A R T I C L E S

Government Intervention in the Economy: Test on Malaysia's Fiscal Conduct*

EVAN LAU, SHAZALI ABU MANSOR AND CHIN-HONG PUAH

Using Malaysia as a case study, this paper investigates the conduct of fiscal policy regimes during the last three decades. Empirical results show that in pre-crisis Malaysia the fiscal stance is not sustainable, while in the full sampling period (including the post-1997 crisis era) it satisfies only the necessary condition for sustainability. Long-run one-way causation from expenditure to revenue was observed, in line with the spend-and-tax hypothesis. The Malaysian government, therefore, must aim to reduce the size of government spending and promote a cost-effective expenditure program with maximum benefits, to moderate the post-crisis fiscal imbalances.

LAU IS LECTURER, FACULTY OF BUSINESS, UNIVERSITI MALAYSIA SARAWAK

MANSOR IS PROFESSOR AND DEAN OF FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITI MALAYSIA SARAWAK

PUAH IS LECTURER, FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITI MALAYSIA SARAWAK

INTRODUCTION

It is well accepted in the literature that economic policy can be of great significance in stimulating growth and development within an overall approach of the role of government in the economy. Economic policies can either be 'growth conforming' or designed to overcome what are perceived to be constraints in the economy. Part of the common fundamental government macroeconomic policy is the conduct of the fiscal policy. Fiscal policy deals with government revenue and expenditure; while the role of government in fiscal policy-making is known as 'public sector economics' or 'public finance' in that it focuses on the microeconomic functions of government.

As an emerging market economy, Malaysia is clearly a success story. During the past three decades, the Malaysian government has effectively implemented numerous medium- to long-term development plans. In particular, the economy has shifted from dependency on the agricultural sector to the development of a strong manufacturing sector. Recently, the government has focused on human resource development. The development plans have been financed by public funds.