



FACULTY OF ECONOMIC AND BUSINESS

BUDGET SUSTAINABILITY OF SELANGOR STATE

Zuraini Bte Shahrudin

Bachelor of International Economics  
Year 3

## Statement of Originality

The work in this Final Year Project, entitled  
**“BUDGET SUSTAINABILITY OF SELANGOR STATE”**  
Is to the best of the author’ knowledge that of the author except  
Where due reference is made.

---

Date

---

Zuraini Bte Shaharuddin  
22948

## ABSTRAK

### KESTABILAN BUDGET NEGERI SELANGOR

Oleh

Zuraini Bte Shaharuddin

Tujuan kajian ini adalah untuk mengkaji kestabilan budget di negeri Selangor dan menentukan hubungan di antara hasil kerajaan dan perbelanjaan kerajaan.

# **BUDGET SUSTAINABILITY OF SELANGOR STATE**

ZURAINI BTE SHAHARUDDIN

This project is submitted in partial fulfillment of  
the requirement for the degree of Bachelor of Economic with Honour  
(International Economics)

Faculty of Economics and Business  
UNIVERSITI MALAYSIA SARAWAK

2011

## **ABSTACT**

### **Budget Sustainability of Selangor State**

**By**

**Zuraini Shaharuddin**

This study investigates the relationship between government revenue (GR) and government expenditure (GE) of Selangor state. This study adopted the annually data from the period 1984 to 2009. The main purpose of this study is to access empirically the fiscal policy regimes in the Selangor State. The fiscal policy of the Selangor state will investigate by using Unit root test, Johansen and Juselius (JJ) cointegration, Dynamic Ordinary Least Squares (DOLS) and Granger causality test the direction of the causality between the variables. We found that, GR and GE of Selangor state was stationary at first different, which is  $I(1)$ . From the cointegration results showed that Selangor state has long run relationship. The result for DOLS test support that GR and GE of Selangor state is at the sustainable condition. While, for Granger causality test result showed that there is a one-way causation from GR towards GE.

## **ACKNOWLEDGEMENT**

First of all, I thank God for helping me and sending people who have been such strong influence in my life. The completion of this work was made possible through the support and cooperation of many individuals.

First of all, I would like to express my sincere thanks to those who have helped me through my study. I am deeply thankful to my main supervisor, Dr Puah Chin Hong, for his guidance and encouragement over the past few years. He supervised me by providing with numerous important materials, taught me the way to analyze and run the data. Besides that, I would like to take this opportunity to express my thankfulness to Prof.Dr Shazali Abu Mansor who has been willing share information to referring in this study.

Furthermore, I would like to express my appreciate to the Faculty Economics and Business, Universiti Malaysia Sarawak for giving me the opportunity to do my final year project in order to fulfill the requirement for graduation.

In addition, my profound thanks and appreciation to all teachers who gave generously of their valuable time and efforts in participating in this study. Finally, I wish to thank my wife father and mother for their patience and understanding during the writing up processes as without their support, this work could have not been complete.

## TABLE OF CONTENT

	Page
LIST OF TABLES	x
LIST OF FIGURES	xi
<b>CHAPTER 1: INTRODUCTION</b>	
1.0 Introduction	1
1.1 A brief background on Selangor State Development	3
1.2 The Economy in Selangor	4
1.3 Selangor State Budget	8
1.4 Problem statement	11
1.5 Objective of the study	12
1.6 Significance of the study	13
1.7 Scope of the study	13
<b>CHAPTER 2: LITURATURE REVIEW</b>	
2.0 Introductions	14
2.1 Reviews of Related Literature from Develop Countries	15
2.2 Reviews of Related Literature from Developing Countries	23

### **CHAPTER 3: RESEARCH METHODOLOGY**

3.0	Introduction	31
3.1	Theoretical model	32
3.2	Data Descriptive	37
3.3	Stationary and Non-stationary	38
3.4	Augmented Dickey Fuller (ADF) Unit Root Test	38
3.5	Johansen Cointegration Test	40
3.6	Estimate of Long Run Equilibrium	42
3.6	Granger Causality Test	42

### **CHAPTER 4: EMPIRICAL RESULT AND DISCUSSIONS**

4.0	Introduction	47
4.1	Unit Root Test	48
4.2	Cointegration Test Result	50
4.3	Estimation of Long-Run Equilibrium Relationship	52
4.4	Granger Causality Test Results	54

