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HOW WAS THE EFFECT OF BILATERAL TRADE AND FOREIGN DIRECT INVESTMENT ON SOMALIA'S ECONOMIC GROWTH: ROLES OF TURKEY[1]

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ABSTRACT

The World Investment Report (2010) states that FDI stocks increased more quickly than exports and imports between 1990 and 2009, surpassing even the rise of intermediate goods exports/imports. Since the 1990s, there has been a sharp growth in regional trade agreements (RTAs)2, many of which have investment-related clauses, which has coincided with this sharp surge in FDI flows. Therefore, the primary goal of this research was to determine how foreign direct investment and bilateral trade affected Somalia's economic development. Turkish roles The data on bilateral trade, interest rates, government spending, exchange rates, gross domestic product, and terms of trade are taken from the Bank of Somalia, however the parameters for foreign direct investment are obtained from the Somalian ministry of planning and economic development. this study used time series analysis with quarterly observations from the first quarter of 2006 through the fourth quarter of 2020. The study further evaluated for causality, cointegration, and carried out other time series tests. According to the Granger causality test, bilateral trade has a positive impact on GDP even though foreign direct investment does not. However, bilateral trade and foreign direct investment both work together to boost the nation's economic growth. Despite the fact that the study's results indicated there is no correlation between GDP and foreign direct investment. To promote economic growth in the future, it is necessary to manage governmental spending, interest rates, exchange rates, and trade terms.

Keywords: Interest Rate, Foreign Direct Investment, Economic Growth, Bilateral Trade

İKİLİ TİCARET VE DOĞRUDAN YABANCI YATIRIMIN SOMALİ'NİN EKONOMİK BÜYÜMESİNE ETKİSİ: TÜRKİYE'NİN ROLLERİ

ÖZET

Dünya Yatırım Raporu (2010), DYY stoklarının 1990 ile 2009 yılları arasında ihracat ve ithalattan daha hızlı arttığını ve ara malı ihracat/ithalat artışını bile geride bıraktığını belirtmektedir. 1990'lardan bu yana, birçoğu yatırımla ilgili maddeler içeren bölgesel ticaret anlaşmalarında (RTA'lar)2 keskin bir büyüme olmuş ve bu DYY akışlarındaki bu keskin artışla aynı zamana denk gelmiştir. Bu nedenle, bu araştırmanın birincil amacı, doğrudan yabancı yatırım ve ikili ticaretin Somali'nin ekonomik kalkınmasını nasıl etkilediğini belirlemektir. Türkiye'nin rolleri İkili ticaret, faiz oranları, hükümet harcamaları, döviz kurları, gayri safi yurtiçi hasıla ve ticaret hadleri ile ilgili veriler Bank of Somali'den alınır, ancak doğrudan yabancı yatırım parametreleri Somali Planlama ve Ekonomi Bakanlığı'ndan alınmaktadır. Bu çalışma, 2006'nın ilk çeyreğinden 2020'nin dördüncü çeyreğine kadar olan üç aylık gözlemlerle zaman serisi analizini kullanılmıştır. Çalışma ayrıca nedensellik, eş bütünleşme açısından değerlendirdi ve başka zaman serisi testleri gerçekleştirilmiştir. Granger nedensellik testine göre, doğrudan yabancı yatırım olmasa da ikili ticaretin GSYİH üzerinde olumlu bir etkisi vardır. Bununla birlikte, ikili ticaret ve doğrudan yabancı yatırım, ülkenin ekonomik büyümesini artırmak için birlikte çalışmaktadır. Çalışmanın sonuçlarının GSYİH ile doğrudan yabancı yatırım arasında bir ilişki olmadığını göstermiştir. İkili ticaret ile doğrudan yabancı yatırım arasındaki eş bütünleşme farklı sonuçlar vermiştir. Gelecekte ekonomik büyümeyi desteklemek için hükümet harcamalarını, faiz oranlarını, döviz kurlarını ve ticaret şartlarını yönetmek gerekmektedir.

