

## CHAPTER IV

### THE GROWTH OF PUBLIC EXPENDITURES IN MALAYSIA

#### Budgetary Process

The main outlines of the Malaysian financial system are laid down in the financial provisions of the Federal Constitution. In the annual Financial Statements of the Federation published by the government two types of expenditures are distinguished, namely charged expenditures and supply expenditures. Charged expenditures are direct charges to the Consolidated Fund. In the Federation these include financial provisions for the Yang di-Pertuan Agong, the judges and pensions etc. For this category of expenditures annual approval by the Parliament is not needed. For all expenditures other than this category annual approval of the Parliament is required before the sum can be expended. This is accomplished by means of a Supply Bill. For this purpose two budgets, which are estimates of revenues and expenditures, are presented to Parliament for approval annually.

The Ordinary Budget covers the recurrent expenditures of the central government such as administration, defence and security and includes the salaries and emoluments of civil servants as well as educational expenditures etc. In short ordinary budget expenditures cover the costs of running the machinery of the central government. The expenditures estimates contain the details of expenditures classified under Heads and Subheads according to departments and ministries. The estimates are subject to debates and amendments, if necessary, by the Parliament. After passing through the Senate and after receiving the royal consent (that of the Yang di-Pertuan Agong) the Supply Bill becomes the legislative authority to incur expenditure.

The Ordinary Budget is presented to the Parliament by the Minister of Finance. The Minister's Budget Speech constitutes a major review of the economic conditions of the country.

The Ordinary Budget also contains detailed estimates of revenues. No tax may be levied without the approval

of Parliament. Taxation proposals or amendments are generally presented in the form of a parliamentary bill. These bills are presented by a minister. In certain circumstances, however, previous publicity in presenting a bill must in the national interest be avoided, and this applies particularly to proposals to vary customs duties. In these cases the Minister of Finance varies the rates of duties by an executive order which is arranged to come into effect at the time when he announces his proposals to Parliament. Should Parliament disallow the new rates or any one of them, the relevant part of the order will be rescinded.

Other than the Ordinary Budget there is a Development Budget which contains expenditures to be charged to the Development Fund.<sup>1</sup> The purposes of the Development Fund include the construction, improvement, replacement and acquisition of holdings, machinery and many other capital assets in connection with a large number of development projects such as drainage and irrigation, transports and communications, defence and security, education and health etc. In other words the Development Budget is in fact an estimate of these varied expenditures for each year. The Development Budget is usually presented by the Minister of Rural Development.

The overall management of the budget is vested with the Treasury which scrutinises every item of expenditures submitted by all Departments and Ministries to be included in the budget proper. For example in 1967 the Treasury processed and scrutinised altogether 88 estimates: 75 submitted by Departments or Ministries and 13 by States. Among other things the Treasury has the responsibility to ensure "an effective allocation of resources, as reflected by the annual Budget, in order to serve national objectives."<sup>2</sup> Presumably these objectives include "high level of employment, price stability, balance of payments equilibrium and growth of the national economy."<sup>3</sup>

However the immediate controlling officer, usually the Permanent Secretary or Head of each Department or Ministry, has the duty to see that expenditures are incurred in accordance with law and that they are properly spent.

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<sup>1</sup> The Development Fund was established by the Financial Ordinance of 1957. In effect it merely took development expenditures out of the Consolidated Fund and credited to the Development Fund.

<sup>2</sup> Budget Summary of Federal Government Expenditures 1969, Government Printer, Kuala Lumpur, Page 321.

<sup>3</sup> Ibid.

The controlling officer is subject to audit query. The actual auditing of actual spending is done by the Auditor-General and is an integral part of control. The Auditor-General is directly responsible to the Yang di-Pertuan Agong. He is therefore independent of the executive. His duty is to ascertain whether all reasonable precautions have been taken to "safeguard the collection and custody of government money and that the correct procedure is followed in making payments." In the performance of his duty he can have access to all relevant documents and he may query any officers concerned. The Auditor-General is expected to, and does in fact, impartially scrutinise and report on all government accounts.

### Growth of Government Expenditures and GNP

A traditional description of the importance of government sector in the economy requires a reference to public expenditures as a percentage of GNP. This is a measure of the extent to which the public sector draws on the total resources of the country and consequently the extent to which it can affect the allocation of resources as between various alternative uses.

