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Private Investment, FDI and Trade Openness in Ghana

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Abstract:
Various policy analysts contend that, the private sector is the engine of economic growth and development. However, to ensure rise in private investment, in addition to other measures, governments are normally encouraged to liberalize their economies as well as institute measures that would encourage the inflow of foreign direct investment (FDI). Therefore, given that previous studies on Ghana focused on how FDI and Trade openness affect economic growth with less attention on their impact on Private Investment, this study filled the gap in the literature by investigating how trade openness and FDI affect private investment in Ghana. By employing time series data on Ghana from 1975 to 2014 and the Ordinary Least Square Regression Technique with further robustness tests, the study found that trade openness and real GDP have positive effects on private investment in Ghana. However, FDI and public investment were insignificant. Therefore, liberalising the Ghanaian economy could be an effective means of boosting private investment which is seen as the engine of economic growth and development.

Keywords: *Private Investment, FDI, Trade Openness, Ghana*

1. Introduction

In various governments attempts to ensure economic development through job creation which would end up bettering the welfare of people, expansion in the private sector has been regarded as one of the most important strategies.

Thus, expansion in the private sector would propel economic growth and create job opportunities for people which would end up bettering their welfare and hence attaining economic development. Therefore, the private sector is largely seen as the engine of economic growth and development.

To ensure rapid growth of the private sector, many strategies have been adopted with some of the most important ones being liberalizing economies as well as creating enabling environments in order to attract massive foreign direct investments (FDI). As such, international trade enhancing initiatives as well as favourable policies to attract FDI have been adopted by various governments of which Ghana is no exception.

However, the other contrary view is that, especially in developing countries, opening up an economy for massive international trade may end up stifling the growth of local firms especially the private firms given their inability to compete head to head with the already established firms in advanced economies who are able to produce more at a lower average cost and hence may end up charging lower prices for their goods. Thus, since firms in advanced economies are more efficient due to larger economies of scale, they may end up pricing out or collapsing the relatively younger and inefficient firms in developing countries. Given the above, some leaders of developing countries are quite reluctant in liberalizing their economies in the name of protecting local firms, which include private ones.

In Ghana, various trade enhancing drives have been embarked upon as well as policies towards attracting more FDI. Further, the private sector in Ghana employs more people than the public sector and hence seen as the engine of growth and development. However, surprisingly most of the studies in Ghana have rather focused on largely how trade openness and FDI affect economic growth with very little attention on how openness and FDI affect private investment in Ghana.

Therefore, with Ghana having a high-level unemployment with an expansion in the private sector seen as a major solution, this study sought to investigate how policies geared towards ensuring expansion in the private sector in the form of trade liberalisation and FDI inflows, have impacted on private investment in Ghana.

Thus, this would bring to light the impacts of trade liberalisation and FDI inflows on private investment in Ghana and hence inform policy makers as to whether to continuously use trade liberalisation and FDI inflows as tools to ensure the growth of the private sector in our attempt to oust unemployment and hence attain economic development.

2. Brief Review of Literature

The theoretical literature on international trade contend that trade among countries would result in economic growth for these countries and hence an improvement in the well-being of people globally. Thus implicitly, international trade would foster the growth of the private sector in participating countries.

However, those who believe in trade protectionism contend that, if care is not taken, competitive, well established and efficient firms in developed economies may collapse or compete out young and inefficient firms in developing or less advanced economies. Therefore, retarding economic growth and private sector investment in developing countries. Given this, trade protectionist is always very cautious in opening up their economies.

Similar circumstance has to do with the impact of FDI on economic growth and development. Thus, whereas some believe FDI may propel the growth of recipient countries, others are of the view that it may retard the growth of certain economies especially less developed ones.

On the empirical literature, Eller (2005) and Lai et al. (2006) have all found positive effects of FDI whiles a negative relationship between FDI and economic growth was found by Frey (1992). Also, a negligible impact of FDI on 16 Arabian economies was found by El-Wassal (2012) and a positive impact of FDI on the Agric sector in Nigeria was found by Oloyede (2014).

On Ghana, Immurana, Abdul-Rahman and Iddrisu (2013) found trade liberalization to increase tax revenue, Sakyi (2011) revealed a long run relationship between economic growth, foreign aid and openness. Djokoto (2013) studied how openness proxied by FDI has impacted on agricultural performance in Ghana. Also, a positive association between FDI and economic growth was found by Antwi et al. (2013). Frimpong and Oteng-Abayie (2006), Frimpong and Oteng-Abayie (2008), Insah (2013) have all studied FDI and economic growth in Ghana. Immurana, Yensu, Sahabi and Adam (2015) have studied the impact of FDI on economic growth and the service sector value additions in Ghana. Also, Iddrisu, Immurana and Halidu (2015) have investigated the impact of FDI on the Agric sector in Ghana.

