

INVESTING IN STABILITY: THE CASE FOR SOMALIA

a One Earth Future **POLICY BRIEF**



Policy Implications:

- ▶ **Investors to Somalia should use lessons learned from countries neighboring Somalia as a constant point of reference.**
- ▶ **Investors should factor in the risks, including those of policy reversals.**
- ▶ **Openness to trade promotes FDI.**
- ▶ **FDI in the region has predominately tended to be resource-based, with undesired effects.**
- ▶ **Diaspora remittances continue to be an untapped resource.**

Whether and how foreign direct investment (FDI) is linked to stability in a country dealing with conflict and underdevelopment.

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RESEARCH BACKGROUND

Research by Victor Odundo Owuor published as “Investing in Stability: The Case for Somalia” in the *Business, Peace and Sustainable Development* journal analyzes whether and how foreign direct investment (FDI) is linked to stability in a country ravaged by conflict and underdevelopment. The analysis is largely tied to the experience of sub-Saharan Africa with particular reference to Somalia. Motivating this analysis is the continued and growing interest in bringing investments and jobs to Somalia as part of international stabilization efforts. The research attempts to add clarity to the proposed link between foreign direct investment and stability by providing the audience of those likely to invest in Somalia with an informed and balanced discussion of planned intervention.



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Cover: Somali businesses, photos by Shuraako

RESEARCH SUMMARY AND POLICY RECOMMENDATIONS

The research includes four specific analyses. The first is a synopsis of present-day Somalia with particular reference to its fragility as a state. Second, dominant empirical findings from an extensive review of literature linking investment to economic growth, political stability, and investment return are reviewed. Third, the analysis documents the best practices found in the research for investing in contexts similar to Somalia. Finally, the policy implications for these research findings are discussed.

This research indicates the following relationships:

- The quality of environment has a significant role in how FDI affects economic growth. The extent to which FDI contributes to growth depends on the economic and social conditions of the host countries. For sub-Saharan Africa, the quality of environment is specifically tied to the rate of savings, the level of critical infrastructure, and the degree of openness to trade.
- FDI in the extractive industries portrays a low level of growth effects. This is especially the case when compared to other industries. This observation is particularly evident in oil, where the bulk of FDI to the region is concentrated.
- FDI in the form of diaspora remittances is positively related to economic growth. Diaspora remittances to the region can be viewed as a “magic lamp” and continue to positively affect economic growth.
- FDI in critical infrastructure has positive economic growth effects. Critical infrastructure for Somalia includes physical assets (buildings, ports, bridges, and highways), financial systems, telecommunications, and education and other forms of human capital.
- The spillover effects of FDIs are exhibited through productivity and technological transfers. FDI in sub-Saharan Africa affects growth in host countries through increased capital accumulation as well as improved efficiency for local companies as a result of contract and demonstration effects. These spillover effects are sector-specific and apply to varying degrees for all the main entry schemes: green-field, joint venture, and franchise business models.
- FDI in the form of “infrastructure privatization” can lead to legal and political conflict. The recurrent problems in the Niger Delta region as well as the experiences of transnational companies with concessions to vast quantities of natural resources in the Central African Republic are apt demonstrations of these conflicts.
- FDI will go to countries that pay a higher return on capital, if other conditions are held constant (as long as an appropriate measure for the return is available). Continued flow of the FDI will then only occur if there are no government policy reversals on the initial investments. Policy reversals have led to the stalling of mining booms in sub-Saharan African states and other countries with ample mineral wealth, such as Mongolia.
- FDI into fragile states and other countries coming out of conflict is less likely to be market-seeking. Market-seeking FDI, unlike non-market-seeking FDI, seeks to serve the host country for goods produced and sold in the host country. Slightly less than half of the sub-Saharan countries receive FDIs that are non-market-seeking because most investments are in the extractives.



divi/Golis Solar company, photo by Shuraako

The research for this study has also shown that the notable recent Somalia business-related developments where these relationships may be applied include the following facts:

- Somalia, a country of 11 million, is an untapped resource and sits at the nexus of a major sea traffic route. The country has almost 2,000 miles of coastline with varied and abundant fish stock.
- Substantial coal, oil, and gas discoveries in the country have recently been documented.
- Despite more than two decades of civil war, the Somali people remain a resourceful group. The market economy is clearly in evidence and the Somali people have an active civil society in most parts of South-Central Somalia, Puntland, and Somaliland.
- The country has managed to build one of the African continent's best mobile telephone and money-transfer systems in spite of not having a fully functioning Central Bank or a well-established legal system.
- Even though the gains made in the country after recent political changes are tenuous, many of the diaspora are returning, bringing with them substantial liquidity, which is most evident in the building boom partly driving the growth of the cities of Hargeisa, Berbera, Bosaso, Garowe, and Mogadishu.
- Some multinational organizations are already on the ground. Coca-Cola has made a return to the country by opening a production plant in Hargeisa after an absence of nearly a quarter of a century.
- The country has regained funding approval from multilateral institutions such as the International Monetary Fund and the African Development Bank.

POLICY RECOMMENDATIONS FOR INSTITUTIONAL INVESTORS TO SOMALIA

Based on the above findings, the following policy implications are evident:

Investors to Somalia should use lessons learned from countries neighboring Somalia as a constant point of reference. Countries in sub-Saharan Africa have on average received less FDI than other regions have because of an adverse regional effect. This is even more the case for Somalia, which has had a difficult history. Investment decisions for the country should be guided by regional experiences—Kenya and Ethiopia being the most prominent.

Investors should factor in the risks, including those of policy reversals. A higher return on investment does not necessarily promote FDI because of the perceived risks. An institutional investor would have to address the factors that aggravate the risk environment in Somalia, such as the risk of policy reversal.

Openness to trade promotes FDI, and those semi-autonomous regions in Somalia that exhibit this trait will be seen as more investment-friendly.

FDI in the region has predominately tended to be resource-based, with undesired effects. As a consequence of this imbalance, critical infrastructure, a necessary component for growth and job creation, has not been given sufficient attention. Sustainable FDI into Somalia is most likely if the intervention includes investment in critical infrastructure (physical assets, financial systems, telecommunications, and human capital).

Diaspora remittances continue to be an untapped resource. The growing funds provide all forms of possibilities for investments, including mutual funds, insurance schemes, and establishments suitable for the stock market.

One Earth Future (OEF) is a private foundation founded to help catalyze systems that identify and eliminate the root causes of war. OEF is committed to improving governance structures by acting at the intersection of theory and practice, helping stakeholders solve specific problems in real time, contributing to research literature, and working to detect patterns and lessons about governance as they emerge. Instilled within OEF's work are values of excellence, empiricism, long-term thinking, and active stakeholder engagement.

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ONE EARTH FUTURE FOUNDATION

525 Zang Street

Broomfield, CO 80021 USA

www.oneearthfuture.org