In Malaysia government expenditure forms a sizeable portion of GNP at market price. And the relative size shows a tendency to grow larger over time. This means that the public sector has become increasingly more important in the allocation of total resources. It also follows from this fact that the government is in a more favourable position to achieve any economic objectives it may set upon itself. From Table 4.1 it can be seen that for the period 1957-1967 the share of government expenditures in GNP at market price shows a steady increase, except for the period 1958-1959 when there was a slight fall in the percentage. For 1957 the share of government expenditures in GNP was 19.3%. By 1964 the share had risen to 25.5% and by 1967 it had soared to 28.9%.

It is evident from the data given in Table 4.1 that there was a positive correlation between GNP and Government expenditures.<sup>4</sup> It is also clear from Table 4.2 that government expenditures grew at a faster rate than GNP. From 1957 to 1967 while the average annual growth

<sup>4</sup> Using the following formula

$$r = \frac{n \cdot \sum x_i y_i - (\sum x_i)(\sum y_i)}{\sqrt{n \cdot \sum x_i^2 - (\sum x_i)^2} \sqrt{n \cdot \sum y_i^2 - (\sum y_i)^2}}$$

the coefficient of correlation is 0.8665.

TABLE 4.1

TOTAL GOVERNMENT EXPENDITURES AS PERCENTAGES  
OF GNP 1957-1967

(4)

(3)

(1) (2)

Year	Government Expenditure (\$ millions)	GNP (\$ millions)	(2) As Percentage of (3)
1957	957	4,948	19.3
1958	988	4,758	20.8
1959	980	5,316	18.0
1960	996	5,836	16.8
1961	1,203	5,914	20.3
1962	1,487	7,044	21.1
1963	1,731	7,430	23.1
1964 <sup>*</sup>	2,051	8,045	25.5
1965	2,215	8,728	25.3
1966	2,531	9,239	25.2
1967	2,748	9,502	28.9

Source : National Accounts of West Malaysia 1955-1963 )  
National Accounts of West Malaysia 1960-1965 )

Department of  
Statistics, Kuala Lumpur.

Bank Negara quarterly Economic Bulletin, Vol. 1 No. 1.

