The relationship of government revenue and government expenditure: a case study of Malaysia

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31 January 2016

"THE RELATIONSHIP OF GOVERNMENT REVENUE AND GOVERNMENT EXPENDITURE: A CASE STUDY OF MALAYSIA".

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ABSTRACT

Malaysia is a developing Islamic state that faced budget deficit since 1998. But it is not accepted by all and hopes that state should be in a position of either balance budget or surplus budget. The optimum level of Government budget is the state where government expenditure is totally offset by source of government revenue and that can be achieved through increasing tax revenue or decreasing expenditure. The aim of this study to find out the theoretical relationship between the revenue and the expenditure in Malaysia using the four hypotheses from literature study. The study finds out that although majority of the government revenue is from direct tax, the government spending only varies due to change in indirect tax revenue and non-tax revenue. Basically the study is analytical in nature and based on data collected from published sources focusing on the impact of the revenue and the expenditure on the continuous development of the Malaysia. Finally, we try to suggest to the authority to follow the proper rules and guidelines at the time policy making whereby they will be able to coup up with the optimum revenue and relevant expenditure in the state.

Keywords: Government Revenue, Government Expenditure, Budget Deficit, Malaysia.

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1. INTRODUCTION

Nowadays the most important debate in macroeconomics is the mode of the association between government expenditure and government revenues. Recently, the question has been prominent with rising government budget deficits in developing countries where government expenditure plays a vital part of an economy. Government expenditure is the engine of economic development in every sector of the economy and enhances the living standard ofthe masses of the state.The government expenditure increasedas population grew and demographic changes took place. The government expenditure on education and health and other public services increased.

In Malaysia, the government per capita expenditure is much higher than in neighbouring countries. For example, the federal government per capita expenditure in Malaysia is almost ten times than in Indonesia, five times than in the Philippines and three times than in Thailand (Chee, 1990). Chee believes that non-economic factors have been more important in explaining the growth of public expenditure in Malaysia than economic factors. Among the economic factors, Chee considers the relative openness of the Malaysian economy one of the important reasons for the growth. The political activation of ethnicity has been the most important non-economic factor according to Chee.

The economy of Malaysia is an open economy system. If anything happens in global economic system, such as financial crisis on 2008, it will affectthe economy of Malaysia as well as impact on government budget. The economic activities involve both domestic community and international community. That means Malaysia involve in domestic and international activities like export, import and foreign direct investment that also involve the other countries as their partner of trade. The economy of Malaysia is also a state oriented market economy. Every state in Malaysia has their own economy structure by using the budget the government gives every year. So, the effective usage of government budget can influence the state with higher income and then can contribute towards economy growth of Malaysia.

However, Malaysian government has experienced budget deficits since 1998, which tended to increase and persist, and generated considerable concern that it would reduce economic growth and development and lead to a crisis, if it continued too long or became too large.

Furthermore, it raised the question of the ability of the government in settling its deficit in the long run. The budget deficit has important implications for economic growth. Itcould reduce national savings and in turn will retard economic growth.Thus, to induce economic growth in a budget deficit economy, at leasttwo things can be done, i.e. 1) raising the national savings, and 2)reducing the budget deficit (Aziz et al, 2001). A government will be able to sustain its deficits if it can raise thenecessary funds by borrowing. However, it is feasible in the short run,but the ability of the government to service its deficits by resorting tofurther borrowing is likely to be questioned once the deficits become persistent (Wong H.T. & Lim, K.P. 2005).

During the Asian financial crisis, which began in mid-1997 and ended in 1998, the Malaysian governmenttightened its fiscal policy with the fear that the economy of the country would become worse. The fiscal policy was mainly implemented to reduce the current account deficit and inflationary pressure arisingfrom the depreciation of the Malaysian currency. However, in the years immediately after the Asian financial crisis, the government implemented the fiscal expansionary policy to stimulate the economy.The fiscal measures included construction activities, establishment of funds to support small-and medium-sized enterprises, a higherallocation for social sector development and a reduction in taxes. Thegovernment also allocated more funds for socio-economic projects to cushion the impact of the crisis. Special funds were also established orexpanded to provide credit to priority sectors at concessionary rates(Ministry of Finance Malaysia, 2003/04).

There are many factors to be considered in determining the size of the fiscal deficit such as ensuring that revenue is able to meet operatingexpenditure, the availability of domestic and external financing without crowding out the private sector, and debt servicing does not exceed 20% of total operating expenditure. Overall, to ensure that public debtremains at manageable levels, a legislated borrowing rule stipulates a ceiling for federal government debt (Ministry of Finance Malaysia, 2003/04).

