

Foreign Direct Investment and Gross Domestic Product in Ghana

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Abstract *This paper addresses how Governments of Ghana has made tremendous effort over the past decade at attracting sustainable Foreign Direct Investment (FDI) inflows to boost its Gross Domestic Product (GDP) and other economic indicators. It is noteworthy that Ghana is well endowed with rich natural resources comprising Gold, Oil, Timber, Cocoa, Bauxite, manganese etc. which form the backbone of its economy and dominates the main sources of foreign exchange(Budget statement, 2004).The low foreign exchange earnings on its export product as a result of its primary state compels it to expostulate to international financial and technical assistance at well as making giant strides to attract Foreign Direct Investment inflows to Ghana to supplement its locally generated revenue. This study explores whether FDI inflows have had any significant impact on GDP growth rate, the results indicate that FDI inflows have had an influence on GDP growth, it is however important to note that there are other important macroeconomic variables which need to be considered.*

Key words Ghana, Foreign Direct investment, GDP Growth

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1.1. Background to the study

It is well known that FDI is one of the most dynamic international resource flows to developing countries. FDI is particularly important because it is a package of tangible and intangible assets and because firms deploying them are important players in the global economy.

There is considerable evidence that FDI can affect growth and development by complementing domestic investment and by facilitating trade and transfer of knowledge and technology (Holger and Greenaway, 2004). The importance of FDI is envisioned in the New Partnership for Africa's Development (NEPAD), as it is perceived to be a key resource for the translation NEPAD's vision of growth and development into reality.

Because of the limited amount of capital accumulation from domestic savings, developing countries rely heavily on foreign source of financing. Mody and Murshid (2005) explained the importance of financial integration and domestic policy to optimize the benefit of capital inflows in the form of foreign direct investment on the domestic investment. The potential benefit of capital inflows is indisputable, especially in the case of limited domestic capital accumulation. Countries that successfully attract foreign direct investment perform better than countries that deter foreign direct investment (Baharumshah and Thanoon, 2006). Therefore, the common policy recommendation is to attract capital inflows to augment capital accumulation for economic growth.

Therefore, these factors may not be directly controllable by the domestic policies. The slow down or sudden stop of capital inflows may cause financial and balance of payment crisis (Calvo, 1998). Furthermore, Bosworth and Collins (2004) argue that capital inflows may not be fully employed for investment. Some portion might be used for current consumption. In addition, capital inflows may not be fully transformed into

resource flows because some parts might be offset by capital outflows, reserve accumulation, or errors and omissions.

Furthermore, capital inflows may affect developing countries in a different way from developed country. Capital inflows can be used to finance current account deficits in developed countries, but may cause current account imbalance in developing countries (Yan, 2007). The incorrect structure of the capital inflows may create detrimental effect for economic growth and financial stability (Van Zyl, 2002). Instead of raising investment, substantial increase of external debt might have negative effects on investment (Javed and Sahinoz, 2005).

This study contributes to the analysis of capital flows from the perspective of developing countries. Literatures on the impact of capital flows on the economy differ in their methodology and approach.

FDI can be defined as an investment made to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor (OECD, 1997:8). The FDI relationship, consist of a parent enterprise and foreign affiliate which together form a transactional corporation (TNC). In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate.

The primary objective of the study is to establish the link between FDI flows and Gross Domestic Growth in Ghana over the years. The study explores the possible causal and impact relations between FDI and GDP to economic growth and development in the country.

1.2. Significance of the study

The findings of the study will keep the recipient country of FDI abreast with measures and mechanisms needed to further improve the investment climate to serve as a parameter for attracting more FDI.

Overview of Foreign Direct Investment in Ghana

2.1. Introduction

This chapter describes the overview of foreign direct investment in Ghana over the past ten years, which is from 2000 to 2010. It describe the inflows to various sectors of the economy.

In this research, FDI refers to the monetary resources foreigners invest in companies or their subsidiaries listed on the Ghana Stock Exchange.

