MALAYSIAN GOVERNMENT EXPENDITURE: AN ANALYSIS OF PATTERN AND PROBABLE DISTRIBUTION IMPACT

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I. INTRODUCTION

In most economies, governments have taken an increasingly active role in influencing the level of aggregate economic activity. Two policy options always at the disposal of the governments, namely monetary and fiscal policies. While monetary policies are related to the management and control of money supply, money demand and interest rates, fiscal policies are concerned with public revenue and expenditure. Both policies, although independent in nature, work hand-in-hand in determining the overall performance of an economy.

While acknowledging the importance of the monetary policies, this paper focusses on the fiscal policies only with specific attention given to the public expenditure aspect. For Malaysia, government expenditure has been a significant fiscal policy instrument in the operations and management of the economy. The pattern and trend in the expenditure has influenced greatly the growth of the Malaysian's economy.

For the past two decades public expenditure in Malaysia has been growing at rapid rates. In 1985, it constitutes some 37 percent of the GDP as contrast to only 26 percent in 1966. Given such a high proportion of the public expenditure, one would agree that the government plays a crucial role in influencing resource allocation of the country. It also implies that if government expenditure is inefficient, a large amount of resources is wasted and taxes are unnecessarily high.

A systematic approach in viewing the role of government expenditure in an economic system can be seen through a simple macro or aggregate demand model. In a most simplified form, for a closed economy, the model suggests that aggregate demand is a function of private consumption (C), private

investment (I), and government spending (G). Mathematically, this model can be expressed as

$$Y = f(C, I, G)$$

Y and G are expected to be highly and positively correlated. Using ceteris paribus assumption, Y would positively response to the change in G. The magnitude of Y response will generally depend upon the value of government expenditure multipliers.

Despite the above correlation between government expenditure and the level of economic activities, views on the role of government in an economic system changes over time. Earlier economist, such as Adam Smith, believes in the "invisible hand". Perfect competition with no interference from the government will lead to an efficient solution of the system. Keynes, however, has an opposite view which, as a matter of fact, further strengthen the argument for increasing government role through increasing its spending. In his most celebrated book "The General Theory of Employment, Interest, and Money", he suggests that under a depressing economic state, such as an economic equiblibrium with a high rate of unemployment, government spending might be an essential economic policy to revive economic vitality because it can effectively generate additional output as well as employment.

In addition, government spending is also an effective instrument to affect income distribution and hence social welfare. Changes in the direction of government spending can have a significant effect on income distribution. As a matter of fact, government spending, as a fiscal measure, has been viewed by developing countries as a logical option to eradicate inequalities and poverty (Selowsky, 1979).

Given the above relationship between government spending and income distribution, an attempt is made in this paper to review historical pattern of public expenditure in Malaysia in the context of distribution impacts. Our main objective is to trace the changes that have taken place in public spending according to functional activities and, where necessary, comment on possible impacts of such an expenditure pattern on distribution. We hope, at the end of the paper, some inferences on who benefits from the past expenditure pattern can be made. A previous study by Meerman (1979) has a direct bearing on this study.

II. METHODS OF ANALYSIS

For the purpose of examining the past expenditure pattern, budget allocation for a 20 year period (from 1966 through 1985) is chosen. This period covers four five-year Malaysia plans from the first to the fourth plans. A significant proportion of the period in the study, specifically from the Second to the Fourth Malaysia Plans, coincides with the major development and budget activities, particularly in relation to the prescription and the implementation of the New Economic Policy (NEP).

As often presented in government statistics, budget data can be found in two major forms, namely the projected and actual expenditures. These two figures, more often, are not similiar. For the purpose of this paper, actual expenditure is taken as it reflects the actual resources injected into the economy. Although budget data are presented here as annual expenditure, we could easily find quarterly data as well. The choice of annual over quarterly data is made as a matter of convenience. Annual data are also considered sufficient for the purpose of this analysis. Trend in expenditure can easily be observed through a brief glance at these data.

Government expenditure is often divided into two main categories, namely operating expenditure and development expenditure. Within operating expenditure, exhaustive expenditure which diverts resources into public sector, and transfer payment represent the main expenditure items. For development expenditure, the provision of economic and social services forms a major proportion. In this study, the operating and development expenditures are initially presented separately in order to trace its changes during the period of the study, and later, they are combined in order to view the overall perspective of the government expenditure.

