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The Importance of Absorptive Capacities in the Foreign Direct Investment-Growth Nexus: Evidence from Sub-Saharan Africa

Authors : Edmund Kwablah, Anthony Amoah

Abstract : The merits associated with Foreign Direct Investment (FDI) inflows to host countries in Sub-Saharan Africa cannot be overemphasized. Against this background, countries have sought to design and implement strategic policies geared towards enhacing FDI and promoting economic growth. In this study, we used the Fully Modified Ordinary Least Squares technique and a panel data for Sub-Saharan African (SSA) countries spanning from 1998 to 2016. We hypothesize that FDI's effect on economic growth is contingent on some absorptive capacities (e.g., financial market development and economic freedom) of the host country. We used financial market data that accounts for market fragility as a measure of financial market development and economic freedom data which uses the overall score of all the freedom indicators as a measure of economic freedom. Our results suggest that FDI has a statistically positive effect on economic growth when we account for host country's absorptive capacities. However, a negative relationship will ensue if these absorptive capacities are not accounted for. We recommend that a developing continent like SSA should focus on identifying and building the relevant absorptive capacities that can translate the effect of FDI into a positive growth. This is because an economy with sound absorptive capacities reduces business risk and spur economic growth.

Keywords : FDI, absorptive capacity, economic growth, FMOLS, Fully Modified Ordinary Least Squares, SSA
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