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Political Economy of Foreign Direct Investmet In Ghana – from an Institutional and Policy Perspective

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1 Introduction and Background

Various economies seek to be competitive and efficient to encourage multinational corporations for investment in their home countries. This approach requires the effectiveness of institutions, the existence of legal and institutional frameworks to settle disputes among trade partners, furthermore the level of transparency and efficiency in host economies is important as it will lead to the attraction of foreign and human capital, and also build investor confidence which will increase not only portfolio but direct investment in the long term. Additionally, a stable and democratic environment will attract FDI in volumes, this will impact economic growth positively, which makes the argument for Political economy of foreign direct investment very important and relevant in today's 21st global century. The theme of whether or not political regimes affect the inflow of foreign capital has been the center of discussion in the Political Science Literature, authors like O'Donnell [1978, 1988, p.3-38] suggests that authoritarian leaders, in their quest to pursue industrial policies, are effective in comparison to their democratic counterparts at safeguarding multinational corporations interest and oligopolistic. However, no existing evidence shows that authoritarian regimes attract more U.S. foreign investment [Oneal, 1994, p. 565–588].

International investment in forms of foreign direct investment and portfolio investment acts as catalyst in stimulating economic growth and development of any economy and this has been at the center of many reserchers, many at times skewed towards developing and emerging econmonies. Economic growth and sustainable development tend to be influenced by both endougenous and exogenouse factors, of which foreign direct investmernt forms huge parts. In addition to growth being affected by the inflows of foreign capital, there is also the need to have an effiecent and effective instiutional development to complement these efforts. The developemet of prudent and efficent financial system is very crucial and important as it acts as a channel for growth. Growth of an economy can be financed led and is requires the creation of institutions which will impleament policies to enhance a conduesive investment and climate within an economy. Through various economic and political reforms in both developing and emerging economies, particualy middle income countries like Ghana, the Ghanaian economy has experinced massive inflow of foreign capital as a result of some of the above mentioned factors.

2 International Institutions

Belonging, appending signatures to international institutions and trade related treaties attracts volumes of foreign direct investment in various forms [Buthe and Milner 2008, p. 741–762], the World Trade Organization (WTO), International Monetary Fund (IMF) and the many negotiated trade agreements, ensures individual member countries to stay committed to a well-defined set of liberal economic policies, thus reducing the problem of obsolescing bargain and thus ensures individual member countries commitment are more dependable.[1]

2.1 Economic and Institutional Reforms

With the introduction and implementation of the Structural Adjustment Program proposed by the International Fund (IMF) in 1983, as part of Ghana's economic reforms, and eventual entry into the World Trade Organization (WTO) in 1995, massive political and economic reforms have been undertaken and continue to take place to meet Internationally accepted standards which induce investors to invest in Ghana and the West Sub-region corridor and among the reforms is the banking and financial Industry in Ghana[2]. These changes have been accompanied by an unprecedented rate of economic boost and growth which has seen Ghana to be major investment destination centre, whiles maintaining strong trading ties with the rest of its trading partners like the United States, the European Union and African Union respectively.

Furthermore Ghana has emerged to be a strong influential member of the sub- regional trading blocs, namely the Economic community of West African Countries (ECOWAS) and the New Partnership for Africa's Development, (NEPAD)[3] and also on the not too long debate on signing an Economic Partnership Agreement with the EU.[4] Ghana's growth rate is not only a regional perspective but also has an international dimension and implications for investment purposes. The major driving force for the Ghanaian economy has been the mining industry, Agriculture sector (cocoa), timber, together

[1] Büthe, T. and Milner H. V. [2008], *The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements,* "American Journal of Political Science", 52 (4): 741–762.

[2] Antwi-Asare, T. O. and Addison, E. K. Y. [2000], *Financial Sector Reforms and Bank Performance in Ghana,* Overseas Development Institute (London, England), University of Ghana. Dept. of Economics, Overseas Development Institute.

[3] See more on: http://www.nepad.org/about [access: 04.08.2017].

