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EXAMINING THE EFFECTS OF LABOUR FORCE, NATURAL RESOURCE ENDOWMENTS AND POLITICAL STABILITY ON FOREIGN DIRECT INVESTMENT INFLOW IN MALAYSIA

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Abstract:

This study investigates the long-run relationship between FDI inflows and selected determinants, namely political stability, natural resources, labour force, financial development, and market size, using annual data for Malaysia from 1990 to 2019. The Autoregressive Distributed Lag (ARDL) bounds testing approach is employed to examine the existence of cointegration among the variables, while the Error Correction Model (ECM) is used to assess the speed of adjustment towards long-run equilibrium. The results provide evidence of a stable long-run relationship between FDI inflows and the selected determinants. Labour force expansion, political stability and financial development are found to exert positive and statistically significant effects on FDI inflows, highlighting the importance of human capital, institutional quality and financial sector efficiency in attracting foreign investment. In contrast, natural resource endowment exhibits a negative but statistically insignificant relationship with FDI inflows, suggesting that resource abundance is not a primary driver of foreign investment in Malaysia. The ECM results indicate a significant adjustment mechanism, confirming convergence towards long-run equilibrium following short-run shocks. These findings suggest that policies aimed at strengthening political stability, enhancing financial sector development, and improving workforce quality are essential for sustaining Malaysia's attractiveness as an FDI destination. The study contributes to the growing literature on FDI determinants by providing updated evidence from a major emerging economy in Southeast Asia.

Keywords: *Foreign Direct Investment, Natural Resource, Political Stability, Labour Force, Financial Development*

INTRODUCTION

Foreign direct investment (FDI) has become one of the most important drivers of economic growth and development in the era of globalization. As economies become increasingly interconnected, developing countries have actively competed to attract foreign investment as a means of supplementing domestic capital formation, promoting industrialization, and accelerating economic transformation. Unlike portfolio investment and external borrowing, FDI is generally regarded as a more stable source of capital because it involves long-term commitments by multinational enterprises (MNEs) in host economies. In addition to financial inflows, FDI contributes to technology transfer, managerial expertise, innovation, employment creation, productivity enhancement, and integration into global production networks. Consequently, attracting and retaining foreign investment has become a central policy objective for many developing nations.

The significance of FDI is particularly evident in emerging economies where domestic savings and investment are often insufficient to support sustained economic growth. FDI enables host countries to access advanced technologies, improve human capital capabilities, enhance export competitiveness, and strengthen industrial development. Theoretical perspectives such as the modernization theory and endogenous growth theory suggest that external capital inflows can stimulate economic expansion by increasing productive capacity and facilitating knowledge spillovers. Furthermore, multinational corporations often introduce advanced production techniques and organizational practices that contribute to improvements in efficiency and competitiveness among local firms.

Over the past several decades, Malaysia has emerged as one of Southeast Asia's leading destinations for foreign investment. Since the implementation of export-oriented industrialization policies in the 1970s, the Malaysian government has actively encouraged foreign participation in key economic sectors, particularly manufacturing, services, and high-technology industries. Through various initiatives, including investment incentives, infrastructure development, industrial master plans, and trade liberalization policies, Malaysia has successfully attracted substantial inflows of foreign capital. FDI has played a significant role in transforming the country's economic structure from an agriculture-based economy into a diversified industrial and services-oriented economy.

Despite its historical success in attracting foreign investment, Malaysia has experienced fluctuations in FDI inflows due to changing domestic and international economic conditions. Factors such as global economic uncertainty, financial crises, political developments, trade tensions, and competition from neighbouring economies have influenced investor confidence and investment decisions. For instance, while Malaysia remained as an attractive investment destination during periods of strong economic growth, FDI inflows experienced volatility during the Asian Financial Crisis of 1997–1998, the Global Financial Crisis of 2008–2009, and subsequent periods of economic uncertainty. Such fluctuations highlight the importance of understanding the determinants that influence foreign investors' location decisions in Malaysia.