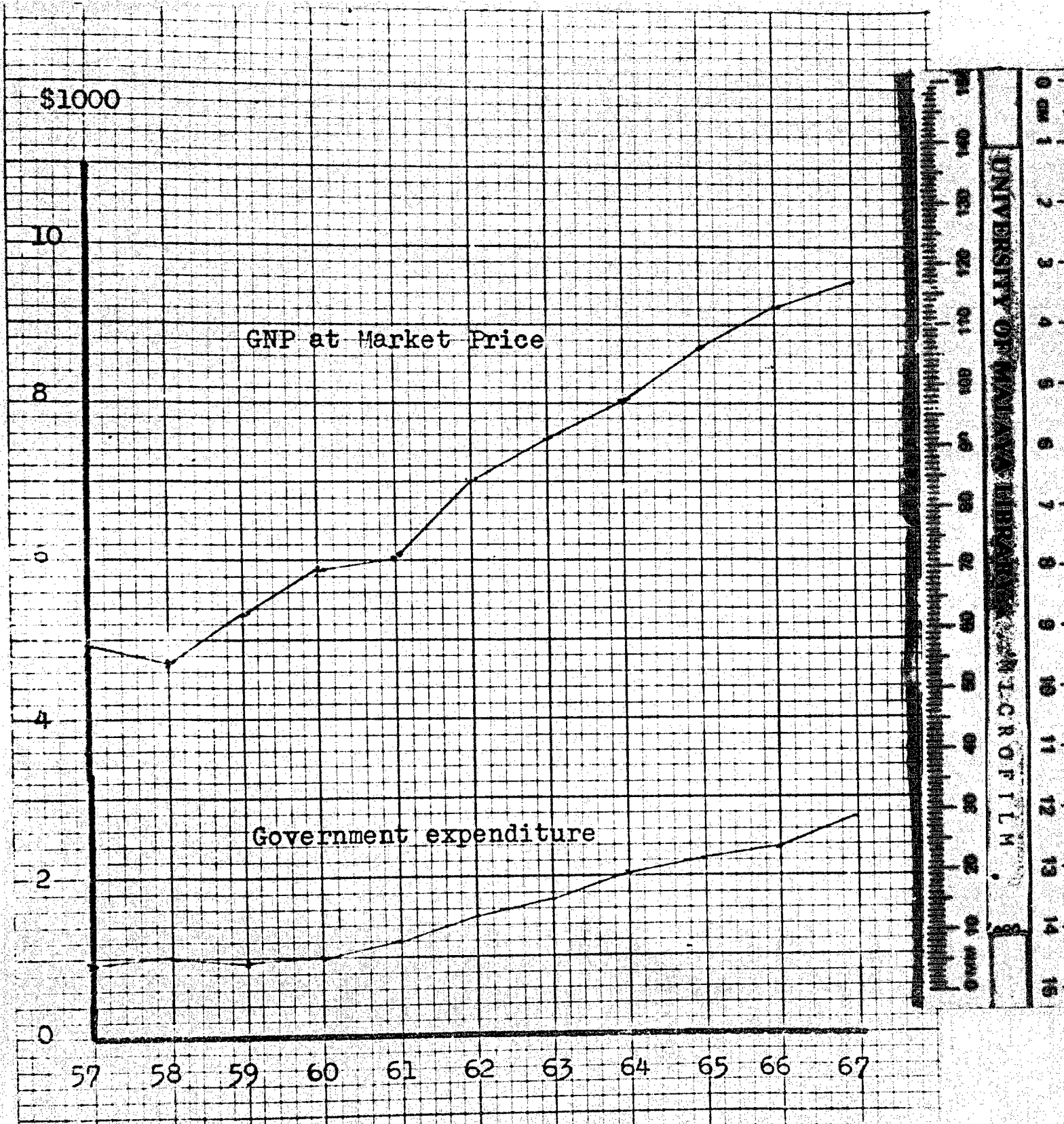
\* Prior to 1964 figures for Malaya only.



