DETERMINANTS OF FOREIGN DIRECT INVESTMENT: ERROR CORRECTION MODEL FOR THE PHILIPPINE MANUFACTURING SECTOR

A Thesis
Presented to the Faculty of the
Allied Business Department
De La Salle University-Dasmariñas
Dasmariñas City, Cavite

In Partial Fulfilment
of the Requirements for the Degree of
Bachelor of Science in Business Administration
(Major in Economics)

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April 2013

ABSTRACT

Loresto, K, A., Determinants of Foreign Direct Investment: Error Correction Model for the Philippine Manufacturing Sector. Bachelor of Science in Business Administration Major in Economics, De La Salle University-Dasmariñas, Cavite. April 2013. Adviser: Dr. Alice T. Valerio.

This study investigated the determinants of Foreign Direct Investment (FDI) in the Philippine manufacturing sector. The study covered the period from 1985 to 2010 on an annual basis. It aimed (a) to describe the performance of FDI in the Philippine manufacturing sector and its selected variables; and (b) to estimate the short-run and long-run multipliers of the selected variables on FDI in the Philippine manufacturing sector.

The error correction model was used to investigate the short-run and long-run relationships of FDI with the selected independent variables (i.e., inflation, infrastructure, human capital, market size, manufacturing growth, and exchange rate) so as to understand and identify which macroeconomic factors significantly affect and influence it. For this reason, the study focused on domestic determinants that policymakers can possibly influence rather than the overall determinants of FDI some of which are beyond the influence of national government.

All variables were found to be stationary at 1st differenced using Augmented Dickey-Fuller test. Also, inflation rate and exchange rate were found to have negative effect on FDI in the manufacturing sector. Its speed of adjustments in the

manufacturing sector resulting from changes in inflation, infrastructure, education, exchange rate, real GDP per capita, and value of production index were 50 percent for two years, 76 percent for four years, 61 percent for three years, 48 percent for two years, 77 percent for five years, and 59 percent for three years, respectively, showing that the short-run adjustment to the long-run equilibrium FDI took relatively a long period of time.

The study revealed that real GDP per capita was significant in determining the FDI in the manufacturing sector and positively related. Conversely, exchange rate was found significant and negatively related to it. Needless to say, a country with a high value of GDP and a more stable exchange rate would entice more foreign investors. It can be a benchmark whether the economy was performing well.

Valuable results showed that there is an existing disequilibrium among domestic variables and FDI. The government should take into considerations the impact of selected domestic variables to further justify the investment climate of the country. It is recommended that the national government should materialize and monitor its planned improvements and developments in the domestic variables used. Also, to consider the mutual interdependence of observations, judicious planning requires reliable forecasts of decision variables where forecast are based on statistical analysis of the past data rather than using the conventional regression methods solely. These selected variables should be linked to economic decisions to justify whether profitable forecasts are possible.

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