The determinants of FDI have been extensively examined in both developed and developing economies. One of the most influential theoretical frameworks explaining FDI location decisions is the Eclectic Paradigm or OLI Framework developed by John H. Dunning. According to this framework, foreign investment decisions are influenced by ownership advantages, location advantages, and internalization advantages. Among these components, location-specific factors are particularly important because they determine the attractiveness of host countries for foreign investors. Such factors include political stability, market size, natural resource availability, labour market conditions, infrastructure quality, institutional effectiveness, and financial development.

Political stability is widely recognized as a crucial determinant of FDI because it reduces uncertainty and investment risks. Investors generally prefer countries with stable political environments, effective governance, and predictable policy frameworks. Political instability may increase operational costs and discourage long-term investment commitments. Similarly, natural resources can attract resource-seeking FDI, particularly in countries endowed with abundant energy resources, minerals, and agricultural commodities. Resource availability often serves as an important motivation for multinational corporations seeking to secure access to strategic inputs for production.

Labour market characteristics also play an important role in attracting foreign investment. The availability of a skilled, productive, and cost-effective workforce enhances a country's competitiveness and encourages multinational enterprises to establish operations. In addition, financial development contributes to investment attractiveness by improving access to credit, reducing transaction costs, and facilitating efficient capital allocation. Well-developed financial systems enhance investor confidence by supporting business activities and promoting economic stability. Market size, commonly measured through gross domestic product (GDP) or population, represents another important determinant because larger markets offer greater opportunities for profitability and economies of scale.

Although a substantial body of literature has examined the determinants of FDI, empirical findings remain inconclusive and often vary across countries and regions. Some studies report that political stability significantly influences FDI inflows, while others find that economic fundamentals such as market size and financial development are more influential. Similarly, evidence regarding the impact of natural resources and labour force characteristics remains mixed. These inconsistencies suggest that the determinants of FDI may be country-specific and influenced by unique institutional, economic, and structural conditions.

In the Malaysian context, existing studies have predominantly focused on individual determinants of FDI or specific sectors of the economy. While previous research has provided valuable insights into the relationship between economic growth, trade openness, infrastructure, and foreign investment, relatively few studies have comprehensively examined the combined effects of political stability, natural resources, labour force, financial development, and market size over an extended period. Furthermore, evolving economic conditions and structural changes in Malaysia necessitate continuous reassessment of the factors influencing foreign investment decisions.

Therefore, this study seeks to investigate the determinants of FDI inflows in Malaysia by examining the roles of political stability, natural resources, labour force participation, financial development, and market size from 1990 to 2019. By employing an autoregressive distributed lag (ARDL) approach, the study explores both the long-run and short-run relationships between these variables and FDI inflows. The findings are expected to contribute to the growing literature on FDI determinants and provide valuable policy implications for strengthening Malaysia's investment climate and enhancing its competitiveness in attracting foreign capital.

This study contributes to the literature in three important ways. First, it integrates political, economic, and resource-based determinants within a single empirical framework. Second, it provides updated evidence on the Malaysian experience using a relatively long time-series dataset. Third, it offers policy recommendations that may assist government agencies in formulating strategies to attract sustainable and high-quality foreign investment. Understanding the determinants of FDI is essential not only for promoting economic growth but also for ensuring that Malaysia remains an attractive destination for international investors in an increasingly competitive global environment.

LITERATURE REVIEW

FDI has received considerable scholarly attention due to its contribution to economic development. FDI facilitates the transfer of technology, managerial expertise, innovation, and advanced production techniques, thereby enhancing productivity in host economies. Borensztein, De Gregorio and Lee (1998) argued that FDI exerts both short-run and long-run effects on economic growth, although the magnitude of its impact remains relatively moderate. Within the neoclassical growth framework, FDI primarily influences output and capital accumulation through economies of scale, while its long-term growth effects are limited as economic expansion eventually converges to a steady state.

Natural resources are frequently identified as a significant determinant of FDI inflows. Studies by Asiedu (2006), Asiedu and Lien (2011), Suleiman et al., (2015) and Bokpin et al., (2015) reported a positive relationship between natural resource availability and FDI attraction. However, empirical findings remain inconclusive. Hayat (2018) found that natural resources may negatively influence economic growth at certain levels of FDI. Similarly, Auzairy et al., (2018) in the Malaysian context and Shan et al., (2018) in the case of Chinese investment in Africa concluded that natural resources neither significantly attract nor deter FDI inflows.

