

**AN ASSESSMENT OF THE RELATIONSHIP BETWEEN
MALAYSIA'S FOREIGN DIRECT INVESTMENT AND REAL
WAGES IN MANUFACTURING SECTOR.**

**INSTITUTE OF RESEARCH, DEVELOPMENT AND
COMMERCIALISATION
UNIVERSITI TEKNOLOGI MARA
40450 SHAH ALAM, SELANGOR
MALAYSIA**

PREPARED BY:

**AZLINA HANIF
ZURIYATI AHMAD
RUHAINI MUDA**

OCTOBER 2005

ACKNOWLEDGEMENT

First and foremost, on behalf of the research group, I would like to express our deepest gratitude to the Institute of Research, Development and Commercialization (IRDC) of Universiti Teknologi MARA for the provision of the research grant to finance this study.

A word of thanks also goes to the members of this research group, Puan Ruhaini Muda and Cik Zuriyati Ahmad for their tireless commitment, effort, and sacrifices rendered to ensure the timely completion of this research.

And last but not least, on behalf of the research group, I would like to extend our sincere thanks to our superiors and fellow colleagues especially Mr. Kamarudin Othman who have directly or indirectly contributed to the completion of this research.

ABSTRACT

The primary objective of this study is to examine the influence of real wages in Malaysia's manufacturing sector on the inflows of foreign direct investment in Malaysia, in terms of direction and the extent to which the former affects the latter. Secondly, the research intends to identify the effect of FDI inflows on the real wages, in terms of the magnitude and direction of change. We hope to empirically confirm the conventional perception that FDI can subsequently raise the real wages of labor in a host country, given the little consensus as to whether FDI inflows bring improvements, skills upgrading, and wages in the host country's manufacturing sector. The simultaneous equation model is used to investigate the two-way causal relationship between FDI and Real Wages, as an alternative method to Granger Causality Test. The technique of Two Stage Least Square is then employed in the regression. The findings suggest that real wage exerts a positive and significant effect on FDI and the reverse causation also holds true in similar trend.

TABLE OF CONTENTS

Title

Title Page

Offer Letter

Letter of Transmittal

Declaration

Acknowledgement

Table of Contents

List of Tables

List of Appendices

List of Abbreviations

Abstract

1.0 Introduction

1.1 Background

1.1.1 Private Capital Flows

1.1.2 Concepts and Definitions of Foreign Direct Investment

1.1.3 Foreign Direct Investment Flows in East Asia

1.1.4 Benefits of Foreign Direct Investment

1.1.5 Risk Associated with Foreign Direct Investment

1.1.6 Foreign Direct Investment Trend in Malaysia

1.1.7 Foreign Direct Investment and Malaysia's Manufacturing Sector

1.1.8 Foreign Direct Investment and Employment in Malaysia's Manufacturing Sector

1.1.9 Wage Trend in Malaysia's Manufacturing Sector

1.2 Problem Statement

1.3 Objectives

1.4 Hypotheses

1.5 Scope of the Study

1.6 Significance of Project

1.7 Structure of the Report

2.0 Review of The Literature

- 2.1 Introduction
- 2.2 Empirical Evidences on the Influence of Real Wages on the Inflows of Foreign Direct Investment
- 2.3 The Effect Of Foreign Direct Investment Inflows on the Real Wages
- 2.4 Conclusion

3.0 Theoretical Model

- 3.1 Introduction
- 3.2 Theoretical Model for Foreign Direct Investment
- 3.3 Theoretical Model for Wage
- 3.4 Conclusion

4.0 Empirical Model

- 4.1 Introduction
- 4.2 Statistical Approach
 - 4.2.1 Two Stage Least Square
- 4.3 Data
- 4.4 Conclusion

5.0 Results Of Empirical Analysis

- 5.1 Introduction
- 5.2 Findings on the Effect of Real Wages on Foreign Direct Investment
- 5.3 Findings on the Effect of Foreign Direct Investment on Real Wages
- 5.4 Findings on the Effect of Foreign Direct Investment and Real Wages on Employment
- 5.5 Conclusion

6.0 Summary and Policy Recommendations

- 6.1 Summary
- 6.2 Policy Recommendations
- 6.3 Limitations and Future Research

Reference

Appendices