Changes in government expenditure are generally influenced by the development pridrity of the government in a particular planning horizon. Such a priority reflects, among other things, political priorities of the government as well as the availability of resources. Therefore, to view some of these priorities, the expenditure is presented and analysed according to functional classification in various five-year development plans.

At a risk of over simplification, the principle of public finance states that the optimum public expenditure is reached when the marginal social advantage of the expenditure equals that of marginal social disadvantage of raising additional public income. This principle is essentially based on the assumption that the government's objective is to maximise social welfare. Therefore, on

the assumption that the marginal benefit of a given dollar of public expenditure for the poor is higher than that for the rich, there is a theoritical justification for the state or government to increase expenditure on the poor and decrease it on the rich. On the same argument, it is expected that more will be spent in low income states as opposed to those in the high income states (Holzhansen, 1974). This principle together with its theoritical conclusion will be used rather subjectively to determine whether or not the past development expenditure pattern reflects this prediction. In order to adress distributional impact of the budget, a detail functional classification of development expenditure which allows sectoral comparision is presented and analysed. In addition, to ensure regional comparison, development expenditure by states is also presented and analysed.

Since distributional impact of the budget depends largely on development expenditure, operating expenditure is excluded in this part of the analysis. This is also similiar to the argument that development expenditure would be most highly valuable to the poor as it involves the creation of assets and improvement in production frontier. By so doing, it does not, however, denied the significant impact of operating expenditure on distribution as a whole.

Under normal circumstances, we would predict that the amount of outlays within a fiscal year would be evenly distributed. Variations in expenditure, however, can also be expected, because of possible changes in programmes or unexpected high inflation rates, for examples. At a glance, the quarterly data of the Malaysian government expenditure generally reveals an opposite picture. Instead of being evenly distributed within a fiscal year, the data shows that the amount of expenditure has been consistently higher in the last quarter of the fiscal year in comparison with those in the earlier quarters. Presumably, this is a reflection of the reaction of government agencies to the present treasury budgetting rule whereby the amount of the unspend allocation for any of the fiscal years will have to be surrendered to the treasury at the end of that fiscal year. This rulling simply induces spending agencies to exhaust their spending limits before a fiscal year is expired. Consequently, this in itself will result in inefficiency as some spending may be incurred without proper planning and careful thought.
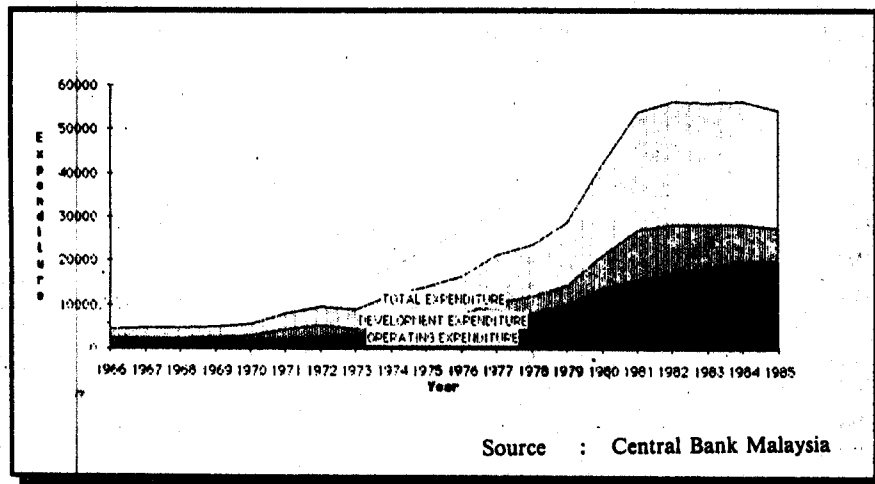
At this juncture, it is approriate to note that this paper explores only a small fraction of the government's resource allocation issue through government expenditure. We are aware that the government resource allocation is also determined by the substantial "off - budget expenditure" made by government companies and quasi-government agencies. Notwithstanding this caveat and limitation, this paper, nevertheless, reports an important part,

though not all, of the federal government budget. It is also important to note that inflation also influences budget allocation. It would have been approriate for the analysis to discount inflationary impact in order to measure the real value of the expenditure in question. However, given tolerable and stable rates of inflation in the past, the impact of inflation on budget allocation is expected to be minimum.