[4] http://www.myjoyonline.com/opinion/2014/May-15th/ecowas-epa-and-wto-compatibility.php [access: 04.08.2017].

with the petroleum (oil and gas discovery) sector, and also the development of the financial service sector, i.e. the increased number of banks operating. With the completion of the Bui hydro-electric dam in 2013 and the start of gas production in Atuabo, started in 2014, electricity supplies should improve and help boost output from the manufacturing sector, the services sector, with finance and telecommunications expected to remain positive and strong in the economy.

With the ever growing influence and dominance of China, on the African Continent, the Republic of Ghana possess the leverage in democracy, good governance, the rule of law and a good environment for doing business. Since the worst economic recession in 2008, economic growth in Ghana slowed down, but did continue to grow.

In 2016, economic performance was not solid. Ghana made much progress on the process of fiscal consolidation by achieving a lower fiscal deficit of 6.3% in 2015, furthermore though the economy missing its fiscal target of 5.3% of GDP in 2016, it also achieved a growth of 3.6% higher than the projected 3.3%, and also an inflation rate of 15.4% in December and a further lower 13.3% in January 2017, closer to the inflation targeting regime of the central bank's range of 6%–10%. [5]

Even with global weakness, imbalances and weak global commodity prices, Ghana's external balance improved in 2016, reflecting increased exports and falling imports. The current account deficit narrowed to 6.4% of GDP in 2016 from 7.6% of GDP in 2015. With Foreign reserves also surging from $4.4 billion to an estimated $4.9 billion, it impacts positively on Ghana's balance of payment accounts [6]. Bolstered by improved oil and gas production, increased private-sector investment, improved public infrastructure development and sustained political stability, growth is still expected to be positive.[7] Ghana did embarked on some monetary and fiscal policies in the wake of the 2008 financial meltdown which spilled over globally, these implemented policies recorded some positive impacts in the areas of infrastructure and investment increasing; furthermore a strong export regime has also boosted the economy with major trading partners like South East Asia and the United States, European Union importing more.

[5] http://www.worldbank.org/en/country/ghana/overview/ [access: 01.07.2017].
[6] Ibidem
[7] http://www.afdb.org/countries/west-africa/ghana/ghana-economic-outlook/ [access: 05.08.2017].

Ghana as cited by Ernest and Young (E&Y) as new a regional hotspot for global investment and doing business[8] has existing massive investment holdings held by major competing traditional investors, i.e.: the United States, European Union, and the United Kingdom economies and presently China. Investments are expected to increase due to favourable conditions and economic stability that continues to flourish in the country. From finance, commerce and trade, Ghana has gradually emerged and is in the global spotlight together with Nigeria, South Africa and Kenya in the sub-region. Supported with strong and high volumes of foreign direct investment over the decades, this has contributed to stabilizing the economy and increased the capital base of financial markets. Financial Reforms in the banking and equity markets together with institutional restructuring has attracted more investors and made the market economy more prudent, efficient and transparent.

With Ghana, attaining a middle income status[9] and its performance in managing its economy effectively combined with a stable political environment, it has impacted on Africa's Economic outlook positively in the last few decades. These bring some advantages for African economies, but it also has significant implications for western policy towards the continent. In a critical starting point it is better to understand the diverse impacts of the inflow of Foreign Direct Investment and other forms of economic assistance to the African continent. Africa is also being affected indirectly by the phenomenal growth of the Asian (China's) economy and other development partners in the 21st century who now have increased their trading quota with the continent.

It is clear that African countries (Ghana) must not give up on own its momentum and determination to tackle its development problems and attain the renewed vision of a prosperous vibrant region as captured partly in the Millennium development goals which range from halving extreme poverty rates especially[10]. In this regard the establishment of the China-Africa Forum offers unconditional support for the AU (African Union) and its various instruments including the New Partnership for African Development (NEPAD), which is being integrated into the sub-regional and National development strategies. Furthermore, economic trade agreements with the European

[8] http://www.ey.com/GL/en/Newsroom/News-releases/News-foreign-direct-investment-in-sub-saharan-africa-on-the-rise [access: 04.08.2017].
[9] http://www.imf.org/external/pubs/ft/survey/so/2013/car061213a.htm [access: 05.08.2017].
[10] See more on: http://www.un.org/millenniumgoals/ [access: 05.08.2017].

