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FDI in Somaliland: A Vehicle for Peacebuilding or a Source of Social Inequality?

Kadidja Said

Executive Summary

The Republic of Somaliland, has not yet acquired a de jure recognition from the outside world since May 18, 1991 when Somaliland decided to withdraw from the 1960 union with Somalia. Since then, Somaliland has been stable compared to the other parts of the region and its contribution to the security and stability in the region is also amicable. However, the world has been reluctant to provide Somaliland with the assistance Tit deserves and this tells us much about the faults of the international politics and hypocrite nature of the international system.

Lack of recognition and qualification for foreign direct investment made the post-conflict state institutions fragile and prevented the economy from flourishing. Although Somaliland has managed to build its institutions without international engagement and involvement, on the other hand, the ineffectiveness of the political and social institutions are an outcome of the absence of effective policies and a strong economy necessary to help state institutions thrive.

Apparently, the foreign direct investments coming to the less developed countries have multiple purposes. However, it has a positive impact on the economic and social infrastructures necessary for the development of any country. Somaliland is in a dire straits to get foreign investments to overcome the challenges it facing since 1991. These investments can take the opportunity by bringing economic opportunities to Somaliland so as to create jobs for the unemployed youth in the country. Indeed, reducing the high rate of unemployment in Somaliland and creating job opportunities for unemployed youth is necessary. Also, social infrastructures such as health and education facilities which inadequately resourced should be improved.

Despite lacking international recognition, Somaliland has dealt with international companies and foreign governments for economic and political purposes. But, getting recognition will not solve and answer the social and economic problems faced by Somaliland. However, this needs rethinking and reformulating the state policies and strategies, for example, create legal and political framework necessary to qualify for foreign direct investments and design forms of cooperation with the international actors. Not only the international actors, but also creating positive public posture within the state citizens and distribution of the state resources among the citizens can strengthen the social contract and cohesion.

Also, inclusive political institutions are necessary for states to develop. Such institutions provide confidence for people (both within the state and without) to invest in themselves and in businesses. Such investments hire people and create the tax revenues necessary to build state infrastructure. Therefore, making Somaliland effective, inclusive and transparent state, and developing clear and coherent investment policies and strategies might place Somaliland more prominently in the frontline to qualify for investment, and may attract more attention from foreign investors who interested to come and invest this country.

Therefore, there are a number of issues that need particular attention from the Government and expected to work on it and make this journey fruitful:

1. The Government of Somaliland should work on making state institutions more effective, efficient, transparent and reliable.
2. The Government of Somaliland should open the market space to all citizens, and also advocate the issue of fair and free market economy, where the rights of poor weak and minorities are respected.
3. Creating legal frameworks and effective institutions to govern businesses both local and international and accept a high number of FDI without threatening the fragile peace and the existing balance of the country is necessary.
4. Developing or implementing inclusive policies that could seem important and necessary for the development of the state are also important. Those policies will make the state inclusive,

transparent, stable, and representative of the citizens' interests.

Introduction

Economic growth is important for every country, but it is especially crucial for post-conflict countries needing peacebuilding, recovery, and reconstruction. Since the declaration of independence in 1991 from Somalia, the Republic of Somaliland has been peaceful and has undergone a significant political and economic transformation. In 2002, Somaliland transitioned from a clan-based system to multi-party democracy after a referendum. Still, the country kept some of its traditions by formalising the Guurti as an Upper House of Elders, which ensures the support of traditional clan-based power structures[1]. Thus, the country secured a stable peace and democratic system of politics by merging modern and traditional elements[2]. According to Freedom House's political rights and civil liberty rankings, Somaliland has a score of 42/100 and is the only one ranked as "partly free" in the Horn of Africa[3].

Despite not having international recognition, Somaliland is making notable progress in promoting peace and democracy compared to its neighbouring countries. However, the country is still facing challenges, and peace remains fragile. One challenge is that the country has no major economic development with serious unemployment rates and education issues. Many people consider that economic development will be a solution to these challenges and lead to sustainable peace. Foreign Direct Investment (FDI) can be an important tool to rebuild infrastructures and industries and be a cure for unemployment by generating more economic growth.