Total government revenue in Malaysia is derived from two sources, which can be classified as taxrevenue, and non-tax revenue. The responsibility for collecting tax revenue falls on IRB itself and Royal Customs and Excise Department. The responsibility for the collection of non-tax revenue is based on the type of income. Direct tax revenue consists of income tax from individuals, companies, and other persons as well as petroleum, stamp duty, estate duty and real property gains. Indirect taxes are collected by the Royal Customs and Excise Department consists of tax revenue, and is not imposed directly on the taxpayer. While Indirect taxes consist of import duties, export duties, excise duties, sales tax and service tax. Non-tax revenues consist of fees for issue of licenses and permits, fees for specific services, proceeds from the sale of government assets, rental of government property, bank interest, returns from government investments fines and forfeitures.

Spending increases every year in Malaysia as well as throughout most of the world. However, the question here is whether sufficient resources are available to fund these expenditures. Careful budgeting is critical and a good fiscal policy is vital to stimulate a stable economy. Fiscal policy in Malaysia can be described as expansionary fiscal policy where there is always an increase in spending and lower taxes (Taha&Loganathan, 2008). The government always provides better incentives to both individual and company taxpayers. TheMalaysian government spends public money to provide a wide variety of facilities and benefits to the public. From federal government reports we can classified the spending to two major categories, operatingexpenditure and development expenditure. Operating expenditure consists of emoluments, supplies and services, asset acquisition and routine expenditures. Development expenditure varied from economic services, social services, security and general administration.

1.1 PROBLEM STATEMENT

Malaysia is one of the developing countries in the world which has a rapid growth and development. However, Malaysia has been facing budget deficit since 1998 continuously. Before the Asian financial crisis 1998, Malaysia had a surplus budget for several years, under the leadership of Mahathir Muhammad as the Prime Minister.

Budget deficit has become a controversy in economics. The mainstream economic position is that budget deficit is desirable and necessary as part of a countercyclical fiscal policy, but there should not be a structural deficit or permanent deficit. The necessity of budget deficit is caused to create the money supply or to satisfy demand for savings in excess of what can be satisfied by private investment. In other words, budget deficit permits the private sector to accumulate net worth. Budget deficit that caused by a huge expenditure in the public sector can increase the economic growth of that particular country, because there will be more infrastructure and creates a market for business output.

Althoughbudget deficit has some advantages from the economic point of view, the controversy of budget deficit is becauseof its advantages and disadvantages to the government and the country simultaneously. Advocates of fiscal conservatism argue that government should always run a balanced budget (and a surplus to pay down any outstanding debt), and that deficit spending is always bad policy. This argument is based on the disadvantages of budget deficit, which can increase taxation in the future, thus burdening future generations. Another disadvantages is budget deficit can cause inflation to the economy and some others disadvantages. Based on the controversy of budget deficit, we want to see how Malaysia should handle their budget deficit in the future so that it will not burden the future generations.

1.2 SCOPE OF THE STUDY

The study will try to find the relationship of government revenue and government expenditure for the period of 2002 – 2013. This study will also look at the GDP growth in Malaysia and its relationship with revenue and expenditure.

1.3 OBJECTIVES OF THE STUDY

Related to the problem stated above, the objectives of this study are:

1. To find out the overview of the Government revenue and Government expenditure
2. To find out the relationship between Malaysian government revenue and expenditure
3. To give suggestion and recommendation related to the study
4. To ascertain the direction of causality between the disaggregated values of government revenue and expenditure in Nigeria by deploying a robust econometric methodology.
5. To test the causality between government spending and revenue

2. LITERATURE REVIEW

Various studies and researches about the relationship of government revenue and expenditure have been conducted by many scholars and researchers around the world. Theoretically, many hypotheses can be used in determining the relationship between government revenue and expenditure. These hypotheses can be divided into four: tax-and-spend or **revenue-and-**

spendhypothesis; spend-and-tax hypothesis or **spend-and-revenue** hypothesis; **fiscal synchronization hypothesis**; and **fiscal independence** or institutional separation hypothesis.

The **revenue-and-spend hypothesis**theorized that the rise in tax revenues will lead to an increase in government expenditures and consequently worsens the governmental budgetary balance. The hypothesis suggests that government would spend all its revenues; therefore, raising government revenues would lead to higher government expenditures. Under this hypothesis, empirical results pre-empt a unidirectional causality running from government revenues to government expenditures. If the revenue-spend hypothesis holds, then budget deficits can be eliminated or avoided by implementing policies that stimulate or increase government revenue.

