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# Foreign Direct Investment and Economic Growth

A Thesis submitted to the Graduate School in partial  
fulfillment of the requirements for the degree  
Master of Economics  
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by

Khor Chia Boon

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## ABSTRAK

Pertengahan tahun 1980-an telah menyaksikan gabungan faktor-faktor yang menggalakkan aliran masuk pelaburan langsung asing (PLA) ke Malaysia. Seperti negara-negara sedang membangun yang lain, kerajaan Malaysia lebih mengalu-alukan kedatangan PLA daripada pelaburan portfolio kerana kerajaan mempercayai bahawa PLA dapat memainkan peranan yang penting dalam pembangunan ekonomi Malaysia. Memang tidak dapat dinafikan bahawa PLA telah banyak menyumbang kepada ekonomi Malaysia secara umumnya dan sektor pembuatan secara khususnya. PLA telah berjaya mempelbagaikan ekonomi Malaysia. Justeru itu, ekonomi negara kita tidak lagi bergantung kepada komoditi primer, tetapi sektor pembuatan telah muncul sebagai jentera penggerak ekonomi negara yang utama.

Objektif tesis ini adalah untuk menyiasat hubungan sebab-akibat antara PLA dengan pertumbuhan ekonomi. Topik ini agak lama dan telah dibincangkan oleh para penyelidik sejak tiga dekad yang lalu. Sejak tahun kebelakangan ini, minat dalam bidang ini dihidupkan semula, memandangkan pengiktirafan bahawa keterbukaan ekonomi dan aliran masuk modal antarabangsa (khususnya PLA) memainkan peranan penting dalam mempromosikan pertumbuhan ekonomi di negara-negara sedang membangun,

Kebanyakan kajian empirikal telah mengabaikan kewujudan hubungan sebab-akibat dua hala antara PLA dengan pertumbuhan ekonomi. Maka, kajian ini menggunakan analisis siri masa dan aplikasi "*Granger Causality*" untuk menentukan hubungan sebab-akibat antara PLA dengan pertumbuhan ekonomi di Malaysia.

Penemuan tesis ini ialah hubungan sebab-akibat dua hala wujud antara PLA dengan pertumbuhan ekonomi di Malaysia, di mana pertumbuhan dalam KDNK akan menarik masuk PLA, manakala PLA juga menyumbang kepada peningkatan dalam output negara.

## ABSTRACT

The mid 1980s saw the convergence of various factors which encouraged the inflow of FDI into Malaysia. Like most other developing countries, the Malaysian government welcome FDI rather than portfolio investment simply because the government believed that FDI would play an important role in Malaysia's economic development. It cannot be denied that FDI has contributed significantly to the Malaysian economy in general and the manufacturing sector in particular. FDI has played a key role in the diversification of the Malaysian economy, as a result of which the economy is no longer precariously dependent on a few primary commodities, with the manufacturing sector as the main engine of growth.

The objective of this thesis is to investigate the causal relationship between foreign direct investment (FDI) and economic growth. The topic is in fact quite old and has been discussed by researchers for the last 3 decades. Interest in this area has been revived in recent years largely due to the recognition that the economy's openness and international capital inflows (particularly FDI) play an increasing role in promoting economic growth in developing countries.

Most previous empirical studies have ignored the bi-directional causal relationship between FDI and economic growth. In this study, I employed time series analysis and Granger Causality test to determine the causal relationship between FDI and economic growth in the case of Malaysia.

The finding of this thesis is that bidirectional causality exist, between foreign direct investment and economic growth in Malaysia, i.e. while growth in GDP attracts FDI, FDI also contributes to an increase in output.

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## **CHAPTER 1 INTRODUCTION**

### **1.0 Introduction**

It is difficult to provide a comprehensive definition of foreign direct investment (FDI). Some authors define it in terms of its international characteristics and contrast it with portfolio investment; others express it in terms of the activities of multinational corporations (MNCs). Most definitions, however seem to have two common elements. One is that FDI involves at least two countries. This criterion relates to the multinational character of FDI. The other is the issue of ownership and control, which distinguishes FDI from portfolio investment. Foreign portfolio investment is a simple transfer of financial capital – equity or loan – from one country to another, whereas FDI involves the ownership and control of production activities abroad. FDI is more complex in nature than portfolio investment since it often involves the transfer of inputs such as technical know-how, managerial and organisational ability, and so on. Moreover, when the necessary finance is raised locally there is no capital flow at all, at least not in a strict sense. Finally, FDI is embodied in the activities of MNCs. Therefore the definition of FDI cannot be practically considered in isolation from the definition of a MNC, which is also difficult to establish.

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