Anahtar Kelimeler: Faiz Oranı, Doğrudan Yabancı Yatırım, Ekonomik Büyüme, İkili Ticaret

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1. INTRODUCTION

Having a strong growth rate while maintaining a low and stable inflation rate is one of the primary goals for the majority of economies in the globe (Odongo, 2012). For many years, it has been an intriguing topic to discuss how bilateral trade and foreign direct investment affect economic growth. Trade and foreign direct investment have been essential to the development of the African economy, according to policymakers, who also feel that these two factors increase the productivity of host nations and promote growth. One of the most frequently highlighted aspects of globalization is the recent rapid expansion of trade and foreign direct investment (FDI) flows.

FDI stocks increased over five times as quickly as exports and imports between 1990 and 2009, outpacing even the growth of intermediate products exports/imports, according to the World Investment Report (2010). Since the 1990s, there has been a sharp rise in the quantity and importance of regional trade agreements (RTAs), many of which have investment-related clauses. These developments have coincided with the sharp rise in FDI flows. From the standpoint of any potential complementarity or substitution effects between trade and FDI, their relationship is examined. In the past, the horizontal FDI was thought of as an alternate method for businesses to internationalize based on the principle of multinational enterprises. Because of this, when nations wish to expand their economies, the substitution impact between trade and FDI takes precedence over complementarity.

It is widely acknowledged that foreign direct investment (FDI) is a key driver of economic growth in developing nations. Many academics have asserted that FDI flows bridge the gap between planned investments and domestically mobilized savings, boost tax income, generate employment opportunities, and enhance management and labor skills in host nations (Mensah et al., 2021). Furthermore, FDI improves the current account of the balance of payments (BOP) by increasing exports as a result of enhanced capacity and competitiveness of local production, which in turn breaks the cycle of underdevelopment (Papers, 2020).

One of the contentious topics in the development literature is the contribution of foreign direct investment (FDI) to the acceleration of economic growth. In the typical Solow type of growth model, foreign direct investment (FDI) enables host nations to attain investment that exceeds their own domestic saving and strengthens capital formation. This theory claims that the potential positive effect of FDI on output growth is limited to the short run. Given the falling marginal returns to physical capital in the long run, the recipient economy could reach its steady state growth rate as if FDI had never occurred, having no long-term effects on the expansion of the economy (Yeshineh, 2017).

2. LITERATURE REVIEW

This chapter offers a review of relevant literature on the impact of bilateral trade and foreign direct investment on economic growth. Both theoretical and empirical literature was included in the review of the literature. The chapter also looks at whether analogous research on the long-term and short-term effects of bilateral trade and foreign direct investment on economic growth have been conducted**.**

2.1 Foreign direct Investment and Economic growth

Numerous studies in this field have been attracted by the expanding discussion on the relationship between FDI and growth. Using data from 1998 to 2017 for 30 of the largest economies worldwide Researchers Benjamin Badeji and Olufunsho Abayomi (2011) examined how FDI influx impacts economic growth. The results of the econometric analysis demonstrated that there was a positively significant impact of FDI on economic growth

during the study period after controlling for factors like the consumer price index, trade openness, unemployment, gross fixed capital formation, and credit to the private sector. (Sukar & Ahmed, n.d.) utilised data on macroeconomic factors for the 12-year (1998–2010) period that they had collected from the European Bank of Reconstruction and Development (EBRD). Investigating how FDI affects the economy was the goal of the study.

Economists have developed a keen interest in studying the differences in FDI influx and economic growth between emerging nations. The effect of FDI on economic growth is the subject of a sizable collection of theoretical and empirical work. But there is a lack of consensus in the available data. Theoretically, FDI should be advantageous to the host nation through transferring resources (the so-called resource transfer effects), providing job opportunities (the employment effects), enhancing the balance of payments (the balance of payments effects), and transferring technology (technology effects). Researchers include (Mensah et al., 2021), among others, stress that FDI offers much-needed physical capital, new technology, managerial and marketing abilities and expertise, international best practices of doing business, as well as greater competition. These resources may have the potential to spread among domestic companies, spurring increased innovation and productivity. By directly creating new jobs and indirectly by increasing local spending as a result of the additional employees' increased use of products and services, FDI helps the local economy create more jobs.

