

## ABSTRACT

The effects of foreign capital inflows (FCI) on economic development have been the focus of attention of many researchers and policymakers. Under conventional expectations, FCI brings positive effects to the host country in terms of new investible funds, augmenting domestic savings and foreign exchange earnings. The critical literature on FCI, however, maintains that FCI have undesirable effects on the domestic savings rate as well as on the recipient's balance of payments position.

This study applies the ordinary least squares method to test both sets of influences in the Malaysian experience between 1966 and 1996. The analysis takes FCI as an aggregate variable as well as disaggregated variable i.e. by distinguishing between debt and foreign direct investment (FDI). The tests find that while FCI augmented domestic investment funds to accelerate the growth rate, it had negative influences on the savings rate as well as on the balance of payments position.

The findings also reveal that domestically-raised funds, through savings and self-generated export earnings, are much better than external funding. These findings suggest that if the country wishes to sustain economic growth, greater efforts will have to be directed towards improving manufacturing sector performance, increasing labour force productivity and mobilizing domestic savings rather than relying heavily on foreign capital. The study also indicates that if foreign capital is required, more foreign direct investment should be encouraged instead of long-term borrowings.

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