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The Impact of Foreign Direct Investment on Unemployment Rate in Malaysia (1995–2025)

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Abstract

Foreign Direct Investment (FDI) is widely recognized as an important driver of economic growth and employment generation in developing countries. This study examines the relationship between Foreign Direct Investment and the unemployment rate in Malaysia from 1994 to 2024. The research aims to determine whether FDI inflows significantly influence unemployment levels and contribute to labour market performance in Malaysia. A quantitative research approach was employed using secondary annual time-series data obtained from the World Bank, Bank Negara Malaysia (BNM), and the Department of Statistics Malaysia (DOSM). The data were analysed using EViews software through descriptive statistics, unit root tests, correlation analysis, and simple regression analysis. The findings indicate that although Malaysia experienced fluctuations in FDI inflows during the study period, the relationship between FDI and unemployment was statistically insignificant. The regression results suggest that increases in foreign investment did not directly contribute to a significant reduction in unemployment rates. This may be attributed to the concentration of FDI in capital-intensive industries that generate limited employment opportunities for local workers. The study concludes that FDI alone is insufficient to reduce unemployment without supportive domestic policies, human capital development, and stronger linkages between foreign investors and local industries. The findings provide useful insights for policymakers to formulate investment and employment strategies to achieve sustainable economic growth and improve labour market outcomes in Malaysia.

Introduction

Foreign Direct Investment (FDI) plays a significant role in promoting economic growth, industrial development, and employment generation, particularly in developing economies. In an increasingly globalised economy, many countries rely on foreign capital inflows to stimulate productivity, improve technological capabilities, and expand employment opportunities. According to the World Bank (2024), global FDI inflows continue to contribute substantially to economic development through capital formation, technology transfer, and international trade integration. Developing countries in Asia, including Malaysia, have actively implemented investment-friendly policies to attract multinational corporations and foreign investors as part of their long-term economic development strategies.

Malaysia has consistently viewed FDI as an important component of national economic growth since the industrialisation period of the 1980s. Through various initiatives such as tax incentives, free trade zones, infrastructure development, and liberalisation policies, the Malaysian government has successfully attracted foreign investment into sectors such as manufacturing, services, and technology. These investments are expected to contribute to economic expansion and create employment opportunities for the local labour force. However, despite the continuous inflow of foreign investment, unemployment in Malaysia remains an important macroeconomic concern. Data from the Department of Statistics Malaysia (DOSM, 2024) indicate that the unemployment rate has fluctuated over time due to economic uncertainty, structural labour market issues, and external economic shocks.

The relationship between FDI and unemployment remains inconclusive in existing literature. Several studies suggest that FDI contributes positively to employment creation by increasing industrial activities, production capacity, and labour demand. Foreign firms may introduce new technologies, managerial expertise, and productivity improvements that stimulate economic activities and generate new jobs. Conversely, other studies argue that FDI does not always reduce unemployment, especially when investments are concentrated in capital-intensive industries that rely more heavily on automation and advanced technology than on labour-intensive production. In such cases, foreign investment may increase economic output without significantly expanding employment opportunities for domestic workers.

In the Malaysian context, understanding the impact of FDI on unemployment is particularly important for policymakers and economic planners. Although Malaysia continues to attract substantial foreign investment, the extent to which FDI contributes to reducing unemployment remains uncertain. The effectiveness of FDI in generating employment may depend on factors such as sectoral investment distribution, labour market conditions, workforce skills, and domestic economic policies. Therefore, examining the relationship between FDI and unemployment is necessary to evaluate whether foreign investment policies are effectively supporting sustainable employment growth in Malaysia.

This study aims to examine the impact of Foreign Direct Investment on the unemployment rate in Malaysia from 1995 to 2025. Specifically, the study investigates whether FDI inflows significantly affect the country's unemployment levels. The research employs a quantitative approach using secondary time-series data obtained from reputable sources, including the World Bank, Bank Negara Malaysia (BNM), and the Department of Statistics Malaysia (DOSM). Statistical analyses are conducted using EViews software to evaluate the relationship between FDI and unemployment.

The findings of this study are expected to contribute to the existing body of knowledge on FDI and

labour market performance in developing economies. In addition, the study may provide useful insights for policymakers in formulating investment strategies and employment policies that promote sustainable economic growth and improve labour market outcomes in Malaysia.

