DETERMINANTS OF ECONOMIC GROWTH IN MALAYSIA 1970-2010

By

NORAZRUL BIN MAT ROS

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Graduate School of Business
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Dean,
Othman Yeop Abdullah Graduates School of Business,
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Kedah Darul Aman.
Economic growth of a country can be seen in term of increase or growth of Gross Domestic Product (GDP). The rapid economic growth will result in per capita income growth and changes in national economic sectors. Thus economic growth is an important indicator in measuring economic development. The objective of this study is to examine the determinants of economic growth in Malaysia. This study uses trade openness, foreign direct investment, government development expenditure and gross fixed capital formation as an independent variables. The empirical analysis is based on time series data for 40 years for period 1970 to 2010. The model that used to tested the long run relationship is by using Johansen and Juselius cointegration approach shows that trade openness, foreign direct investment, government development expenditure and gross fixed capital formation are the determinants of economic growth in a long run. On the other hand, results that based on Vector Error Correction Model (VECM) shows that trade openness and foreign direct investment are the significant determinants of economic growth in a short run but bring negative impact to economic growth. Furthermore, an ECM variable is negative and significant, that postulates the cointegration among given variables. The response coefficient value is -0.343895, that suggesting moderate adjustment behavior, approx 34.4% percent of the disequilibria of the previous period’s shock adjust back to the long run equilibrium in the current year. Based on causality test in this study found that, firstly OPEN variable is Granger cause to GDP variable. Secondly is GDP variable is Granger cause to GDE variable. Thirdly is GDP variable is Granger cause to GFCF variable. Fourthly is OPEN variable is Granger cause to FDI, GDE and GFCF variables. Based on the Ordinary Least Squares (OLS) regression in this study shows that trade openness, government development expenditure and gross fixed capital formation fixed at 1 per cent significance level. This indicates that these variables have a positive effect on economic growth in Malaysia. While foreign direct investment variable is not significant to the growth of Malaysian economy. Results also shows that government development expenditure is the highest variables affect Malaysia economic growth of 1% increase in development expenses will lead to the growth rate increase by 2.16%. Second highest variable is trade openness of a 1% increase in trade openness will lead to 1.28% increase in the growth of the Malaysian economy. Third highest variable is gross fixed capital formation of a 1% increase in gross fixed capital formation will lead 0.98% increase in economic growth in Malaysia. Results obtained in this study suggest that policymakers should keep an eye on all of the significant variables since it will give impact on economic growth.
ABSTRAK

Pertumbuhan ekonomi sesuatu negara boleh dilihat dari sudut peningkatan atau pertumbuhan keluaran Negara kasar (KDNK). Pertumbuhan ekonomi yang pesat akan menghasilkan pertumbuhan pendapatan perkapita dan perubahan besar dalam sektor ekonomi negara. Kajian ini mempunyai objektif untuk mengkaji faktor-faktor penentu pertumbuhan ekonomi di Malaysia. Kajian ini menggunakan keterbukaan ekonomi, pelaburan langsung asing, perbelanjaan pembangunan kerajaan dan pembentukan modal tetap kasar sebagai pembolehduan bebas. Analisis kajian ini adalah untuk tempoh 40 tahun bermula tahun 1970 sehingga tahun 2010. Ujian kointegrasi berdasarkan pendekatan Johansen dan Juselius menunjukkan bahawa keterbukaan ekonomi, pelaburan langsung asing, perbelanjaan pembangunan kerajaan dan pembentukan modal tetap kasar sebagai penentu kepada pertumbuhan ekonomi dalam jangka masa panjang. Keputusan berdasarkan Model Pembetulan Ralat (VECM) bagi hubungan jangka pendek menunjukkan keterbukaan ekonomi dan pelaburan langsung asing signifikan terhadap pertumbuhan ekonomi dalam jangka masa pendek tetapi memberi kesan negatif kepada pertumbuhan ekonomi. Tambahan pula, pembolehduan ECM adalah negatif dan signifikan. Pembolehduhan ini menunjukkan lebih daripada 34.4 % pelarasan jangka pendek bagi penentu pertumbuhan ekonomi Malaysia. Hasil penganggaran ‘Ordinary Least Squares’ (OLS) yang diuji dalam kajian ini menunjukkan bahawa keterbukaan ekonomi, perbelanjaan pembangunan kerajaan dan pembentukan modal tetap kasar pegun pada aras keertian 1 peratus. Ini menunjukkan bahawa pembolehduhan ini memberi kesan positif kepada pertumbuhan ekonomi Malaysia. Manakala pembolehduhan pelaburan langsung asing adalah tidak signifikan terhadap pertumbuhan ekonomi Malaysia. Hasil penganggaran ini menunjukkan bahawa perbelanjaan pembangunan kerajaan adalah pembolehduhan yang paling tinggi memberi kesan kepada pertumbuhan ekonomi Malaysia iaitu 1% peningkatan dalam perbelanjaan pembangunan akan menyebabkan 2.16% peningkatan dalam pertumbuhan ekonomi Malaysia. Pembolehduhan kedua tertinggi ialah keterbukaan ekonomi iaitu 1% peningkatan dalam keterbukaan ekonomi akan menyebabkan 1.28% peningkatan dalam pertumbuhan ekonomi Malaysia. Pembolehduhan ketiga tertinggi ialah pembentukan modal tetap kasar iaitu 1% peningkatan dalam pembentukan modal tetap kasar akan menyebabkan 0.98% peningkatan dalam pertumbuhan ekonomi Malaysia. Hasil kajian menjadi satu petunjuk bahawa pembuat polisi seharusnya lebih peka kepada pembolehduhan-pembolehduhan yang signifikan ini semasa menggubal polisi kerana tanya merupakan faktor penting yang mempengaruhi pertumbuhan ekonomi.
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TABLE OF CONTENTS

