

CHAPTER 1

INTRODUCTION

1.1 Introduction

The purpose of this paper is to elucidate the impact of basic educational funding on income inequality in Malaysia. In order to do so, we shall first examine how investments in basic education affect income of the poor, and second, the extent to which government involvement in the financing of education services contributes to achieving a more equitable distribution of income.

The contribution of this paper to the first issues should be viewed as part of the growing body of literature trying to deepen our understanding about relationship between education and incomes and, as a corollary, about the impact of educational funding on the distribution of income. The second aspect of the problem is treated more directly as a public finance and public policy issue. Once the impact of education on earnings has been recorded, the next question to raise is: What (if anything) can the government especially the education authorities do or should do about it? This, of course, assumes that government is in some ways interested in shaping the final distribution of income.

Those interested in explaining the incidence of poverty have traditionally seen educational attainment as a key variable. Causal empiricism suggest, and more systematic studies support, the claim that educational attainment is positively correlated with income at an individual level, although there are many different

explanations to why this correlation exist.¹ The correlation between education and income suggests the possibility that programs which subsidize education and strive to create equal opportunity for educational attainment might be successful as devices for lessening poverty and, more generally, making the distribution of income more equal. This paper will evaluate the role of the state in educational funding and with relate to poverty reduction and income distribution as well as trying to establish that education do increases the incomes of the poor. We will also investigate the relationship between equality in education attainment and equality in the distribution of income in the Malaysia economy, in an effort to explore the success of programs which equalize educational opportunity and promote income equality.

Malaysia has been enjoying tremendous economic advancement and growth prior to the economic turbulence experienced since mid July 1997. Since then, stringent measures undertaken by the government in the financial and capital market have proven to bring positive response. This has also been due to the immediate action by the government to check the inflow of foreign workers and also deportation of excess temporary foreign workers and the existing illegal foreign workers in Malaysia.

The science of economics helps to determine the optimal types of goods and services to be produced by a country through optimum utilization of scarce resources. In pursuing economic growth a country is often at a dilemma whether to pursue economic or social goals. All too often in order to stand at par with the elite of developed nations, social welfare is sacrificed to pay for economic development.

¹ This is a result which can be explained within the context of the human capital approach [eg., Mincer (1974), Thurow's job competition model (1975), and Spence's signaling model (1973)].

It is important to note that to make economic development possible, first the nation must have a skilled work force, healthy and educated. This will enable the enhancement of productivity and also to create new inventions and to be innovative. In short, health and education are vital to enhance economic growth and development. In order to materialize a stable and competitive economy, the human capital is crucial to drive factors of production.

Malaysia realizing the need to ensure a healthy and educated workforce has continued to provide basic health care and also to provide basic education for the society. The government's expenditure on health, education, social security and welfare, and defense can be seen in Table 1.1.

**Table 1.1: Central Government Expenditure by Function
(Percentage of total expenditure)**

	Health		Education		Social security and welfare		Defense		Others	
	1981-90	1991-95	1981-90	1991-95	1981-90	1991-95	1981-90	1991-95	1981-90	1991-95
Malaysia	4.9	5.6	18.7	20.4	4.0	5.9	10.7	11.7	61.8	56.3
Thailand	5.7	7.6	19.7	21.3	3.2	3.6	19.1	15.6	52.4	51.8
Singapore	5.5	6.8	19.1	21.0	1.5	3.3	20.6	26.5	53.2	42.3

Source: World Bank (1997).

Table 1.1 shows that the Malaysian central government's spending on health had increased by 14.29% from 1981-90 to the 1991-95 period, education increased by

9.09%, social security and welfare increased by 47.5% and defense increased by 10% and others decreased by 8.90%. The high increase in social security and welfare is due to the campaign to increase awareness and protection for children, women and also care for the elder members of society.

1.2 Objective and Methodology

This paper attempts to test the hypotheses that (1) educational funding and hence its expansion directly improves the incomes of the poor and (2) whether the more equal distribution of educational funding and attainment has contributed to a more equal distribution of income in Malaysia. We will test the first hypothesis using the data for 111 countries over a period of 40 years and a measure of human capital, which considers international differences in the quality of education. The evaluation will take into account both 'direct' and 'indirect' positive effects of education. With the international evidence proven, we will then move our focus to Malaysia and investigate whether the more equal distribution of educational funding and attainment has contributed to a more equal distribution of income in Malaysia, holding other factors (which will be elaborated more in Chapter 4) constant. We will examine the applicability of international finding in the Malaysian context.

In addressing whether educational equality contributes to income equality, this paper indirectly test Mincer's human capital model as compared to other models of income determinations. Of these specifications, only the human capital model would predict that increased equality in educational attainment would cause the distribution of

income to become more equal, for only in this model is there a direct causal link between a worker's education and his or her productivity.² We will elaborate more on the Mincer's human capital model in Chapter 4.

The methodology used in the study is regression analysis using the ordinary least squares (OLS) method. Education's direct effects on the income of the poor are tested using the quality adjusted human capital as an explanatory variable in the average per capita income equation. The size, sign, and the significance of the human capital variable, which will be computed by elasticity coefficients, indicate the strength and direction of its impact on per capita income of the poor.

The data used in the study were mainly obtained from secondary sources which include UNESCO's Statistical Yearbooks, Treasury Economic Reports, World Bank Poverty Reports, Deininger and Squire data-set,³ Penn World Tables (Marks 5.6),⁴ Statistical Department's Census of Populations, Malaysian plan documents and other sources.

² In Thurow's model, productivity rests in the job and not in the worker, and education is linked with the costs of training a worker. Spence's model views a worker's productivity as given, and educational attainment as a signal of that productivity.

³ Deininger and Squire (1996).

⁴ Summers and Heston (1995).

1.3 Organization of Chapters

Chapter 2 will focus on the literature reviews and some past studies on the relationship between educational funding, poverty and income inequality in Malaysia and other countries. In Chapter 3, will conduct an overall survey of the educational funding, poverty reduction and income distribution in Malaysia for the last 30 years.

The empirical analysis will take place in Chapter 4 where the impact of the educational funding on the income of the poor will be discussed using the statistical analysis. The first part of this chapter will focus on the establishment of the first hypothesis that education does increases the income of the poor from an international perspective. We will then move our study from the international scene to Malaysia. The second part of the Chapter 4 will examines the relationship between equality in educational funding and attainment and equality in the distribution of income in Malaysia economy. We will explore the success of the New Economic Policy (NEP) which tried to equalize educational opportunities and promote income inequality. We will also find out whether the international experience is applicable to Malaysia.

Finally, Chapter 5 concludes the analysis by highlighting the key findings and implications of the study.