DIFFERENTIAL EFFECT OF FOREIGN CAPITAL AND CAPITAL GROWTH IN GHANA

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ABSTRACT

Ghana has initiated various policies to attract foreign capital and this has increased the inflow of capital into Ghana. The key issue addressed by the study is whether the dramatic increase in foreign capital inflows has resulted in the desired effect on economic growth in Ghana. The study aimed at examining the differential effect of foreign capital on economic growth in Ghana. Foreign direct investment (FDI), foreign aid, external debts and personal remittance was used to measure foreign capital whereas Gross Domestic Product (GDP) (constant, 2010) was used as a proxy for economic growth. Control variables are domestic capital, labor and trade openness. Data were obtained from World Development Indicator and Index mundi over the period of 1980-2018. The result showed that both foreign aid and FDI had a negative effect on economic growth whereas external debts and remittances had positive effect in the long run. In the short run, only foreign aid had a significant negative effect on GDP. The findings on causality suggest that there is a bi-directional causality between remittance and GDP whereas unidirectional causality running from FDI to GDP was identified. The study concluded that even in the presence of weak trade policy, external debts and remittance were seen to be significant growth-enhancing as compared to foreign direct investment and foreign aid. The study recommends that the government of Ghana should ensure proper allocation of foreign capital inflows into both physical and social infrastructure and should abstain from excessive dependent on government revenue.

Keywords: *Economic growth, Foreign capital inflows, Gross Domestic Product*

1. INTRODUCTION

Capital has always been the central element in the process of economic development and Economists value capital as one of the main tools for economic growth (Waheed, 2004). Based on this view, capital-deficient economies and developing countries greatly depend on Foreign Capital Inflows (FCIs) in order to foster rapid economic growth since the growth of these countries have not been encouraged over years (Waheed, 2004; Mowlaei, 2018; Nwaogu & Ryan, 2015). Foreign capital is a major source of finance to facilitate the transfer of modern technology and industrial innovation to developing countries, thus helping to accelerate their economic growth (Fambon, 2013; Rehman & Ahmad, 2016). However, the effect of FCIs on economic growth varies from country to country, and or region to region depending on their local conditions and macroeconomic policies (Nwaogu & Ryan, 2015).

The different forms of FCIs are foreign direct investment (FDI), personal remittance (PR), official development assistance (ODA), external debts (ED) and foreign portfolio investment (FPI) (Klobodu & Adams, 2016; Rehman & Ahmad, 2016; Nwosa & Akinbobola, 2016; Nwaogu & Ryan, 2015; Mowlaei, 2018). However, the current study focused on only four forms of FCIs such as FDI, PR, ODA and ED due to the availability of data. FDI can be defined as the cross-border investments which are made by an investor with the view to establishing a lasting financial interest in an industry or enterprise and trying to exert a degree of influence on the operations of the enterprise and where the foreign investor holds an interest of at least 10% in equity capital (Duce, 2003).

Foreign aid which is also known as Official Development Assistance (ODA), includes the payment of subsidized status credits (no credit repayments) and the Development Assistance Committee (DAC), through multilateral agencies, and to promote monetary development and government assistance in countries and regions where ODA beneficiaries are underperformed by non-DAC countries (World