The second hypothesis, **spend-and-revenue hypothesis**, is a reverse of the revenue-and-spend hypothesis in which revenue responds to prior spending changes. This hypothesis suggests that government would raise the funds to cover its spending, and therefore, higher government expenditures lead to higher government revenues. Thus, empirical results are expected to show a unidirectional relationship running from government expenditure to revenue. If the spend-revenue hypothesis holds, it suggests that government's behaviour is such that it spends first and raises taxes later in order to pay for the spending. This situation can bring about capital outflow as a result of the fear of consumers paying higher taxes in the future (Eita and Mbazima, 2008).

The third hypothesis, the **fiscal synchronization hypothesis** or the fiscal neutrality hypothesis indicates bidirectional relationship between revenue and spending. If the bidirectional causality between government revenue and government expenditure does not hold, it means that government expenditure decisions are made without reference to government revenue decisions and vice versa. This situation can bring about high budget deficits if government expenditure increases faster than government revenue.

The last hypothesis is the **fiscal independence** or institutional separation hypothesis where decisions on revenue are taken independently from allocation of government expenditure, and therefore no causal relation between revenue and spending is expected.

By looking at the previous studies we can see the trend of the relationship of government revenue and expenditure in the countries around the world. One of the studies that have been conducted by Hock Sen and Kian Ping (2005)shows that there is a long-run relationship between government revenue and expenditure in Malaysia from 1965 to 2002. They said that in Malaysia government expenditure is determined by government revenue or government revenue leads government expenditure, which support the revenue-and-spend hypothesis.

Another study by Aziz *et al.* (2001) reported bidirectional causality between federal government revenue and expenditure of Malaysia over a different period 1960-1996. Thus, the government may not strictly stick to one rule in implementing its fiscal policy, subject to the situation of the economy and the interest of the nation to be achieved.

Loganathan et al. (2011) reported that the government spending is directly cause by direct and indirect tax revenue and it shows a unidirectional causality running from tax revenues to government spending in Malaysia for period of 1970 – 2009. The study suggests that Malaysia government should reform taxation policies to ensure continuous tax revenue as a dominant factor cause on sustainable economic growth.Taha et al. (2008) found a bidirectional relationship running from direct tax revenues and indirect tax revenues to government spending, but no unidirectional relationship between non-tax revenues and government spending. These results indicate that reducing direct and indirect taxes rates may lead to a fall in government spending in the future. In addition, non-tax revenues seem to be less important contributor to the successfulness of country's growth as compared to direct and indirect taxes.

Study by Mithani et al (1999) showed that the results indicate a unidirectional causal influence from government expenditure to government revenue, supporting the spend-and-revenue hypothesis in the short run. The implications of the results is that the size and growth of the public sector and consequential tax burden as well as fiscal deficit in Malaysia are largely determined by the spending decision or spending habits of Malaysian government.

Study from another ASEAN country, Indonesia, by Sriyana (2009) showed that there was a strong long run relationship between tax revenue and government expenditure in Indonesia over the period 1970-2007. In the short term, the model explained unidirectional causality relationship from tax revenue to government expenditure. This phenomenon increased the budget deficit. It implies that the government should make better public finance policies supporting the tax-spend fiscal policy.

From Middle East country, Al-Khulaifi (2012) studied about relationship between government revenue and expenditure from 1980 to 2011 in Qatar which found unidirectional causality that runs from government revenue to expenditure in support of revenue-and-spend hypothesis. Al-Qudair (2005) studied about the relationship between government revenue and expenditure in the Kingdom of Saudi Arabia. The Cointegration test of the studies indicates the existence of long run equilibrium between government expenditure and revenue, and the causality test indicates a bidirectional causal relationship between government revenue and expenditure in both the long and short run.Fasano and Wang (2002) did a research on the causality of government expenditure and revenue in oil-dependent GCC countries. The results show government expenditure follows oil revenue which support spend-and-revenue hypothesis.

Takumah (2014) researched on causal relationship of government revenue and expenditures in Ghana for the period of 1986 – 2012. The study found a bidirectional causal relationship between government expenditure and revenues in both the long and the short run hence confirming the Fiscal synchronization hypothesis. The results suggest that there is interdependence between government expenditure and revenues. The government makes its expenditure and revenues decision simultaneously.

Gounder et al. (2007) did research on the related topic in the case of Fiji Island. The study showed bidirectional causality running between government expenditure and customs duties; and in the long-run there is evidence of fiscal synchronization, implying that expenditure decisions are not made in isolation from revenue decisions.