Union and the United States must be negotiated in good faith to have value for the continents vast natural resources which has been the main driving force for growth and investment on the continent.

2.2 Foreign Direct Investment and Financial sector development

On the Theory of Foreign Direct Investment, numerous empirical studies examining the impact of foreign direct investment (FDI) and financial sector development on economic growth has been on the ascendency ever since the emergence of endogenous growth theory. In the FDI-growth literature, empirical studies have so far yielded mixed results on whether FDI contributes positively to economic growth [e.g. Balasubramanyam et al., 1996; Borensztein et al., 1998; Carkovic and Levine, 2005; Hansen and Rand, 2006], on the other hand with financial development-growth literature, the empirical results have been more conclusive; most studies found that financial sector development contributes positively to economic growth [e.g. Beck et al., 2000; Christopoulos and Tsionas, 2004; King and Levine, 1993a; Levine, et al., 2000].

However, more recent studies have shown that the positive growth impact of FDI is dependent on the extent of financial sector development in host countries. Hermes and Lensink [2003, p 142-163], Alfaro et al. [2004, p. 89-112.] among others, have provided empirical evidence supporting this proposition. Despite this, the number of empirical studies examining this complementary impact has been relatively small. Most of the cross-sectional empirical studies have not been region specific, except for the study by Omran and Bolbol [2003, p. 231-249] which focuses on Arabic countries. There are studies that have examined the role of financial sector development in enhancing the contributions of FDI on economic growth in Ghana but to a limited extent – a country that have seen some of most rapid economic growth over the last decade.

Several debates and roundtables have developed and formulated questions like: Does financial development provide economic stimulation as result of financial liberalization or does it affect the economy inversely. Ghana’s financial sector has since 1983 gone through series of restructuring and transformation. Reforms in the financial sector in 1983 under the Structural Adjustment Program, the Financial Sector Adjustment Program (FINSAP) in 1988 in two phases, financial liberalization in 1990 and the introduction of Universal banking in 2003, all aimed at building and creating a vibrant financial architectural framework which will facilitate the transition to market economy. Whiles FINSAP made gains in the banking sector it is also credited with establishment of capital market in Ghana.

The Ghana Stock Exchange was incorporated in July 1989 as a private company under the Ghana Companies' code, 1963 (Act179). However, the status of the company was changed to a public company under the company's Code in April 1994. Pushing for full liberalization in the financial sector, 'universal banking' was introduced by the Bank of Ghana in the first quarter of 2003, which allowed banks to embark on commercial, development, investment or merchant banking without separate requirements to operate in these new areas. The development in the financial sector did also occur during a period when the economy recorded substantial increase in growth. The GDP growth increased from -7.5% in 1982 to 6.2% in 2006; per capita income increased from -10.2% to 4.3% over the same period [World Development Indicators, October 2008]

These reforms brought about effectiveness and efficiency in the financial sector in Ghana, additional economic growth has been positive since the start of the economic adjustment and consistent since 1990 especially from 2001 to 2013. The basic economic question that can be asked is how the vicious cycle of poverty in most African economies can be corrected through their trade relationship with major trading partners like the EU, US and by new partners like the People's Republic of China. Economic growth leads to greater economic prosperity, increasing overall prosperity improves the lives of those able to partake in the system which is empirically linked to higher overall levels of human happiness and betterment.

Recent developments in growth theory have considered various sources of long-run growth, each of which involves an externality associated with some activity. Examples include human capital accumulation through either learning by doing or education and technological advance through R&D activities. Policy makers and academics contend that foreign direct investment (FDI) can have important positive effects on a host country's development effort, but that empirical evidence for FDI generating positive spill overs for host countries is ambiguous at both the micro and macro levels. In a recent survey of the literature, Hanson [2001] argues that evidence that FDI generates positive spill overs for host countries is weak. But Balasubramanayam et al. (1996) found that in developing countries pursuing outward-oriented trade policies, FDI flows were associated with faster growth than in those developing countries that pursued inward oriented trade policies.