III. FINDINGS

The findings of this paper show several features of the Malaysia's government expenditure. Over the 20 year period from 1966 to 1985, the aggregate expenditure, on the whole, shows a high degree of stability and demonstrates an increasing trend (Figure 1). The range of the expenditure is wide, ranging from $2,270.7 million in 1966 to $27,308.2 million in 1985. As a percentage of GNP, the share of government expenditure in this period has increased from 25 percent to 38 percent.

Figure 1 : Total Government Expenditure 1966 - 1985

Source   :   Central Bank Malaysia

The average government expenditure in the period between 1966 to 1985 is $12,143.15 million. Using this average as a yardstick, we observe that the annual expenditure from 1966 to 1978 (13 years) has been below the average, while those after 1978 (7 years) have been significantly higher than the average. As expected, the average value of expenditure was highly influenced by the high values of expenditures in the latter years, especially those recorded in 1980 to 1985 (see Table 1).

TABLE 1

Malaysia : Total Federal Government Expenditure
($ Million)

Year	Operating Expenditure	Development Expenditure	Total Expenditure
1966	1,619.6	651.1	2,270.7
1967	1,789.2	625.2	2,414.4
1968	1,796.0	618.7	2,414.7
1969	1,930.2	615.3	2,545.5
1970	2,163.0	725.0	2,888.0
1971	2,398.0	2,085.4	3,483.4
1972	3,067.9	2,242.1	4,310.0
1973	3,341.5	1,128.1	4,469.6
1974	4,318.0	1,876.4	6,194.4
1975	4,900.0	2,151.2	7,051.2
1976	5,828.5	2,377.7	8,206.2
1977	7,398.3	3,216.8	10,615.1
1978	8,040.8	3,781.6	11,822.4
1979	10,040.2	4,281.4	14,321.6
1980	13,692.5	7,470.0	21,162.5
1981	15,686.0	11,358.0	27,044.0
1982	16,671.5	11,485.3	28,156.8
1983	18,374.4	9,669.9	28,044.3
1984	19,805.6	8,407.5	28,213.1
1985	20,066.2	7,141.9	27,208.1
Total Expenditure	162,927.4	79,935.6	242,863
Average Expenditure	8,146.37	3,996.78	12,143.15

Source : Central Bank, Malaysia. Quarterly Bulletin, various issues.

It is worth to note that the government expenditure reached its maximum value of $28,156.8 million in 1982, after which it began to decline slightly. Such a decline was attributed by a significant decline in the development expenditure, despite an increase in the operating expenditure. The other point that is worth noting is the rate at which government expenditure changes over time. As shown in Figure 1, annual expenditure was changing at a fast rate after 1973 compared to that of the earlier years.

The increasing trend of public sector expenditure worried the government because it was not matched by equal expansion in the sources of government revenue. As shown in Table 2, from the First to the Fourth Malaysia Plans, total expenditure has increased by as much as ten folds. Development expenditure alone increased by as much as 14 times, while operating expenditure multipled by 9 times. Following this, the composition of development and operating expenditure has changed with a slight increase in composition of the former and a decrease for the latter. Despite this, however, operating budget remains unfavourably high. The situation is worse when operating expenditure constitutes a large proportion of the total budget. The discrepancy between total budget and total revenue of Malaysia as noted in the overall budget deficit in the period considered has resulted in expansionary trend in government borrowing. As a result, net foreign borrowing has increased immensely from $503.5 million in 1966 to $23,075 million in 1985. As a proportion of the Gross National Product (GNP), the share of foreign debt has increased, over the same period, from only 5% to as much as 32%. A natural consequence of the increasing foreign debt is the increasing public debt changes which has escalated from $133.6 million in 1966 to $5,041.6 million in 1985 (Central Bank Malaysia, 1986).

Broadly, the trend of aggregate expenditure after 1966 is in contrast with those of the earlier years. Prior to 1966, even though the budget was on an increasing trend, they were budgetary surpluses. During this period, except after 1960, expenditure was kept at a relatively low level, implying a minimum direct involvement of government in economic activity. Economic activity in this period rested heavily in the hands of the private sector. With its conservative policy, the government allows a maximum exploitation of the economy by the private sector and confines itself to providing basic socio-economic facilities (including public utilities) and infrastructures.