Obioma and Ozughalu (2010) examined the relationship of government revenue and expenditure in Nigeria from 1970 to 2007. The study indicates that there is a long-run relationship between government revenue and government expenditure in Nigeria. There is also evidence of a unidirectional causality from government revenue to government expenditure. Thus, the findings support the revenue-and-spend hypothesis for Nigeria, indicating that changes in government revenue induce changes in government expenditure. Nwosu and Okafor(2014) did the same study in the same country for period of 1970 – 2011. The study indicates, in contrary with Obioma and Ozughalu (2014), long run unidirectional relationship running from expenditure to revenue variables. The findings support spend-and-revenue hypothesis in Nigeria indicating that changes in government expenditure instigate changes in government revenue.

Eita and Mbazima (2008) tested the relationship of government revenue and expenditure in Namibia for the period of 1977 – 2007. The results show a unidirectional causality from government revenue to government expenditure. It supports the revenue-and-spend hypothesis.

While in Romania, Hye and Jalil tested the revenue and expenditure nexus. It shows a bidirectional long run relationship between government revenues and government expenditures. Moreover, the study suggests government revenue shock has more sharply impact on the government expenditure as compared to the shock in government expenditure and response of government revenue collection.

Briefly, from all the previous studies above, we can see that the results of six studies supports the revenue-and-spend hypothesis, three studies support spend-and-revenue hypothesis, and the remaining six studies support the bidirectional causality or the fiscal synchronization hypothesis. In the case of Malaysia, there is two studies support revenue-and-spend hypothesis, and another two support fiscal synchronization hypothesis, while the other one support spend-and-revenue hypothesis.

3. CONCEPTUALIZATION OF THE PROBLEMS

Malaysian government has been facing budget deficit since 1998 when the financial crisis hit. As we have discussed earlier, budget deficit has advantages and disadvantages.The government could run deficits during recessions to compensate for the shortfall in aggregate demand, but note that it should be a cyclical deficit and not a structural or permanent deficit. During the boom times of the economy, the government should run the balance budget or even the surplus budget to pay the debt that was created during the budget deficit.

In Malaysia case, the budget deficit has been started since 1998 when the financial crisis hit the Asian market. Based on the argument above, it is good to have a budget during the recession time, but the budget deficit has been running for 17 years until now. Furthermore, Malaysia government plan to have budget deficit until 2019, and has a balanced budget in 2020.

In this study, we want to find the relationship between government revenue and expenditure using the four hypotheses that has been proposed by previous study, which are revenue-and-spend hypothesis; spend-and-revenue hypothesis; fiscal synchronization hypothesis; and fiscal independence hypothesis. Also, to find out how this relationship affects the fiscal policy in Malaysian economic system.

4. DATA AND METHODOLOGY

The study aims to find out the relationship between government revenue and expenditure in Malaysia. This study will use type of secondary data where all the data related to the revenue and expenditure of Malaysian government is taken from the website of Malaysian government such as Bank Negara Malaysia and Ministry of Finance Malaysia. Besides, previous studies and research that related to this topic will be referenced later with the result of this study. Another resource such as online news and report by private sector will be used in this study as well.

Quantitative method will be used in this study. Quantitative method will be in the form of data of Malaysian government revenue and expenditure from 2002 to 2013, which mean after the financial crisis until the most recent data available. In this study, descriptive analysis will be used to analyse the data. Descriptive analysis means quantitative statistic data will be described to explain the problem of the study. In another words, descriptive analysis is an analysis tool which explain and describe the problem statement so that it will be easy to understand and conclude.

5. RESULTS AND DISCUSSIONS

As we recon the global economy in early 2000s, the situation was not that impressive or too bad in term of overall performance. The introduction of Euro currency in late 20th century did not impact the global economy in a distinctive manner (neither positive impact or negative impact), but still it create a small shock in the global economy in a form of a moral boost that help the global economy achieve 4.79% growth in GDP in the 2000 compared to 3.64% in 1999. Malaysian early 2000s and late 2000s was forced to peg its currency against the US Dollar as a result of the Asian financial crisis in 1998.

The Malaysian economy was hit by the Asian financial crisis which forced the government to consider more its expenses and revenues so it can survive the aftermath. The table below shows the expenditure and revenues of Malaysia between 2002 and 2013.

Year	Revenue (in RM mil)	Expenditure (in RM mil)
2002	83515	104676
2003	92607	114577
2004	99396	120162
2005	106305	128278
2006	123547	143501
2007	139885	163648
2008	159794	196346
2009	158639	206582.42
2010	159653.15	204425
2011	185419.43	229010.13
2012	207912.82	252469.32
2013	213370.23	253480.13

Table 1: Revenue and Expenditure in Malaysia

The numbers trending positively on a yearly basis for both expenditure and revenue reflecting the fact that the economy as a whole will increase in size and need over the year. The only time when the trend were affected is between 2008 and 2010 when the Global Financial crisis took place the chart below shows a flat line with a small fall in 2010.

