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ABSTRACT

This study intends to examine the effect of the debt on economic growth of Malaysia from the perspective of domestic debt and external debt. Furthermore, the impact of different type of debts on growth upon either above or below certain threshold level of the debt also investigated using Threshold regression method for sample period 1980-2015. Empirical findings indicate that the threshold level for domestic debt is approximately 37% of GDP while 4% of GDP for external debt. Initial domestic debt accumulation contributes positively to the economic growth of Malaysia when the domestic debt level is below the threshold level but becomes detrimental to economic growth when the debt level exceeds the threshold level. On the other hand, external debt has negative impact on the economic growth when the debt is below the external debt threshold and become positive when exceed the threshold level. In terms of policy recommendation, government has an uphill task in managing the debt at optimal level as different type of debts and levels of debt may have different impact on the economic growth.

Keywords: Debt; Threshold; Economic Growth.

1. INTRODUCTION

Malaysia as one of the fast-growing economy in the Southeast Asia region experienced challenging tasks in managing the increasing level of debts. This is due to the accumulation of debt is unavoidable for the purpose of acquiring capital for overcome the negative implication of the external economic shocks such as global financial crisis, fluctuation of the currency and volatility in the oil price. Figure 1 depicts the debt level of Malaysia from 1990 to 2015 which are expressed as percentage of GDP. There was a drastic reduction in the level of debt from 75% of GDP to 30% of GDP in 1990 and 1997 respectively. This was due to the significant development in the Southeast Asia region where most of the countries in the region, including Malaysia, act as Foreign Direct Investment (FDI) preference destination. The spillover effects of the FDI contributed to the economic growth of Malaysia and eventually reduce the debt dependency. However, there was an upsurge of the debt level since 1998, which is post Asian Financial crisis, with 34% of GDP and further increased to 50% of GDP in 2010. The upward trend resumed until 55% of GDP in 2015. In terms of debt composition, the aggregate debt comprises of domestic debt and external debt.

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