The research focuses is only on foreign investors who live both inside and outside Ghana and invest their monies into the various companies listed and not listed on the stock Exchange.

2.2. FDI Inflows in Ghana and the Investment Climate

The history of FDI in Ghana can be traced date back in the post-independence era when the pioneer industries and companies Act of 1959, giving a ten – year tax holiday came into force. This was followed by the enactment in 1963 of the capital Investment Act which sought to offer a variety of fiscal and other concessions to potential investors provided they adhered to certain strict conditions. Firstly, is that private enterprises gave the first options for the Government to acquire any equity capital it intended to be off loaded or sold out.

Secondly, is that foreign private enterprises and enterprises jointly owned by the state and foreign investors be required to reinvest 60% of their net profit in Ghana as stipulated by Nkrumah’s regime? (Friedland and Rosberg, 1964–1972).

Also, both the NLC (1966 – 1969) and Busia (1969 -1972) governments claimed to have pursued liberal policies to solicit inflows of capital in an initiative described as “an experiment with import liberalization even though the NLC passed a decree setting out timetable for Ghanaianisation which was corroborated by the Busia government in a legislation. (Tsikata et al, 2000).

In addition the 1973 investment decree (NRCD 1413 and investment policy decree (NRCD 329) of 1975 were intended to encourage local and foreign investment. The 1981 investment code (Act 437) which aimed at centralizing investment promotion functions in the capital investment. Moreover, the 1985 investment core (PNDCL 116) established the Ghana Investment Centre as a central investment promotion agency charged with the power to promote and regulate investment on behalf of the government.

This was replaced by the Ghana Investment promotion center which was set up under GIPC Act 478 (1994) with the aim of reviewing the 1985 investment code in order to focus more attention on private sector investment as parameter for economic growth and development.

The GIPC was established to promote and facilitate investments in all sectors of the economy except mining and petroleum and to assist both domestic and foreign investors in;

- i) The provision of information on investment opportunities in Ghana;
- ii) The identification and promotion of value added activities and new potential area of investment;
- iii) Liaising the MDAs to create the enabling environment for investment;
- iv) Facilitating the acquisition and transfer of technology (GIPC Annual Report 1998).

The first GIPC 5 year medium Term corporate plan 1995 – 1999 reviewed and modified within the vision 2020 context is based on general “aggressive investment promotion” strategy which has been pursued and financed primarily through the USAID sponsored Trade and Investment Programme (TIP) (GIPC Annual Report, 1998). Other mechanisms include the Financial Sector Adjustment Programme (FINSAP) initiated in 1989 to boost private investment and to underscore the need and motivation to undertake a comprehensive analysis of FDI in Ghana (Tsikata et al, 2000).

Moreover, the first trade zones/free ports were established in May 1996. One was established near Tema Steelwork Ltd in the Greater Accra Region and two other sites located at Mpintsin and Axim near Takoradi. The seaports of Tema and Takoradi as well as Kotoka International Airport (State of the Ghana Report, 1999). The law also allows the setting up of single factory zones outside or within the free trade zones. A company qualified to be a free zone if it exports 70% of its products and the incentive include ten year corporate tax holiday and zero duty on imports (Bank of Ghana Bulletin, 2005).

2.3. FDI and GDP Growth Nexus

The government of Ghana had been making several attempts purposely to improve the economic and financial performance of the economy in order to improve the GDP growth rate as against the domestic debt situation which was seen as an abattoir on the neck of the nation. This had called for an effective policies aimed at reducing inflation to a single digit, rising output growth improved external account balance, stabilizing the exchange rate of the cedi and indeed enhancing the position of the foreign exchange reserve. Some of the policies include the structural adjustment programme, and recently the operationalization of the enhancing HIPC initiative and the Multilateral Debt Relief initiative.