PERMISSION TO USE  i
ABSTRACT  ii
ABSTRAK  iii
ACKNOWLEDGEMENTS  iv
TABLE OF CONTENTS  v
LIST OF TABLES  viii
LIST OF FIGURES  ix
LIST OF ABBREVIATIONS  x

CHAPTER ONE:  INTRODUCTION

1.1 Introduction  1
1.2 Malaysia Economic Performance  3
  1.2.1 Economic Growth Performance  3
  1.2.2 Trend and Flow of Trade Openness  7
  1.2.3 Theoretical study of Foreign Direct Investment  10
  1.2.4 Theoretical study of Government Development Expenditure  14
  1.2.5 Theoretical study of Gross Fixed Capital Formation  17
1.3 Problem statement  20
1.4 Objective of the study  22
  1.4.1 General Objective  22
  1.4.2 Specific Objective  22
  1.4.3 Significance of study  22
  1.4.4 Scope and limitation of study  23
  1.4.5 Organization of the study  23

CHAPTER TWO:  LITERATURE REVIEW

2.1 Introduction  24
2.2 Theoretical Framework  24
  2.2.1 Economic Growth Theories  24
  2.2.2 Theoretical study of Trade Openness  25
  2.2.3 Theoretical study of Foreign Direct Investment  27
  2.2.4 Theoretical study of Government Development Expenditure  29
2.1.5 Theoretical study Of Gross Fixed Capital Formation 31

2.3 Empirical Studies 32
  2.3.1 Trade openness 32
  2.3.2 Foreign Direct Investment 36
  2.3.3 Government Development Expenditure 40
  2.3.4 Gross fixed Capital Formation 44

CHAPTER THREE: METHODOLOGY

3.1 Introduction 47
3.2 Model Specifications 47
3.3 Measurement of Variables 49
3.4 Sources of data 52
3.5 Estimation Procedures 53
  3.5.1 Unit Root Test 53
  3.5.2 Vector Autoregressive Model (VAR) 54
    3.5.2.1 Johansen and Juselius test for Cointegration 55
  3.5.3 Granger causality test 56
  3.5.4 Ordinary Least Squared Method (OLS) 57
  3.5.5 Vector Error Correction Model (VECM) 58
  3.5.6 Diagnostic Test 59
    3.5.6.1 Auto-Regressive Conditional Heteroskedasticity (ARCH) 60
    3.5.6.2 Lagrange Multiplier (LM) test 60
  3.5.7 Normality test 61

CHAPTER FOUR: DATA ANALYSIS

4.1 Introduction 62
4.2 Unit Root Test 62
4.3 Cointegration Test 64
4.4 Pairwise Granger Causality Test 66
4.5 Gross Domestic Product Determinants 70
  4.5.1 Cointegration analysis 70
4.6 Diagnostic test 74
  4.6.1 ARCH test 74
  4.6.2 LM Test 75
  4.6.3 Normality test 75