3 Investment Motives

For Multinationals the most important and common incentives to motivate an investment are mainly: efficiency seeking, resource seeking and market seeking respectively [Dunning, 1993, p. 78]. Adequate availability of natural resources combined with labor, unskilled, skilled and semi-skilled and the presence of a well-developed infrastructure encourages resource seeking investment as in the case of China in most African and other parts of the world like Canada and others. The abundance of raw materials gives a comparative advantage and creates the possibility of trade. Resource seeking investment takes place rapidly when there is lack of the adequate capital base to develop the vast base of resources or when this shortage of skilled and professional knowledge to apply [UNCTAD, 1998].

In the Market seeking motive, the process is encouraged when there exists a huge market size in terms of population size, per capita income as measurement to determine the economic prospects of the investment. New markets which are unsaturated give firms the chance to compete and grow, thereby making specialization an object in gaining economies of scale. In assessing the size of markets, China looks that the Sub-Saharan African corridor as one massive investment hub and other regional blocks as investment destinations, among others countries like Nigeria combined with Ghana, Kenya, South Africa and other investment hotspots provide markets for Chinas manufacturing and production capabilities.

Finally, motivation of efficiency seeking FDI is “to rationalize the structure of established resource based or market-seeking investment in such a way that the investing company can gain from the common governance of geographically dispersed activities. The intention of the efficiency seeking MNE is to take advantage of different factor endowments, cultures, institutional arrangements, economic systems and policies, and market structures by concentrating production in a limited number of locations to supply multiple markets. In order for efficiency seeking foreign production to take place, cross-border markets must be both well developed and open, therefore it often flourishes in regionally integrated markets"[11]. It must be also noted that Multinationals do combine all above motives when seeking investment proposals.

4 Political Economy of Foreign direct Investment in Ghana

4.1 Legal Framework and Investment Policy of Ghana

The Promotion Act (Act 478) of 1994 established the Ghana Investment Promotion Centre (GIPC), with the aim of attracting foreign and domestic busniess and also monitor thier business operations. The GIPC encourages, promotes and facilitates investment in Ghana consistent with Ghana's economic policy goal and registers projects respectively. As a result of good infrastructure and financail sector development in Ghana, Chinese investments benefit emensly form this. The conduesive investment climate and better legal and administrative nature of the economy makes doing business an easy one. Between 1982 and 1992, the government of Ghana implimented the Strutural Adjustment Program[12] and this was accompained by various transforamtion including signing of varoius trade treaties and agreements within the Wrold Trde Organization, and also liberalization of the financail sector which encourages foreign investments to flow.The liberal foreign direct investment Ghana's (FDI) policy makes Ghana a safe destination for investment opportunites, not forgetting the rich wealth of natural resources that exist.

Investment regulations allows foreign investors to employ foreign nationals in Ghana, the GIPC's investor-targeting strategy has identified China as one of ten countries with potential to increase investment in Ghana and plans to open an office in Shenzhen, a sub-provincial city in Guangdong province, to facilitate investment between China and Ghana. Investment forums and missions staged in both Ghana and China will implement plans – now in development – to improve language integration, investment drives and promotional activities.[13]

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[11] Kudina.A, and Jakubiak, M. [2008], *The Motives and Impediments to FDI in the CIS*, Global Forum on International Investment, 27–28 March.

[12] See more on: http://dspace.knust.edu.gh:8080/xmlui/handle/123456789/2969 [access: 05.08.2017]. - for detailed information on the SAP program implemented from 1992-82, see the Ministry of Finance and Economic Affairs.

[13] See more on: *Looking East: China-Africa engagement-Ghana* - country case study, Accra, December 2009, http://acetforafrica.org/acet/wp-content/uploads/publications/2016/09/Looking-East-Ghana-China-Case-Study-2010.pdf [access: 06.08.2017].