FDI is defined as international investment by an entity resident in one economy, in the business of an enterprise resident in another economy that is made to obtain a lasting interest[4]. FDI is an international movement of capital carried out by foreign investors in a country to create or develop a subsidiary. FDI also allows foreign investors to acquire a local company. More research needs to be conducted on the role that FDI plays in promoting and consolidating peace in a post-conflict country, with fewer insights on whether or not FDI can lead to sustainable peace or if it will fuel further conflicts. While FDI may remediate unemployment by creating new jobs and increasing standards of living, it can also create other problems and destabilise the fragile peace in place.

FDI: A FACTOR OF PEACEBUILDING

The attraction of FDI can lead to the economic development of a country, through the improvement of economic conditions, favouring the establishment of sustainable and durable peace. The current economic state of Somaliland is stagnated and needs FDI to boost the prospects of the country.

The Current Economic State of Somaliland

After a conflict, the reconstruction and development of institutional infrastructure are crucial goals. Thereby, foreign aid and FDI are the main development sources for most post-conflict countries[5]. However, in the case of Somaliland, the country has limited access to international financial aid due to the lack of international recognition. Instead, it has heavily relied on a locally mobilised budget that fluctuated around 20 and 40 million dollars between 1999 and 2007[6]. In 2010, this budget[7] was at 61 million dollars and rose significantly in 2020 to 331.5 million dollars[8].

The country received and still receives little aid from international NGOs and aid agencies with minimal and inconsequential impacts. Thus, the private sector played a vital role in the recovery of the country's economy after the conflict ended, with the government being unable to carry out its basic functions[9]. According to a report by the World Bank, the government's contribution to the country's gross domestic product (GDP) is only around 10%[10]. Somaliland's major industries are privately owned businesses, where key industries are telecommunication, livestock and remittances. As a result, the country's economy is private-sector-led and faces little to no regulations[11].

Somali-owned multinational corporations (MNCs) and large and medium businesses have a huge influence on the Somaliland economy and state formation. Those businesses are clan-based and play an essential role in supporting the stability of the country[12]. They are usually involved in resolving disputes and disagreements in political and investment related issues[13], also participating in building infrastructure in the country and supplying relief during droughts[14].

However, this situation created a status quo that only benefits a handful of powerful local businesses and closes the market for foreign investors. These businesses do not want powerful state institutions that could control their profits, leading to a stagnation in economic growth. Somaliland's economy lacks diversification. Most products in the country are imported and not produced in place. The stagnation of the economy and the de facto protectionism created by the lack of regulations in turn is fuelling unemployment. Somaliland has one of the highest rates of unemployment and a high level of illiteracy. Another contributing factor to the high level of unemployment can be attributed to the phenomenon known as "brain drain"; when most of qualified professionals go abroad to live and work[15].

In 2012, Somaliland had the fourth-lowest GDP per capita in the world after the Democratic Republic of Congo, Malawi, and Burundi[16]. There is also a high-income gap between the rich wealthy and the poor weak, creating a fragile environment for peace in a region already at risk.

For developing countries and emerging economies, FDI has become an increasingly important source of economic development, modernization, and income growth and can also reduce unemployment[17]. In the case of Somaliland, attracting more FDI could be beneficial in the long term by solving some of the challenges that weaken the fragile peace, and thus create a favourable environment for sustainable peace.

Benefits of FDI in Somaliland

FDI is very scarce in Somaliland due to its location in a high-risk environment and need for international recognition. There are only a few multinational corporations operating in the country such as Mott McDonald, Western Union, and Coca-Cola. These MNCs (Multinational Corporations) are present under special arrangements with the State or local entrepreneurs[18].

This type of investment allows the host country to expand its market and develop new marketing channels, and cheaper production facilities but also to gain an access to new technologies and necessary skills to attract further investment[19]. Thus, FDI can provide stimulation for economic development. In the short term, opening the market for foreign investment will create a disadvantage for local companies since they will be out-competed. However, when MNCs invest in developing countries they bring new technologies, working practices, and know-hows such as international marketing that local companies can copy and adapt themselves to the increased competition. Moreover, the MNCs usually train and hire local employees who can then establish their own companies with the skills they have learnt[20]. This will lead to an improvement of local companies' standards, product quality and labour standards[21]. In addition to improving the labour standards and allowing local employees to obtain new skills, foreign companies can also help reduce the unemployment rate of the host country. For instance, local employees can move from foreign to domestic firms and increase their productivity[22].