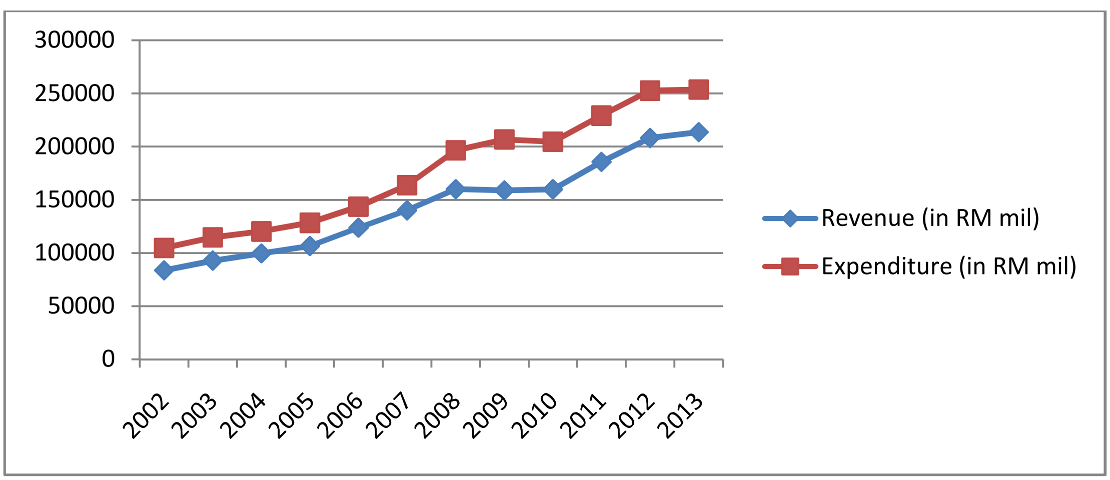

Chart 1.1: Government Revenue and Expenditure in Malaysia on 2002 – 2013

Revenues and expenses went up in 2011 following through till the end of 2012 after the start of 2013 the line shows a flattering trend with a small increase 2.63% for revenues and 0.4% for expenditures.

The correlation coefficient between revenue and expenditure is 0.9932.The relationship between expenditure and revenue is too high, which mean both are near perfect in their movement and reaction to each other. Thegovernment has a deficit by 20% as of 2002 and end up by 16% in 2013.

What we can capture from the charts above is deficit policy imposed by the government, or a reflection of the Malaysia situation which is being in open economy in which force the government to spend more to cover some weak or newly established business sectors (cars manufacturing or electronics).

Both revenues and expenses are moving together where the statistical correlation is near perfect, 0.9932. The growths in expenses and revenues reflect the assurance of a balanced economy policy. Rather than pushing one up or down, the government should consider the real economic power to strive rather than any policy that can hide a weakness which can pin the economy down in the future. The chart below shows the growth in both expenditure and revenues in the 12 years span.