TABLE 4.1

GROWTH OF GNP AND GOVERNMENT EXPENDITURE

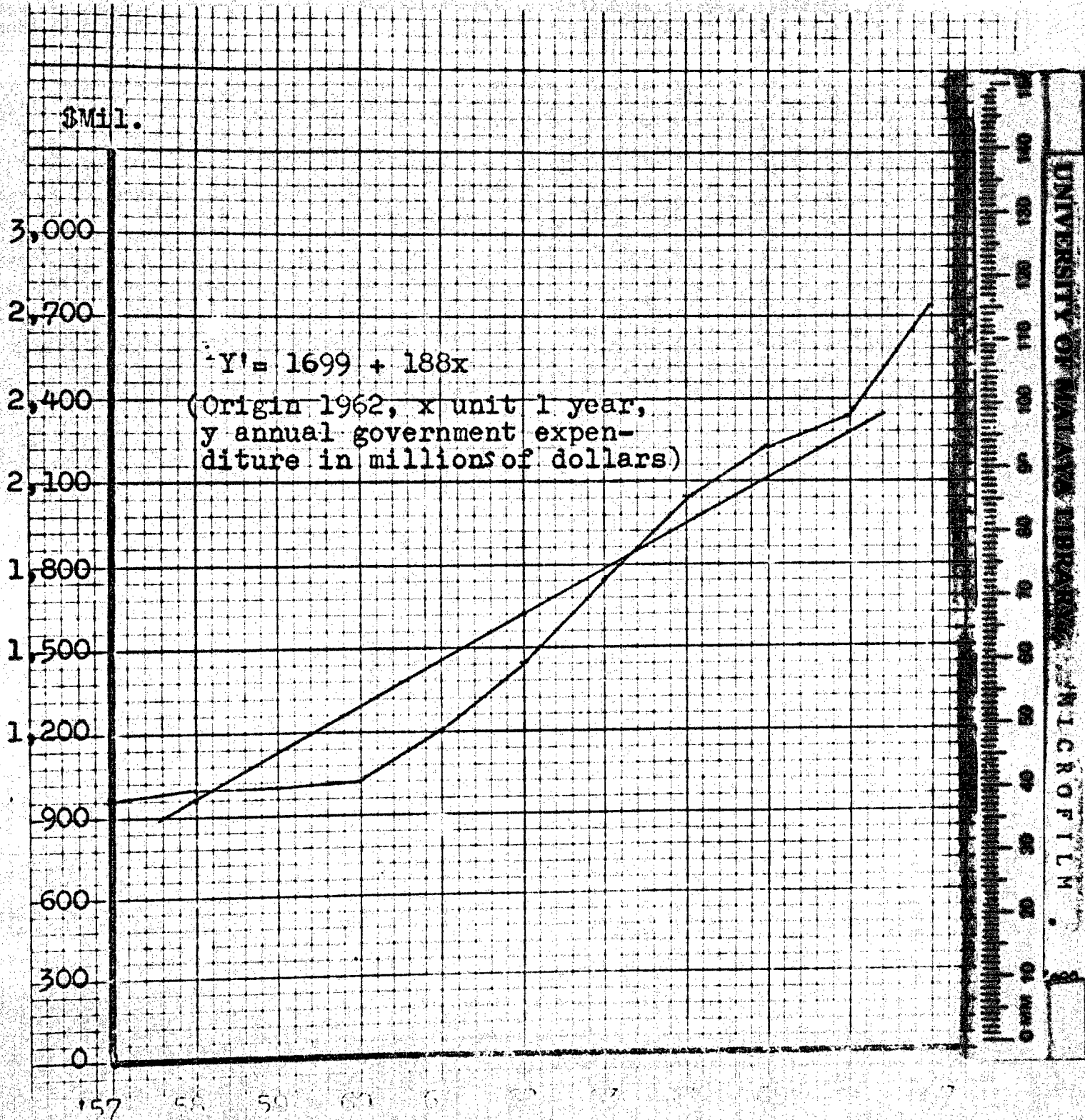
1957-1967



Source: drawn from data in Table 4.1

GRAPH 4.2

TREND GROWTH OF GOVERNMENT EXPENDITURES  
IN MALAYSIA



Source: Calculated and drawn from data in Table 4.1.

rate of GNP amounted to 8.3%, that of government expenditures was as high as 16.4%. These results thus appeared to have provided an empirical verification of Wagner's Law. Malaysia seems to fit Wagner's Law because she has just embarked on a process of industrialisation which aims at transforming her predominantly agricultural economy to an industrial economy. It may be recalled that this was what happened in nineteenth century Western Europe from where Wagner derived his generalisation that there was a functional relation between government expenditures and GNP.

TABLE 4.2

RELATIVE GROWTH OF PUBLIC  
EXPENDITURES AND GNP  
1957 - 1967

	1957 M11	1967 11	Annual Growth Rate %
Total Budget Expenditure	957	2,683	16.4
Recurrent Expenditure	763	1,847	13.0
Development Expenditure	168	856	36.1
GNP at Market Price	4,948	9,502	8.3

Source: As in Table 4.1

Note: Recurrent and Development expenditures do not add up to Total Budget Expenditure because of transfer to statutory funds.

It should be noted that the growth of government expenditures was not evenly spread out with regard to recurrent and development expenditures. Development expenditure grew at a much faster rate than recurrent expenditure. Thus from 1957 to 1967 while development expenditure grew at the rate of 36.1% per annum the corresponding figure for recurrent expenditure was 13.0% only. This point had some implications in the allocation of resources through the public sector.

Since there had been no major revision of salary scales for the civil servants and there had been no significant rise of general price level the increase in recurrent expenditures would reflect an increase of goods and services provided by the government. This in turn was reflected by an increase in public sector employment. Thus government services provided employment for 200,000 persons in 1960 but the figure rose to 257,000 in 1965. The annual growth rate was 5.1%.<sup>5</sup>

To the extent that the rise in government expenditures is the inevitable consequence of the increase in population, it may be considered as a "permanent influence". The logic is quite simple: more expenditure must be incurred to cater for more people even if only to maintain a stationary level of public services. In 1957 the population of Malaysia was 5.4 millions but had risen to 10.1 millions in 1967.<sup>6</sup> The annual population growth rate is about 3%, one of the highest in the world. For the period under study a special feature of the population growth needs to be emphasized because it has an important bearing on government expenditures during the period under study as well as in the near future. It is that the increase in population had been mainly in the younger age group and so created a dependency problem for parents and government alike. Specifically more educational and social expenditures must be incurred for this group of unproductive citizens so as to make them more productive in future.

