Chapter 6: Conclusions

In this study, the co integration methodology and Granger-Causality test are used to examine behavioural relationships between national income and public expenditure in Malaysia for a period spanning from 1970-2000 on the basis of quarterly data. Unit root tests showed that real public expenditure and national income were non-stationary in their levels but stationary in their first differences. However, our results indicate that the two variables do not co integrate. Finally, we used the Granger-Causality testing procedure to determine the direction of causality. We may draw conclusions that there exists uni-directional causality from public expenditure to national income (GDP) at log differences, which supports the Keynesian framework. The rejection of Wagner's Law may be due to various unique circumstances that happened in Malaysia.

In developing countries, the public sector tends to play a greater role as an investor than in industrial countries. Developing countries tend to need more investment in infrastructure than the industrial countries. Malaysia as a developing country is no different. Most public expenditures are directed to development projects particularly in building infrastructures and investing in projects that generates revenues. One important rationale of investing in development projects is to help to create vast employment opportunities for the labour market. Developing expenditures are mainly directed to sectors like agriculture, commerce and industry, telecommunications, transport, utilities and social services. Examples of large development projects undertake by the Government include the construction of Kuala Lumpur International Airport (KLIA), Sepang circuit, Light Rail Transit System (LRT), Petronas Tower, Putrajaya, Multimedia Super Corridor and many others. No doubt that the initial capitals for these projects are very large. Despite the high capital needed, the projects were implemented because of their high-expected returns to the economy in the future even though they may have long payback period. The invalidity of causation from national income to public expenditure may be due to the high developing expenditure that Malaysia undertook. Contrary, the high developing expenditure provides a good explanation for the existence of Keynesian hypothesis that implies that causation runs from public expenditure to national income.

Furthermore, the Malaysian Government historically has been an ardent practitioner of Keynesian framework in managing its economy. Various economic downturns and recessions in Malaysia witnessed the application of expansionary fiscal policy as a main tool to steer back the economy to equilibrium. For example in the 1985 international recession, the government attempted to spend its way out with increased public spending and a public employment expansion policy financed with foreign borrowings. As the deep structural nature of the international recession became increasingly apparent, the government was forced to abandon the counter-cyclical expansionary fiscal strategy (Jomo, 1994). Despite the abandonment of the expansionary public spending, it demonstrated the willingness of the Malaysian Government in using public expenditure as an important fiscal tool. In the more recent 1997 financial crisis, the government who later abandoned IMF prescription of tight fiscal policy eventually embarked on a series of fiscal stimulus package in order to revive the economy. These efforts proved to be successful in pulling the economy out of the recession.

Another reason, which may have caused the invalidity of Wagner's Law, is the Privatisation Plan adopted in the mid-1980. The cutback on public expenditure invariably went against the proposition of Wagner's Law of 'increasing public expenditure'. In accordance with the Privatisation Plan, a large portion of public enterprises has been transformed to corporate companies. Although the Government still maintains as the major shareholder in some of these privatised companies (particularly in the utilities sector), a fraction of the shares were allotted to private partners.

Operating expenditure, which also indicates that causality runs from public expenditure to national income, puts additional support for Keynesian theory. A reasonable explanation for this outcome is that the Malaysian Government has tried to spur economic growth by increasing operating expenditure. For instance, the government announced a half-month salary bonus or a minimum of RM1,000 as well as another 10 per cent salary increase for civil servants in the 2002 Budget to boost domestic spending.

Rejection of Wagner's Law in Malaysia suggests to us that there is no one general hypothesis that can sufficiently explain the trend of public expenditure but instead are greatly influenced by the situation prevailing in the countries involved.