Methodology of Research

3.0. Introduction

The methodology involves estimating simple trend analysis and correlation of GDP as the depending variable as well as other explanatory indicators like Foreign Direct Investment (FDI) inflows, average exchange rate volatility (AERV) and the rate of inflations (INFR) within the time frame of 1994 -2010.

3.1. Trend Analysis

The impact of FDI on Gross Domestic Product (GDP) can be measured using series of variables which factors by themselves have critical consequences on the outcome of FDI inflows to developing countries such as Ghana.

The variables are mainly categorized into two main political and economic factors namely;

- i) Political ii) Economic environment

The trend and correlation for estimating the impact of GDP based on the variables outlined above is adopted from the study of (Barro, 2004) and a procedure developed by (Jahansen, 1991).

The trend I is as following;

$RGDPGER = F(FDI, AERV, INF)$ where

RGDPGER = Real Gross Domestic Product Growth Rate

FDI = Foreign Direct Investment

INFER = Inflation rate

AERV = Average Exchange rate volatility

4. Results and Discussions

Introduction

This chapter focuses on the findings and discussion of the result. The first regression result as indicated in table 1 is based on the Basic Static Regression model. The basis static has a low explanatory power judging from a low R-squared figure. To augment and strengthen the explanatory powers, a second regressions model known as contemporaneous dynamic regression model was adopted for the seconds' analysis. This is also indicated in the summary output in table 1.

4.1. Statistical data analysis and results

The result for the static panel regression result used to ascertain the impact of FDI and other macroeconomic explanatory variables on the dependent variable are presented in the table below;

The result is interpreted as the Real Gross Domestic Product Growth Rate (RGDPGR): $RGDPGR = 5.049 - 0.027 AERV + 0.05 FDI - 0.023 INFR$.

Table 1. Basic static regression model (summary output)

Depending variable: Real Gross Domestic Product Growth Rate (RGDPGR)

Sample: 1985 – 2010

Regression statistics

ANOVA

	Coefficient	Standard Error	t stat	P-value	Lower 95%	Upper 95%
Intercept	5.04897741	0.506376	9.970813354	2.861E-08	3.975508927	6.1224459
AERV	-0.0267285	0.039819	-0.671248308	0.5116377	-0.111141066	0.05768414
FDI	0.01475292	0.009747	1.513521824	0.1496491	-0.005910668	0.0354165
INF	-0.00026913	0.012304	-0.218740767	0.8296178	-0.028773902	0.02339128
Multiple R	0.39959947					
R square	0.15967974					
Adjusted R Square	0.00211969					
Standard Error	1.21845633					
Observations	20					
F	1.0134532					

4.3. Basic Static Model

Inferring from the table above, the dependent variable (RGDPGR) exhibits a positive relationship with FDI inflows and a negative relationship with the rest of the variables. These states of affairs are in accordance with a priori expectation. This direction of the RGDPGR and the explanatory variables (AERV, FDI and INFR) are in conformity with the reality on the ground. The relationship stands to show that an increase in FDI inflows may result in the growth of Real Gross Domestic Product Rate. However the influence of the growth in FDI inflows to RGDPGR is insignificant judging from the fact that the t-statistics as indicated in the above table is less than two which is below the significant level.

The Average Exchange Rate Volatility (AERV) in table 1 shows that there is a negative relationship between FDI and AERV. Thus when exchange rate to the dollar falls below expectation, investor confidence is eroded because import of raw materials and other technology become comparatively high and unbearable though it is argued in other quarters that Parents Company of multinational may come to the aid of its subsidiary to offset whatever currency discrepancies. Also, the ERV rate plays no influential or significant role in the determined of RDPGR as indicated by its low t-statistics of less than one (-0.671).

Inflation rate as expected has an impact of RGDPGR but again its effect is minimal because its t-statistics is less than significant (0.219). This means that though a nations which experiences an uncontrollable spiral of inflation and for that matter a decrease in the growths of RGDPGRs, there are other macroeconomic factors whose effects are more paramount.