Post 1966 government expenditure reflects a redirection of government policy orientation. While the acceleration of economic growth is maintained as the main thrust in all development plans, the policy incorporates distribution aspect with the introduction of the New Economic Policy in the Second

TABLE 2

MALAYSIA: GOVERNMENT EXPENDITURE, 1966 – 1985

Expenditure Type	FMP 1966-70 ($Million)	(%)	SMP 1961-75 ($Million)	(%)	TMP 1976-80 ($Million)	(%)	FMP 1981-85 (Million)	(%)	*FMP – FMP	Percentage Change *FMP – FMP
Development	3,235.3	(26)	7,483.2	(29)	21,127.5	(32)	48,062.6	(35)	44,827.3	1,386
Operating	9,298.0	(74)	18,025.4	(72)	45,000.3	(68)	90,603.7	(65)	81,305.7	874
Total	12,533.3	(100)	25,508.6	(100)	66,127.8	(100)	138,666.3	(100)	126,130	1,006

Source : Central Bank, Malaysia. Quarterly Bulletin, various issues.

Malaysia Plan 1971-75 and thereafter. The NEP carries two basic objectives, i.e. the eradication of poverty by raising income levels and increasing opportunities for all Malaysians, irrespective of race, and the rapid restructuring of society to correct economic imbalance and eventually eliminate the identification of race with economic function. In the efforts to achieve the NEP goals, government budget since 1970 has been "consciously" prepared to affect distribution, mainly towards raising the income level of the poor who are mainly in the agricultural and rural sector and concurrently to narrow regional income differences. This is assumed achievable via increasing government expenditure on the low income groups as well as in the poor states.

Table 3 shows development expenditure according to functional classification. An examination of the figures provided, they reveal expenditure items that were given priority by the government. Like many other countries, defence and security forms a sizeable component of the budget. Although there has been a notable increase in absolute dollars, its proportion of the total development expenditure, however, shows a declining trend. Similiar trend is also observed for agriculture and rural development where the allocation of the development expenditure indicated a decline from 28 percent in the First Malaysia Plan to 13 percent in the Fourth Malaysia Plan. Percentage allocation for commerce and industry and transport sectors, on the other hand, increased substantially. Such a trend in the composition of public development expenditure is a reflection of the prevailing structural changes in the economy. This structural change presumably reflects partly the effort of the government to reduce heavy dependency on agricultural sector, while at the same time enlarge contribution of industrial sector to the economy. In addition to the commercial sector, percentage allocated for housing also experienced a remarkable increase from 5% to 11%. Such an expansion was atttributed by substantial demand for low cost houses by the low income group. Expenditure on other items such as education, social and community services, public utilities, communication, and general administration remains highly stables over the 1966-1985 period.

As indicated earlier, the principle of public finance suggests that if the government's goal is to maximise social welfare, then more expenditure must be incurred on low income group where marginal benefit per dollar spend is higher than that of the high income groups. This principle brings us to a discussion of Table 4 which shows the optimal targets in the development expenditure in various states in the Third and Fourth Malaysia plans. The target values are calculated mainly on the basis of three factors, namely per capita state GDP, human and natural resources potential and the past growth rates. Because of vast diversity among states in terms of the three variables mentioned

TABLE 3

**MALAYSIA: DEVELOPMENT EXPENDITURE FROM THE FIRST TO
THE FOURTH MALAYSIA PLANS: A FUNCTIONAL CLASSIFICATION**

($ MILLION AND PERCENTAGE OF TOTAL)

	FMP 1966-70	SMP 1971-75	TMP 1976-80	*FMP 1981-85
Defence and Security	689.3(21)	1008.4(14)	3330.5(16)	7157.8(15)
Agricultural & Rural Dev.	898.7(28)	1795.5(24)	3873.0(18)	6437.5(13)
Commerce and Industry	217.7(7)	1366.8(18)	3298.8(16)	6827.3(14)
Transport	404.7(13)	1371.6(18)	3501.3(17)	7211.0(15)
Communications	195.1(6)	255.4(3)	1177.4(6)	2852.7(6)
Public Utilities	173.0(5)	317.6(4)	1793.4(9)	4551.0(10)
Education	254.3(8)	738.9(10)	1691.2(8)	4677.9(10)
Health and Family Planning	135.4(4)	183.2(2)	278.3(1.3)	662.8(1.4)
Housing	150.9(5)	149.1(2)	1159.2(6)	5325.5(11)
Social and Community Service	20.3(0.6)	46.3(0.6)	358.5(2)	1331.2(3)
General Administration	88.4(3)	216.0(3)	622.1(3)	823.3(1.7)

Source   :   Central Bank, Malaysia. Quarterly Bulletin, Various Issues

above, therefore, optimal rates differ substantially with generally low rates in the low income states and high rates in the high income states. Table 4 only reports target rates. In practise, there is a substantial difference in target values and actual allocation made in the plans considered. In the Third Malaysia Plan, for example, actual allocation to low income states such Kedah, Kelantan, Perlis and Malacca were significantly below the target values, while for richer states such as Federal Territory and Selangor, the data show the opposite.