### **CHAPTER 5: CONCLUSION AND RECOMMENDATION**

5.0	Introduction	55
5.1	Summary and Finding of the study	57
5.2	Recommendation	58
5.3	Limitation of the study	59



## LIST OF TABLES

	Page
Table 1: Selangor State Budget Components from 2000-2009	10
Table 2: The Summary of Related Literature from Develop Countries	19
Table 3: The Summary of Related Literature from Developing Countries	27
Table 4: Augmented Dickey-Fuller (ADF) Unit Root Test Results	48
Table 5: Johansen-Juselius Cointegration Test Result	50
Table 6: Estimation of Long-Run Equilibrium Relationship Result	52
Table 7: Granger-Causality Test Results	54

## LIST OF FIGURES

	Page
Figure 1: Gross Domestic product (GDP) per capita in Selangor, 1960-2010	5
Figure 2: Selangor State Budget from 1984-2009	8
Figure 3: CUSUM test	53

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.0 Introduction**

Fiscal sustainability is the pattern of government spending that does not exceed government revenue. The purpose of the fiscal sustainability is to achieve that fiscal deficit can be refinanced. Besides that, the concept of sustainability relies on the need for government to have enough resources to ensure its ability in spending on economic growth. So that, government can be maintained in the long run and thus generate ongoing financial resources.

From an economic perspective, there are several important differences between the concept of strong and weak sustainability. Strong sustainability is situations there are no future problem in deficit behavior are expected to arise. Hence, less of fiscal reform by government changes in the process control the government revenue and expenditure

However, weak sustainability implies that government might have future problems such as raising the interest rate that may have preserve effect on economic growth and public budget, public debt and necessitating fiscal reform. The budget deficit process found that the sustainable in the weak sense. Government budget deficit involves an increase in government spending or a fall in revenue.

Government expenditure is essential used for the efficient running of the economy. The government spends money in a productive way that can be used to generate a sufficiently high of return and thus, the economy will benefit. However, government revenue may produce a misallocation and inefficient make a budget deficit in the economy. Budget deficit have negative significant impact on the economy. Fiscal imbalance tends to reduce national saving which in turn has the effect of impeding rapid economic growth (Abdul Aziz et all, 2000. p.45)

Policy maker usually will try to stimulate economic growth by reducing government expenditure and/ or raising tax revenues when the economy faces budget deficit. Fiscal policy has three possible can be affect the budget outcome of the economy activity especially during the economy crisis which are neutral, expansionary and contractionary. A neutral stance of fiscal policy implies a balance budget where the total government expenditure is equal to total revenue. Besides that, when the government imposes rising government spending or fall in taxation revenue or combination of the

two it involved an expansionary stance of fiscal policy and will lead to budget deficit. In addition, a contractionary fiscal policy will lead to a budget surplus when the government reduces their spending or higher taxation revenue or a combination of two.

The policy maker should pay full attention to the fiscal policy because it will influence the future economic growth. The fiscal sustainable can avoid government facing serious macroeconomic imbalances, declining economic growth, rising poverty and poor social indicator.

### **1.1 A brief background on Selangor State Development<sup>1</sup>**

Selangor is one of the 13 states of Malaysia. Selangor was officially granted independence on 1963. The city of Kuala Lumpur functions as the national capital of Malaysia and the state capital of Selangor. In 1974, Selangor relinquished Kuala Lumpur to the federal government. As the largest geographical position in the centre of Peninsular Malaysia, Selangor contributed to the state rapid development as Malaysia transportation and industrial hub. Selangor aims to be fully developed state along with the rest of the country by 2020.

The State Executive Council was established in 1956, led by the sultan of Selangor, the chief minister and members of other ministers. The chief of minister of

---

<sup>1</sup> The discussion in this adapted from Selangor State Development Corporation

Selangor and member of minister are appointed by the Sultan from the members of the State Assembly. The current chief minister of Selangor is Tan Sri Abdul Khalid Ibrahim. Before changing of government in 2008, Datu Seri Dr Khir Toyo was the chief minister starting in 2000 until 2008.

