Chapter 4
The Effect of Foreign Direct Investment Inflow on the Economic Growth in Somalia

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ABSTRACT

This study explores the impact of foreign direct investment (FDI) on the economic growth of Somalia in between 1998-2019. To estimate the economic growth model, the study applied the autoregressive distributed lag (ARDL) method. Findings from the study showed that the major drivers of economic growth in the long run are inward FDI, labor stock, domestic investment, and exports. In the short run, the growth drivers are the labor force stock, domestic investment and current FDI stock. It was determined that inflation did not have a significant effect on economic growth in Somalia.

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INTRODUCTION

In general, underdeveloped and developing states are not able to attain economic development only with the domestic capital like the developed states. Therefore, foreign direct investment (FDI) has become as one of the fundamental drivers of capital mobility and cross-border investments as well as one of the active means of economic growth in a host country. Furthermore, FDI could be termed as the direct investment equity flows in a recipient economy. It is the total of equity capital, reinvestment of earnings and other sorts of capital forms. FDI is a classification of cross-border investment related to a resident in one economy possessing control or an important degree of influence on the management of an organization which is a resident in another country. Having an ownership of 10% or more of the general shares of voting stock is the main criteria for determining the existence of a direct investment correlation. FDI shall be addressed as a formation of capital, technology, management and entrepreneurship which enables the operation of a firm in a non-domestic market. Many developing countries facilities and apply incentive policies to retain the international commerce and to amplify the volume of the foreign investments. Different elements that affect FDI have been commonly researched such as the country stability, the cost and the quality of the workforce as well as governance indicators to draw more FDI inflow. The size of the market, cost of labor, quality of infrastructure, economic stability, commercial openness, currency value and gross capital formation are principal determinants of FDI inflow. FDI should contribute directly and indirectly to the economic development of host countries by enabling the transfer of technological and organizational know-how, augment laborship, skill acquisition as well as the introduction of new managerial applications and firm arrangements Henceforth, the economic state of the recipient country are significant to the favorable effect of FDI on economic growth. Such conditions rest on the economic policies, adopted by governments. Government policies such as free market promotion, labor and capital market regulations as well as commercial liberalization and public investments related to infrastructure development are significant to accomplish economic growth (Benghoul & Aydın, 2019; Luu et al., 2017; Khalid & Marasaco, 2019).

Foreign direct investment refers to direct investment of equity flows to an economy. It is the accumulation of equity capital, reinvestment of earnings and other sorts of capital. Foreign direct investment could be termed as a set of investments in which a resident organization in one country constitutes a long-term interest in another organization outside of its country frontiers. FDI is a classification of cross-border investment related to a resident in one economy having control or an important degree of impact on the management of an organization which is resident in another country. Ownership of 10% or more of the ordinary stakes of voting

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