CHAPTER FIVE: CONCLUSION AND POLICY IMPLICATION

5.1 Conclusion 77
5.2 Policy Implication 79
5.3 Recommendation of the Future Studies 84
## LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 4.1</td>
<td>Results of Unit Root Test</td>
<td>63</td>
</tr>
<tr>
<td>Table 4.2</td>
<td>Test result from Johansen procedure</td>
<td>65</td>
</tr>
<tr>
<td>Table 4.3</td>
<td>Pairwise Granger Causality Test</td>
<td>66</td>
</tr>
<tr>
<td>Table 4.4</td>
<td>Cointegration result for GDP determinants</td>
<td>70</td>
</tr>
<tr>
<td>Table 4.5</td>
<td>VECM result for GDP determinants</td>
<td>72</td>
</tr>
<tr>
<td>Table 4.6</td>
<td>ARCH test for GDP determinants</td>
<td>74</td>
</tr>
<tr>
<td>Table 4.7</td>
<td>LM test for GDP determinants</td>
<td>75</td>
</tr>
</tbody>
</table>
# LIST OF FIGURES

<table>
<thead>
<tr>
<th>Figure</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1.1</td>
<td>Economic Growth in Malaysia</td>
<td>3</td>
</tr>
<tr>
<td>Figure 1.2</td>
<td>Trade openness in Malaysia</td>
<td>8</td>
</tr>
<tr>
<td>Figure 1.3</td>
<td>Foreign Direct Investment in Malaysia</td>
<td>12</td>
</tr>
<tr>
<td>Figure 1.4</td>
<td>Government Development Expenditure in Malaysia</td>
<td>15</td>
</tr>
<tr>
<td>Figure 1.5</td>
<td>Gross Fixed Capital Formation in Malaysia</td>
<td>19</td>
</tr>
</tbody>
</table>
# ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADF</td>
<td>Augmented Dicky Fuller</td>
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<td>AIC</td>
<td>Akaike Information Criterion</td>
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<tr>
<td>ARCH</td>
<td>Auto-Regressive Conditional Heteroskedasticity</td>
</tr>
<tr>
<td>D-8</td>
<td>Developing Eight Organization</td>
</tr>
<tr>
<td>ECM</td>
<td>Error Correction Model</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GCC</td>
<td>Gulf Cooperation Council</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GFCF</td>
<td>Gross fixed capital formation</td>
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<tr>
<td>IMF</td>
<td>International monetary fund</td>
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<td>INC</td>
<td>Per Capita Income</td>
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<tr>
<td>INF</td>
<td>Inflation</td>
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<tr>
<td>LDC</td>
<td>Less Developed Country</td>
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<td>LM</td>
<td>Lagrange Multiplier</td>
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<tr>
<td>MWALD</td>
<td>Modified Wald Test</td>
</tr>
<tr>
<td>NKRA</td>
<td>National Key Result Area</td>
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<tr>
<td>NEP</td>
<td>New Economic Policy</td>
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<td>OLS</td>
<td>Ordinary Least Square</td>
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<td>OPEN</td>
<td>Trade openness</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
</tr>
<tr>
<td>SAARC</td>
<td>South Asian Association for Regional Cooperation</td>
</tr>
<tr>
<td>VAR</td>
<td>Vector Autoregressive</td>
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<tr>
<td>VECM</td>
<td>Vector Error Correction Model</td>
</tr>
</tbody>
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CHAPTER ONE

INTRODUCTION

1.1 Introduction

Sustainable economic growth is a desire of every countries in the world. Malaysia continue to move towards its vision of becoming a high-income developed country. Sustainable economic growth is an important factor to a country because a country can provide a good living standard for community (Osman, 1994). Malaysia is a country that practices a system of export oriented open economy. Malaysia economic growth is measured based on the percent change in the rate of Gross National product (GDP). When a country GDP increased from the previous year, the country is said to have growth in economy. The growth rate is equal to the percentage change in real GDP.

Lai (2003) state that economic growth is one of the key performance measures in the development and growth of the national economy. Economic growth shows the development of physical economy as an additional infrastructure and infrastructure increased from time to time and also will improve the living standards of the people as real income increases from time to time. Chaudhari (1989) defines the gross domestic product (GDP) as the total market value of all goods and services produced within the borders of a country for a period of one year. Lai (2002) also defines GDP as the total value of final goods and services produced by the factors of production owned by locals and foreign national of country.
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