However, among all the above studies on Ghana, it can be observed that none of them investigated how trade liberalization (openness) and FDI influence private investment. Therefore, given the various attempts being made to liberalize the Ghanaian economy as well as attract more FDI, with the private sector being seen as the engine of economic growth and development, it remains important that a study is conducted to investigate the impacts of trade openness or trade liberalization and FDI inflows on private investment in Ghana.

2.1. Methods

This section tackled the sources of data for the study as well as the empirical estimation strategy.

2.2. Data

The study used time series data on Ghana from 1975-2014 extracted from the World Development Indicators data base of the World Bank and Global Development and Network Growth Database. The variables included in the study were Private Investment as a percentage of GDP (PRI), Trade Openness (OPEN) measured as imports plus exports as a percentage of GDP, Net Inflows of Foreign Direct Investment as a Percentage of GDP (FDI), Public Investment as a Percentage of GDP (PUBI) and real per capita GDP (RGDP). Thus, the dependent variable of the study was Private Investment as a percentage of GDP (PRI) with all the other variables being independent variables.

2.3. Empirical Model of Estimation

In our attempt to find out the impact of Trade Openness and FDI on Private Investment in Ghana, the study specified equation 1 using the ordinary least square regression technique as found below:

$$LNPRI_t = \varphi_0 + \varphi_1 LNOPEN_t + \varphi_2 LNFDI_t + \varphi_3 LNRGDP_t + \varphi_4 LNPUBI_t + \varepsilon_{t,} \quad (1)$$

The meanings of the variables remain as stated above with φ_0 being the intercept of the regression equation whiles $\varphi_1, \varphi_2, \varphi_3,$ *and* φ_4 are the coefficients of the various explanatory variables and the error term being ε.

In order to bring the variables to the same unit and hence curb heteroskedasticity, we specified them in natural logarithmic form. Also, the study employed the variance inflation factor as a test of multicollinearity, the Breusch-Pagan / Cook-Weisberg test for heteroskedasticity, the Breusch-Godfrey LM test for autocorrelation and the Ramsey RESET test of functional form in order to further show the robustness of our results.

3. Results and Discussion

This section tackled the results and discussion on the impact of Trade Openness and FDI on Private Investment in Ghana as outlined below.

Variable	Coefficient	Standard Error	P-value
LNOPEN	.1234919	.0238604	0.000
LNFDI	.0022661	.0024457	0.361
LNRGDP	.1108654	.0395579	0.008
LNPUB	-.2477511	.1657936	0.144
Constant	-.6406702	.2342636	0.010

Table 1: The Impact of Trade Openness and FDI on Private Investment in Ghana
Source: Authors Computation from data sources stated above, Number of obs = 40, Prob > F = 0.0000 and R-squared = 0.8761

The overall P-value (Prob > F) of our model which was significant at 1% revealed the robustness of our results. Further, the R-squared of 0.8761 showed that about 88% of the variation in private investment is explained by the independent variables.
The results in Table 1 showed that, FDI and public investment had no statistically significant impact on private investment in Ghana even though FDI had a positive coefficient.
Also, trade liberalization was found to have a positive coefficient of .1234919 that was statistically significant at 1% since its P-value of 0.000 was less than 0.01. Thus a 1% increase in openness or trade liberalization would lead to a 0.1% increase in private investment. The implication is that liberalizing the Ghanaian economy exerts a positive influence on the growth of the private sector which is largely seen as the engine of economic growth and development.
Further, real GDP had a positive 1% significant coefficient of .1108654 which implied that a 1% increase in real GDP led to a 0.1% increase in private investment in Ghana. This result is similar to the finding on openness above. Thus, an expansion in the productive capacity of the economy could further lead to a growth in the private sector.

H_o: no serial correlation			
lags(p)	**Chi2**	**df**	**Prob > chi2**
1	0.767	1	0.3811

Table 2: Breusch-Godfrey LM test for autocorrelation
Source: Authors Computation from data sources stated above

Ho: Constant variance	
Chi2(1)	**Prob > chi2**
0.31	0.5798

Table 3: Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Source: Authors Computation from data sources stated above

Ho: model has no omitted variables	
F (3, 32)	**Prob >F**
1.36	0.2719

Table 4: Ramsey RESET test of Functional Form
Source: Authors Computation from data sources stated above,

Variable	VIF	1/VIF
RGDP	5.56	0.179756
FDI	3.98	0.251550
OPEN	3.96	0.252559
PUB	2.44	0.409427

Table 5: Test for Multicollinearity Using the Variance Inflation Factor (VIF)
Source: Authors Computation from data sources stated above

Additionally, results from Tables 2, 3, 4 and 5 proved that our model did not suffer from autocorrelation, heteroskedasticity, incorrect functional form and multicollinearity and hence additionally proving the robustness of our results.

4. Conclusion

Based on the findings, this study therefore concluded that liberalizing the Ghanaian economy could be an effective means of enhancing private investment in order to attain economic development through job creation. Thus, as the private sector expands, more people would be employed which would end up improving their welfare.

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