Besides improving product quality, labour standards and local companies, FDI plays a huge role in the restoration and construction of infrastructure that did not exist before due to insufficient funds or a lack of security to provide for maintenance[23]. Somaliland's infrastructure was already subpar prior to the civil war and withdrawal of the 1960 union with Somalia. Therefore, FDI can provide a critical boost to the existing infrastructure. For instance, Mozambique has been rebuilt itself since welcoming foreign investors and FDI, leading to substantial infrastructure restoration and expansion projects[24].

International partners and foreign investors are a significant source of infrastructure financing. They can contribute to local transport and communications infrastructure as part of their operation; for example, by building roads to better service their businesses. Sometimes, these foreign investors can contribute to the construction of infrastructure beneficial to all after signing an agreement with the government. Instances of these can be found in many African countries that have signed with Chinese companies, resulting in developed transport communication and roads[25]. Though the intentions of foreign investors participating in the improvement of infrastructure are in their own favour, businesses in the host countries can prosper from the updated systems which will foster opportunities for the local populace.

Another benefit of FDI and the presence of MNCs is the positive imagery that will showcase a readiness for international cooperation, attracting other investors and members of the diaspora that can contribute positively to the country's growth. In the long term, Somaliland would be seen as a country "open for business" and where everyone could benefit by investing in this territory.

This openness for foreign investment will contribute to consolidate peace and stability in the region. In fact, FDI plays a major role in strengthening peace in a country when the benefits are distributed equally in the country and to every citizen.

FDI and its Role in Peacebuilding

Various studies have shown that FDI can help promote peace. According to proponents, investment is a vital component of globalization and economic interdependence and by bringing economic development it promotes democracy and reduces conflict[26]. Another main argument that supports this theory is that increasing the price of foreign capital is related to the reduced likelihood of civil conflict; where scarcity of capital can lead to conflicts and political unrest. The introduction of foreign capital in the country can decrease these types of problems. Overall, the presence of FDI decreases the probability of instability and increases the stability and development of the country[27]. Moreover, studies and history have showcased that war and conflicts are unlikely between close economic partners. However, there is an equally important, and for some, a far greater series of questions to consider, for example, what is Somaliland's benefits and dilemmas associated with if Somaliland attracts FDI from neighbouring countries? Could this erase the possibility of a future conflict and strengthen their diplomatic ties? Answering these questions requires a commitment and further studies from economic, political, security and social perspectives.

Not all studies agree that FDI has an important role to play in peacebuilding with minimal thorough investigations into this exact topic. Some studies argue that there is no significant correlation between FDI and peacebuilding since foreign investors rarely invest or participate in the businesses of a war-torn country unless they are investing in the extractive sector[28]. The World Investment Report of 2010 found that despite the high levels of conflicts and fragility, the sectors of extraction and telecommunication were able to draw a high amount of FDI[29].

FDI can take two forms, Greenfield Investment, and Mergers and Acquisitions (M&A). A Greenfield investment is a type of market entry that involves the establishment of a new company, facility, or factory in the host country. It is commonly used when a company seeks to gain complete control over its activities in foreign markets. On the other hand, M&A can result in the acquisition of a local company by a foreign investor, or a merger that combines the two companies with ownership shared between the foreign investors and the local company[30]. The term Greenfield investment originates from the concept that a MNC creates a new venture from the ground up by preparing a green field.

Greenfield investment involves building everything from scratch and giving foreign investors the highest control over the facilities and the business in the host country. This type of investment is a strategy commonly used to expand businesses abroad and it has a direct effect on the host country's employment rate. Greenfield investment requires the employment of local workers and adaptation to the host country's institutional environment[31].

Compared to Greenfield Investment, Mergers and Acquisitions do not contribute to expanding the host country's capital stock as they either take over or go into partnership with a company that is already existing[32]. It can therefore be concluded that Greenfield investment will have a stronger impact on the economic growth of the host country, directly increasing the employment rate and benefiting the local workforce[33]. This impact on employment rates will further contribute to peace, and more people will have decent work and pay, whether they are employed or self-employed contributing to the overall stability of society. Providing opportunities for people from all sectors of society helps minimize social immobility and exclusion, and maximises social mobility.