The phenomenal increase in government expenditure was also to a certain degree a reflection of the improved standards of living. As measured by per capita income the standards of living in Malaysia had shown some improvement, from \$772 in 1957 to \$940 in 1967.<sup>7</sup> For this reason we could now afford more public goods and services than formerly.

But the increase in GNP alone could not have sustained such a tremendous rise in government expenditure. What then was the basic cause? The correct answer could be found in the changing emphasis of government's role in the national economy. In other words government spent

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<sup>5</sup> Source: First Malaysia Plan 1966-1970, Government Printer, Kuala Lumpur, Page 35.

<sup>6</sup> Source: UMEC Economic Review Vol. III No. I and Vol. IV No. I, Page 49 and 40 respectively. The 1957 figure was for Malaya only.

<sup>7</sup> Ibid.



more not because we were richer but rather that we now had a different conception of the role of government and of the types of goods and services which should be provided by the government.

This point was amply borne out by the tremendous increase in government expenditures, especially development expenditure, after Independence. Not only was the annual growth rate of development expenditure much greater than that of recurrent expenditure but it was being accelerated recently. Expressed as a percentage of total government expenditures, development expenditure was 17.1% in 1957 but had soared to 31.1% in 1967. Since Independence the government had consciously taken upon itself the task of guiding the direction of the national economy even though all along it had subscribed, and still subscribes, to the principle of free enterprise.

This tremendous increase in development expenditure was the result of a strong desire and genuine effort to diversify the base of the national economy, to lessen the nation's dependence on the export earnings of tin and rubber which had for so long been the pillars of Malaya's prosperity but which had also caused so much fluctuations in the Malayan economy.<sup>8</sup> There was also a vast programme to build up a sound economic infrastructure on which further progress could be made, presumably by the private sector. The actual projects of development were embodied in the various five year plans.<sup>9</sup>

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<sup>8</sup> See Lim Chong Yah, Economic Development of Modern Malaya, Oxford University Press, Kuala Lumpur, 1967, Chapter I.

- <sup>9</sup> (i) First Development Plan 1951-1955.  
(ii) Second Development Plan 1956-1960  
(First Malaya Five Year Plan).  
(iii) Third Development Plan 1961-1965  
(Second Malaya Five Year Plan).  
(iv) Fourth Development Plan 1966-1970  
(First Malaysia Five Year Plan).

## The Share of Government in Fixed Capital Formation

As government development expenditure includes the acquisition of property and capital goods already in existence it does not express the contribution of the public sector to capital formation in the economy. From the point of view of the growth of the public sector and that of the degree of control that the government can exercise on investment decision and hence the allocation of resources, the amount of capital formation in the public sector is more relevant.

The relative importance of the public and private sector in gross fixed capital formation is shown in Table 4.3. It can be seen that except for 1958, 1959 and 1964 gross fixed capital formation in the public sector increased steadily in absolute terms. As a percentage of total fixed capital formation it also increased steadily; in 1957 the percentage was only 25.5% but in 1965 it had risen to 31.6%. The decline in the size of public sector fixed capital formation in 1958 was mainly due to the fact that the Malayan economy was faced with a depression in 1958. Because of this depression government revenue declined tremendously and consequently less resources were available for capital formation. This pattern was carried forward to 1959 even though the economy started to recover in that year. This recovery was actually reflected in the increase in fixed capital formation in the private sector. The continued fall in public sector capital formation could be accounted for by the lack of synchronization between the budget and actual economic conditions. Thus the budget for 1959 was formulated in 1958 when there was a depression which was expected to continue in 1959 so that even though economic conditions began to improve in 1959 public sector capital formation still declined as compared to 1958. Incidentally this decline in public sector capital formation when the economy began to recover from a depression produced a countercyclical effect which was never intended.<sup>10</sup>

Having analysed the overall picture of fixed capital formation in the public sector we must now look into the distribution of capital formation as between different sectors of the economy. However detailed statistics of sectoral capital formation is not available so that we can only rely on the public investment data given by the various five year plans as a rough guide. In this connection it must be remembered that public investment includes the purchase of existing assets. As such it is not the

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<sup>10</sup> The countercyclical effects of government expenditures are discussed in the following section.

