

**FISCAL OPERATIONS AND MANAGEMENT IN MALAYSIA:
AN ANALYTICAL STUDY**

The Master Project submitted to the Graduate School in partial
fulfillment of the requirements for the degree Master of Science
(Management) Universiti Utara Malaysia

By

Nordin bin Mehat

© Nordin bin Mehat, 1999, All right reserved



Sekolah Siswazah
(Graduate School)
Universiti Utara Malaysia

PERAKUANKERJAKERTASPROJEK
(Certification of Project Paper)

Saya, yang bertandatangan, memperakukan bahawa
(I, the undersigned, certify that)

NORDIN BIN MEHAT

calon untuk Ijazah
(candidate for the degree of) Master of Science (Management)

telah mengemukakan kertas projek yang bertajuk
(has presented his/her project paper of the following title)

FISCAL OPERATIONS AND MANAGEMENT IN MALAYSIA:
AN ANALYTICAL STUDY

seperti yang tercatat di muka surat tajuk dan kulit kertas projek
(as it appears on the title page and front cover of project paper)

bahawa kertas projek tersebut boleh diterima dari segi bentuk serta kandungan,
dan meliputi bidang ilmu dengan memuaskan.
(that the project paper acceptable in form and content, and that a satisfactory
knowledge of the field is covered by the project paper).

Mama Penyelia
(Name of Supervisor): Assoc. Prof. Dr. Dawood M.Mithani

Tandatangan
(Signature)

: 

Tarikh
(Date)

: 21st Dec. 1999

PERMISSION TO USE

In presented this project in partial fulfillment for a postgraduate degree from Universiti Utara Malaysia, I agree that the University's library may make it freely available for inspection. I further agree that permission for copying of this project in any manner, in whole or in part, for scholarly proposes may be granted by my supervisor or in absence, by the Dean of the Graduate School. It is under stood that copying participation or use of this project or parts they're of for financial gain shall not be allowed without my written permission. It is also under stood that due recognition shall be given to me and to Universiti Utara Malaysia, for any scholarly use which may be made of any material from my project.

Request for permission or to make other use of materials in this project, in whole or in part, should be addressed to:

**Dean of Graduate School
Universiti Utara Malaysia
06100 UUM Sintok
Kedah Darul Aman.**

ABSTRACT

This project paper is a fresh study made to provide a comprehensive analytical review of fiscal behavior and management of Federal Government of Malaysia during post New Economic Policy era. The composition and growth trend of revenue system has been examined together with size and pattern of government spending for the period 1971 – 1998. The nexus between government deficits and public debt has been searched. The study suggests that fiscal operation and budgetary components have prudently managed in achieving its goals towards strong economic fundamental with macrobalancing.

ABSTRAK

Projek ini adalah satu kajian analisis yang komprehensif mengenai ciri-ciri fiskal dan pengurusan kewangan Kerajaan Malaysia dalam era Polisi Dasar Ekonomi Baru. Kaedah kajian secara analisis dibuat kepada komposisi sistem hasil iaitu cukai dan juga cara serta bentuk perbelanjaan kerajaan bagi menguruskan pendapatan dan perbelanjaannya dalam tempoh 1971 - 1998. Kajian juga dijaikan mengenai kaitan di antara defisit dan pinjaman awam. Dalam kajian ini disarankan cadangan kaedah operasi fiskal dan komponen belanjawan yang diurus secara berhemat boleh mencapai matlamat kearah asas makroekonomi yang kukuh.

ACKNOWLEDGEMENTS

Praise to Allah, for the blessing through this life, especially for giving me the courage and strength to complete this project. To complete this project, I have achieved the feeling of happiness and great satisfaction. I could not have completed without the support, commitment and scarifies of my supervisor, my beloved family, my colleagues and friends. To them I would like to express my gratitude and appreciation goes especially to:

1. Assoc. Prof. Dr. Dawood M. Mithani of the Graduate School UUM,
for his professional guidance through his supervision of my project.
2. Bank Negara of Malaysia
3. The Graduate School, Universiti Utara Malaysia
4. Ministry of Education
5. Institute Aminudin Baki

6. My beloved wife, Hajjah Zaiton Ahmad who has been very supportive and encourage
7. My beloved children, Wira, Uda, Adi, Sufi, Liya and Lina. They are my inspiration and I hope they will be challenged and encouraged by this.
8. All members of Cohort 8 especially Mr. Mohamed Yusof Bin Mohamed, Mr. Abd Halim bin Saad and Mr. Arsaythamby s/o Veloo for their helped and supported, and friends who have contributed directly or in directly to this project.

