CHAPTER 5

CONCLUSION

The major aim of this study has been to examine graphically and empirically the role of foreign direct investment (FDI) as a determinant of the behavior of growth and savings. The study is essentially a time-series study on the impact of FDI on the economic growth and domestic savings of each of the 5 selected ASEAN countries. This study uses data on 5 selected ASEAN countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand) for the period 1970-2000.

Overall Findings

On the basis of the results from the analysis on the magnitude and trend of FDI inflows into the 5 countries from 1970-2000, it has been found that the 5 ASEAN countries has been and remains a highly attractive location for FDI, particularly following economic reforms in the ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) in the post-1986 periods. From the analysis on the magnitude of FDI inflows relative to GDP size and gross domestic capital formation (GDCF), the relative importance of FDI has been rising in the 1980s. In regard with the analysis of the impact of the financial crisis on FDI inflows to the 5 ASEAN countries in this study, it has been found that, in general, direct investors in these countries have proved to be much less skittish than other investors in responding to the crisis.

From the graphical and empirical analysis of this study, the following conclusions can be made:

i. FDI does show differential impact on the growth rate and saving rate of each country in this study. This is seen clearly in the graphical analysis where the relationship between FDI inflows, growth and saving rates vary from year-to-year for each country in this study. The empirical study shows that the magnitude, sign and significance of the variable FDI in the growth equation and savings equation varies from country to country.

ii. The FDI inflows into Indonesia, Malaysia and Singapore made significantly positive contribution to the economic growth of each country in the period 1970-2000. The FDI inflows into Thailand over the same period had a significantly negative impact on its economic growth.

The graphical analysis shows the occurrence of positive impact of FDI inflows on the growth of Indonesia, Malaysia, the Philippines and Singapore was more frequent than negative impact, whereas for Thailand the occurrence of negative impact was more frequent than positive impact.

The graphical analysis is supported by the regression results on the growth equation, which showed empirically that the sign of the coefficient of FDI is significantly positive for Indonesia, Malaysia and Singapore. For the Philippines, the coefficient of FDI in the growth equation carries a positive sign but it is not statistically significant. The regression analysis supports the orthodox position that FDI augments domestic savings and increases the investment rate, which

accelerates economic growth. The coefficient of FDI in Thailand's growth equation, on the other hand, shows a significantly negative sign.

The regression analysis of the single equation on growth also indicates that inflow of other foreign capitals, the domestic saving rate and the growth rate of labor also contributed positively to accelerate the economic growth rate of all the 5 ASEAN countries in this study.

The analysis also shows that saving rates contributed more to growth than FDI inflows for the Philippines and Singapore. This result suggests that domestically financed investment is more productive than FDI. Whereas, for Indonesia and Malaysia FDI inflows played a greater role in accelerating growth.

The regression analysis also indicates the importance of FDI inflows in growth in comparison with other foreign capitals, as shown in the result of the regression analysis of Indonesia, Malaysia, the Philippines and Singapore. This suggests that FDI was an important source of financing for Indonesia, Malaysia, the Philippines and Singapore.

iii. The impact of FDI inflows on the domestic saving rate was found to be significantly negative for Malaysia and Singapore. On the other hand, the impact of FDI inflows on Thailand's domestic saving rate was significantly positive over the period 1970-2000.

The graphical analysis showed that the relationship between FDI inflows and saving rates for Indonesia, Malaysia, the Philippines and Singapore was generally negative and the occurrence of negative impact of FDI on saving rates for these countries was more frequent than positive impact. Thailand generally

showed a positive relationship between FDI inflows and its domestic saving rate and the occurrence of positive impact was more frequent than negative impact. This again was supported by the regression results on the savings equation.

The regression results indicate that FDI inflows into Malaysia and Singapore had negative impact on the countries' saving rates. This is shown by the significant negative sign on the coefficient of FDI in the savings equation of each country. This is clearly contrary to the orthodox view. The regression result also indicates that FDI has only negatively affected the saving rates, but has not reduced the absolute level of savings for these countries, as the value of the coefficient of FDI lies between 0 and -1. Thus, the positive FDI contribution to economic growth expected by orthodox theory was reduced because of FDI's adverse effect on the domestic savings, which would reduce, instead of raising the investment rate.

The FDI inflows into Thailand, on the other hand, showed a positive impact on its domestic saving rate. The regression analysis on saving rates also indicates that growth rate, export and growth rate of labor contributed positively in the saving rate equation.

Policy Implications

The most important policy implications of the major findings from this study is that, although FDI has a positive role to play, growth of labor force and domestic savings rate have also contributed favorably to growth. FDI inflows serve to augment and not substitute domestic saving and growth rate of labor in

accelerating the growth process. Thus, in evolving a strategy to improve growth performance, recipient countries are well advised to improve the rate of domestic saving mobilization and to achieve more rapid increases in labor productivity. These tasks may involve difficult choices and tough policy measures, but there is no escaping the implication that reliance on FDI alone does not offer the solution for high and rapid growth. The recipient country should, however, continue to accept FDI in those areas where domestic resources do not provide an adequate substitute.

The most efficacious way of encouraging FDI is to implement policies that generally improve the investment climate. Where domestically financed investment is booming, FDI will seek to participate. Finally, maximum benefit from FDI can be achieved in open economies that are free of domestic distortions such as financial repression and trade controls. When the domestic economy is distorted, FDI inflows are associated with a low or negative growth.

Further Research

This study has shown useful insights by conducting individual country studies. It indicates that FDI has differential impact on the economic growth and savings of each of the 5 ASEAN countries in this study.

In this present study, the number of observations is small because of the unavailability and incomplete data on some of the variables for some of the countries. Thus it will be useful to empirically examine the impact of FDI by using the pooled sample time-series and cross-sectional data, which may provide

more information for policy implementations. In view of the openness of these economies, it might be more relevant to use a simultaneous equation model to study the impact of FDI on growth and savings.

On the issue of the relative effectiveness of different types of foreign capital, this study could not provide definitive answers. It indicated that, in such cases, a more detailed analysis to understand the mechanism through which different types of foreign capital influences economic growth and savings will be much useful and illuminating.

In this study, savings rate variable was used in highly aggregated form. Domestic savings could well be decomposed into private versus public savings. It would be interesting to examine whether and to what extent different types of foreign capital have differential impact on different types of domestic savings. Such disaggregations may provide useful and illuminating results for policy purposes.