It is worth mentioning that the RGDPGR itself has a high t-statistics pointing to the fact that all the three explanatory variables play a role in its growth rate but the impact of other macroeconomic variables which are not captured in this research for outweigh the determinants of the RGDPGR.

The basic regression model shows that 16% of the variations in the overall growth rate in GDPGR are explained by macroeconomic variable included in this study as postulated by the R-squared value of 0.168. The remaining 84% variable which influences the growth rate of GDP can be attributed to macroeconomic factors which are not considered as an explanatory variable in this research work.

The adjusted R-squared further reduce the model explanatory power to 0.12% taking into account the number of independent variable used. This poses some questions about the validity of the model used because of its weak explanatory nature.

However with the F-value of 1.013 and the significance rate of 0.4125 gives credence to the fact that there is only 41.25% chance that the model fits the data purely by chance and a 58.75% chance that the data represented by the identifiable variable (AERV, FDI and INFR) explain that growth rate in GDPGR according to the specified model.

The low impact of the independent variables renders their effect in the regression model somehow low and redundant. This outcome could indicate an error of measurement error in gathering of regression data and in addition there could be an error in the specification of the regression.

Owing to the above contradiction an alternative and more valid specification i.e. a dynamic regressions model is adopted. This model is indicated in table below.

Table 2. Dynamic Regression Model

Sample Observation: 21

The results were obtained from the model;

$$RGDPGR = + AERV_{t-1} + AERV + FDI_{t-1} + INFR_{t-1} + s INFR$$

Table 2. Dynamic regression model (summary output)

REGRESSION STATISTICS						
	Coefficients	Standard Error	T Stat	P-Value	Lower 95%	Upper 95%
Intercept	4.915337241	1.685095993	2.916947913	0.014014	1.206465969	8.624209
AERV	-0.054706833	0.06079665	-0.899833027	0.387484	-0.18851936	0.079106
FDI	0.01754383	0.012123252	1.447122437	0.175753	-0.00913927	0.044227
INF	0.000225955	0.01721817	0.013123074	0.989765	-0.03767098	0.038123
AERV (t-1)	0.013968884	0.059560519	0.234532613	0.81888	-0.11712293	0.145061
FDI(t-1)	-0.007946872	0.012260036	-0.648193215	0.530158	-0.03493103	0.019037
INF (t-1)	0.004196912	0.01687499	0.248706039	0.808171	-0.03294469	0.041339
GDPGR(t-1)	0.049964183	0.298183474	0.167561878	0.869969	-0.60633322	0.706262
Multiple R	0.493379085					
R Square	0.243422921					
Adjusted R Square	-0.23803522					
Standard Error	1.389333994					
Observations	19					
F	0.505595					

4.4. Dynamic Model

From the dynamic results, I estimates fixed dynamic model, now considering first and second logs of the explanatory variables. To find out how logged microeconomic variables affect current RGDPGR, I included in the set of independent variable first and second logs of the overall GDPGR as well as first and second logs of the returns of the macroeconomic factors. This is to enable thorough investigation of how previous FDI inflows and other macroeconomic variable (AERV, INFR) affect the Real Gross Domestic Product Growth Rates currently and even the year after. However because the number of observation still remain the same, it affects the adjusted R-squared in a negative directions.