Political stability has been widely examined as a determinant of FDI inflows. Asiedu, (2006) and Jun and Singh (1996) found that political risk negatively affects foreign investment in developing economies. In contrast, Gastanaga et al., (1998) demonstrated that economies characterized by lower corruption, reduced political risk, and stronger contract enforcement tend to attract higher levels of FDI. Furthermore, Egger and Winner (2005) identified a positive relationship between corruption and FDI inflows based on cross-sectional evidence from 73 economies. Busse and Hefeker (2007) and Sabir and Khan (2018) also reported a significant relationship between political stability and FDI inflows in developing and Asian economies.

The labour force constitutes a critical factor influencing FDI inflows, particularly in developing countries. Lucas (1990) argued that shortages of low-skilled labour may discourage foreign investment. Similarly, Zhang and Markusen (1999) emphasized the importance of human capital availability in FDI-receiving economies. Dunning (1988) further noted that educational attainment and workforce skills significantly influence foreign investors' decisions. Empirical evidence from Peric and Filipovic (2021) supports a positive relationship between labour force quality and FDI inflows. However, higher wages can reduce the attractiveness of labour-intensive FDI, particularly in export-oriented manufacturing (Ismail, & Yussof, 2003).

Financial development is widely recognized as an important determinant of FDI inflows and economic growth. Deichmann, Karidis and Sayek (2003) found that increased FDI inflows contribute to higher levels of financial development. Similarly, Nguyen and Lee (2021) argued that stable and well-developed financial systems encourage both FDI and economic expansion. Efficient financial institutions improve access to credit, facilitate business growth, and support investment activities. Moreover, Alfaro et al., (2004) and Azman-Saini et al.,(2010) emphasized that the effectiveness of technology transfer and innovation in host economies depends largely on the sophistication of financial systems. Ang and McKibbin (2007) further argued that efficient financial mechanisms enhance technology spillovers and promote long-term economic growth.

Market size has been extensively examined as a determinant of FDI inflows. While some studies, including Herzer and Dierk (2010) and Gorg and Greenwood (2004) reported weak or insignificant relationships between market size and FDI, numerous studies identified a positive association. Aqeel and Nishat (2006), Billington (1999), Tsai (1994), Shamsuddin, (1994) and Sader (1993) found that larger markets and favourable trade policies significantly attract foreign investment. Similarly, Singh and Jun (1995), Fedderke and Romm (2006), and

Moosa and Cardak (2006) supported Dunning's (1993) argument that multinational enterprises seek access to both domestic and regional markets. Ang (2008) further observed that trade liberalization enhances FDI inflows, while Solomon et al., (2015) reported that market size and economic development positively influence inward FDI, particularly in low-tax environments.

RESEARCH METHODOLOGY

Building upon the theoretical and empirical foundations of this study, the long-run relationship between the selected determinants and FDI inflows is examined using the Autoregressive Distributed Lag (ARDL) cointegration approach. The ARDL framework is considered particularly appropriate due to its econometric flexibility and robustness compared to alternative cointegration techniques. Unlike the conventional cointegration approaches developed by Engle and Granger (1987) and Johansen (1988, 1991), which generally require variables to be integrated of the same order, the ARDL bounds-testing approach permits a mixture of I(0) and I(1) variables, provided that none of the variables is integrated beyond I(2) (Pesaran, Shin, and Smith, 2001).

In addition, the ARDL model is highly suitable for empirical analyses involving relatively small sample sizes (Paul, 2014). The optimal lag structure is determined using the Akaike Information Criterion (AIC) while the bounds testing procedure based on F-statistics is employed to examine the existence of a long-run cointegration relationship among the variables. Where cointegration is confirmed, the ARDL framework enables the decomposition of the estimated relationships into both short-run and long-run dynamics. Furthermore, a series of diagnostic and stability tests are conducted to ensure the validity, reliability, and robustness of the estimated model. These procedures are essential in verifying the consistency of the empirical findings and the overall adequacy of the model specification.