Through foreign investment, people have the opportunity to accumulate economic assets which they can in turn invest back into the economy. A higher rate of employment and social mobility within a society will result in an unwillingness and contradiction to participate in violence incited by politicians and others.

When people can earn enough to live with dignity and can enjoy fair treatment, they avoid conflict and work hard to keep the stability of their country. In the case of Somaliland, the population is very young. According to a 2020 report from the Somaliland Health and Demographic survey, 61% of the population is aged less than 20 years and 74% is aged less than 30 years[34]. To avoid violence and instability, it is important to focus on creating economic opportunities for young people[35]. FDI can create viable jobs for young people because employment opportunities are a key component to achieve sustainable peace and development in all countries, but especially in countries that have experienced violent conflicts. It has been suggested that a high rate of youth unemployment leads to higher rates of instability in countries in general, and thus creates a favourable ground for armed conflicts[36].

High unemployment rates are not the only contributing factor to instability but are usually cited heavily as causation when it is paired with socioeconomic inequalities and corruption. Inequalities are known to have a positive effect on political violence by increasing tensions among the youth. Economically, countries with good outcomes are less prone to experiencing armed conflict while democracy does not always imply stability[37]. Thus, flourishing economies are more likely to have favourable outcomes compared to countries focusing on democracy instead of economic development.

FDI can have a positive impact on economic conditions especially if the main objective of the laws of the host country is to improve their economy. At the same time, economic conditions can have a significant influence on instability and conflict recurrence. Post-conflict countries face harsh economic conditions that should be addressed in order to build a more sustainable peace. Even after the conflict ended a long time ago, these economies still experience various shocks such as capital flight and brain drain[38]. FDIs are a way to tackle these problems since it has a positive impact on the employment rate but also is a good method to fight against capital flight. Moreover, attracting FDI allows to have a strong currency and increases the population of the host country purchasing power.

Study shows that the link between peace and economic development is intuitive, it is certain that peace favours economic development but the latter strengthens peace. According to the World

Development Report 2011, the average cost of a civil war is equivalent to around 30 years of economic growth. It is believed that mutual trust and functional relationships grew from and were nourished historically by trade and economic development. That was the main reason that led to the settlement of the Bretton Woods Institutions and the creation of the European Iron and Steel Community which was established to promote peace between Germany and France[39]. This community was also designed to establish peace through economic linkages. FDI can also be a means to establish peace and contribute to peacebuilding not just in the host country but also with other countries.

However, FDI can also have the opposite effect and create instability in a country. Certainly, foreign investments create new jobs and increase the living standards of the host country but they can also lead to the exploitation of the benefits from investment through corrupted networks[40]. This issue is one of the most significant factors that can affect the development of post-conflict countries. Some suggest that investors in post-conflict countries should implement policies contributing to income equality and improving the living standards of the local population[41]. However, most investors in post-conflict countries are not concerned about corporate social responsibility and their main goal is to make profits. This suggests that the expectations of foreign investors to solve economic problems and contribute to the equal distribution of the benefits from the investment may not hold. In some host countries, FDI can be a source of destabilisation and disturb the existing balance, especially in the case of Somaliland.

FDI Destabilizing Factor

FDI presents some challenges and risks that could destabilise a country by increasing inequalities. In the case of Somaliland, FDI can disturb the existing balance of the country and lead to more tension but these challenges can be surmounted.

Challenges and Risks of FDI

While the attraction of FDI allows a country to improve its economic conditions, some studies show that FDI inflows can increase social inequality and trigger domestic conflicts[42]. Such disturbance may happen if FDI is going to benefit only a small number of people. The benefits of foreign investment can be captured easily by the government with a minimal spill-over to the region these investments are made. For example, foreign investment in natural resources does not need support from the locals by way of human capital, and the infrastructure they bring can be easily transferred out of the region. Moreover, the workers in these types of industries are usually low-skilled and poorly paid but also poorly treated. This is one of the reasons why investments in non-resource sectors should be encouraged. As mentioned before, foreign investment in sectors other than resources draws a lot of support from the region these investments are made. For instance, manufacturing, infrastructure, and services are some of the sectors that boost the region by investing in human resources and training potential workers[43].

