

The relationship between economic growth and foreign direct investment in Malaysia analysis based on location advantage theory

ABSTRACT

Foreign direct investment is an important indicator to boost the economic growth of Malaysia. Foreign direct investment was identified as a medium in order to acquire skills, knowledge, technologies and to internationalize business and at the same time to reduce debts. However, in the year 2009, inflow of foreign direct investments into Malaysia had decline as much as 81.13 percent. McKern (1996), Kathuria (1998, 2000 and 2001) and Noorbakhsh et al., (2001) believed that foreign direct investment does not take place automatically in a nation. Whereby, inflow of foreign direct investment should be encouraged. Hence, this study aims to identify which location advantage channels and its threshold value that can influence the inflow of foreign direct investment into Malaysia. Location advantage channels were formed using human capital development, financial development and environmental condition whilst foreign direct investment was used as an interactive term as well as an independent variable. The results revealed that, without incorporating interactive terms, all the location advantage channels were able to stimulated economic growth. However, when location advantage channels were used as an interactive term with foreign direct investment, the result revealed that all the interactive term variables become insignificant towards economic growth. Thus, the study support that a certain value of location advantage channels are important as a precondition for foreign direct investment to have a positive effect on economic growth in Malaysia.