EMPIRICAL STRATEGY

Empirical Framework

The theoretical framework developed by Dunning (2009) serves as the foundation for examining the existence of long-run relationships among the selected variables, beginning with the determination of their order of integration. In line with the methodological approaches adopted by Phung (2016) and Awad (2020), this study incorporates variables that are both theoretically grounded and empirically relevant in modelling the FDI equation. Furthermore, these variables have been extensively employed in prior empirical studies, including Alfaro et al., (2004), Borensztein et al., (1998), Azman-Saini et al., (2010), Bengoa and Sanchez-Robles, (2003), Belloumi (2014) and Saini and Singhania (2018). The functional specification of the model is presented below.

$$FDI_t = \beta_0 + \beta_1 NRS + \beta_2 PST_t + \beta_3 LBR_t + \beta_4 FDV_t + \beta_5 GDP_t + \epsilon_t \qquad (1)$$

Where FDI_t indicates inward foreign direct investment, captured by net inflows in the balance of payment and measured as current US dollars; NRS_t shows natural resources gas rent percentage of GDP; PST_t shows political stability in the country measured by the Political Risk Index which consists of multiple factors namely Investment risk conditions, Quality of bureaucracy, Law enforcement and legal stability, Ethnic tension, Stability in government, Corruption, Democratic accountability, Internal and External conflicts, Religious tension influence of military in governance and Socioeconomic conditions; LBR_t shows total labour force; FDV_t shows credit to private institutions domestically as the percentage of GDP; and GDP_t shows constant 2010 USD aggregate national output. Lastly, ϵ_t is assumed to be the white noise error term. The expected sign for all independent variables is positive with FDI.

The variables employed in this analysis are derived from Online World Development Indictors except for political stability which is obtained from International Country Risk Guide Dataset for Malaysia, covering the period from 1990 to 2019. Establishing long run relationship requires preliminary assessment of stationarity and integration order of variables, the analysis begins with unit root testing to determine their respective integration orders. This process is discussed in detail in a subsequent section. In addition, unit root test where the sequence of empirical procedures in a cointegration analysis becomes unnecessary in cases where the variable attain stationarity after first differencing, the Augmented Dickey Fuller test is employed for verification.

ARDL Bounds Test for Cointegration.

The Autoregressive Distributed Lag (ARDL) approach is employed in this study due to its flexibility in accommodating variables that are stationary at level, *I(0)*, as well as variables that become stationary after first differencing, *I(1)*. The ARDL model, initially developed by Pesaran (1997) further advanced by Pesaran and Shin (1998) and refined by Pesaran et al., (2001) is particularly appropriate for empirical studies involving relatively small sample sizes, as it does not impose the restrictive requirement that all variables be integrated at the same order.

The suitability of the ARDL framework is further validated through unit root testing, which confirms that the variables satisfy the necessary conditions for ARDL estimation. In addition, the ARDL technique enables the simultaneous estimation of both short-run and long-run dynamics within a single reduced-form equation, thereby providing a comprehensive understanding of the relationships among the variables. The framework also accommodates variables integrated at either *I(0)* or *I(1)*, provided that none of the series are integrated beyond the second order.

Furthermore, Pesaran and Shin (1998) demonstrated that the Ordinary Least Squares (OLS) estimation procedure within the ARDL framework generates reliable short-run estimates and consistent long-run coefficients, even in the presence of limited observations. Consequently, the ARDL model is considered a robust and efficient econometric approach for examining the cointegration and dynamic relationships between the selected determinants and FDI inflows.