Several theoretical defenses exist for why poor nations would not benefit from FDI, despite some of the data provided in recent research. As a result of the adverse selection problem, (Argiro, 2003) contends that the host countries may not always benefit from the transfer of control from domestic to international enterprises. The ownership of businesses may be transferred from local to foreign, less productive corporations, if FDI is carried out during a crisis under the "Fire Sale" clause. This issue is particularly crucial for developing nations, like those in the SSA, since state-owned industries are frequently sold to foreign companies during privatization simply because they have access to more funding than indigenous companies.

Argiro, noted that unfair rivalry between foreign enterprises and domestic ones might potentially "crowd out" domestic firms. There is also fear that the enclave-like nature of many foreign-owned businesses and their weak connections to the rest of the economy could decrease the potential contribution of spillovers to the national economy. The balance of payments may potentially worsen as a result of the probable future transfer of subsidiary earnings from overseas enterprises to their parent company. Furthermore, it is asserted that foreign businesses frequently engage in transfer pricing and develop improper items to appeal to the wealthy segment of the consumer base in the host nation.

Additionally, there is conflicting empirical data regarding the relationship between FDI and economic growth. In 2007, Khanq & Noy, substantiate FDI's beneficial benefits on economic growth. However, FDI does not always have a growth-enhancing effect; instead, it depends on several country-specific factors. According to (Benjamin Badeji & Olufunsho Abayomi, 2011), the benefit of FDI increases with a host country's degree of development. A higher degree of development enables nations to profit from the productivity boosted by foreign investment.

2.1.1 Trends of FDI inflow in Africa

in the 1980s, both the total amount and the percentage amount of foreign direct investment increased. Both foreign investors and recipient nations now widely spread it. From 3.5 billion dollars in 1970 to 16.2 billion dollars in 2002, the total amount of FDI into developing nations grew. The flow of international FDI into emerging nations is not evenly distributed. Inflows of FDI into Africa, Asia, and Latin America are depicted in Figure 1 as a trend. Starting from comparable levels in the 1970s, annual FDI inflow to Africa lagged substantially behind that of Asia and Latin America. In contrast to Asia, Latin America, and the Caribbean islands, which saw average FDI inflows of $1.6 billion, $3.3 billion, and $3.3 billion, respectively, in 1970, Africa saw an average FDI inflow of $1 billion. Africa received less money in the 1980s than Latin America and Asia combined, which was a striking contrast to Africa's stagnant income.

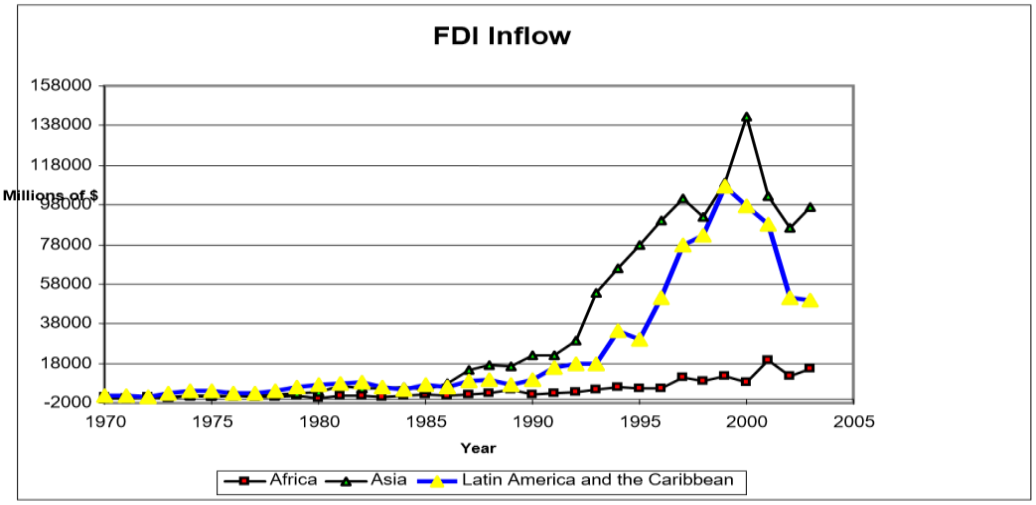


Figure 1.1: Trends In FDI Inflow Into Developing Regions

Although FDI inflows to Africa are modest in numerical terms, their economic impact is bigger than the absolute figure would imply. Between 2000 and 2003, the average proportion of FDI flows in gross domestic capital creation in Africa was 13.9 percent, compared to 11.1 percent and 16.8 percent for Asia and Latin America, respectively (Figure 2).