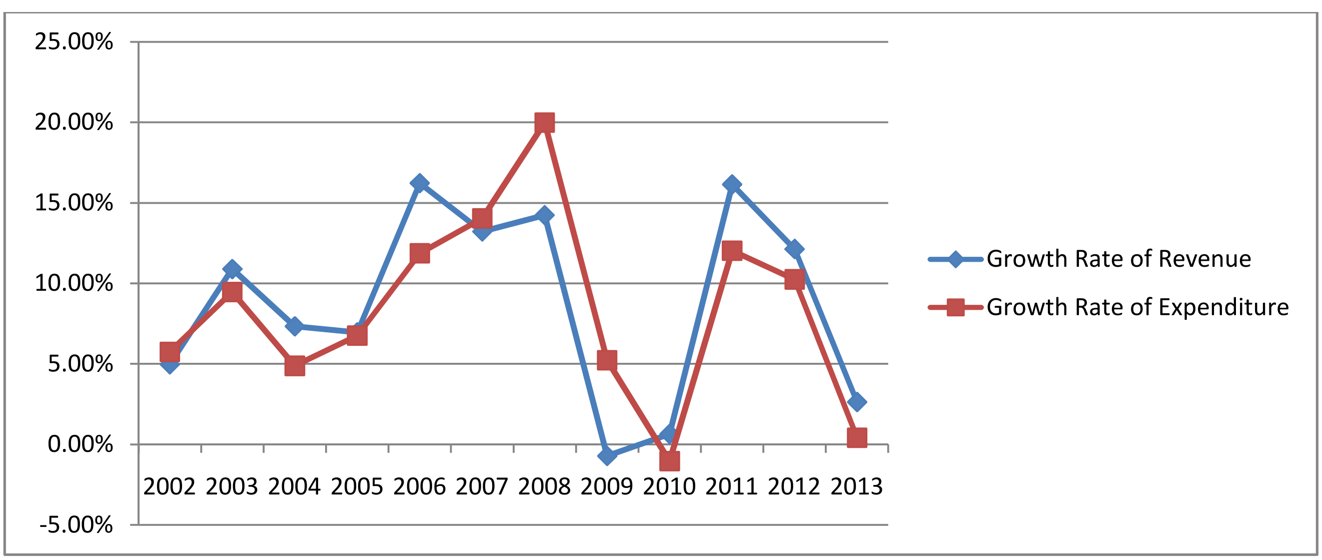

Chart1.2: Growth of Government Revenue and Expenditure on 2002 – 2013

Year	Tax Revenue	Non-Tax Revenue	Growth of Tax Revenue	Tax Revenue (%of GDP)
2002	66860	15759	8.73%	17.45%
2003	64891	23130	-2.94%	15.50%
2004	72049	26511	11.03%	15.20%
2005	80595	25053	11.86%	14.83%
2006	86631	36005	7.49%	14.52%
2007	95168	43950	9.85%	14.30%
2008	112898	45911	18.63%	14.66%
2009	106504	50789	-5.66%	14.94%
2010	109515.15	48867	2.83%	13.74%
2011	134885.34	49423.05	23.17%	15.24%
2012	151643.16	54909.327	12.42%	16.10%
2013	155952.22	54450.478	2.84%	16.0%

Table1.2: Taxes Revenuein Malaysia (2002-2013)

The main source of income of Malaysian revenue is tax, amounting to 16% of the total GDP in 2013. The growths of tax revenues showed in above table are increasing on average 9% each year. The increase in taxes also reflect the increase in total revenues the correlation between the total revenues and taxes is 0.89846 which is quite high (1% increase in one factor = 1% in the other factor).

From the expenditure perspective, expenditure in Malaysia growsin a similar fashion as revenues (correlation is 0.9932).While both are showing a similar growth and decline over the year, we cannot overlook the fact of different type of expenditures in particular operating expenditures and development expenditures.The development expenditures represent how much the governments are investing in long run projects, such as infrastructure, health, insurance, etc.In 2002, development expenditure was 35% of total expenditure in Malaysia and fell to 23% in 2004 and sustained this position till 2010. The index shows a downfall in 2011 with 20% only with a losing trend to reach 17.5% in 2013.

On the other hand, operation expenditure was 65% in 2002 climbed to 77% in 2004 and showed a minimum amount of movement throughout the decade till 2010. In the years afterward the operational expenditure started to increase in 2011 80% and reached 82.5% at the end of 2013.

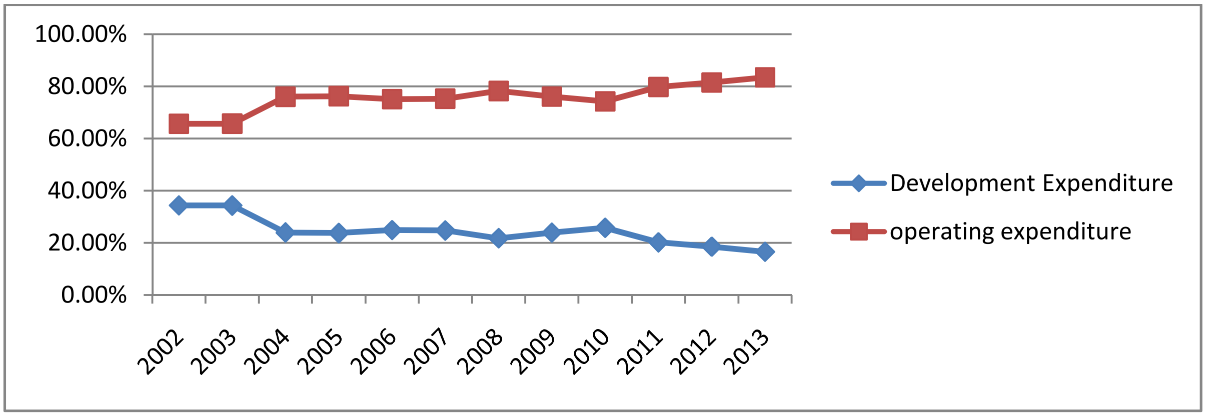

Chart 1.3: Composition of Government Expenditures on 2002 – 2013

The major economical element that we are looking at is the GDP which reflect the gross domestic production over the year. Malaysia was out of the Asian crisis in early 2000 but still their GDP showed a good growth, recording an average of 5.8% increases between 2002 and 2008.When the global financial crisis took place, the GDP was fallingto -1.78% in 2009. This fall was a periodic transition for the Malaysian economy since the year afterward shows a significant growth 7% growth and remains stable after that in the following years.