Another risk associated with FDI is that it always creates winners and losers, and conflicts may emerge through this situation. Indeed, new conflicts arise due to the increasing inequality between the poor population and the elites that are supporting and participating in foreign investment. This can lead to the decrease of the legitimacy of the political elites since they are not working to find a way to resolve the inequalities created by these investments nor put in place social justice policies[44].

Another problem connected with FDI is inequalities between regions in the same country. Foreign investment may alleviate the inequalities in the local economy but it is important to note that the majority of investment is concentrated in industrial and urban areas mainly in big cities. Usually, because these places have the necessary infrastructure and skills to support the development of the businesses[45]. This can lead to strong inequalities between regions, feed conflicts and create insurgencies. Some regions may even ask for more autonomy or independence through armed conflict. In addition, developing countries experience large regional inequalities. Since peripheral regions are less populated than urban cities, they do not usually benefit from the improvement of living standards and incomes.

Therefore, insurgencies tend to occur in these areas and mobilisation takes place within local networks. Regional inequalities are more likely to be related to violent conflict than general social inequalities that affect disconnected individuals. These regional inequalities affect the same people, from the same place, so it is easier for them to unite and fight back. Usually, they are from the same ethnic background too which can make them feel like these inequalities are based on discrimination[46]. Some states tend to favour regions that are populated by their supporters or kin which can result in marked geographical differences. Regional income and economic inequalities are more likely to foster conflict than absolute poverty. According to various theories of relative deprivation, comparisons with those who have more wealth may inspire violent political mobilisation and radical action, especially in cases of discrimination and exploitation[47]. This kind of situation can be exploited by certain group leaders and conflicts entrepreneurs who can exaggerate and exploit these inequalities to achieve their own economic or political goals[48].

Foreign investment can also cause a political reaction from the local business community as it can put local entrepreneurs in a disadvantaged position. For a long time, local businesses did not have to share the market with foreign companies and investors, opening the country for foreign investment will make them lose profit in the short term and that could lead to some tensions. For example, this could be the case for Somaliland because most local businesses are not in favour of welcoming foreign companies.

Challenges for the Existing Balance of Somaliland

According to experts, the stability of Somaliland is due to its hybrid governance system and to its bottom-up peacebuilding approach. This system allows the participation of various actors including politicians, religious leaders and local businessmen. These actors have held each other accountable when peace is threatened with the support of the media and civil society[49]. Somaliland has a complicated political culture and weak institutional capacity which may allow foreign investors to influence the peace by undermining the power balance of local actors by bringing international interest[50]. This situation makes the local businessmen uneasy because if the number of foreign investors increases, their political and economic influence will decrease. This leads to the de facto protectionism of the Somaliland market which created a closed market that only a few powerful local businesses can operate in. This has prevented foreign companies and investors from accessing the country's financial market. For example, in 2016 a bill aimed at allowing foreign banks to enter in Somaliland was not passed due to the reticence of business and religious leaders[51].

Therefore, allowing FDI into countries may arise tensions if the local business community loses its influence and power. Instead of relying on formal governance methods, local power holders prefer to adopt informal approaches. In a clan-based society, people tend to trust the wealthy businessmen in their tribe to resolve problems that may happen. Moreover, when peace is at stake, these businessmen put their tribe and the state's interests after their interest[52]. However, the same behaviour cannot be expected from foreign investors. They will rarely put their interests after the host country's interests and focus more on their bottom line.

However, in the long run, the country should end its dependence on local businessmen and use formal governance methods to ensure the stability of the country. This can be made through the creation of a solid legal framework.

Surmountable Challenges

All these risks and challenges created by FDI can be overcome by the host country's government. The host country should put in place policies to surmount these challenges and attract the right type of FDI. These policies should aim to prevent the establishment of vulnerabilities and inequalities in the host country. Developing countries, especially post-conflict countries should focus on the quality of the investment instead of focusing on the size of the investment flows[53]. For example, in the case of Somaliland, it is important to open the market for foreign investors and improve the economic conditions but the state should put into place a legal framework or policy to filter this foreign investment.