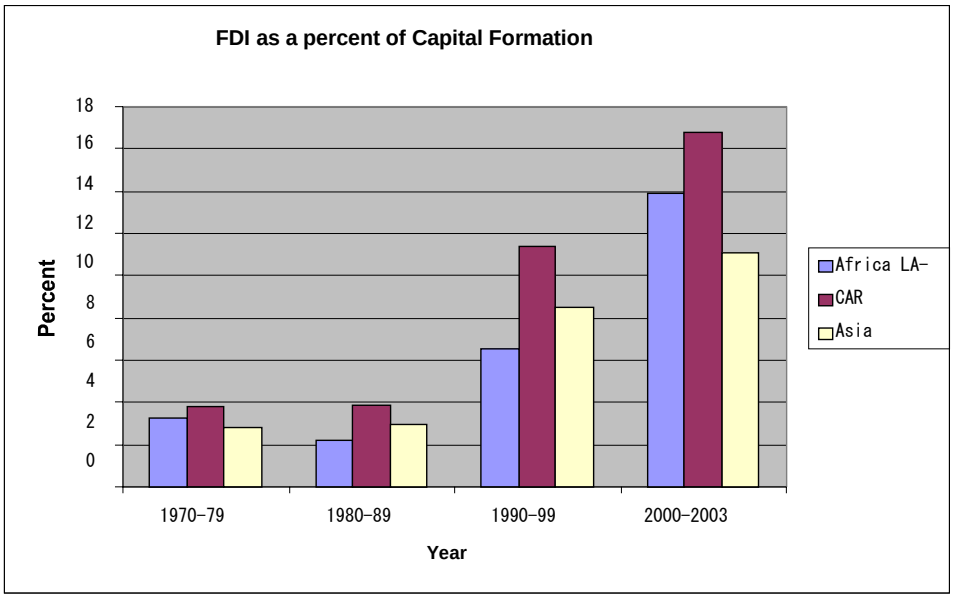


Figure 1.2: FDI As A Percent Of Gross Fixed Capital Formation

Many African political figures up until the 1980s had negative views about FDI and the growth of the private sector in general. There was widespread anxiety at the loss of authority over significant businesses, particularly if foreigners are engaged. Large-scale privatization initiatives did not start until the latter half of the 1990s. African governments resisted opening vital industries like banking, telecommunications, and energy even after privatization had begun. This hesitation probably hampered private investment. There are numerous structural and institutional factors that prevent FDI from flowing into Africa, in addition to the continent's lack of macroeconomic stability and economic growth

According to (Wilhelms, 1998), the perception that African nations are inherently dangerous may deter foreign direct investment from the continent. Risks connected to the likelihood of negative changes worry investors. The traditional causes of these dangers and pessimisms— war, starvation, widespread corruption, project failure, and weak governance—involve the possibility of spreading consequences. Even if the rate of return in many African countrieshas been higher than that of other developing nations, Africa has got a small amount of FDI. This implies that Sub-Saharan African nations face greater dangers than those in otherregions.

2.1.2 Determinants of FDI

Market size and growth are two of the most important long-term predictors of FDI in SSA, according to (Galvo & Raiher, 2019). The relevance of economic expansion in luring FDI flows to Africa is supported by evidence found in (Baby & Sharma, 2017). (Asongu et al., 2018) further demonstrate that SADC member nations receive more foreign direct investment(FDI) than other nations in Africa after controlling for pertinent country conditions. Some foreign investors, particularly those from East Asian nations, have made investments in Botswana in order to supply the South African market.

Due to the need for industrializing countries in Europe and North America to ensure an affordable and dependable source of minerals and primary products, the availability of natural resources has historically been a key element in attracting FDI (Wp01175.Pdf, n.d.). Even if it is losing relative relevance, the availability of natural resources is nevertheless crucial for inbound investment in nations with a wealth of resources, as comparative advantage in these areas is no longer enough to encourage FDI (Asante & Gyasi, n.d.).