Literature Review

Unemployment Rates

The unemployment rate refers to the proportion of the labour force that is actively seeking employment but unable to secure work within a specific period. It is widely recognised as one of the most important macroeconomic indicators because it reflects the overall performance and stability of a country's economy. High unemployment rates indicate underutilisation of labour resources and may negatively affect economic productivity, household income, and social welfare (Mankiw, 2021). In developing countries such as Malaysia, unemployment remains a persistent issue influenced by both cyclical and structural factors, including fluctuations in economic growth, technological changes, labour market mismatches, and demographic transitions.

In Malaysia, unemployment trends have fluctuated over the years due to domestic and external economic shocks. According to the Department of Statistics Malaysia (DOSM, 2024), the national unemployment rate ranged between 3.0% and 4.8% over the past decade, with a significant increase during the COVID-19 pandemic period. Although Malaysia has experienced steady economic development, job creation has not always kept pace with labour force participation and population growth. Persistent unemployment may reduce aggregate demand, increase income inequality, and create social instability (Furuoka, 2014).

Several empirical studies have examined the determinants of unemployment in Malaysia. Ahmad and Nor (2024) argued that macroeconomic variables such as foreign direct investment (FDI), domestic investment, inflation, and population growth significantly influence unemployment dynamics in Malaysia. Similarly, Fung and Nga (2023) found that structural labour market issues and technological transformation contribute to unemployment, particularly among youth and low-skilled workers. These findings suggest that unemployment in Malaysia is influenced not only by economic growth but also by investment patterns, labour productivity, and policy effectiveness. Therefore, understanding unemployment as a dependent variable is essential in evaluating how macroeconomic factors affect labour market performance and sustainable economic growth.

Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) refers to long-term investment made by foreign individuals, corporations, or governments in another country through the establishment of businesses, acquisition of assets, or ownership of enterprises. FDI is widely regarded as an important driver of economic growth because it contributes to capital accumulation, technological transfer, managerial expertise, productivity enhancement, and employment creation (Borensztein, De Gregorio, & Lee, 1998). According to the World Bank (2024), global FDI inflows exceeded USD 1.3 trillion, highlighting the continuing importance of foreign investment in supporting economic development and international trade integration.

For developing economies such as Malaysia, FDI has played a major role in accelerating industrialisation and economic transformation since the 1980s. Through policies such as free trade zones, tax incentives, and investment liberalisation, Malaysia has successfully attracted multinational corporations into manufacturing, services, and technology sectors (Athukorala & Menon, 1995). The inflow of foreign investment has contributed to export growth, industrial productivity, and employment opportunities, particularly in export-oriented industries.

However, the relationship between FDI and unemployment remains inconclusive in the empirical literature. Some studies suggest that FDI positively contributes to employment creation by increasing industrial production and labour demand. For example, Jude and Silaghi (2016) found that FDI significantly reduced unemployment in Central and Eastern European countries through higher economic activities and job creation. In the Malaysian context, Jamaludin et al. (2024) reported a significant long-run negative relationship between FDI and unemployment, indicating that increased foreign investment contributed to employment growth and labour market expansion.

Conversely, other researchers argue that FDI does not necessarily reduce unemployment, particularly when investments are concentrated in capital-intensive and technology-driven industries. Ma'in and Mat Isa (2020) found that although FDI contributed positively to Malaysia's economic output, its effect on unemployment was less significant due to automation and reliance on skilled labour. Similarly, Shaari et al. (2022) argued that the employment effects of FDI depend largely on sectoral distribution and linkages between foreign firms and local industries. When FDI is concentrated in highly automated sectors, foreign firms may increase productivity without substantially increasing employment opportunities for domestic workers.

Furthermore, the effectiveness of FDI in reducing unemployment depends on a country's absorptive capacity, labour market conditions, educational attainment, and economic policies (Azman-Saini, Law, & Ahmad, 2010). Weak technological spillovers, low-skilled labour, and limited integration between foreign and domestic firms may reduce the potential benefits of FDI for employment generation. Therefore, policymakers must ensure that investment policies are aligned with workforce development and industrial upgrading to maximise the employment benefits of foreign investment.

Based on the literature reviewed, this study proposes the following hypothesis:

H1: Foreign direct investment significantly influences the unemployment rate in Malaysia.