4.2 Special Economic Zones and the Gateway Programme

"The Ghana Free Zones Scheme, in 1995 the parliament of Ghana promulgated the Free Zones Act which will be signed in to law. This Act of parliament was to accelerate the exploration of the countries potential. In order to assist the activities of the export processing zones (EPZs), the Ghana Free Zones board was established to help monitoring the activities respectively. The EPZs is specialized in industrial sector, located physically and administratively without and outside the jurisdiction of custom barrier, and is focused towards export production. This zone helps attract investors into various sectors because of the incentives it provides in itself as an administrative and policy making body, when it relates to investment. The main objective of this Act is the attraction of FDI. To achieve this there have some provisions to achieve such an objective:

- The enjoyment of a tax exemption for in relation to income or profit tax for 10 years.
- Payment of a minimum 8%, after the tax exemption after 10 years.
- The possibility of withholding Tax on dividends accruing form free zone investments.
- The opportunity to hold all 100% share in any free zone venture.
- The assurance of in respect of repatriation of earned profits and also against the policy of Nationalization of assets in case change of government or regimes.

The New Partnership for African Development (NEPAD) is also one very important policy directions."[14] The introduction of the Gateway programme with the objective of promoting Ghana as an investment and trade destination center in the hub of West Africa was also established, the approach is emphasizing on export processing zones and foreign direct investment. Part of the agenda was also to attract the establishment of financial, transport services, telecommunication networks thus enhancing Ghana's position as an Economic hub and power house in the region. The emphasis on developing three export free zones enclaves by private operators, whiles the government provides the framework for investment. The Program also focused on ISO 9000 and International Chamber of Commerce (ICC) standards.[15]

[14] Abodakpi, J. [2012], *Multinational Corporations and Spillover Effects in Ghana – A Look at FDI, Its Targets, Impacts, and Potential*, Unpublished Master thesis, UEK, Cracow, p.34-35.
[15] Ibidem.

5 Trends of Foreign Direct Investment in Ghana

The inflow of FDI volumes has been steady over a period of time after the recent global recession of 2008 but on the whole "(…) Ghana has been one of the world's fastest-growing economies, on the back of the emergence of its oil industry and underpinned by its political stability and the strength of its other commodity sectors. While GDP growth is expected to slow this year, the Ghana Investment Promotion Centre (GIPC) is targeting a 20% increase in foreign direct investment (FDI), following a dip in 2013"[16] and this trend continue to be positive. The World Bank's "Doing Business 2014" ranks Ghana 67th out of 189 countries – one of the best performing economies in Africa and above certain European Member states. Ghana's business environment has improved with respective ranking of 28th in the world for accessing credit facilities and 34th for investor protection respectively[17].

In the decomposition of investments, foreign direct investment accounts for a value of US$203.74million (98.55%) of total value, whereas about US$3 (1.45%) million accounts for local currency component with total foreign equity amounting to US$36.32 million. During the same period US$19.64 million was also recorded as initial equity transfer. Analysing the countries with much projects, China still tops with 11 projects, but in terms of estimated value of projects France tops with an amount of US$127.83 million.[18]

In the second half of 2017, the total number of projects registered was 46, with 35 of these projects being fully foreign owned representing 76 % and an estimated value of US$61.75 million, accounting for almost 30% of the total value of projects. Of this registered investments, 11 were joint ventures between Ghanaian and foreign partners with an estimated value of US$144.98. The distribution of registered Ghanaian projects also saw significant improvements with 20 investments being made in various regions of the country. The highest registered number of projects of 14 in the Capital regional city of Ghana, Accra. Furthermore, the service sector registered 8 projects being the top among sectorial distribution of projects registered. The economic benefits of these registered projects also have created about 497 jobs which will also impact

[16] http://www.oxfordbusinessgroup.com/news/ghana-targets-20-fdi-increase-2014 [access: 06.08.2017].
[17] Ibidem.
[18] For further details, see more on: GIPC quarterly report 2017 - Volume 13, Issue 2.