TABLE 4
Malaysia: Optimal Targets of Public Development Expenditure By State

Low Income States	TMP	FMP*
Kedah	6.3	8.11
Perlis	1.0	0.91
Kelantan	7.6	6.88
Terengganu	5.4	4.51
Malacca	3.0	3.62
Higher Income State		
Penang	6.2	4.82
Perak	12.5	10.66
Selangor)	13.2	15.55
Federal Territory)		
Pahang	9.0	7.10
Negeri Sembilan	5.1	5.44
Johor	11.8	11.6
Sabah	8.4	9.9
Sarawak	10.5	10.9
	100.0	100.0

Source :   Malaysia (1980) and (1976)

IV. DISCUSSION AND CONCLUSION

From the preceeding analysis, a number of observations can be made. Firstly, the total government expenditure over the 1966-1985 period has indicated a steadily increasing trend. The trend, however, changed after 1982 when the development budget began to experience some cut-backs. Secondly, the composition of federal budget indicates a lean towards operating expenditure rather than that of development expenditure as the former has accounted for more than 60% of the total share. The fast growing expenditure unmatched with available finance has generally resulted in the substantial amount of foreign debt.

The extent to which the development budget benefits the poor can be gauged in sectoral comparison of the development budget. Since defence and security is often classified as unproductive expenditure, and sometimes counter-productive, it does not affect distribution as aimed. In this respect, however, one can always argue that high proportion of defence budget over time is necessary and desirable. Low defense budget, implying poor defence capability could strategically prove costly to the country.

The most probable impact on distribution from the development budget constitutes largely that of agriculture and rural development, education, housing, and commerce and industry. Expansion in agriculture and rural development through land development through land development schemes and in-situ agricultural development has directly benefitted the poor. However, with the declining proportion of expenditure allocations for these activities, it could deteriorate the contributions of agriculture and rural development towards improving rural income. This would affect the majority of the population in the rural sector whose livelihood has been directly and indirectly dependent on agriculture. Therefore, declining public expenditure allocation for agriculture and rural development may not be justified. In the case of education, the distibutional impact is seen in the enhancement of human capital formation and improved the accessibility of, particularly, the poor to social and economic opportunities, while that of housing concerns the contribution to increasing property ownership among the populace, including those of the low income groups. As for commerce and industry, the generation of opportunities for greater bumiputra participation in related fields in line with the NEP implies some distributional impact.

Using the above significant areas to reflect distributional impact of development budget, it has indicated the crucial role of the government in resource allocation and the effectiveness of government budget and expenditure

as an instrument to affect social welfare. The government's commitment to realise the distributional goals is reflected in the magnitude of the expenditure allocated to the above mentioned sectors. In the Fourth Malaysia Plan, as an example, 60% of total development expenditure has been allocated to agriculture and rural development, education, housing and commerce and industry.

State-wise, however, the basis on which optimal targets of development allocation contradicts that of the objectives of the government to reduce regional disparity is reflected in the higher allocations given to the more developed states compared to that of the less developed. It is, of course, logical and rational to allocate a high percentage of the budget to the more developed and prosperous states when viewed in terms of aggregate growth. However, if the trend continues it may eventually, overtime, increase further regional disparity between the more and the less developed states as the latter always have to survive with minimum allocations implying limited opportunities for greater growth and development.

On the basis of the above analysis, if distribution is the priority, government development expenditure for agricultural and rural development should be increased accordingly and that the basis for determining optimal targets of development budget for states should be based on the principle of public finance as suggested earlier.

While the above discussion has raised pertinent issues in the need for greater and equitable distribution, it is worthwhile to note that there may also exist a concurrent increases in inequality and disparity between as well as within sectors, particularly if the allocation of the budget always fall short of, and does not effectively trickle down to, the target groups.

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