*Global Economy and Finance Journal*
*Vol. 3 No. 1 March2010, Pp. 31-43*

# Determinants of International Capital Flows: The Case of Malaysia

Muhammad Asraf Abdullah* Shazali Abu Mansor** and Chin-Hong Puah***

*This paper examines the determinants of international capital inflows into Malaysia in the forms of pull and push factors. The results from Johansen and Juselius cointegration test confirm the existence of a long run stable equilibrium relationship among the variables in the model. In addition, the Error Correction Model (ECM) has been utilized to detect the long run divergence from the equilibrium relationship between the explanatory variables and capital inflows in the specified model. The Wald tests from the ECM further support the notion that real GDP, domestic Treasury bill rate, budget balance, current account balance and US production do Granger cause capital inflows into Malaysia in the short run. The empirical findings in this study show that the pull factors especially budget balance and current account are imperative in explaining inflows of capital into Malaysia. Another interesting finding is the role of real factor as denoted by domestic and industrial country's outputs in affecting the capital inflows.*

**Field: International Economics**

## 1. Introduction

Economic liberalization and globalization have resulted in rapid mobility of resources between nations to reap the comparative advantage of the respective country. As a small open economy, Malaysia is not an exception to attract capital in pursuing its development agenda. Thus, Malaysia has been depending on capital inflows as one of the vital sources of growth for decades since its formation in 1965. With industrialization policy took effect in 1960s, Malaysia has expanded as one of the most attractive destinations for foreign direct investment (FDI) in Asia. This is particularly true when the United Nations Conference on Trade and Development (UNCTAD) through World Investment Report 2008 listed Malaysia as one of the highest FDI potential countries along with other countries to name a few Brunei, Hong Kong, Singapore, Thailand and United Kingdom (World Investment Report, 2008). This was translated into high exports manufactured goods from 22% in 1980 to 79.7% in 2007. Among the manufacturing sub-sectors, the electrical and electronics sector contributed the most to total manufacturing export since the 1970s. Determinants of capital flows are varied depending on the scope of

---

*Muhammad Asraf Abdullah, Department of Economics, Faculty of Economics and Business, Universiti Malaysia Sarawak. Email: amasraf@feb.unimas.my
**Shazali Abu Mansor, Department of Economics, Faculty of Economics and Business, Universiti Malaysia Sarawak. Email: mshazali@feb.unimas.my
***Chin-Hong Puah, Department of Economics, Faculty of Economics and Business, Universiti Malaysia Sarawak. Email: chpuah@feb.unimas.my
♣Financial support from UNIMAS through the Fundamental Research Grant Scheme [FRGS: 05(07)/621/2006(54)] is gratefully acknowledged. All remaining flaws are the responsibilities of the authors.