the national GDP. China has managed a place in the top 10 investor countries since establishing trade and economic relations with Ghana.[19]

Table 1 Top 10 Source of Investments by FDI Value (II quarter, 2017)

Countries	FDI Value [US$M]	FDI Value [%]
France	127.83	64.75
Democratic …	20.00	10.13
China	17.80	9.02
USA	9.06	4.59
Mauritius	5.98	3.03
Switzerland	5.50	2.79
India	3.22	1.63
Netherlands	3.20	1.62
Turkey	2.72	1.38
South Africa	2.10	1.06
Total	**197.41**	**100.00**

Source: Own calculations based on: GIPC, Annual Investment Report, II quarter, 2017, Volume 13, Issue 2, p.3.

Table 2 Top 10 Investor countries by FDI Value (I and II quarter, 2017)

Countries	FDI Value [US$M]	FDI Value [%]
Netherlands	2,437.60	77.85
India	405.36	12.95
France	128.83	4.11
United Kingdom	49.71	1.59
China	44.84	1.43
Democratic …	20.00	0.64
USA	15.39	0.49
Canada	12.08	0.39
Kenya	9.19	0.29
Mauritius	7.98	0.25
Total	**3,130.98**	**100.00**

Source: Own calculations based on: GIPC, Annual Investment Report, II quarter, 2017, Volume 13, Issue 2, p.6.

The devaluation of the cedi as a consequence of massive trade and current account imbalances also poses as one of the main sources of problems for investors. Example in 2013 the currency witnessed a massive and sharp decline of 15% in against the dollar, making it one of the worst performing currencies at that time but has stabilised over recent months and years. Numerous measures and mechanisms have then been put in place to protect the currency and boost investor confidence in the economy,

[19] Ibidem.

despite all these setbacks, the country still remains one of the largest FDI recipients in West Africa.

6 Concluding Remarks

Within the legal and institutional framework for investment in Ghana, The Ghana Investment Promotion Centre (GIPC) is governing institution for investment promotion agency and mandated to promote and attract foreign direct investment into the country. The contribution of foreign direct investment (FDI) to Ghana's yearly GDP cannot underestimate; hence efforts must be put in place to facilitate the smooth functioning of this institution.

The effects and implication with respect to foreign direct investment has many diverse outcomes. Employment of labor both skilled and unskilled has been a major positive contributing factor when analyzing the investment climate in Ghana. There is training made available and also technological transfers as well as spillovers in the various sectors which also employs experts, this helps upgrades the human development index of the country in a context. But on the contrary it is obviously clear that the quantity of export commodities from Ghana to other trading partners is abysmally lower in comparison to the percentage and Volume of imports from China in terms of goods and services to Ghana[20]. The manufacturing sector of the Ghanaian economy and other African countries like South Africa, Nigeria and others are missing out on the opportunities with trade in the Chinese markets and other Asian economies.

Because of the increasing and growing Asian Investment, especially Chinese business and investment with majority shareholder control, the industrial sector is being challenged with the increase and continuous importation of manufactured goods. The fears competition of this sector is both external and international, as a result of the smaller size of the Ghanaian economy and the stiff competition it faces due to aspects of globalization, market liberalization and deregulation policies. Governments must put policies and regulations in place to protect infant and growing industries in all sectors of the economy. Another area which has raised serious concerns has been the textile industry in Ghana. The sector faces unequal competition, due to heavy subsidized Cheap Chinese textile flooding the markets of Ghana, making

[20] See more on: *Looking East: China-Africa engagement-Ghana* - country case study, Accra, December 2009, http://acetforafrica.org/acet/wp-content/uploads/publications/2016/09/Looking-East-Ghana-China-Case-Study-2010.pdf [access: 06.08.2017].

it difficult to sell quality products produced in Ghana. Policy directions towards certain sensitive areas of the economy must be protected to enhance the development of local industries and protect national pride respectively.

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