The associated equation is defined as follows:

$$\begin{aligned}\Delta FDI_t = \alpha_0 &+ \sum_{i=1}^{n} \alpha_i\, \Delta FDI_{t-i} + \sum_{i=0}^{n} \alpha_i \Delta\, NRS_{t-i} + \sum_{i=0}^{n} \alpha_i \Delta PST_{t-i} + \sum_{i=0}^{n} \alpha_i \Delta LBR_{t-i} \\ &+ \sum_{i=0}^{n} \alpha_i \Delta FDV_{t-i} + \sum_{i=0}^{n} \alpha_i \Delta GDP_{t-i} + \beta_1 FDI_{t-1} + \beta_2 NRS_{t-1} \\ &+ \beta_3 PST_{t-1} + \beta_4 LBR_{t-1} + \beta_5 FDV_{t-1} + \beta_6 GDP_{t-1} + \varepsilon_t\end{aligned}$$

The symbol Δ in the above equation refers to the first difference, short terms effects are captured by the α_i parameters, whereas the β_1 parameters describe the long-term equilibrium connections among the variables. The presence of cointegration is tested using null hypothesis (H_0) and alternative (H_1) are tested as follows:

H_0 : $\beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = \beta_6 = 0$ (No long-run co-integration)

H_1 : At least one $\beta i \neq 0$ (Existence of long-run co-integration)

Within the bounds testing framework proposed by Pesaran et al., (2001) the estimated F-statistic is compared against the lower and upper critical bound values to determine the existence of a long-run cointegration relationship among the variables. The null hypothesis of no cointegration is accepted when the calculated F-statistic falls below the lower bound critical value. In contrast, an F-statistic exceeding the upper bound critical value leads to the rejection of the null hypothesis, thereby confirming the presence of a statistically significant long-run relationship among the variables. However, if the estimated F-statistic lies between the lower and upper bounds, the result is considered inconclusive. Following the confirmation of long-run cointegration through the ARDL bounds testing procedure, the long-run model specification is estimated as follows:

$$FDI_t = \alpha_0 + \sum_{i=1}^{n} \beta_i\, FDI_{t-i} + \sum_{i=0}^{n} \beta_i\, NRS_{t-i} + \sum_{i=0}^{n} \beta_i PST_{t-i} + \sum_{i=0}^{n} \beta_i LBR_{t-i} + \sum_{i=0}^{n} \beta_i FDV_{t-i} + \sum_{i=0}^{n} \beta_i GDP_{t-i} + \varepsilon_t$$

To account for short run fluctuation without discarding long run equilibrium information, the error correction model (ECM) can be stated as follows.

$$\Delta FDI_t = \alpha_0 \sum_{i=0}^{n} \alpha_i \Delta FDI_{t-i} + \sum_{i=1}^{n} \alpha_i\, \Delta NRS_{t-i} + \sum_{i=0}^{n} \alpha_i \Delta\, PST + \sum_{i=0}^{n} \alpha_i \Delta LBR_{t-i} + \sum_{i=0}^{n} \alpha_i \Delta \mathrm{FDV}_{t-i} + \sum_{i=0}^{n} \alpha_i \Delta GDP_{t-i} + +\varphi_i ECM_{t-i} + e_t$$

Estimated φ coefficient of ECM reflects the adjustment process by which the system returns to its long-run equilibrium following the short- run shocks. For models, to demonstrate valid equilibrium behavior, this parameter must exhibit a statistically significant negative value. A negative and significant φ confirms that short-term disequilibrium errors diminish over time, demonstrating convergences toward long-run steady state linkages among the variables.

RESULTS AND DISCUSSION

Correlation

As a preliminary step in the analysis, a correlation matrix is generated to assess the degree of association among dependent and explanatory variables, as illustrated in Table 1 below. Since multicollinearity does not appear to be severe, stationarity tests are then conducted on the variables.

Table 1:Correlation Matrix

	FDI	**NRS**	**PST**	**LBR**	**FDV**	**GDP**
FDI	1					
NRS	0.110196	1				
PST	0.141486	0.006594	1			
LBR	0.36631	0.844554	-0.0084	1		
FDV	-0.02622	0.026764	0.170591	0.177479	1	
GDP	0.37485	0.839321	0.070759	0.993256	0.238043	1

Unit Root Test

As a preliminary diagnostic in the time series analysis, the order of integration for each variable was examined using the Augmented Dickey–Fuller (ADF) unit root test (Table 2), while the diagnostics test results are presented in Table 3. The ADF results indicate the presence of unit root under both intercept and trend specifications. Most variables were found to be integrated at different orders, either at level, *I(0)*, or at first difference, *I(1)*.