Another crucial factor affecting FDI is the availability of cheap labor and the caliber of the labor force (Castro et al., 2013). Lower labor costs lower manufacturing costs, all other conditions remaining constant (e.g., Schneider and Frey, 1985). However, it's crucial that salaries reflect productivity rather than merely being low (Castro et al., 2013). Most people agree that highly educated workers can learn and embrace new technology more quickly and that retraining them will also be less expensive (Papers, 2020). Therefore, nations with a plentiful supply of inexpensive but talented human capital draw more FDI. Sakali offer proof that improved infrastructure encourages foreign direct investment in Africa. The number of main telephone lines and the proportion of paved roads, however, are two areas where Africa falls short, according to Kubick and Husmann (2019). The findings from Sakali's (2013) study, which employed fixed effects panel estimation, alsoshow that the marginal benefit of increased infrastructure was lower in the 1990s than it was in the 1980s. As a result, African nations must improve their infrastructure if they want to attract investments at levels similar to those of the 1980s. Sakali (2014) further demonstrates that, from 1980–89 to 1990–99, the SSA region's rate of increase in infrastructure availability, dependability, and development was lower than the pace for all developing nations.

3. Research and Methodology

The methods and procedures used in this study to accomplish the desired objectives are described in this chapter. These include the data source and type, variable selection and description, pre-estimation tests, model formulation, diagnostic tests, and ethical considerations.

3.1 Data Sources and Variable Definition

In this investigation, secondary data were employed. Data on bilateral trade, interest rates, government spending, exchange rates, gross domestic product (GDP), and terms of trade are derived from the Bank of Somalia, however information on foreign direct investment is obtained from the Somalian ministry of planning and economic development. To examine the impact of bilateral trade and foreign direct investment on Somalia's economic growth, the study used time series data with quarterly observations spanning from 2006Q1 to 2020Q4.

Variable Definition and Measurement

Variable	**Definition**	**Unit of measurement**	**Expected sign**
Gross Domestic Product (GDP)	GDP is the value of all goods and servicesof a country in monetary terms.	Billion Somali shillings	+/-
Foreign direct investment (FDI)	FDI is an investment in the form of a controlling ownership in a business in one country by an entity based in another country. It is thus distinguished from a foreign portfolio investment by a notion of direct control.	Percentage	+
Exchange rate (ER)	Exchange rate is the price of one currency in terms of another currency.	Shillings/US$	+/-
Bilateral trade	Bilateral trade is trade exclusively betweentwo states, particularly, barter trade based on bilateral deals between governments, and without using hard currency for payment.	Billion Somali shillings	+
Government expenditure (GE)	Government expenditure refers to the resources allocated by the government to social goods and services such as health care, education and infrastructure.	Billion Somali shillings	+
Interest rate(I)	Interest rate is the price a borrower pays for the use of borrowed money from a lender/financial institutions or fee paid on borrowed assets.	Percentage	-
Terms of trade	Terms of Trade is the average price of exports by the average price of imports. Itis a measure of a country's relative competitiveness.	Billion shillings	+

3.1 Data Analysis

E-views was used to analyze the data (version 9.0). The error correction model was used to identify the short run dynamics of the model, a log-log model was used to determine the long run dynamics of the model, and graphs were used to check for some features of the variables. Causality was examined using the Granger causality test.

3.2 Pre- Estimation Tests

The following tests were run to determine the validity and reliability of the study's conclusions because using time series data raises a number of economic problems about the robustness of the regression results.

3.2.1 Testing for Normality For The Variables

The Jarque-Bera statistic test was applied to determine if the variables were distributed normally. The statistical analysis compares the null hypothesis—that the series is normal— with the alternative—that the series is not normal. When the likelihood of the statistic islarger than 0.05 threshold of significance, the series is considered to be normal, and vice versa.

