THE IMPACT OF FOREIGN DIRECT INVESTMENTS ON THE ECONOMIC GROWTH RATE AND DOMESTIC INVESTMENTS OF MALAYSIA

RESEARCH MANAGEMENT INSTITUTE
UNIVERSITI TEKNOLOGI MARA
40450 SHAH ALAM
SELANGOR DARUL EHSAN
MALAYSIA

BY:

YONG SZE WEI
CHONG VUI HOK
GAN SIEW LING

MARCH 2012

S.NO	TITLE CALL NO. PLACE/PUBLISHER/YEAR	ICAT SMD NOTE AREA	ISBN AUTHOR	VOLUME OFFICER	LOCATION DATE	STATUS
1.	THE IMPACT OF FOREIGN DIRECT INVESTMENTS ON THE ECONOMIC GROWTH RATE AND DOMESTIC INVESTMENTS OF MALAYSIA					Marked For Digitization
		ITM			SWK	
	113061	ITM	Yong Sze Wei	174172	18/04/2018	
	Kota Samarahan, Sarawak / Universiti Teknologi MARA. Faculty of Business Management / 2012	UiTM Digitization				

Summary :

Total Titles : 1 **Total Copies : 1**

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5. Report

5.1 Proposed Executive Summary

Malaysia was among the countries in Southeast Asia which experienced rapid economic growth since the 1970s. In fact, during the period, Malaysia underwent significant economic transformation, from an agricultural-based to a manufacturing and service-based economy. Although her growth was somewhat derailed by the Asian Financial Crisis in 1998 – 1999, Malaysia had since recovered. The recovery was seen to be in no small part due to the contribution from foreign and domestic investments. In particular, foreign direct investments (FDIs) had been viewed as an engine of economic growth in Malaysia through its spillover effects such as capital injection, technology transfer and creation of job opportunities.

In spite of the perceived beneficial impacts of FDIs, the government targetted to reduce Malaysia's dependence on FDIs and to raise the proportion of domestic private investments (DPIs) to 60% of total investments by 2020. Therefore, does the inflow of FDIs in Malaysia crowd out domestic investment or complement it?

Due to that, the main objective of the study is to investigate the relationship and effect of domestic investment in boosting the Malaysia economic growth as compared with foreign direct investment in this globalization era. The time series data from the period of 1970 until 2009 will be adopted in order to capture the different implications of the domestic and foreign investment towards Malaysia economic growth particularly prior and post crisis. Methods that applied in this study consist of Unit Root Test, Cointegration Test, Granger Causality Test based on Error Correction Model and Impulse Response function.

Major contribution of this study is to provide essential insights to the policymaker in strategizing the appropriate policies to the allocation of aggregate investment for the country.

5.2 Enhanced Executive Summary

Foreign direct investments (FDIs) refer to investments that established a lasting interest in or effective management control over an enterprise in a foreign country. FDIs may include buying shares of a foreign-owned business enterprise, reinvesting earnings of the foreign enterprise in the country where it is located, and parent firms extending loans to their foreign affiliates. It may take the form of 'greenfield' investments or mergers and acquisitions (M&As). Malaysia had traditionally promoted FDIs as a complement to domestic investments (DIs) for the achievement of economic growth and development. Nevertheless, the dependence on FDIs had its drawbacks, among which is the uncertain quantum of inflows. Further, the beneficial effects of FDIs on economic growth had not been universally substantiated, both theoretically and empirically.

This study is undertaken to investigate the impact of FDIs on the economic growth rate of Malaysia and to determine the extent and nature of 'crowding' effect of FDIs on DIs. It employs the multivariate cointegration technique. The study utilized annually foreign and domestic investments time series data of Malaysia covering the period 1980 - 2010. Among the findings were that an inverse relationship existed between FDIs and economic growth in the long run. Conversely, there was a significant and positive association between DIs and the economic growth of Malaysia. Further, it was found that FDIs had a 'crowding-in' effect on DIs in Malaysia.

5.3 Introduction

The World Bank (2011) defined foreign direct investments (FDIs) as 'investments that established a lasting interest in or effective management control over an enterprise (in another country). FDIs could include the buying of shares of an enterprise in another country, reinvesting earnings of a foreign- owned enterprise in the country where it is located, or parent firms extending loans to their foreign affiliates. FDIs may be in the form of 'greenfield' investments, also known as 'mortar and brick' investments or mergers and acquisitions (M&As). The latter involved the acquisition of existing interests rather than new investments.

Since the onset of globalization in the early 1990s, there had been an explosive growth of FDIs, mostly involving multinational corporations. Subsequently, FDIs had become an increasingly important source of investment capital for developing and less developed countries. According to the United Nations Conference for Trade and Development (UNCTAD), (2001), the flow of FDIs to less developed countries increased by sevenfold between 1991 and 2000 while the value of FDIs increased by fivefold. According to the World