Keynesian Theory

The theoretical foundation of this study is Keynesian economic theory, which explains the relationships among investment, aggregate demand, and employment. Keynesian theory, introduced by John Maynard Keynes (1936), argues that unemployment occurs when aggregate demand within an economy is insufficient to absorb the available labour force.

According to Keynes, investment expenditure plays an essential role in stimulating production, income generation, and employment opportunities.

Under Keynesian theory, both domestic investment and foreign direct investment are considered important components of aggregate demand. Increased investment leads to higher production activities, business expansion, and labour demand, thereby reducing unemployment levels. Conversely, a decline in investment reduces aggregate demand and economic activities, resulting in lower employment opportunities and rising unemployment (Mankiw, 2021).

In Malaysia, Keynesian theory is highly relevant because the country relies significantly on foreign investment to support economic growth and industrial development. Increased FDI inflows into sectors such as manufacturing, technology, and services may stimulate economic activities, raise productivity, and generate employment opportunities. Domestic investment also contributes to local business expansion and labour market absorption. Therefore, Keynesian theory provides a useful framework for explaining how investment variables, particularly FDI, influence unemployment rates in Malaysia.

Methodology

Quantitative research is a methodically and scientifically based process that focuses on gathering and analyzing numerical data to identify patterns, relationships, or trends among variables. Quantitative research seeks to quantify phenomena and, using statistical analysis, generalize the results from a sample to a population. Quantitative research is based on measurable data that is used to test hypotheses and objectively validate theoretical assumptions. In economic and social research, quantitative methods are sometimes used to study cause-and-effect relationships between independent and dependent variables. Quantitative research relies on structured instruments or frameworks that are developed using standardized measurement and statistical validation of data accuracy and reliability (e.g., surveys, experimental or causal-comparative research, or analysis of secondary data). Quantitative research allows researchers to show correlations between variables or make predictions based on statistical modeling. Quantitative research provides an understanding of how different variables interact or relate, that is, clear, or based on evidence, or clear evidence.

In this research study, we have applied a quantitative approach to examine the relationship between the unemployment rate (dependent variable) and several independent variables—population growth, minimum wage, poverty level, domestic investment, and foreign direct investment (FDI)—in Malaysia. The research study used secondary data collected from reputable sources such as the World Bank, the Bank Negara Malaysia (BNM), and the Department of Statistics Malaysia (DOSM) over a 30-year period (1994–2024). In testing the hypotheses, the study employed statistical analyses including descriptive analysis, correlation, and regression using EViews software. Figures and tables are incorporated throughout the main report to present numerical findings as clearly and as expected as possible, while adhering to academic expectations and avoiding added visual elements like shadows or frames, whilst maintaining a professional, consistent, and clarifying presentation of reporting findings for the reviewer or reader's interest in the study.

This thesis employed a secondary data sampling method, meaning it relied on pre-existing, verified datasets from reputable institutions and organizations rather than original data obtained through surveys, interviews, etc. The data come from credible institutions like the World Bank, the Department of Statistics Malaysia (DOSM), and Bank Negara Malaysia (BNM). The dataset covers

a 30-year period from 1994-2024 and provides the necessary information to illustrate Malaysia's unemployment rates and their relationship to macroeconomic indicators such as population growth, the minimum wage, poverty levels, foreign direct investment (FDI), and domestic investment. The population for this research comprises the entire Malaysian economy, while the study's sampling frame comprises national-level annual macroeconomic indicators (or new indicators). This sampling frame enables accuracy, consistency, and standardized economic measures that adequately reflect national trends. The data selection focused on time-series variables that are consistently recorded and comparable from year to year to ensure longitudinal validity.

To analyze the data, the study employs quantitative statistical methods using EViews, an advanced econometric program specialized in time series and regression analysis. The analysis will include descriptive statistics, unit root tests, correlation analysis, and simple regression analysis to test the hypotheses and assess relationships between dependent and independent variables. Descriptive analysis outlines a broad range of trends and distributions associated with the data, while the unit root test provides assurance of data stationarity, ensuring the credibility of the estimated model. After assessing and understanding descriptive statistics, correlation and regression analyses quantify the strength and direction of the relationships between unemployment and selected macroeconomic variables. This will orient the analysis process systematically, by entering the secondary data into EViews, performing the required diagnostics tests, interpreting statistical outputs, and displaying results in tables and figures embedded in the report. Each analytical approach will produce valid, reproducible, and evidence-based findings on how investment and economic variables influence unemployment in Malaysia.