TABLE 4.3

GROSS FIXED CAPITAL FORMATION 1957-1965  
(Millions of dollars)

	57	58	59	60	61	62	63	64	65
Gross Fixed Capital Formation of Private Enterprise									
Gross Fixed Capital Formation of Public Corporation	469	447	472	615	660	736	803	855	896
Gross Fixed Capital Formation of Government Enterprise									
Gross Fixed Capital Formation of General Government.	161	133	108	140	256	394	391	374	415
Total Fixed Capital Formation	630	580	580	755	916	1130	1194	1229	1311

Source : National Accounts of Malaysia '55-64 )  
National Accounts of Malaysia '60-65 }

Department of Statistics, Kuala Lumpur.

N.B. The figures include Federal Government, State Governments and Local Authorities.

TABLE 4.4

**PUBLIC INVESTMENT IN MALAYSIA 1956-1965**  
(In millions of dollars)

	<b>First Five Year Plan (Actual) 1956-1960</b>	<b>Second Five Year Plan 1961-1965</b>
<b>Agriculture</b>	227.5	426.4
<b>Transport</b>	206.5	445.3
<b>P.W.D. Plant and Equipment</b>	25.6	62.4
<b>Communication</b>	51.6	137.9
<b>Utilities</b>	238.6	237.8
<b>Industries</b>	12.1	60.4
<b>Social Services</b>	128.8	430.2
<b>General</b>	73.0	145.0
<b>Security</b>	35.0	373.9
	<b>1,007.0</b>	<b>2,303.3</b>

Source : Federation of Malaysia Official year book 1964, Kuala Lumpur.

N.B. Investment by Central Government only.



same as capital formation but can be taken as an approximate figure. In spite of this discrepancy the investment figures do throw some light on the actual process of capital formation in the public sector.

Public investment in Malaysia is shown in Table 4.4. It can be seen that most of the investment had been of an infrastructure nature. The predominance of agriculture in both plans was obvious, reflecting the attempt to improve the lots of the rural people. Of the total investment in agriculture a large part was for rubber replanting, especially in the First Five Year Plan. Land development was another big item. For example as much as 145,000 acres of land were opened up by the Federal Land Development Authority during the period 1961-1965, providing for new settlement of 12,000 families.<sup>11</sup>

Another sector which showed marked increase in investment was social services which included education, health and welfare services.

It should be noted that public investment for the period 1961-1965 more than doubled that of 1956-1960. This was an indication of some determined efforts to improve the standard of living of the people. The increasing importance of the public sector in total fixed capital formation was also a reflection of these efforts. These trends thus supported our argument that increase in government expenditures was mainly due to a change of government's attitude as regards its role in the national economy.

### Expenditures as an Instrument of Fiscal Policy

Fiscal policy has come to mean a policy by which the government manages its finances in such a way as to exert a stabilising influence upon the economy as a whole. In doing so the government can operate in three broad areas; in expenditures, in taxation and in debt management. To the extent that expenditures are to be used as an instrument of fiscal policy they should be reduced in inflationary periods and increased in periods of deflation.

However there are several important constraints which limit the use of expenditures as an instrument of fiscal policy. Most of these constraints originate from the inflexibility of certain categories of government expenditures. For example national defence expenditures are determined by the international situation and a country's

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<sup>11</sup> First Malaysia Plan 1966-1970, Government Printer, Kuala Lumpur, Page 103.

foreign policy; they are therefore not amenable to manipulation for fiscal policy purposes. Interest payments on public debt can hardly be reduced in inflationary periods. On the contrary these interest payments can be expected to rise because the banking and the monetary authorities will raise interest rates in an attempt to curb the inflation. There are still other types of expenditures which social convention requires to be increased even in periods of inflation, thus aggravating the inflation. Among these expenditures are pensions, family allowance and other social welfare expenditures. It is an almost universally accepted principle that pensions, family allowance and other similar expenditures should be increased in periods of inflation even if only to maintain the recipients' original purchasing power.