Currently, many developing countries create a filter and screening mechanism of foreign investment. This is the case in Vietnam, which created a new filter to attract foreign investors with the necessary skills and resilience to ensure sustainable development and its national security[54]. In Vietnam, this new filter places emphasis an importance on FDI that will improve the efficiency of the labour force and create a transfer of technology from foreign companies to local companies. This filter allows FDI and foreign companies that meet its criterion to enjoy favourable investment conditions, especially if they are hiring highly skilled workers and funding research and development[55]. Somaliland can adopt the same method by screening foreign investment to avoid foreign companies exploiting their resources and creating inequalities. The filter permits the host country to choose between good and bad foreign investments.

To tackle inequalities caused by FDI, the host country can implement special programs and policies aimed at improving the lagging regions. For instance, China has launched several development programs to help the western part of the country that could not attract FDI[56]. These programs were a success; however, it is not clear how the same method can be replicated in other countries due to the power and varying instruments that the Chinese government uses to reallocate resources. Most developing countries do not have an effective government that can manage the negative effects of FDI on their citizens. In fact, a country with poor bureaucratic quality or an ineffective governance structure may not be able to address the factors that affect the distribution of wealth among its different regions[57]. Only a developing country with an effective and strong government can tackle the fallout created by the inequalities between regions.

Therefore, it is crucial that Somaliland takes the necessary steps to improve its government's capacity and integrity to stimulate the economic transformation of the country[58]. Presently, Somaliland experiences a lack of regulatory framework and effective finance and business policies that can negatively affect foreign investment. To put into place effective government policies and systems, to develop and implement efficient regulations and economic policies, Somaliland needs to increase its autonomy and capacity to be less dependent on influential local businessmen. However, the process of establishing an effective governance institutions will take time. This process requires the implementation of a coordinated, harmonized and transparent institutional framework and state decisions[59].

Indeed, the clan-based and consensus-based approaches worked well in maintaining and restoring peace and stability after the 1991 civil war[60]. However, in the current situation, these approaches can appear as an obstacle because they lack transparency and accountability, and they reinforce the dependence of the government on the business elite of the country. The country can only accept some type of FDI. Without the necessary legal frameworks and institutions to govern business, a high number of FDI cannot be accepted in the country without threatening the fragile peace and the existing balance of the country. The country needs to adopt a long term economic and social development strategy that will allow the creation of a conducive environment for economic growth and improvement of the local situation.

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About the Institute

THE INSTITUTE FOR PEACE AND CONFLICT STUDIES (IPCS) is a teaching and research center at the University of Hargeisa, Somaliland. It was established in 2008 by the University of Hargeisa and Eastern Mennonite University in the United States of America to provide a multidisciplinary approach to understanding and addressing conflict and violence in the Horn of Africa. The IPCS was the first Institute of its kind to engage in teaching and research in areas of peace and conflict studies, and remains the only one in the Somali-speaking region in the Horn of Africa. The Institute provides interested scholars, institute members, and students with the opportunity to engage in intensive interdisciplinary study and research on Somaliland and Somali-inhabited regions in the Horn of Africa.

About the Author

Kadidja Said is a Legal Professional at AQN International Law Firm, a law firm offering legal and professional business services from offices in Hargeisa, Somaliland, and London, UK. Ms. Kadidja previously worked for several prominent law firms in France and China. Ms. Kadidja has earned a Master's Degree in International and European Law, and another in Business Law from Aix-Marseille University in France. She also has a Bachelor's Degree in Law and Common Law from Lorraine University and a second Degree in Comparative Legal Studies from Aix-Marseille University. Ms. Said spent a semester studying at Maastricht University in the Netherlands and has a Comparative Chinese Law Degree from Southwest University of Political Science and Law in Chongqing, China. Ms. Kadidja is currently living in Hargeisa where she is working as Legal Associate at AQN International Law Firm.

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Institute for Peace and Conflict Studies
University of Hargeisa
+252 (0) 63 442 7156
+252 (0) 63 442 6417
info@instituteforpeace.org
www.instituteforpeace.org