Descriptive Analysis

Descriptive Statistics

	LUR	LFDI
Mean	1.213462	3.071776
Median	1.223775	2.116256
Maximum	1.526056	20.13258
Minimum	0.916291	0.770108
Std. Dev.	0.131609	4.384458
Skewness	0.061591	3.460063
Kurtosis	3.968935	13.26872
Jarque-Bera	1.232263	198.0575
Probability	0.540030	0.000000
Sum	37.61731	95.22507
Sum Sq. Dev.	0.519626	576.7042
Observations	31	31

Descriptive statistics for Foreign Direct Investment (FDI) and Unemployment Rate in Malaysia are reported in Table 4.2.1. For the Unemployment Rate, a mean of 1.2586 suggests that unemployment may have been moderately high during the study period. The standard deviation of 0.1549 also shows that the level of unemployment was relatively stable or that any fluctuations over the years were of small magnitude. The stability of unemployment rates implies that the labour market in Malaysia was relatively resilient to changes in economic conditions, as the unemployment rate did not exhibit any dramatic movements over the course of the study.

With regard to Foreign Direct Investment, the mean of 2.3363 indicates that Malaysia received a

moderate level of foreign capital inflows over a 30-year period. The standard deviation of 0.4242 also indicates that FDI capital inflows varied a little from year to year, perhaps influenced by global economic currents or shifts in the domestic investment climate and FDI policy. Hence, while the evidence shows continuity in FDI inflows, there was no significant decline in unemployment. Therefore, foreign investment could not be said to have been a fully effective tool for employment generation. This is important information that indicates the potential need for further inquiry and analysis into the effectiveness of FDI in reducing unemployment in Malaysia.

Histogram and Normality Test

Table 2:
Histogram

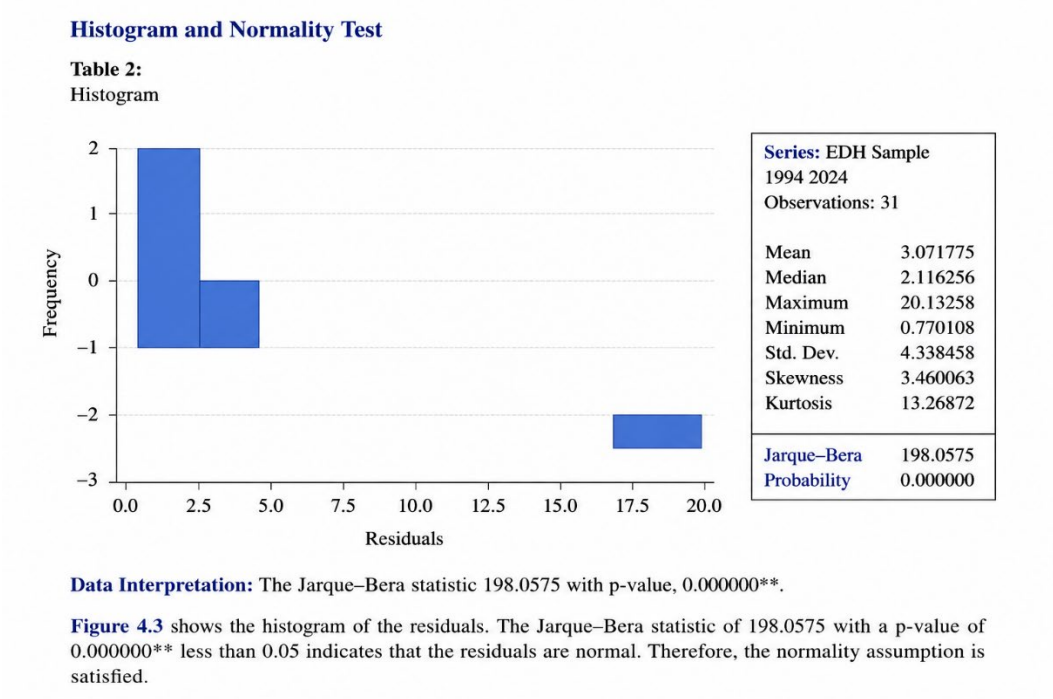
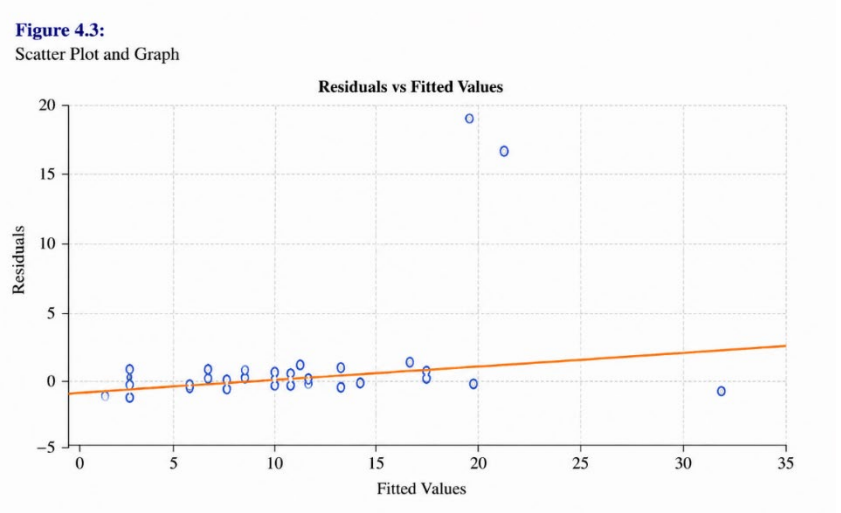