The test outcomes reveal that the null hypothesis of a unit root cannot be rejected for the FDI, FDV, GDP, NRS, LBR, and PST series based on the reported t-statistics at the 1% and 5% significance levels. These findings suggest that the variables exhibit a mixed order of integration, comprising both stationary and first-difference stationary series. Consequently, the data satisfy the necessary preconditions for the application of the ARDL model.

Table 2: Unit root ADF test

	Level		**First Difference**	
	Constant	Constant & Trend	Constant	Constant & Trend
FDI	-4.65	-5.12	-6.37	-6.25
NRS	-1.66	-0.89	-6.93	-7.06
PST	-3.01	-2.97	-4.47	-4.34
LBR	-1.34	-5.11	-4.23	-4.46
FDV	-5.31	-4.21	-4.14	-4.38
GDP	-0.54	-3.35	-3.94	-4.13

Note: ADF test indicates variable Null of non-stationary rejection at 1 and 5 percent of the significance level. FDI= Foreign direct investment; NRS= Natural resources; LBR= Total labor force; PST= Political stability; FDV= Financial development level; GDP= Gross domestic product.

ARDL Bounds Test

Following the diagnostic tests that confirmed the adequacy and reliability of the estimated model, the existence of a long-run equilibrium relationship among the variables was examined using the ARDL bounds testing approach. The computed F-statistic is 12.426 with five regressors (k = 5). When compared with the critical bound values reported by Pesaran et al., (2001) the estimated F-statistic substantially exceeds the upper bound critical values at all conventional significance levels.

Given that the calculated F-statistic of 12.426 exceeds the upper bound critical value at the 1 percent significance level, the null hypothesis of no cointegration is rejected. This finding provides strong empirical evidence of a stable long-run equilibrium relationship among the variables. Consequently, the confirmation of cointegration justifies the estimation of both long-run coefficients and short-run dynamics through the ECM within the ARDL framework.

Table 3: Bounds Test Statistics

Co-Integration	Value	Significance Level	I (0) Bound	I (1) Bound
F-stat	**12.426**	10%	2.26	3.35
k	5	5%	2.62	3.79
		2.50%	2.96	4.18
		1%	3.41	4.68

Long-Run Relationship

This section examines the determinants of Malaysia's long-run capacity to attract FDI. The empirical findings indicate that labour force expansion, political stability, and domestic credit availability are the primary factors enhancing Malaysia's attractiveness to foreign investors. A growing labour force reflects improved human capital endowment, while political stability fosters policy continuity and strengthens investor confidence. In addition, a well-developed banking and credit system supports investment activities by improving access to finance and facilitating business expansion.

In contrast, natural resource endowment shows a weak negative relationship with FDI inflows; however, this effect is statistically insignificant. This suggests that resource abundance alone is not a decisive determinant of FDI inflows and may be overshadowed by institutional quality, policy frameworks, and external economic conditions. Potentially, the importance of natural resources has gradually declined relative to other factors such as market size, human capital, infrastructure, and technological capabilities, as Malaysia has shifted towards a more diversified and industrialized economy. Natural resource abundance directly attracts resource-seeking FDI into mining, oil, and gas extraction. However, Malaysia is more focused on attracting FDI in non-resource sectors (like manufacturing or services), causing natural resources to be a less likely candidate to determine FDI inflow. Consequently, while natural resources remain an important determinant, they may not be the primary driver of FDI in recent years.

The results further demonstrate that political stability exerts a strong positive influence on FDI inflows. Specifically, a 1% increase in political stability is associated with an approximately 9% increase in FDI inflows in the long run. Similarly, labour force expansion exhibits a substantial positive effect, whereby a 1% increase in labour supply leads to an estimated 15% increase in FDI inflows.

Moreover, financial development, proxied by domestic credit provided by banks, also has a positive and statistically significant effect on FDI inflows. The results indicate that a 1% increase in domestic credit is associated with a 2.35% increase in FDI inflows, depending on the lag structure. This finding is consistent with the results of Deichmann, Karidis and Sayek, (2003) who similarly found that financial sector development enhances foreign investment by improving capital allocation efficiency and access to financing.