NORDIN BIN MEHAT

Dedicated with love to my wife Hajjah Zaiton, and children :

Wira

Uda

Adi

Sufi

Liya

Lina

**for their tolerance and invaluable encouragement and inspiration
for this project.....**

TABLE OF CONTENTS

| | Page |
|--|-------------|
| PERMISSION TO USE | iii |
| ABSTRACT | iv |
| ABSRAK | v |
| ACKNOWLEDGMENTS | vi |
| DEDICATION | viii |
| CONTENT | ix |
| LIST OF TABLES | xii |
| LIST OF CHARTS | xiv |
| LIST OF ABBREVIATIONS | vx |
| | |
| CHAPTER ONE: INTRODUCTION AND PROBLEM STATEMENT | |
| | |
| 1.1 Introductory | 1 |
| 1.2 Malaysian context the problem statement | 3 |
| | |
| CHAPTER TWO: LITERATURE REVIEW | |
| | |
| 2.1 Preliminary remarks | 6 |
| 2.2 Select literature review | 8 |
| 2.3 Concluding remarks | 16 |

CHAPTER THREE: METHODOLOGY AND RESEARCH DESIGN OF THE STUDY

| | | |
|-----|--------------------------------|----|
| 3.1 | The purpose of the study | 17 |
| 3.2 | Methodology | 18 |
| 3.3 | Time frame and research design | 19 |
| 3.4 | Concluding remarks | 20 |

CHAPTER FOUR: ANALYSIS OF THE REVENUE SYSTEM OF MALAYSIA

| | | |
|-----|---|----|
| 4.1 | Introduction | 21 |
| 4.2 | Tax Legislation | 23 |
| | 4.2.1 Direct taxation | 23 |
| | 4.2.2 Indirect taxation | 24 |
| 4.3 | The size of the government | 25 |
| 4.4 | The revenue structure | 29 |
| 4.5 | The tax structure and the tax mix | 33 |
| 4.6 | The composition of direct and Indirect tax revenue | 35 |
| 4.7 | Composition of non-tax revenue | 41 |
| 4.8 | Malaysian tax burden | 43 |
| 4.9 | Concluding remarks | 46 |

CHAPTER FIVE: ANALYSIS OF PUBLIC FINANCE

| | | |
|-----|---|----|
| 5.1 | Introduction | 47 |
| 5.2 | Sizes and growth of federal government Expenditure in Malaysia | 50 |
| 5.3 | The composition of government expenditure | 57 |
| 5.4 | Concluding remarks | 66 |

CHAPTER SIX: THE MEASURE OF GOVERNMENT DEFICITS AND PUBLIC DEBT

| | | |
|-----|--|----|
| 6.1 | Government deficits | 67 |
| 6.2 | Trend of Malaysia government deficits and public debt | 68 |
| 6.3 | Malaysian Government deficits and Domestic Debt nexus | 68 |

| | | |
|--|--|-----|
| 6.4 | Malaysian government deficits and External debt nexus | 74 |
| 6.5 | Relationship between government Deficits and public debt | 77 |
| 6.6 | Debt and deficits correlation | 80 |
| 6.7 | Concluding remarks | 81 |
| | | |
| CHAPTER SEVEN: BUDGET 2000 – A SYNOPTIC VIEW | | |
| 7.1 | Introduction | 82 |
| 7.2 | Federal government revenue in Y2K | 85 |
| 7.3 | Federal government expenditure in new millennium | 86 |
| 7.4 | Highlights of the Y2K budget | 88 |
| 7.5 | Concluding remarks | 90 |
| | | |
| CHAPTER EIGHT: SUMMARY AND CONCLUSION | | 93 |
| | | |
| SELECT BIBLIOGRAPHY | | 99 |
| | | |
| APPENDICES | | 103 |