Figure: Scatter Plot and Graph



The scatter plot of the Unemployment Rate versus Foreign Direct Investment is shown in Table 3.

There is a slight upward trend in the scatter plot, suggesting a positive correlation between the two variables. The scatter plot suggests that as foreign direct investment increases, the unemployment rate tends to increase as well. The scatter points are widely dispersed around the trendline, indicating a weak relationship and low correlation between the unemployment rate and worldwide foreign direct investment.

Table 3:
Unit Root Test

Unit Root

Variables	level		First Difference	
	ADF t-statistic	lag	ADF t-statistic	lag
Lfdi	-4.047334	3	-6.042291	3

Table 2 outlines the results of the Augmented Dickey-Fuller (ADF) unit root test for Foreign Direct Investment (FDI) and Unemployment Rate. For the FDI variable in level form, the ADF t-statistic of -4.047334 with a lag of 3 indicates that the variable is non-stationary, since the value exceeds the 5% critical value. This means that the FDI data series exhibits time-varying stochastic processes that are not stable over time. However, upon first differencing Lfdi, the ADF t-statistic is -6.042291, which is more negative than the 5% significance level critical value, indicating that the variable becomes stationary in first differences. The unemployment rate variable also achieves stationarity at first difference. In conclusion, both FDI and the unemployment rate are I(1), meaning that the variables can be used in regression and long-run estimate analysis. The results confirm the validity of additional econometric testing on the relationship between FDI and the unemployment rate in Malaysia.

Simple Regression Analysis

Table 3:
Simple Regression Analysis

	Coefficients	t-statistic	P-Value
FDI	0.004605	0.836114	0.4099

Table 3 presents simple regression results on the effect of Foreign Direct Investment (FDI) on the Unemployment Rate in Malaysia. The coefficient value for Lfdi is 0.004605, with a t-statistic of 0.836114 and a p-value of 0.4099. The p-value exceeds 0.05, indicating that Lfdi does not have a statistically significant impact on the unemployment rate in this study. In other words, changes in FDI inflows are not related to changes in Malaysia's unemployment rate. Even though the coefficient is positive, indicating a slightly upward-sloping relationship, its non-significance implies that FDI has very little effect on unemployment, and that other economic factors, such as automation, outsourcing to foreign labour, or capital-intensive investment, are affecting unemployment.

Accordingly, the hypothesis that FDI has a statistically significant impact on unemployment is rejected; the conclusion is that foreign investment in Malaysia has not decreased unemployment rates throughout the observed period.

Hypothesis Testing Summary

Table 4:
Hypothesis Testing

Hypothesis	Statement	Result
H4	Foreign Direct Investment Significantly Affects Unemployment Rate in Malaysia.	Rejected

The summary of hypothesis testing findings is presented in Table 4 below. The multiple regression analyses have indicated that three independent variables significantly affect the unemployment rate in Malaysia. The population growth rate, for instance, has an inverse and significant relationship with unemployment, meaning that an increase in the population growth rate is associated with lower unemployment. Minimum wage and domestic investment have a significant positive statistical impact on the unemployment rate. This results in a significant contribution of the increase in the minimum wage and domestic investment to a higher unemployment rate. The findings indicate that the population growth rate, minimum wage, and domestic investment were all statistically significant determinants of the unemployment rate in Malaysia.