Table 4: Long Run Estimation Results, Dependent variable: FDI

Variables	Coefficient	Standard Error	t-Stat	Probability
LNFDV	2.354	1.029	2.286	0.037**
LNGDP	-6.456	2.847	-2.267	0.038**
LNLBR	14.786	5.045	2.930	0.010***
LNNRS	-0.342	0.412	-0.829	0.419
LNPST	9.010	3.034	2.969	0.009***

1. Long-run estimates derived from the ARDL (2, 0, 0, 1, 0, 0) specification
2. Notes: ***, **, * denotes statistical significance at the 1%, 5% and 10% levels respectively. FDI= Foreign direct investment; NRS= Natural resources; LBR= Total labor force; PST= Political stability; FDV= Financial development level; GDP= Gross domestic product

Countries with relatively stable economic growth are often associated with lower marginal investment returns, which may be less attractive to foreign investors seeking higher risk-adjusted returns. Consequently, faster-growing economies may exhibit a negative coefficient for GDP growth, reflecting investors' preference for environments offering higher return differentials rather than stable but comparatively lower-yield conditions. In addition, for efficiency-seeking FDIs, investors tend look for countries that offer relatively low labor costs, specialized skills, or favourable geographic locations to set up export platforms.

The empirical results of this study further indicate that natural resources have an insignificant relationship with FDI inflows, consistent with the findings of Auzairy et al., (2018). This outcome contrasts with the broader empirical literature, which generally reports a positive relationship between natural resource endowment and FDI inflows (Aqeel & Nishat, 2004; Billington, 1999; Sader, 1993; Shamsuddin, 1994; Tsai, 1994). Similarly, Asiedu (2006) finds that natural resource abundance is positively associated with FDI attraction, although the magnitude and direction of this relationship may vary depending on country-specific institutional and economic conditions.

Diagnostic Tests

The prerequisite diagnostic tests for the application of the ARDL bounds testing approach and long-run estimation are reported in Table 3. The results indicate that the model satisfies the fundamental econometric assumptions required for reliable estimation. Specifically, the Lagrange Multiplier (L-M) test confirms the absence of autocorrelation, as the associated p-values provide insufficient evidence to reject the null hypothesis of no serial correlation in the residuals.

Moreover, the Breusch–Pagan–Godfrey (BPG) test, White test (without cross-products), and ARCH test collectively confirm the assumption of homoscedasticity, indicating that the residual variance remains constant throughout the estimation process. The Jarque-Bera (J-B) test further demonstrates that the residuals are normally distributed. Overall, these diagnostic results confirm the adequacy, stability, and reliability of the estimated ARDL model.

Table 5: Diagnostic tests

Diagnostic	F-statistic	Prob
Breusch–Godfrey LM test	0.651	0.537
BPG Heteroskedasticity	1.306	0.308
White (without Cross-Product)	1.165	0.383
ARCH	1.585	0.219
J-B test for Normality	0.766	0.681

Stability Test

In this section, the stability of the long-run model is assessed using recursive residual-based diagnostic tests, namely the cumulative sum (CUSUM) and cumulative sum of squares (CUSUMSQ) tests developed by Brown et al., (1975). These tests are widely applied to detect potential parameter instability and structural changes in regression coefficients over time. In particular, the CUSUMSQ test is sensitive to structural breaks and provides evidence on the constancy of the estimated parameters.

As shown in Figure 1 below, both the CUSUM and CUSUMSQ statistics remain within the 5% significance boundaries throughout the sample period. This indicates the absence of structural instability in the model. Accordingly, the results confirm that the estimated coefficients are stable over time, thereby supporting the robustness and reliability of the specified long-run model.