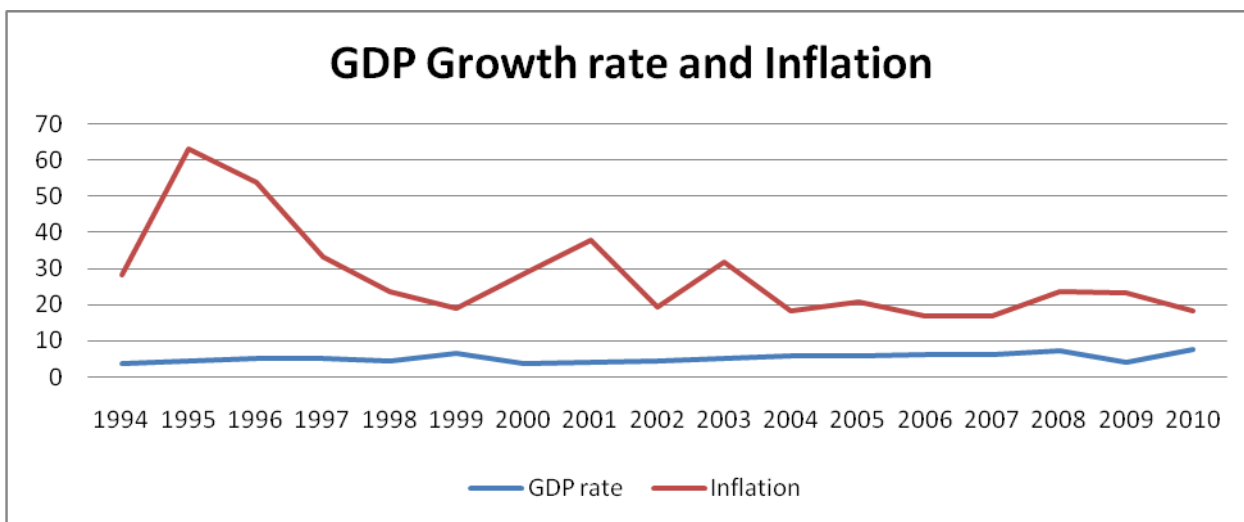
As indicated in table 2, this dynamic model explains 24.3% of the variation in the overall macroeconomic environment as postulated by the R-squared of 0.243423. This shows an increase and

improvement of the explanatory power in the static regression model. Given F-value of 0.5055 in the panel data set and with significance F value of 0.8125% implies that there is 81.24% chance that the data may fit the model by pure chance. This also portrays the specification validity of the model.

Also from the dynamic regression model, the coefficient of the variables, the t-statistics, standard error and the related probabilities are not significant enough to be influencing the RGDPGR. Thus, the first leg of the explanatory variables (AERV (t-1) has a coefficient of 0.0139 t-statistics of 0.2345 and a standard error of 0.0596. clearly the rates of the t-statistics which is less than 2 makes its impact less significant if the previous year average exchange rate increases by 0.139%. this means that out of the total change in the overall macroeconomic situation if the previous year data changes by 10%, 0.139% in the current year’s figure will be influenced by the previous changed in the same direction.

The first and second lag of the other two explanatory variables have improved a regards the previous years and they may exhibit the same characteristics as the first-variable since their t-statistics are also not up to the significant level of two.

It is therefore obvious from the lagged variables that whiles FDI and the other explanatory variable are important in influencing Real Gross Domestic Product Growth Rate, there are other macroeconomic variables whose effect are more pivotal in determining the GDP growth rate than just the considered macroeconomic variables.



Source: Survey Data, 2012

Figure 1. GDP Growth and Inflation Rate

From the table above, it can be seen that inflation rate as expected has an impact on (RGDP) but its effect is minimal. This means that though a nation which experience an uncontrollable spiral of inflation and for that matter a decrease in the growth of RGDP rate. It can be concluded that inflation has a negative relationship with GDP rate and can be confirm in the correlation table in table 3.

Table 3. Correlation Table

	GDP	Exchange rate	Inflation	FDI
GDP	1			
Exchange rate	0.2999	1		
Inflation	-0.46826	-0.241987206	1	
FDI	0.592923	0.078511256	-0.298999191	1