## **1.2 The Economy in Selangor**

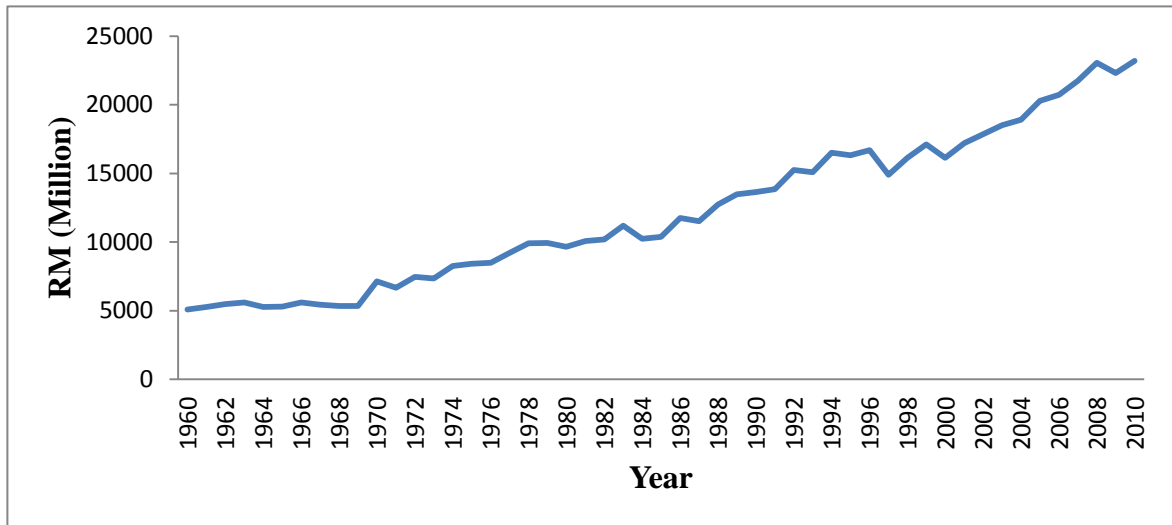
Selangor is the richest state in the country in terms of gross domestic product (GDP) per capita (PPP), which is at USD 33,147 2008 comparable to the nominal per capita values of Western Europe and Hong Kong<sup>2</sup>. Selangor has identified four main sectors as the key sources of growth which is agricultural sector, manufacturing, construction and services sector.

The availability of natural resources such as rubber, palm oil, tin mining and higher population has made Selangor one of the States an interactive choice for investor. Selangor is richest and develop State in Malaysia due to various in economy sector. The main sector contribute into economic growth sector is agriculture and manufacturing sector. Besides that, development of port Klang rapidly expanding industrial areas increasingly contributing towards the prosperity of state. In additional, Tourism sector also has its impact on the economy in Selangor because of the domestic attraction and Natural Park.

---

<sup>2</sup> "Selangor Maju Criteria". Bernama. Archived from the original on April 10, 2007.

**Figure 1: Selangor GDP per capita (2000=100) from 1960 -2010**



Source: Selangor State Economy Planning Unit (UPEN)

As shown in figure 1, Malaysia facing the early commodity crisis there has been a decrease of the GDP around 1956-1972. The crises took place in the early stage, the country's dependence on the primary sector, mainly on agriculture sector. In 1980-81, the wars and conflict in the oil rich region of the Middle East disrupt world oil supply, increase of oil price and other factors influences on the oil prices. Through this phenomena Malaysia actually benefited from the high oil price because Malaysia one of the country produce the oil. However, there had impact on economic where the imported of goods price increase (inflation), the rising of unemployment and slow economic growth.

The performance of the government in 1986 took a bad turn. This was due to dramatic drop in price of the main commodities. The sector which experienced depletion in income was agriculture, mining, construction and services as well as manufacturing industries.

In 1995, the contribution of Selangor GDP to the GDP of others Countries was 20.4%. For this time, Selangor fasters moving towards achieving advanced state status by 2005 based on the vision 2005, which the contents of the documents were integrated into the seventh Malaysia Plan 1996-2000 Selangor Darul Ehsan. In 1997 the economy affected and drawn into financial crisis. There are similar between community crisis and electronic crisis. While the magnitude of the affect from the crisis happened was bigger compare the crisis before. The action has been taken by government to gain back market confidence such as introduction of capital control, stimulate package is 7 billion to build up the economic growth and increase the interest rate.