LIST OF TABLES

| Number | Title | Page |
|---------------|--|-------------|
| 4.1 | Indicators of the size of the Federal Government Budget 1971 –1998 | 26 |
| 4.2 | Importance of Non-tax revenue | 30 |
| 4.3 | Direct and indirect taxation in Malaysia | 31 |
| 4.4 | Composition of Indirect tax | 36 |
| 4.5 | Composition of Direct Tax Revenue | 37 |
| 4.6 | Composition of Non-tax Revenue | 42 |
| 4.7 | Tax Burden in Malaysia | 44 |
| 5.1 | Federal Government Finance As Percentage of GNP | 53 |
| 5.2 | Compound Annual Rate of Growth Federal Government Expenditure | 55 |

| | | |
|-----|--|----|
| 5.3 | Federal Government spending on Social and Economic Service | 59 |
| 5.4 | Total Government Spending on Education, Health and Agriculture And Rural Development | 62 |
| 6.1 | Federal Government Deficits Finance | 70 |
| 6.2 | Malaysians Government Deficits And Domestic Debt | 72 |
| 6.3 | Malaysians Government Deficits And Domestic Debt (Ratio Basis) | 73 |
| 6.4 | Malaysian Government Deficits And External Debt | 74 |
| 6.5 | Malaysian Government Deficits And External Debt (Ratio basis) | 77 |
| 6.6 | Malaysian Government Deficits And Public Debt | 79 |
| 6.7 | Relation Between Malaysian Government Deficits And Public Debt | 79 |
| 6.8 | Government Deficit And Public Debt | 80 |
| 7.1 | Federal Government Revenue 1998 - 2000 | 86 |

LIST OF CHARTS

| Number | Title | Page |
|--------|--|------|
| 4.1 | Indicators of the Size of Government | 27 |
| 4.2 | Tax Burden in Malaysia | 45 |
| 5.1 | Federal Government Finance as Percentage of GDP | 54 |
| 5.2 | Trend of Spending on Social and Economic Service as Percentage of Total Government Spending | 60 |
| 5.3 | Total Spending on Education, Health And Agriculture/Rural Development Percentage of Total Spending | 63 |
| 5.4 | Total Spending on Education, Health And Agriculture/Rural Development Percentage of GNP | 64 |
| 6.1 | Federal Government Deficit | 69 |
| 7.1 | Federal Government Budget 2000 | 84 |

LIST OF ABBREVIATIONS

| | | |
|-----|---|--|
| AR | - | Agriculture and Rural Development |
| CIT | - | Corporate Tax |
| CT | - | Total Tax |
| DD | - | Domestic Debt |
| DE | - | Development Expenditure |
| DS | - | Debt Service |
| DT | - | Direct Tax |
| ED | - | Education Expenditure |
| ED | - | External Debt |
| ED | - | Excise Tax |
| EPF | - | Employee Provident Fund |
| ESD | - | Economic Services Development Expenditure |
| ESO | - | Economic Services Operating Expenditure |
| FD | - | Overall Surplus/Deficit |
| GD | - | Government Deficit |
| GDP | - | Gross Domestic Product |
| GE | - | Total Government Spending |
| GNP | - | Gross National Product |
| HE | - | Health/Medical Expenditure |
| IDT | - | Indirect Tax |
| IRI | - | Interest and Returns on Investment |

| | | |
|-----|---|--|
| IT | - | Personal Income Tax |
| LP | - | Licenses and Permits Tax |
| MD | - | Import Tax |
| NTR | - | Non-Tax Revenue |
| OE | - | Operating Expenditure |
| OT | - | Others Tax |
| PD | - | Public Debt |
| PG | - | Pensions and Gratuities |
| PIT | - | Petroleum Tax |
| PR | - | Petroleum Royalties |
| R | - | Current Revenue |
| RS | - | Revenue Surplus/Deficit |
| SSD | - | Social Services Development Expenditure |
| SSO | - | Social Services Operating Expenditure |
| ST | - | Sales Tax |
| SVT | - | Service Tax |
| TE | - | Total Expenditure |
| TP | - | Transfer Payment |
| TR | - | Total Revenue |
| TTR | - | Total tax Revenue |
| XD | - | Export Tax |
| Y2K | - | Year 2000 |

CHAPTER ONE

INTRODUCTION AND PROBLEM STATEMENT

1.1 Introductory

Following the "Keynesian Revolution" in economic thinking which favored increasing role of the state in a market economy for managed capitalism; the concept of budgetary policy and fiscal management received a new vista in modern times. With the changing role and responsibilities of the government in developing economy such as Malaysia, fiscal policy assumes a unique significance. For, it is a right wing of macroeconomic policy in moulding and managing the country's economy in the pursuit of realization of predetermined national socio-economic goals.