Findings and Discussion

The regression analysis conducted using EViews examined the relationship between Foreign Direct Investment (FDI) and the unemployment rate in Malaysia for the period 1995–2024. The results indicate that the coefficient for FDI is positive ($\beta = 0.004605$) with a t-statistic of 0.836114 and a p-value of 0.4099. Since the p-value exceeds the 0.05 significance level, the findings show that Foreign Direct Investment does not have a statistically significant effect on the unemployment rate in Malaysia.

Although the regression coefficient suggests a slight positive relationship between FDI and unemployment, the relationship is weak and statistically insignificant. This implies that changes in FDI inflows do not significantly explain variations in unemployment during the study period. Therefore, the hypothesis that FDI significantly affects unemployment in Malaysia is rejected.

The findings suggest that foreign investment alone may not be sufficient to reduce unemployment in Malaysia. One possible explanation is that a substantial portion of FDI inflows is concentrated in capital-intensive and technology-driven sectors that require limited labour input. In such industries, increases in investment may contribute more to productivity and output growth than to employment generation. Furthermore, multinational firms may rely on automation, advanced technologies, or skilled foreign labour, thereby limiting employment opportunities for the domestic workforce.

These findings are consistent with several previous studies that reported weak or insignificant relationships between FDI and employment in developing economies. While FDI contributes positively to economic growth, its impact on labour market outcomes depends heavily on the structure of the economy, workforce skills, industrial linkages, and government policies supporting inclusive employment growth.

Overall, the study concludes that Foreign Direct Investment did not significantly reduce unemployment in Malaysia during the observed period. Policymakers should therefore focus not only on attracting foreign investment but also on ensuring that incoming investments generate sustainable

employment opportunities through stronger domestic linkages, workforce development, and labour-intensive economic activities.

Conclusion

This research examined the relationship between Foreign Direct Investment (FDI) and unemployment in Malaysia from 1995 to 2025 using a quantitative approach and secondary data. The study concludes that FDI and unemployment have a weak, statistically insignificant relationship, indicating that foreign investment does not directly lead to jobs. There has been a significant increase in FDI inflows, but it still has not had a sufficient effect on the unemployment rate. This is likely due to the continued focus of FDI on capital-intensive sectors and industries that typically do not offer many employment opportunities for Malaysian citizens. On the other hand, the effects of domestic investment and population growth were more pronounced in the context of employment, indicating that domestic economic activity and population growth continue to drive labour market outcomes in Malaysia.

The findings lend backing to the perspective espoused by Keynesian economic theory that an increase in investment will increase aggregate demand, and in this context, employment, but only when the economics of inclusive economic policy supports sustaining these new job opportunities. Hence policymakers need to focus on attracting quality foreign investment, especially investments that have the potential to create jobs, create change agents through technology transfer and sustain forward-backward linkages with domestic firms. Supporting skill development and domestic entrepreneurship can increase the likelihood that FDI in Malaysia will result in (sustained) employment opportunities and economic resilience. Future research should consider approaches that examine the impact of FDI on different sectors and the intersection with, and impact on also important economic dynamics about digital transformation, automation and restructuring the economy in the aftereffects of a pandemic, specifically for employment intention in Malaysia.

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Conflict Of Interest

The authors declare that they have no known competing financial interests or personal

relationships that could have appeared to influence the work reported in this paper.

Author Contribution Statement

Author 1 helped develop the study's conceptualization, research design, and writing the original draft. He completed data analysis, interpreted results, and helped coordinate the research overall. Author 2 assisted in data collection, literature review, and statistical analysis using EViews. He also contributed to refining the research framework and ensuring data accuracy.

Ethics Statement

The study's procedures were consistent with the ethical guidelines of the Faculty of Business and Management, Universiti Poly Tech Malaysia (UPTM), and with the principles of the Declaration of Helsinki. In this study, secondary data from publicly available, reputable sources, consisting of the World Bank and the Department of Statistics Malaysia (DOSM). The study did not involve direct human participation, so ethical clearance and informed consent procedures were not necessary. The researchers ensured proper citation of all data from secondary sources and used this information for academic and research purposes only. The research team appropriately managed participants' privacy and confidentiality, as well as institutional data.

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