3.2.2 Augmented Dickey-Fuller Test for Stationarity (Unit Root Test)

The first stage in time series analysis is to determine whether the data are stationary since non-stationary data lead to erroneous conclusions and a false association between the variables when used in the analysis. To check if the data were stationary, this study employedthe Agumented Dickey Fuller (ADF) method. Estimating the subsequent regression is the test's main component.

$$\Delta Y_t = \beta_1 + \beta_2 t + \delta Y_{t-1} + \sum_{i=1}^{m} \alpha_i \Delta Y_{t-1} + s_{1t} \quad (3.1)$$

Where t denotes

Where t denotes the time trend, s_t is a pure white noise error term, m is the maximumnumber of lags and

$\Delta Y_{t-1} = Y_{t-1} - Y_{t-2}$, $\Delta Y_{t-2} = Y_{t-2} - Y_{t-3}$ etc. The hypothesis of the ADF test are specified as follows:

H_0: δ=0 and H_a: δ<0. If H_0 cannot be rejected, this implies that the data is non-stationary or has unit root. Conversely, the rejection of H0 indicates that the data is stationary or has no unit root, and the next step was to test for co-integration between variables.

4. Data Analysis and Findings

The findings of the analysis are presented in this chapter. It includes findings from pre-diagnostic tests such as normality, stationarity, and optimal lag selection tests, as well as model estimates for short run effects using the VECM and VAR for long run effects.

4.1 Descriptive Statistics

The study used visual time series plots for the FDI, Bilateral trade, exchange rate, interest rate, GDP, and terms of trade for descriptive analysis

4.1.1. GDP

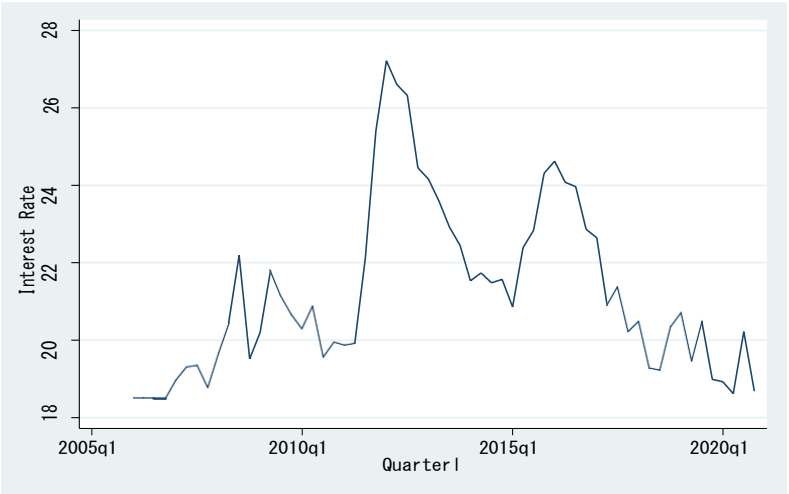
Figure 4.1.: GDP for Somalia

The level of economic activity in the nation has been negatively impacted by the performance of interest and exchange rates. According to the graph, Somalia's GDP exhibits around four regular drops and just three irregular peaks. The rising interest and exchange rates are to blame for the decrease in the nation's GDP.

4.1.2. FDI

Since there are few possibilities created by these types of investment for Somalis abroad, the changes in the FDI outflows from Somalia have had no negative effects on employment rates in the economy. Therefore, after domestic investment, FDI inflows continue to be Somalia's biggest source of employment possibilities. Nevertheless, there is hardly any difference between the two employment sources.

4.1.3. Interest Rate



The performance of interest rates in Somalia is incredibly erratic. Consequently, investing in it is very risky. As can be seen, the line plot increased considerably between 2011 and 2016 and then increased again between 2016 and 2019. It was stochastic from the third quarter of 2005 to the first quarter of 2011, and then it increased again between 2016 and 2019.

Following this, the Bank of Somalia intervened and lowered the CBR to under 10% in an effort to stabilize interest rates; nonetheless, commercial banks and other financial institutions playing the game have had little success in bringing down rates. The leptokurtic distribution of interest rates makes them extremely risky for business and investment. Because of this, Somalia's economic development is hindered.