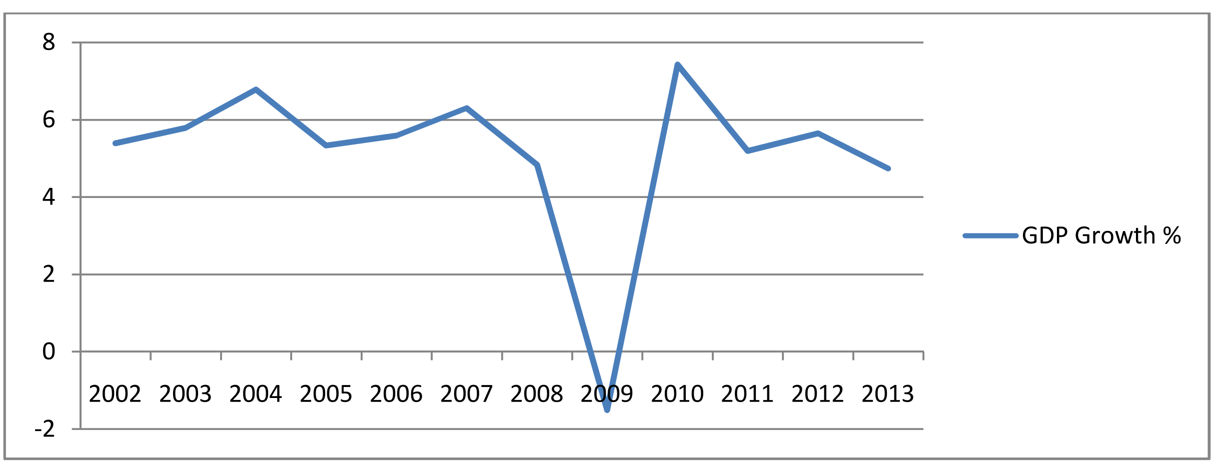

Chart2.1: % of GDP Growth

Expenditure and revenues are a reflection of the money movement in and out or within the economy, so the effect it has on GDP can be spotted most the time and Malaysia is no exception of that. Thechart below shows the ratios of revenues and expenditures as % of GDP, also the cash surplus/deficit as % of GDP.

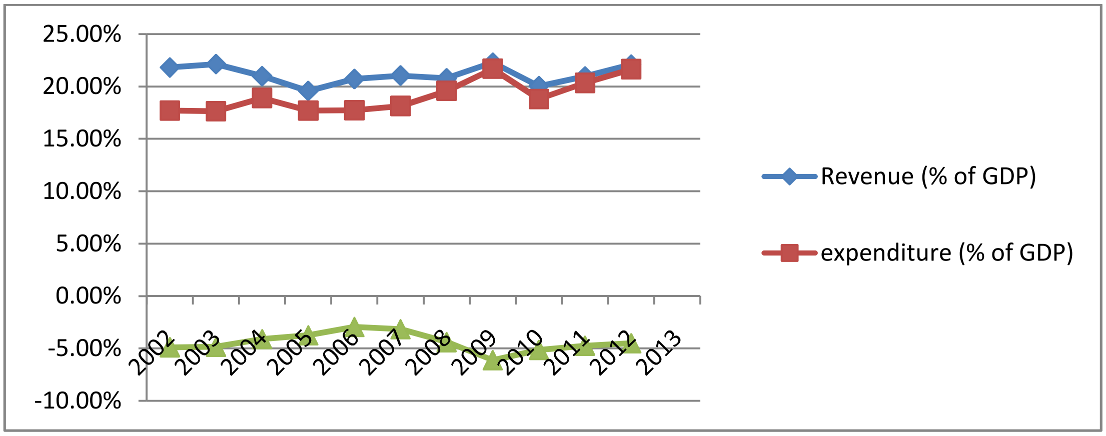

Chart2.2: Government Expenditure and Revenue As Ratio of GDP on 2002 – 2013

The chart reflects where and when the deficit has a bad impact on the economy.In 2008 – 2009, the expenditure was 21.8% of the GDP while the revenue was 22%. This shock during the economic crisis on 2008 shows some vulnerability in the system expenditure ratio of the GDP jumped from 19% in 2007 – 2008 to reach 22% in 2008 – 2009.A 3% jump in one year means the deficit will increase in cash deficit from -4.5% in 2008 to -6% in 2009, a nearly 2% increase. The fall in the global financial system and the negative effect on the Malaysian market was not enough to hurt the market drastically, as in the following years both expenditure and revenues went stable and the deficit reflect that in the span of 2010 – 2013a near -5% deficit with some tending to be even close to -4.5% at the end of 2013.

