UNIVERSITI TEKNOLOGI MARA

THE IMPACT OF POLITICAL INSTABILITY ON FOREIGN DIRECT INVESTMENT IN MALAYSIA: A SECTORAL LEVEL ANALYSIS

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ABSTRACT

Foreign Direct Investment (FDI) is a critical driver of economic growth and development, particularly in developing nations such as Malaysia. However, the country's recent episodes of political instability have introduced significant uncertainties regarding its ability to attract and sustain FDI. This study rigorously examines the impact of political instability on FDI inflows across Malaysia's primary, secondary, and tertiary sectors from the first quarter of 2008 to the fourth quarter of 2023. This study examines the impact of political instability on FDI in Malaysia, focusing on sectoral variations across the primary, secondary, and tertiary sectors. Using quarterly data from 2008 to 2023, the research employs the Autoregressive Distributed Lag (ARDL) model to investigate both the short-run and long-run effects of political instability on FDI inflows. Political instability, a recurring issue in Malaysia's recent history, is analysed alongside key macroeconomic variables such as GDP growth, interest rates, exchange rates, and trade openness. The findings reveal that political instability exerts a significant negative impact on FDI across all sectors, with the primary sector being the most adversely affected. In contrast, the secondary and tertiary sectors, though also impacted, exhibit less sensitivity to political volatility. The study further identifies that macroeconomic factor, particularly GDP growth and interest rates, play crucial roles in shaping FDI inflows. GDP growth is shown to positively correlate with FDI, reinforcing the notion that a robust economy attracts foreign investment. Conversely, higher interest rates are found to deter FDI by increasing the cost of capital, particularly in the primary and secondary sectors. Trade openness has a positive but varied impact across sectors, while exchange rate fluctuations show limited influence on FDI. This research contributes to the existing literature by offering a sectoral analysis of FDI determinants in Malaysia, highlighting the significance of political stability and macroeconomic management. The findings provide valuable insights for policymakers seeking to attract and retain foreign investment, emphasizing the need for stability, favourable macroeconomic conditions, and targeted policies to address sector-specific challenges.

Keywords: Foreign Direct Investment, Political Instability, Primary Sector, Secondary Sector, Tertiary Sector, ARDL model, Malaysia

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CHAPTER 1
INTRODUCTION

1.1 Introduction

Foreign direct investment (FDI) has emerged as a cornerstone of economic growth and development in the globalized world. This form of investment, typically involving capital flows from multinational corporations (MNCs) into foreign countries, is pivotal in shaping economies, particularly in developing and transitioning nations. FDI facilitates the establishment or expansion of operations abroad, providing both the host and home countries with significant economic and strategic benefits. The crucial role of FDI is underscored by its potential to enhance productivity, generate employment opportunities, foster innovation, and facilitate the transfer of technology and managerial expertise across borders. These benefits are not only crucial for economic growth but also for enhancing global economic integration (Borensztein et al., 1998; Alfaro et al., 2004).

The importance of FDI as a conduit for economic advancement cannot be overstated. Its impact transcends mere capital flows, as it also serves as a vehicle for knowledge and technology transfer, thereby contributing to the modernization of industries in host countries. MNCs, through their FDI activities, introduce new technologies, operational practices, and management techniques to the countries in which they invest. This technology transfer is particularly valuable for developing countries, as it helps bridge the technological gap between them and more developed nations. Furthermore, the spillover effects of FDI often stimulate domestic industries, encouraging innovation and competitiveness within the local economy. The creation of jobs, both directly and indirectly, as a result of FDI further contributes to the host country's economic development, enhancing living standards and reducing poverty.

Additionally, FDI helps integrate economies into the global market, as foreign investments often lead to developing export-oriented industries. These industries not only boost the host country's export capacity but also expose it to international competition, driving improvements in productivity and efficiency. By engaging with global markets, countries can diversify their economic base, reducing dependence on domestic markets and promoting more balanced and sustainable economic growth.