Export-led Growth Hypothesis in Malaysia: An Application of Two-Stage Least Square Technique

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ABSTRACT

This paper aims to re-estimate the robustness of the relationship between export and economic growth in the Malaysian economy from 1959 to 2000. Combining both production function and international trade and development theories, a six variable (economic growth, exports, imports of consumption goods, capital formation, labour force and exchange rate) vector autoregression (VAR) model has been developed. Multivariate cointegration results revealed that there exists a single cointegrating vector in the estimated system. This means that these variables are linked together in achieving their steady state equilibrium in the long run. Resulting from the endogeneity problem of the variables involved, two-stage least squares was applied to estimate the short run causality model. From our error correction model, we reported that all variables, except exchange rate Granger-cause economic growth in the short run at 5 percent significance level. This implies that export-led hypothesis growth is valid in the Malaysian economy in both short- and long-run. Besides, our results suggest that the growth rate of capital formation and imports have positive impacts on economic growth, while labour has a negative impact in the short-term.

Keywords: Export-led growth hypothesis, endogeneity, multivariate cointegration test, two-stage least square, Granger-causality, production function theory.

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INTRODUCTION

Export-led growth hypothesis generally reflects the relationship between exports and economic growth, in particular, output growth is driven by exports. This relationship, however, remains the subject of debate. Some studies provided empirical results to support this hypothesis (Arnade and Vasavada 1995; Fosu 1996; Thornton 1996), some found contrasting evidence that export is Granger caused by the economic growth