ON THE CAUSAL LINK BETWEEN FOREIGN DIRECT INVESTMENT AND GROWTH: COMPARISON IN MALAYSIA AND CHINA

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APRIL 2007

ABSTRACT

This paper analyses on the causal link between foreign direct investment and growth in developing countries likes Malaysia and China. The factors that will be analyzed are gross domestic product (GDP), inflation rate, current account balance and exchange rate as determinants of the level of foreign direct investment inflows. The purpose of this study is to examine the factor that effect foreign direct investment in Malaysia and China from 1974 to 2006. This study used Regression analysis method which is single and multiple regression to determine the coefficient of determination (R-Square) and ANOVA test to predict the relationship of the variables. From the result to make comparison which factor is a significant contributor to foreign direct investment inflow for Malaysia and China.

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CHAPTER 1

1.0 INTRODUCTION

This chapter will discuss on the background of the study. It contains the problem statement, objectives of the study, the significance of the study, scope of the study and the limitations of the study in doing this project paper.

1.1 Overview Malaysia Economy

The Malaysian economy is small and one of the most open economies in the world. Malaysia's economic openness has increased over the years. In 2005, it was the 33^{rd} largest economy in the world by purchasing power parity. Its gross domestic product for 2005 was estimated to be $290 billion.

Malaysia is a country on the move. The structural transformation of Malaysia's economy over the last 40 years has been spectacular. Often dubbed the "lucky country" because of its wealth of mineral resources and fertile soils, Malaysia did not rest on its laurels but took decisive steps to progress from an economy dependent on agriculture and primary commodities in the sixties, Malaysia has today become a manufacturing-based, export-driven economy spurred on by high technology, knowledge-based and capital-intensive industries.

The mid-1997 economic and financial crisis which hit several countries in the Asia Pacific Region and caused a currency crisis and stock market crash in Malaysia, provided proof of the strength and resilience of the Malaysia economy. Within less than two years, helped by selective exchange controls and pegging of the ringgit, Malaysia bounced back and went on track towards economic recovery.

The Malaysian economy has performed remarkably well over the years due to the country's political stability, the sound financial and economic policies adopted by the government, and efficient management of its natural resources which include oil and gas. Even more impressive is the fact that economic growth in Malaysia was achieved within an environment of relatively low inflation.

Malaysia's GDP grew at an average rate of 5.1% in the 1960s and 7.8% in the 1970s. In the 1980s, Malaysian economy continued to grow, albeit at a lower average rate of 5.9% due to the global recession in 1985-1986.

With the recovery of the world economy, the Malaysia economy grew rapidly from 1991-1995 at an average rate of 8.7% per annum. The growth momentum over the next five years from 1996-2000 was disrupted by the severe contraction in 1998 arising from the East Asian financial crisis. Malaysia's GDP had expanded at an average rate of 8.7% per annum during the period from 1996-1997 before registering a negative growth rate of 7.4% in 1998. Efforts by the government to resuscitate the economy starting from mid-1998 succeeded in generating an average growth rate of 7.2% during the period from 1999-2000. Overall, the economy grew better than expected at an average of 4.7% per annum during the period.

Through fiscal stimulus and accommodative monetary policies, the government was able to sustain growth due to the expansion in domestic demand and