These constraints, though important, do not imply that expenditures are ineffective as an instrument of fiscal policy. There are other categories of government expenditures which are more flexible and which can be used to regulate the economy. For this purpose public development expenditures are considered highly flexible provided there is proper planning on the part of the authority concerned. In principle, at least, these expenditures can be increased during depressions and scaled down during inflation. It has been vigorously argued by Benjamin Higgins that in spite of the technical difficulties involved in their planning and execution development expenditures should be used as a countercyclical instrument.<sup>12</sup>

Before we proceed to examine the expenditure policy, if any, of the Federation of Malaysia, it is necessary to note some of the characteristics of Malaysian economy in connection with economic fluctuations. In common with other underdeveloped countries which export primary commodities, economic fluctuations in Malaysia are externally induced. Malaysia is heavily dependent on the export earnings of tin and rubber as a major source of income. But like other primary commodities these two are subject to violent price fluctuations according to the forces of supply and demand in the international market. A drop in the price of exports will reduce the income and employment of the export sector. However the deflationary effect will not stop there. A reduction of income in the export sector will also reduce general demand for domestic products, which will in turn reduce income and employment. The effect will spread throughout the economy through the

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<sup>12</sup> Benjamin Higgins, Economic Development, Principles, Problems and Policies, Central Book Depot, Allahabad, 1956, Page 564-68.

multiplier and the accelerator processes. Thus violent changes in gross export proceeds will bring about a corresponding violent change in national income and employment. This process had been amply illustrated by the Malaysian experience of trade cycles.<sup>13</sup>

In the context of Malaysian economy as described in the last paragraph the main problem of fiscal control is to ensure that expenditures are maintained or even increased during periods of depression i.e. periods of low rubber and tin prices, so as to maintain employment.

During the period under study (1957-1967) there were two periods of deflation and one of inflation.<sup>14</sup> We shall examine the pattern of government expenditures in each case separately.

TABLE 4.5  
TOTAL GOVERNMENT REVENUE AND EXPENDITURE  
1957-1967

Year	Revenue (\$ million )	Expenditure (\$ million )
1957	800	957
1958	762	988
1959	891	980
1960	1,069	996
1961	1,081	1,203
1962	1,108	1,487
1963	1,150	1,731
1964	1,221	2,051
1965	1,492	2,215
1966	1,739	2,331
1967	1,893	2,748

Source: Federation of Malaysia Financial Statements 1957-65  
Bank Negara Annual Report 1967

<sup>13</sup>For a detailed study of trade cycles in Malaya, see Lim Chong Yah, op.cit., Chapter I. <sup>14</sup>Ibid.

The year 1958 was a bad one for Malaysians. Primarily owing to a sharp fall in the prices of rubber and tin, a depression set in resulting in a high level of unemployment. Export earnings of rubber dropped from \$1,946 million in 1957 to 1,790 million in 1958. The export earnings of tin fell from \$448 million to \$281 million in the same period. As a result GNP at market price fell and so did government revenue.<sup>15</sup>

What was the government's expenditure policy during this period of deflation? Was there any deliberate increase in expenditures so as to relieve the pressure of unemployment and to induce a recovery? Statistics suggest that the answer is in the negative. For the year 1958 total government expenditures amounted to \$988 million, an increase of \$31 million as compared with the previous year. But this increase was by no means a deliberate attempt to bolster the economy. The apparent countercyclical effect was produced by the time lag between budgeting and actual incurrence of expenditure. For example the 1958 expenditures were budgeted for in 1957 when conditions were favourable. In fact the 1958 expenditures fell short of the authorised amount; while the authorised development expenditure was \$173 million the actual expenditure amounted to \$140 million only. Similarly actual recurrent expenditure was \$848 million while a total of \$934 million had been authorised by Parliament, indicating that the government sector did not expend as much as desired. More specifically all those categories of government expenditures, such as expenditures on public works and agriculture, which could potentially give rise to more employment, either declined or rose to an insignificant extent as compared with the 1957 figures. All these can be seen from Table 4.6. In all cases actual expenditures fell short of the amount authorised by Parliament.<sup>16</sup>

That all the actual expenditures fell short of the authorised amount suggests that there were some technical or administrative difficulties which prevented the expenditures from being carried out in the same period. These technical and administrative difficulties tended to reinforce the government's conservative policy so that these expenditures were reduced even during periods of deflation. It should be noted that even the authorised

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<sup>15</sup> Source: Tables 4.1 and 4.5.

