ASSESSMENT OF BUDGET SUSTAINABILITY IN SARAWAK

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ABSTRACT

This study reexamines the sustainability of budget stance of Sarawak state, 1970-2008. Using the intertemporal borrowing constraint as a framework, the study tests the long-run relationship between government revenue and expenditure. Empirical results demonstrate a long-run equilibrium relationship among the variables. The cointegration test result suggests that Sarawak state’s fiscal stance satisfies the weak sustainability condition. In addition, the Granger causality test result reveals a bi-directional relationship between government revenue and expenditure. This means that fiscal authorities made simultaneous decisions on expenditure and revenue. Government revenue and expenditure will mutually reinforce each other.

Key Words: Fiscal Sustainability, Cointegration, Revenue, Expenditure, GDP and Sarawak.

JEL classification: E62, H2, H3,H6

INTRODUCTION

In managing the economy, a government uses both fiscal and monetary policies. Fiscal policy is the use of government spending and revenue collection to influence the economy. The two main instruments in fiscal policy are government spending and taxation. Changes in the level and composition of taxation and government spending will affect the aggregate demand and level of economic activity as well as the pattern of resource allocation and the distribution of income. Fiscal policy can also be used to bring the economy to the potential level if policymakers understand the relationship between government expenditure and revenue. Research on budget sustainability has attracted significant interest, because budget sustainability has an important impact on economic growth.

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