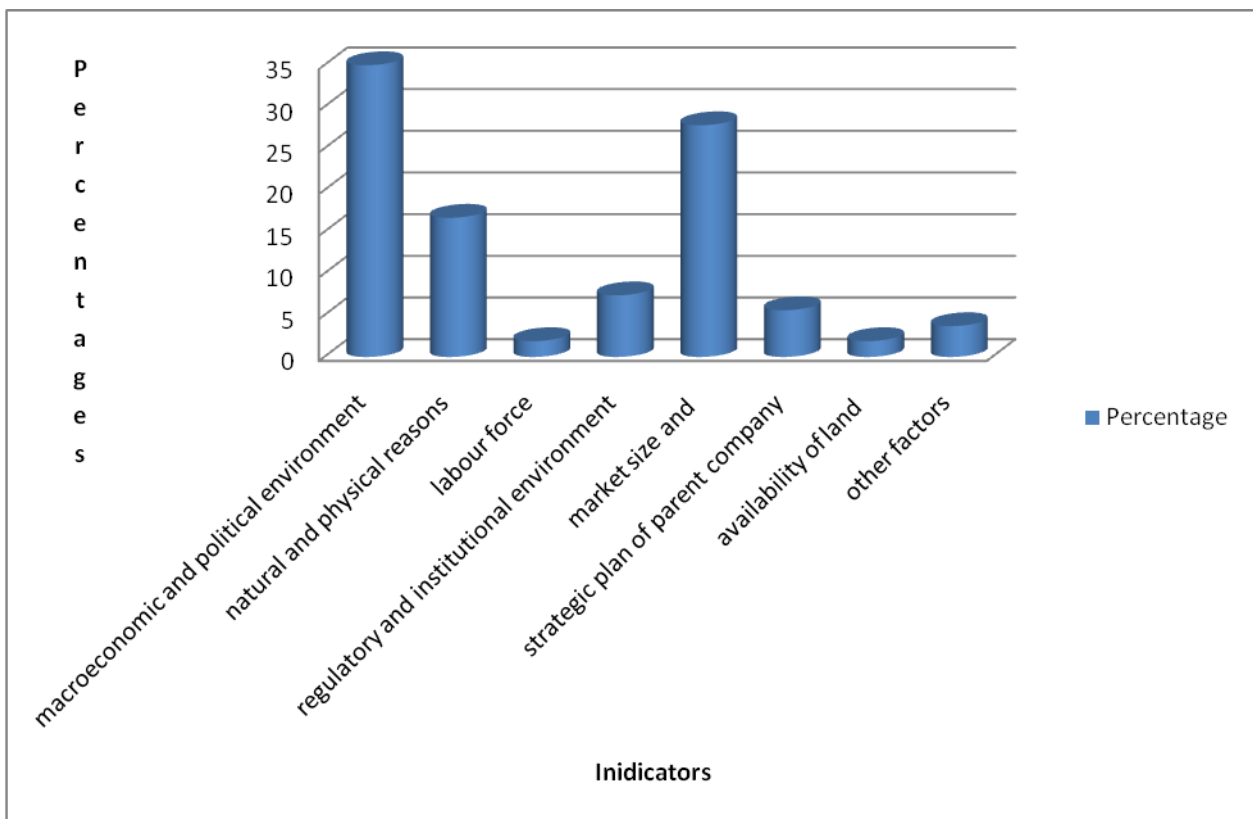
Source: Survey: Data, 2012

It is therefore obvious from the trend analysis that whiles FDI and other macroeconomic indicators are important in influencing real Gross Domestic Product Rate ,there are other macroeconomic indicators whose effect are more pivotal in determining the GDP growth rate than the considered macroeconomic variables. There is high significant level between FDI and GDPGR because an increase in FDI by 1% will increase GDP by 59.2%, added to the above point because of increase of FDI into the country greater output is achieved thereby increasing our total output as a whole. For instance the discovery of Ghana oil has increased Ghana’s total output significantly to Ghana cedis 59,264 million (GSS Report2011).

5.4. Factors That Influence Investors Decision to Invest in Ghana

According to the data the most important factor that influences the choice of Ghana as an investment destination is the macroeconomic and political environment.