<sup>16</sup> Source: The figures in this paragraph are taken from Tables 4.1, 4.5 and 4.6.



TABLE 4.6

SELECTED ITEMS OF GOVERNMENT EXPENDITURES  
1957 and 1958  
(In Millions of Dollars)

Items	Development Expenditure			Recurrent Expenditure				
	1957		1958	1957		1958		
	Authorised	Actual	Authorised	Actual	Authorised	Actual		
Transport, Communications, Roads and Public Works and Post	n.a.	59.8	62.3	46.9	71.4	71.1	67.0	63.5
Agriculture (including drainage and irrigation)	n.a.	7.0	9.7	7.4	19.2	13.0	22.9	14.8

Source : Federation of Malaya Financial Statements 1957 and 1958.

N.B. n.a. means not available.

expenditures for 1958 fell short of the actual expenditures for 1957 or only rose by a negligible amount. This clearly was an indication of the conservative nature of the government's expenditure policy because had there been any desire to increase expenditures in order to counter the deflationary pressure the government could have done so by means of a Supplementary Bill in spite of the original budget. The principal constraint on government expenditures seemed to be the drop in revenue. In other words the government was just as adversely affected as the individuals and behave accordingly. It is thus clear that there had been no deliberate use of government expenditures as an instrument of fiscal policy.

The economy began to recover in 1959. For that year government expenditures were \$930 million, \$8 million less as compared with the previous year. Apparently expenditures seemed to have been cut down to avoid a rapid inflation. But again this was not a deliberate policy. It was another manifestation of the time lag between budgeting and actual incurrence of expenditures as described in the last paragraph. Expenditures in 1959 declined simply because revenue for 1958 fell and was expected to continue to fall in 1959.

But all these had changed by 1967. In 1967 the general slackening of economic activities and the decline in world trade again adversely affected the Malaysian economy. Primarily as a result of the drop in the prices of rubber and tin national output expanded at a slower rate than in 1966. The average unit value of rubber was estimated to have declined by 17%, that of tin by 7 $\frac{1}{2}$ % and palm oil by 5 $\frac{1}{2}$ %.<sup>17</sup> As a result economic activities in the private sector slackened. However, unlike previous practice in depression, this time the government sector turned out to be the main impetus of growth. Total government expenditures were \$2,748 million or \$437 million more than that of the previous year. Out of \$2,748 million \$843 million were development expenditures. Hence the public sector was "the main dynamic factor in stimulating the economy despite a slackening in the rate of growth of government expenditures."<sup>18</sup> As a result of the stimulation of this dynamic factor capital formation in the public sector still increased by 2 $\frac{1}{2}$ %, or the same as in the previous year.

In short by this time expenditure had been

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17 Source: Tan Tiew Bin, Budget Speech 1968, cyclostyled, page 8.

18 Ibid.

deliberately manipulated to exert a stabilising effect on the economy. The authority concerned had realised the necessity of a stabilisation policy. In the words of the Minister of Finance, "the resources of the government should be used to cushion the effects of the decline in export receipts and reduced domestic demand even though this had generally put severe strain on the government's finances."<sup>1</sup> It was primarily due to the suction effect produced by government expenditures that the economy recovered from the deflation of 1967 much sooner than it did in 1958.

### Conclusion

In this chapter we have seen that government expenditures increased tremendously during the period from 1957 to 1967, basically due to the change in the government's attitude regarding its role in the economy.

In the earlier years of the period under study there was no deliberate attempt to manipulate expenditures as an instrument of fiscal policy, although the lack of synchronization between budgeting and actual incurrence of expenditures produced a slight countercyclical effect. However in the later years the government had realised the potentiality of its own expenditures as an instrument of stabilisation policy. Such a stabilisation policy was successfully carried out in 1967.