Bera Normality Test	0.650233	0.722443
Reset test	3.063977	0.1549

Table 5: Autoregressive distributed lag long run and short run results

Variable	Coefficient	t-statistics
LNCPR	−0.035314	−1.237590
LNGEX	0.096493*	2.090331
LNGDP	−0.386709***	−3.882446
LNPOP	0.208292***	0.0001
Short run results		
D (LNCPR)	−0.021305	−4.829993**
D (LNGEX)	0.053033	5.312788***
D (LNGDP)	0.127114	7.587130***
D (LNPOP)	−0.253878	−3.913168**
CointEq(−1)	−0.428072	−9.0054968***

***, **, and *refer to the significance level at 1%, 5% and 10% respectively

directional alignment with previous research affirms the general consensus on the detrimental effects of corruption on employment.

In addition, the analysis confirms an inverse relationship between economic development (LNGDP) and unemployment. A 1% increase in LNGDP results in a statistically significant 0.386% reduction in unemployment at the 1% level. This is consistent with Okun's Law, which posits a strong inverse relationship between GDP growth and unemployment. Studies by Chen (2022), Han Ang (2022); Hjazeen et al. (2021) and Hjazeen et al. (2021) provide

Table 6: Fully modified least squares

Variable	Coefficient	t-statistics
LNCPR	−0.066113**	−2.160136
LNGEX	−0.032002	−2.231183
LNGDP	−0.10612***	−3.419183
LNPOP	0.257821***	37.26872

***, **, and *refer to the significant level at 1%, 5% and 10% respectively

further empirical support for this relationship.

On the other hand, government expenditure (LNGEX) and population growth (LNPOP) are found to be positively associated with unemployment. A 1% increase in LNGEX is linked to a 0.096% rise in the unemployment rate. This result is in line with findings by Abouelfarag and Qutb (2021), who argued that both discretionary and non-discretionary public spending can elevate long-term unemployment, especially due to inefficiencies in government wage structures and subsidies. Likewise, a 1% increase in LNPOP contributes to a 0.20% increase in unemployment, corroborating the conclusions of (Ali et al., 2021) and Rabiu et al. (2019).

Short-run dynamics, presented in Table 5, reveal that LNCPR maintains a negative and statistically significant relationship with LNUE. A 1% increase in LNCPR results in a 0.021% decrease in unemployment, albeit slightly smaller than the long-run estimate. Notably, population growth (LNPOP) in the short run also shows a negative and significant effect on unemployment. In contrast, LNGEX and LNGDP display positive short-run relationships with LNUE, suggesting that, in the short term, increased government spending and economic activity may temporarily raise unemployment by 0.053% and 0.127%, respectively. The error correction term (ECT) is negative and statistically significant, indicating that deviations from long-run equilibrium are corrected over time. This reinforces the reliability and practical applicability of the model's policy implications.

4.5. Robust Analysis

The study employed the Fully Modified Least Squares (FMOLS) method to validate the long-run estimates derived from the ARDL approach and to avoid potential misinterpretations that could result from relying solely on a single estimation technique. As shown in Table 6, variables such as control of corruption and GDP demonstrated statistically significant effects on unemployment reduction in Somalia. These results align with earlier long-term studies, thereby reinforcing the reliability of the findings. In conclusion, the FMOLS outcomes support and confirm the long-run predictions of the ARDL model.

5. CONCLUSION AND POLICY RECOMMENDATIONS

Governance is the management of a nation's economic and social resources, involving governments in planning, creating, and implementing policies. It involves empowering citizens to express their interests, exercise their rights, fulfill obligations, and seek resolutions for problems. An anti-corruption body is crucial for national governments, especially in developing nations, as it affects foreign investment inflow and makes high-corruption countries less competitive in attracting international investment. Corruption in sub-Saharan Africa is a significant issue, affecting economic growth, political stability, skill acquisition, and entrepreneurial endeavors. It transfers resources from infrastructure, education, and healthcare, creating a negative environment for firms, deterring investment, and erodes public trust. Five out of the top 10 countries with high corruption levels are located in Africa, affecting young individuals' access to quality education and training, increasing youth unemployment rates, and reducing their appeal to employers. Corruption contributes to a significant portion of Africa's GDP, putting an annual economic burden of around $1.26 trillion on developing nations. Somalia, with its inexperienced institutions, poor law enforcement, chronic poverty, and clan-based political culture, faces significant corruption rewards, particularly in weaker nations. The country's political and economic instability is further exacerbated by civil war, governance issues, and state institutional breakdown.

The findings revealed that LNGEX, LNGDP, and LNPOP significantly impact unemployment, while LNCPR does not. In Somalia, a 1% improvement in LNCPR leads to a 0.035% reduction in unemployment. This suggests a broader relationship between governance quality and labor market outcomes. Previous studies, such as Triatmanto and Bawono (2023), Oueghlissi and Derbali (2024), and Bello et al. (2024), support this interpretation. These studies show that corruption negatively affects employment and human capital, highlighting the need for institutional reforms and investment in human resources. The Somalia-specific result aligns with previous research, affirming the detrimental effects of corruption on employment.

The study outlines several crucial policy recommendations for the Somali government to address the intertwined challenges of corruption and youth unemployment. First, enhancing institutional quality and governance is essential, as weak institutions and ineffective leadership are strongly associated with elevated corruption levels and hinder both economic growth and job creation. To address this, anti-corruption efforts must be reinforced through comprehensive strategies that also promote political stability, government efficiency, transparency, and accountability. In addition, increasing the digitalization of the economy can play a transformative role by fostering transparency in governance and generating inclusive digital employment opportunities for young people. Sustainable job creation must also be central to any economic development strategy, particularly to address the widespread issue of graduate unemployment, which is a key contributor to Somalia's broader socio-economic crisis. Finally, the adoption of an Import Substitution Industrialization (ISI) strategy is recommended to stimulate domestic manufacturing, reduce reliance on imports, and create employment for both skilled and unskilled workers. To make this effective, the government should identify and develop strategic sectors that can drive industrial productivity and support broader economic expansion.

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