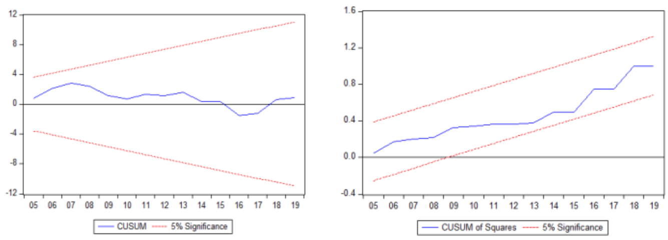

Figure 1: Stability test

Short-Run Relationship

To analyse the short-run relationship we found that the error correction term (ECT) is negative and statistically significant, confirming the existence of a stable long-run equilibrium relationship among the variables (Engle & Granger, 1987). The magnitude of the ECT indicates a rapid speed of adjustment, whereby approximately 97% of any short-run disequilibrium is corrected within one period. This result underscores a strong convergence mechanism toward long-run equilibrium, consistent with the theoretical expectations of the error correction framework.

Table 6: Short Run Relationship (ECM)

Dependent variable D(FDI), ARDL Model (1, 1, 2, 0, 2, 1)				
Regressor	**Coeff:**	**S. E**	**t-Stat**	**Prob**
D (LNFDI (-1))	-0.48483	0.124685	-3.88841	0.0012***
D(LNFDV)	-5.50247	2.234305	-2.46272	0.0248**
D (LNFDV (-1))	4.842876	1.457164	3.323495	0.004***
D(LNGDP)	19.69534	3.927657	5.014525	0.0001***
D (LNGDP (-2))	-22.6267	4.849338	-4.66595	0.0002***
D(LNLBR)	13.23245	11.12514	1.189419	0.2506
D(LNNRS)	-1.93376	0.643085	-3.007	0.0079***
D(LNPST)	-13.9561	4.67725	-2.98382	0.0083***
D (LNPST (-1))	21.60988	4.856039	4.450103	0.0004***
ECM (-1)	**-0.97445**	**0.365636**	**-2.66507**	**0.0163****
Adjusted R-squared = 0.78185				

Notes: ***, **, * denotes statistical significance at the 1%, 5% and 10% levels respectively.

CONCLUSION AND POLICY IMPLICATIONS

This study identifies the principal determinants of FDI inflows in Malaysia. The empirical results indicate that financial market development, political stability and labour force availability are significant positive determinants of FDI inflows. However, natural resource endowment is insignificant in determining FDI inflow. This suggests that the importance of natural resources in attracting FDI to Malaysia has gradually declined as the country has become more diversified and industrialized. Investors now place greater importance on factors such as market size, skilled labour, infrastructure, and technological development. Therefore, although natural resources remain an important factor, they are no longer the main driver of FDI inflows into Malaysia. In contrast, GDP growth exhibits a negative relationship with FDI inflows. This finding may reflect investors' preference for higher risk-adjusted returns in more dynamic economic environments, whereas relatively stable economies may offer lower marginal returns on investment. Overall, these results are consistent with the investment behaviour of multinational corporations operating across emerging and regional markets.

The findings yield several important policy implications. First, FDI inflows are not determined solely by exogenous resource endowments; rather, institutional quality, financial market development, and policy stability play a decisive role in shaping investment attractiveness. Accordingly, countries with limited natural resources may still successfully attract FDI by strengthening governance structures and improving the efficiency of financial systems. In this regard, international institutions such as the International Monetary Fund (IMF) and the World Bank may contribute by supporting policy reforms and promoting investor-friendly institutional environments.

Second, the results underscore the importance of regional economic cooperation in enhancing FDI inflows. Regional integration can facilitate policy harmonisation, strengthen macroeconomic stability, and expand effective market size. For relatively small economies such as Malaysia, regional coordination is particularly important in improving market access and strengthening competitiveness. However, effective implementation requires coordinated policy enforcement across jurisdictions, which may present institutional and administrative constraints.

Finally, although FDI is generally considered a catalyst for economic growth, its impact is not automatic or uniform. The FDI–growth nexus remains theoretically and empirically inconclusive. Some studies suggest a positive relationship under specific conditions, such as capital deepening (de Mello, 1999), higher income levels and global integration (Blomström et al., 1994), and well-developed financial systems (Alfaro et al., 2009). Conversely, Levine and Zervos (2002) highlight the limited robustness of the relationship between FDI and economic growth. Overall, these findings suggest that Malaysia can maximise the developmental benefits of FDI only when supportive macroeconomic stability, institutional quality, and financial sector development are consistently sustained over time.

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