The manufacturing sector is the most important sector, which accounted for approximately 52.9% of GDP Selangor. This was followed by the transportation sector 12.2%, finance, property and business and sub-10.3%, and wholesale and retail trade 10.6%.The GDP per capita in the state of Selangor recorded an increase of 2.4 % from RM111, 977.8 in 2004 to RM 12,264.2 in 2005. The States of Selangor registered a GDP growth of 5.2% million in 2004 to RM58, 110.8 million in 2005. The major



contributor to the state GDP was the manufacturing sector contributing about 51.34% in 2004 and increased slightly about 51.90% in 2005. The manufacturing sector generated a turnover of RM31, 672.1 million in 2005. The Second largest contributor to the states GDP was services sector contributing of about 41.95% which generate RM25, 603.2 million in 2005. In terms of GDP components the agriculture sector, mining sector and construction contributed about 2.15%, 0.71% and 3.28% respectively in 2005.

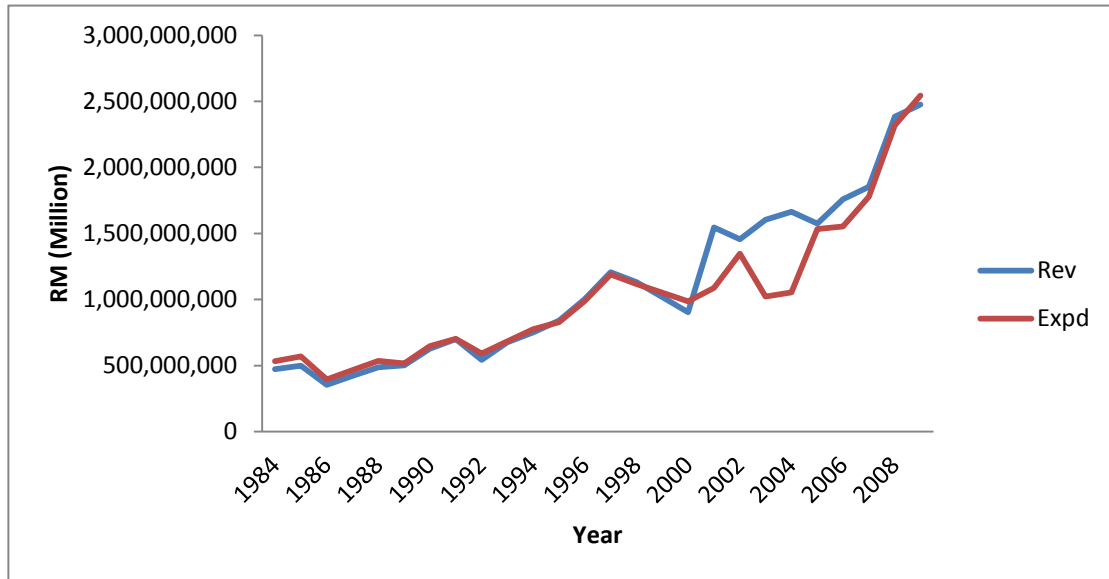
However, the global financial crisis happens in 2008-2009 lead to contraction of the global economy. Declining of the Electric and Electronic sector contribute negative impact on the state which were highly dependence on this industry. Affected from this downturn, Selangor which included the highest GDP growth exposed to low GDP growth. In 2008, the GDP of Selangor 8.4 percent and shrank to -1.6 percent<sup>3</sup>.

---

<sup>3</sup> The discussion in this adapted from Department of Statistic Malaysia,2010

### 1.3 Selangor State Budget

**Figure 2: Selangor State Budget from 1984-2010**



Sources: Selangor State Economy Planning Unit (UPEN)

As shown in figure 2, Selangor state is contribute significantly to the nation's wealth and economic development. These interests of all stakeholders are to ensure the state is properly run and managed in order to continue attracting domestic and foreign investment. A crucial aspect of this lies in the form of financial management of the state resources.

Selangor state budget from 1984 to 2009, there has been increase of the expenditure around 1984 to 1990. The total expenditure slightly increases from RM534.089 Million in 1984 to RM702.201 Million in 1991. During that time there was a community crisis in 1982. While government has increases the expenditure to enhance the economic recovery.

Meanwhile, the revenue gain by government increase 21%. The revenues gain mainly via collection of quit rent arrears through the land and district offices. During 1997 to 1999, there was a slowdown phase because Asian financial crisis. Some actions have been taken by the Malaysia government to gain back market confident such as introduction of capital control and increase interest rate. State government increases the expenditure to spur the economic growth. Out of budget, 58% contribute to operating expenditure and 42% to development expenditure.