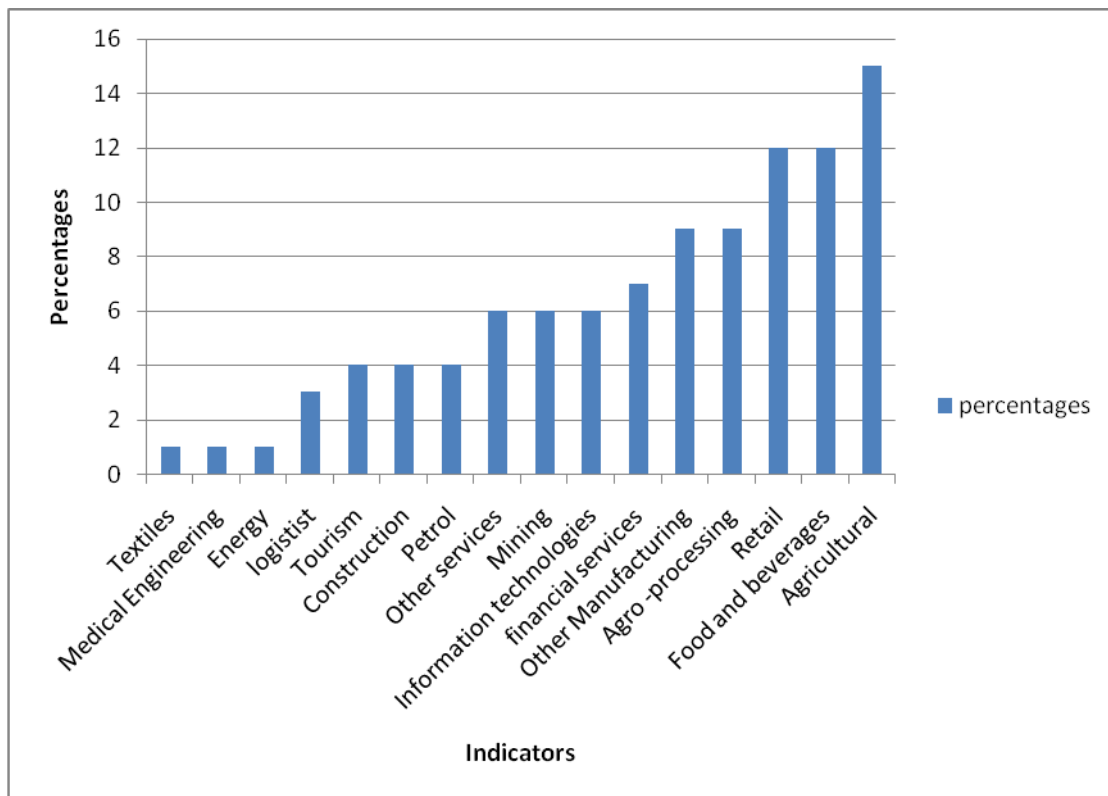
When firms were asked to name the most important factor that influences investment decisions today, about 35 percent said it is the macroeconomic and political environment. It can be illustrated in the table below.



Source: Survey Data, 2012

Figure 2. Reasons for Investment in Ghana

From the table above, a sample of firms that were interview shows that most firms choose to invest in Ghana due to the following reasons, macroeconomic and political environment had 35%, natural and physical reasons represent 16% labor force represent 1.9% , regulatory and institutional environment represent 7.4%, market size 27.6%, strategic plan of parent company 5%,availability of land 1.9% ,other factors 3.7%.



Source: Survey Data, 2012

Figure 3. Sectorial Allocation of Foreign Direct Investment in Ghana

Of the firm sample, 15% are in agricultural sector, Retail, food and beverages represent 12% manufacturing and Agro processing represent 9%, financial services represent 7%, while information technologies, mining, other services represent 6%, petrol, construction, tourism represent 4%, logistics represent 3% while energy, medical engineering textiles represent 1%. Agriculture affects most of FDI because of the sector provides more jobs, and foreign exchange through exports of goods as well as taxes. In contrast, Ghana has not received much FDI in manufacturing and assembly sectors which, on average, offer higher positive growth effects through spill over in the long run. Among the most important reasons for not receiving more FDI, as identified access to land, property registration and the labour market (regulations, availability of skilled labour, labour productivity).