5. CONCLUSION, DISCUSSION AND RECOMMENDATIONS

5.1 Discussion of the study

The key finding from the result analysis is that there is some correlation between the variables in all three groups. Future research is necessary; however, this may indicate that the number of countries has a greater influence on the relationships between these factors in the cross-country analysis. This shows that there is no fixed relationship between FDI and trade flow; rather, it can vary based on the country's economic development, the type of investment, the country's capacity to absorb the investment, the time frame, or the method of measurement employed in empirical research.

A more in-depth examination would be one at the industry level because this analysis also depends on the sectoral level. Studies in this area take into account aggregate data, although this data can conceal the underlying relationship. Future research can focus on industry and product-based analyses to address this because key industry and product features, such tradability, have a significant impact on the outcomes (Panitchpakdi 2006). The statistics above also indicate that there is a higher likelihood of a complimentary link than a causal one between FDI, GDP, and trade flows. Therefore, FDI investment boosts trade flows. This conclusion is consistent with the research, which implies a complementary relationship on a macroeconomic level (Raybaudi 1996).

A host country's capacity and exporting ability increase as a result of FDI because it gives them a competitive edge. In addition to bringing modern technology and organizational know-how to the host countries, international collaboration that invests in other nations creates more productive and efficient businesses, which can also improve the productivity of domestic businesses. Pelinescu and Radulescu (2009) concentrate on the Romanian economy during the period of transition and "think that exports are supported by FDI, which create output primarily for export and that FDI generates an increase in the competitiveness of Romania."

Studies like those by Goh and Tham (2013) have also discovered a positive correlation between inbound FDI and trade and a negligible correlation between outward FDI and trade for the home nation. The authors tie Malaysia's status as a developing nation and the services-based sector to their findings about outbound FDI. Trade and foreign direct investment (FDI) are more likely to complement one another in developed economies. Market- and efficiency-driven firms in developed economies establish ties with their home nations, which has a favorable impact on trade. According to Djokoto's (2012) analysis of Ghana's agricultural trade and FDI, there is either a complimentary (vertical) or a substitutive (horizontal) relationship between the two.With the FTA variable included, the distance coefficient is no longer meaningful.

5.2 Summary of The Findings

Given a unit increase in GDP over the previous year, the GDP rate is expected to rise, coef. = 1.274833, p-value = 0.000. GDP is predicted to fall by roughly -.4 cents in the quarter if the country's GDP is accompanied by hard work and productivity. According to the VAR, bilateral trade and foreign direct investment are separate predictors ofGDP. On the other hand, control factors including the exchange rate, interest rate, and terms of trade revealed some significant information.

A rise in exchange rates indicates that GDP would be negatively impacted in the first quarter and then drop (depreciation).Similar to how a small rise in interest rates predicts a growth in GDP during the following quarter as opposed to a 1 percent decline. Finally, the terms of trade did not predict changes in the GDP rate in either of the two quarters.

5.3 Conclusions

According to the Granger causality test, bilateral trade increases GDP even though FDI does not. But when done together, bilateral trade and foreign direct investment raise GDP. Despite the fact that the study's results indicated there was no correlation between GDP and foreign direct investment Results for cointegration between bilateral trade and GDP suggested the opposite.

Data of the VECM suggested that there is a short-term relationship between the two variables. In particular, results showed that when FDI in Somalia is excessively large, itswiftly converts to a low GDP rate. Additionally, the economy's trade volume increases whenthe average GDP is excessive.

The results of the VAR show that past government spending, the exchange rate, and the interest rate are all quite sensitive to changes in future GDP, while FDI, bilateral trade, and terms of trade may be disregarded for predicting future GDP rates.

5.4 Recommendations

Results have shown that bilateral trade and FDI together increase GDP. The Bank of Somalia may utilize these series to anticipate future GDP and so mitigate associated risk. The cointegration test showed that FDI and GDP did have some cointegration. The two cointegrating variables GDP and FDI are self-adjusting, according to the VECM model. Without the transmission mechanism provided by the central bank, these two could adapt to changes in the economic system.

In order to enhance GDP in the future, interest and exchange rates must be under control.

5.5 Suggestions for Further Research

Future studies should aim to incorporate foreign direct investment and bilateral trade as control variables when examining the effects of interest rates, currency rates, and terms of trade on GDP.

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