The Effect of Public Debt on FDI-Growth Nexus: A Panel Analysis

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JUNE 2017

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4.2 Enhanced Executive Summary

This paper aims to examine the linkages between Foreign Direct Investment and economic growth from public debt perspectives for five ASEAN countries, namely Indonesia, Malaysia, the Philippines, Singapore and Thailand over the period of 2000 to 2013. Precisely, this paper attempts to determine the long run relationship of FDI and economic growth and the impact of FDI on economic growth with the existence of public debt threshold effect via the panel analysis. The empirical result indicates that there is a positive and significant cointegrating relationship between FDI and economic growth for ASEAN-5 countries in long run. Furthermore, the result shows that the elasticity of GDP with respect to FDI is 0.526% by using the Fully Modified OLS (FMOLS) and 0.147% through the Dynamic OLS (DOLS) methods. Finally, our finding reveals that the impact of FDI on economic growth shows diminishing trends after public debt exceeds the pre-determined threshold level. This study provides new evidence to the policy makers and market investors on the role of public debt which bring the impact to the FDI and economic growth nexus. Thus, it is important for policy makers or government to emphasize on the different aspect such as public debt in formulating FDI policy in order to attract FDI inflow substantially to the host country.

4.3 Introduction

Foreign Direct Investment (FDI) remains as one of the essential tools in stimulating the economic growth for developing countries, especially for Association of Southeast Asian Nation (ASEAN) countries in the 1990s. This is due to the positive spillover effects from FDI such as technology transfer, increased productivity, employment opportunities and others. Although the internal (such as 1997 Asian Financial crisis) and external (such as 2008 global financial crisis) uncertainties in the recent years contributed to the regional and global instability, the inflow of the FDI in this region remain favorable. Many economists and academicians suggested that FDI play vital roles in the host country's economic growth in terms of capital accumulation as well as enhancement of total factor productivity. (de Mello,1999; Nair-Reichert and Winhold, 2001; Merican, 2009; Mehic et al., 2013; Yucel, 2014) On the contrary, there are several literatures that show different findings where FDI does not impact economic growth. (Hermes and Lensink, 2003, Ayanwale, 2007; Belleoumi, 2014). The mixed evidences of FDI and economic growth nexus indicate that there is no universal consensus about the positive linkage between FDI and economic growth. There are many possibilities and other determinants that might affect the relationship between FDI and economic growth. Therefore, it is crucial to examine FDI and economic growth nexus from various perspectives to fill the existing gap in the literature review.

The United Nations Conference on Trade and Development (UNCTAD) report in 2015 revealed that ASEAN is the largest recipient of FDI in developing countries due to the resilient regional economic fundamentals, cost advantages and market factors such as regional integration among the ASEAN countries. These factors managed to attract investments mostly from ASEAN's Dialogue Partners such as Australia, China, the EU, Korea and the United States through the establishment of five ASEAN +1 free trade agreements (FTAs). Furthermore, ASEAN countries members also negotiating on the Regional Comprehensive Economic Partnership (RCEP) and Trans-Pacific Partnership (TPP) between four ASEAN countries members (Brunei Darussalam, Malaysia, Singapore and Vietnam) with other countries

4.4 Brief Literature Review

There are numerous literatures which examines the effect of the FDI on economic growth in order to find out the significance of FDI as engine of growth for developing countries. Most of the studies support the positive impacts of FDI towards growth due to the spillover effects via total factor productivity, human capital development, technology transfer, trade activities and others (Pradhan, 2009; Lean and Tan, 2011; Diaconu, 2014; Fadhil and Almsafir, 2015). Merican (2009) who studied on the effect of FDI and gross domestic investment towards Growth for ASEAN-4 (Malaysia, Thailand, Indonesia and the Philippines) via the Autoregressive Distributive Lag (ARDL) technique identified that FDI contributes to the economic growth in Malaysia and Indonesia but not for Thailand and the Philippines.

Meanwhile, Pradhan (2009) who analyzed the FDI-growth relationship for ASEAN-5 countries (Indonesia, Malaysia, Philippines, Singapore and Thailand) over the period of 1970-2007 found that there is long term relationship between FDI and economic growth in ASEAN-5 through panel integration test. Furthermore, Granger causality test for both individual level and panel level has been applied in the study proved that the existence of bidirectional causality between FDI and economic growth for ASEAN-5 except Malaysia at the individual level. However, Lean and Tan (2011) indicated that FDI has significant relationship towards economic growth for Malaysia and increase of FDI would lead to positive impact to the domestic investment of Malaysia. Another study by Moudatsou and Kyrkilis (2011) on the FDI and economic growth for the causality of EU and ASEAN (Indonesia, the Philippines, Singapore and Thailand) revealed that the existence of two-way causality between FDI and GDP per capital for Indonesia. Furthermore, the study by Diaconu (2014) on the FDI in South East Asia for the past decade concluded that South East Asia region is still a favorable region to attract FDI due to the competitive advantages. Recent study on Malaysia as one of the South East Asia country by Fadhir and Almsafir (2015) had found that FDI inflows associated with the human capital development contributed to the Malaysia's economic growth.