Thus revenue sharply increases from 2000 until 2007. Government revenue increases about 20% compare to the year 2000. However, state government has been experiencing budget deficit in 2008 due to global financial crisis. In 2008, budget deficit enlarge from RM231.706 Million to RM254.393Million. State government increases the spending from RM146.724 Million to RM182.983 Million operating expenditure go to emoluments, services and supplies, purchase of assets, grants and fixed payments and

other expenses. The development expenditure is RM714.100 went to infrastructure sector, economic sector, social sector and municipal sector.

Therefore, encourage payment of quit rent by individual and companies, the government would retain the revenue to reduce budget deficit. Besides that, entertainment tax in Selangor contributes to raise the revenue. Table 1 below shows, Selangor State Budget components from 2000-2009:

**Table 1: Selangor State Budget Components from 1988-2010**

Year	TR	NTR	NRR	OE	DE
2000	288.789	392.865	221.422	121.385	864.471
2001	271.380	354.400	920.580	530.430	556.870
2002	332.370	398.160	724.340	765.640	581.230
2003	340.350	412.970	850.870	463.330	558.720
2004	342.660	511.420	810.730	520.060	533.010
2005	360.770	474.620	737.990	1,034.500	499.440
2006	452.160	494.720	812.570	1,087.690	465.190
2007	446.050	559.820	846.460	1,153.220	625.550
2008	495.830	676.940	121.087	1,467.240	849.820
2009	471.560	471.150	153.403	1,829.830	714.100

Notes: The figure is Ringgit Malaysia (RM) million  
 TR – Total Revenue  
 NTR – Non Tax Revenue  
 NRR – Non Revenue Receipt  
 OE – Operating Expenditure  
 DE – Development Expenditure

## 1.4 Problem statement

The study is necessary to identify relationship between government revenue and expenditure during the economic crisis. Government will know whether they should increase the budget or decrease the expenditure in order to build up the economic growth during the economic downturn. Therefore, government needs to have the maximum finance or stability in financial capacity to sustain the economic growth.

. However, if the government increases the expenditure rather than revenue it will lead government deficit. Large government deficit can pose a serious threat to a county is economic growth. Government cannot incur a deficit lasting, but the government should determine the type of income and expenditure is more effective in influencing economic growth.

In addition, it is crucial for to know what kind of the fiscal policy should be implement during the economic crisis such as the neutral, expansionary or contractionary. The policy maker should pay full attention to the fiscal policy because it will influence the future economic growth. Hence, when government made wrong implemented decision it will lead to serious macroeconomic problem that would weaken the strength in sustain the economic growth.

## **1.5 Objective of the study**

### **1.5.1 General Objective**

The general objective of this study is to find out the relationship between government revenue and government expenditure in Selangor with specific objectives as follows:

### **1.5.2 Specific Objective**

1. To examine the long-run co integration relationship between Selangor state government revenue and expenditure.
2. To test the sustainability condition of fiscal policy in Selangor.
3. To determine empirically the causal direction between government revenue and expenditure in Selangor.

## **1.6 Significance of the study**

From this study, the empirical result will determine the relationship between government revenue and expenditure affect to economic. That is important to determining government to build up the policy to reduce the budget deficit. On the other hands, the right decision for the fiscal policy can be stimulate increase the revenues and tends to increase expenditure which turn has the effect of impeding rapid economic growth for the state of Selangor .

## **1.7 Scope of the study**

The study is a time series data analysis and the sample size will focus on 26 years of state Government expenditure and government revenue in Selangor from 1984 to 2010 annually. This study will begins with the introduction of the research that will be presented in chapter one. In the chapter two, literature review will be given on various views of previous researchers related to the topic. In chapter three, the research methodology and data collection will be discussed while chapter four will contain the empirical results and discussion of the results. A conclusion remarks and policy suggestion will be included in the final chapter of this study.

## **CHAPTER 2**

### **LITERATURE REVIEW**

#### **2.0 Introductions**

There had been extensive theoretical and empirical studies on fiscal sustainability in both developed and developing countries. The empirical results which are provide some on fiscal sustainability condition among those countries. These studies contributed towards the development and improvement of statistical approach. We can clarify and identify the relationship between government revenue and expenditure impacts on economic growth using methodology utilized by the previous study. From the numerous literatures, we will look through the relationship among these variables to identify the sustainability condition.