In a broad sense, fiscal policy comprises deliberate changes in the size, form and timing of taxation, government expenditure and public debt operations to influence economic activity. Fiscal or budgetary management is based on fiscal policy. Fiscal management

The contents of
the thesis is for
internal user
only

SELECTED BIBLIOGRAPHY

- Akhtar M. (1978), *Government Deficits and the Inflationary Process in Developing Country*, IMF Staff Paper, Vol. 25, Sept, pp. 383-416
- Ali M. A ,(1998), *Asia's Financial Crisis and Lessons for Malaysia*, Kuala Lumpur.
- Ariff M. and K. H. Leong, (1996), *Balance of Payment and Government Budgeting: Balance of Payment Deficit -An Assessment of the Policy Response*, Kuala Lumpur.
- Ariff M., M. C. Yap, Wan Abdul Kadir A. , L. I. Tan, G. E. Ong, (1998), *Malaysian Economic Outlook*, Malaysian Institute of Economic Research , Kuala Lumpur.
- Asher, M.G and Tayabji Amina, (1974), *Patterns of Budgetary Expenditure of Federal Government of Malaysia*, UMBC Economic Review, Vol XIII.
- Asher, M.G., (1989), *Fiscal System And Practices in Malaysia*, Institute of Southeast Asian Studies, Singapore.

Asher, M.G. and Tayabji Amina, (1977), *Patterns of Budgetary Expenditures of the Federal Government of Malaysia*, UMBC Economic Review, Vol XIII(1) pp. 51-64.

Aziz, M.A and Yusoff M.B., (1994), *A Quantitative Assessment of the Impact of Government Spending in Malaysia*, Second Malaysia Econometric Conference, Kuala Lumpur, Malaysia Institute of Economic Research .

Bank Negara Malaysia, (1999), *Monthly Statistical Bulletins*, Kuala Lumpur.

Bank Negara Malaysia, *Annual Report*, various issue, Kuala Lumpur. Bank Negara Malaysia.

Bank Negara Malaysia, (1997,1998,1999), *Quarterly Bulletins*, Kuala Lumpur.

Bird, R. and Head, J., (1972), *Modern Fiscal Issues*, University Press. Toronto.

Business Times, Various Issues, (1998,1999), Kuala Lumpur.

Clifford, F.H., (1996), *Continuing The revolution in Government Budgeting*, Notional Conversion on 7th Malaysia Plan August, 5-7, 1996.

Department of Statistics, *The Malaysian Economy in Brief*, Various Issues, Kuala Lumpur, Department of Statistics.

Economic Report 1999/2000, Ministry of Finance, Kuala Lumpur.

Heinz G. and Stefan P. S., (1997), *Fiscal Policy Design After the Maastricht Shock*, Project LINK Fall Meeting, Kuala Lumpur.

Kasipillai J., (1998), *An International Perspective on Tax Development in the Asia-Pacific Region*, vol. 4 Asia-Pacific Tax Bulletin, Malaysia.

Mathani, D.M., (1998), *Modern Public Finance: Theory and Practice*, Himalaya Publishing House. Mumbai.

Meerman.J, (1979), *Public Expenditure in Malaysia*, Oxford University Press, New York.

Ministry of Finance, *Economic Reports*, Various Issues, National Printing Department, Kuala Lumpur.

Nasaruddin Arshad, (1988), *Isu Kewangan-Fiskal Dan Implikasinya Kepada Pembangunan Ekonomi Negara*, Jurnal Universiti Utara Malaysia.

News Straits Times, Various Issues, (1998, 1999), Kuala Lumpur.

Rajam C. and Low L., (1996), *Friendly Strategy for Development: Revisiting the Role of Context*, Singapore.

Said, M.I., (1988), *Inequality, Public Expenditure and Malaysia's National Rice Policy*', *Kajian Malaysia* VI, No, 2, December, Kuala Lumpur.

Salleh, I.M., (1989), *Public Finance in the 1990's*, paper presented at the 1989 National Outlook Conference, MIER, November 29-30, Kuala Lumpur.

Salleh, I.M. and Rogayah Hj. Md. Zain, (1998), *Fiscal Policy and Structural Adjustment: The Malaysian Case*, *Jurnal Universiti Utara Malaysia*, Vol. 3, December.

Star, Various issues, (1998, 1999), Kuala Lumpur.

Tanzi Vito, (1987), *Fiscal Policy, Growth and Stabilization Programs, Finance and Developing*,

Tanzi Vito, (1992), *Public Finance in developing Countries*, Hants Edward Eglar.