6. CONCLUSION AND RECOMMENDATION.

Malaysia has a deficit budget from the 1998 till now. It has effects on the national saving which than affect private investment. It goes without saying that government cannot move alone denying private sector in the economy. If there is budget deficit then private reluctant to invest their money whereas economic development become hamper at a large position. During budget time government should consider all important relevant factors so that there be balanced budget that indicate the optimum uses of the economic resources. By these way private sector and public sector move simultaneously creating real value in the economy that creates monetary value for that economy.

From the analysis above for the period 2002 – 2013, we found that the relationship of Malaysian government revenue and expenditure is following the spend-and-revenue hypothesis, which means that its revenue responds to prior spending changes. This hypothesis suggests that government would raise the funds to cover its spending, and therefore, higher government expenditures lead to higher government revenues. We also saw the effect on GDP was positive across the timeline which prove that the Malaysian government is following a structured plan that span more than 10 years. Comparing the current economic system with the economic system at the early system is quite hard and impossible to compare, because the difference of current condition and early Islamic era's condition.

The spend-and-revenue hypothesis suggests that the government will spendstheir money first and later will raise the funds to cover its prior spending charges. Without a proper rules and regulation, this relationship will cause a continuous budget deficit, because higher government expenditures will lead to higher government revenues. Later, to cover their budget deficit, government will have to borrow money either from domestic sources or foreign sources. Government should take note that borrowing money oncontinuous basis will not solve the deficit budget. The situation where government spends their money today and later raises the taxes in order to cover their budget deficit can cause a capital outflow from the economy as a result of the fear of consumers paying higher taxes in the future.

Malaysian government financed their deficit mostly by borrowing money to domestic lenders or investors, which has been happening for the last 17 years. With all these borrowing money, the government has to pay interest on the debt, which can make government expenditure higher. In 2015, Malaysia plans to cut its budget deficit to 3% of the GDP, which mean 0.9% lower than 2013 deficit. As a long term goal, Malaysia plans to have a balanced budget on 2020. It seems that Malaysia has imposed some policy in order to reduce their budget deficit, until it reaches a balance point, on 2020.

One methods that is used by Malaysia to increase the revenue and reduce the budget deficit is by introduce a new tax, which is Good and Services, that replaces the sales tax and services tax. This tax, also known as value added taxes, will increase Malaysia revenue by 4.5% in 2015. However, there has been a lot of issues and debates about the application and implications of this tax on the Malaysian economy system. In order to cover its budget deficit and accomplish their goal to have a balanced budget on 2020, Malaysian government has no choice but to impose a new tax to the people.

Another method by Malaysian government to minimize the budget deficit is to cut down the subsidy in the oil price in the Malaysian market. Before the declining of oil market price, the Malaysian government used to give subsidy to the oil price because the oil price is too high for the people. But, since the oil price has declined, government made a policy that it will not subsidize the oil prices in the market. The oil prices in the consumption market are determined by the oil prices in the global market. This policy allows government to save some money and reduce its expenditure; hence it will reduce the budget deficit.

Related to the declining of oil prices in the global market, Malaysia as one of the oil producer in the world will be affected by the low price of oil. PETRONAS, which some of its shares owned by the Malaysia government, will be affected and it will give a lower return to the government. The lower return will cause lower revenue in the government budget for 2015.

Without a proper rule and regulations, the increase in government expenditure will widen the budget deficit. Thus, government will be left with an option to borrow which could increase indebtedness to lending countries and institutions. Internal borrowing also reduces the amount meant for private investment in the country. Based on our analysis above, therefore we would like to suggest:

- To reduce the operating expenditure and spend more on the development expenditure, just like in the early 2000s. The cost of running the government should be reduced and the funds recovered from such put to development or investment expenditure.
- Find the alternative for the declining of oil price, which will reduce the return from PETRONAS. Even though it will not affect the revenue in a huge number, but still reduce in return can make the deficit wider. Since the relationship between revenue and expenditure is spend-and-revenue theory, the expenditure will not follow the revenue either it goes down or up, it is the revenue that will follow the expenditure movement. If the revenue goes down, the expenditure will not follow the revenues and make the deficit wider.
- Since there is a controversy about the application and implication of GST, government need to make sure that GST will not be a burden to the people. The benefits that arise from GST should be perceived by the people, so people will not mind to pay the taxes and the controversy of the application can be removed.

With this paper,

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