The macro effect of foreign capital and aid on the economic growth in Malaysia

ABSTRACT

Economic interdependence among nations of the world has become important and enormously complex. Foreign capital and aid is an important form of economic interdependence because they are the main components of capital formation especially for the developing nation. A significant amount of foreign capital and aid which has amounted to around $30 billion of the world's gross domestic product, grows at an annual rate of 15 percent (higher than the economic growth rate of certain nation). Multinational corporations in search for profits in the developing nation undertake inflow and outflow of foreign capital in the form of foreign direct investment, skills and technology. This creates internal economies of scale for the parent company and external economies of scale for its subsidiaries. Overwhelming performance of foreign capital can also create external diseconomies of scale known as "stunting effects" for the developing nation. The government of the developed countries for political and humanitarian reasons also offers foreign aid. Foreign aid should be paired well with the stages of the economic development of a country to create increasing returns. This paper provides a critical analysis of growth in relation to foreign capital and aid in Malaysia. The analysis is divided into two sections. The first section looks at foreign capital and aid as an independent variable while the second section looks at foreign capital and aid as the dependent variable. Foreign capital is found to be positively correlated to economic growth and it is also highly significant compared to foreign aid which has no positive correlation and hardly contributes to Malaysia's economic growth. Finally some policy options are recommended to improve the economic growth in Malaysia.