5. Conclusion

This study investigated the linear relationship between FDI inflows and its impact on Real Gross Domestic Products Growth Rates. Additional three variables were considered since FDI inflows is also influenced by certain macroeconomic factors. FDI inflows from 1994 to 2010 were considered.

The impact of FDI inflows was analyzed and two other macroeconomic variables were analyzed to see its effects on Real Gross Domestic Product.

The empirical result confirms that, FDI has the greatest impact indicated by its high impact trends compared with the other explanatory variables (AERV, INFR).

The average exchange rate volatility and inflation rate both exhibit a negative correlation with the GDP growth rate in accordance with the a priori expectation. A high AERV and INFR will serve as disincentive for foreign investors to invest in the economy as there is the tendency for their imports of technology to be expensive and export value of their imports of technology to be expensive and export value of their product to be high. High inflation rate portrays similar characteristics. The above analysis justifies the empirical result on the ground but not as significant as expected.

The dynamic model shows a positive relationship between the GDPGR and the AERV/INFR. By using the dynamic regression model, the two explanatory variables responded differently in the opposite direction indicative a weak statistical significance. It was realized that there are other important macroeconomic variable whose effect are more influential than the considered variables.

Despite the above remarks the study has made some important consideration

It was found in the study that FDI even though has a role to play in GDP growth rate its impact is not as strong as expected; there are factors which needs to be taken into considerations.

Methodologically, this means that even though FDI inflows plays an important role in determining GDP growth rate other macroeconomic variable which are not a basis of consideration in this study are more important. Further research needs to be conducted asking account of the other variables.

Moreover, since FDI inflows are influenced by certain macroeconomic variables, two additional explanatory variables were considered. The two are the average exchange rate volatility and inflation rate. They both do not show a good expectation. That is the average exchange rate volatility was found to exhibit a negative relationship with FDI inflows and its negative spiral effect on GDP growth rate. High inflation rate was found to stifle smooth inflows of FDI since foreign investors will be reluctant to invest in an economy where the return on their investment will be dwindled by the high inflation rate.

The exchange rate also showed a negative relationship with FDI inflows. The depreciation of the cedi also tend to scare foreign investors as their investment capital will be reduce to nothing relative to its trading partners.

Moreover lack of coordination amongst regulatory agencies was a major problem since ti makes gathering of information cumbersome and unreliable.

Next key issues embodied in the study and recommendation considered to be feasible is that further research on the interaction effect of FDI need to be conducted. Also serious consideration must be given to updating the GIPC information database so that information on FDI inflows and their cost would be readily available to investors for the purpose of informing them about the investment climate at a point in time and knowing where investment are more concentrated as against where subsequent investment projects should be focused.

Added to the above is the development and enhancement of capacity building of the personnel of the various regulatory agencies (GIPC, Statistical Service, and Bank of Ghana) in order for them to appreciate the need of divulging information on investment in the country to prospective investors. This will go long way to promote and development of the economy.

Moreover it was realized that financial resources channeled into domestic investment occupy a minute proportion of total investment, so any means by which small and medium scale enterprises would be boosted wither in terms of financing or tax exception to entice them into venturing into areas occupied solely by FDI would be a booster to economic growth and development of the country.

Another salient recommendation would be to strengthen investment promotion and gateway strategies by improving out maritime engineering and embarking upon a multi facility Economic zones. The recent acknowledgement of Ghana as the international financial centre and the rating of Ghana by Moody's as B+ is indeed a step in the rights direction but more innovative polices must be put in place to open up the country by giving incentive to investors who would be prepared to set up factories far beyond the gateway zones into the interior areas.

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