

**THE RELATIONSHIP BETWEEN BUDGET DEFICIT AND ECONOMIC GROWTH
FROM MALAYSIA'S PERSPECTIVE**



**UNIVERSITI TEKNOLOGI MARA (TERENGGANU)
MALAYSIA**

BY:

NUR HAYATI BINTI ABD RAHMAN

NURUL FAHANA AINI HARUN

2012

ACKNOWLEDGEMENTS

First and foremost, I would like to express my deepest thanks and appreciation to Universiti Teknologi MARA (UiTM) for providing me a research grant under a name of 'Dana Kecemerlangan'. With the grant provided, I am able to complete this research in a timely manner and present the findings in the International Conference on Economics, Business Innovation (ICEBI), Kuala Lumpur. Moreover, part of the contents in this paper have been successfully published in the third volume of the International Journal of Trade, Economics and Finance. Both proceeding paper and journal article that have been published are attached together at the appendix section of this research paper.

Besides, It is an honor for me to express my gratitude specifically to my family members and fellow friends for their continuous encouragement and support in completing this paper. I am also indebted to the staffs of Pusat Jaringan Industri (PJI) who have guided me in various processes related to the grant scheme. Thanks a lot! May Allah bless us all.

EXECUTIVE SUMMMARY

Theoretically, there are controversial thoughts that discussed on the relationship between budget deficit and economic growth. While Keynesian economies claimed that these two series are positively related, the neo-classical economies claimed the opposite. Meanwhile, the Ricardian equivalence hypothesis argued that there is neutral relationship between budget deficit and economic growth. The objective of this paper is to investigate the relationship between budget deficit and economic growth from Malaysia's perspective. Four variables were used, namely real Gross Domestic Product (GDP), government's debt, productive expenditures and non-productive expenditures. AutoRegressive Distributed Lag (ARDL) approach is used to analyze the long-run relationship between all series since it can cater for small sample size. By using quarterly data from 2000 to 2011, it was found that there is no long-run relationship between budget deficit and economic growth of Malaysia, consistent with the Ricardian equivalence hypothesis. However, productive expenditure has positive long-run relationship with the economic growth. In case if there is a shock in the Malaysian economy, the only variables that can help to converge the economy to its equilibrium is the changes in GDP and productive expenditures. For future recommendation, it is suggested that other researchers will enhance this research by including other developing countries as the sample of analyses.

TABLE OF CONTENTS

LIST OF FIGURE	vi
LIST OF TABLE	vi
LIST OF SYMBOLS AND ABBREVIATIONS	vii
CHAPTER 1: INTRODUCTION.....	1
1.2 Background of the Study.....	3
1.1 Objective of the Research	3
1.2 Significant of the Research	4
1.3 Scope of the Study.....	4
1.4 Limitation of the Study	4
1.5 Organization of the Report.....	5
CHAPTER 2: LITERATURE REVIEW	6
2.1 Theoretical Framework	6
2.2 The Relationship between Budget Deficit and Economic Growth	8
2.2.1 Productive Expenditure vs. Non-Productive Expenditure.....	8
2.2.2 Empirical Evidences on the Relationship between Budget Deficit and Economic Growth.....	9
CHAPTER 3: RESEARCH METHODOLOGY	12
3.1 Research Procedure	12
3.1.1 AutoRegressive Distributed Lag (ARDL) Model	12
3.1.2 Granger Causality Test	14
3.2 Research Design.....	14
CHAPTER 4: RESULTS AND DATA ANALYSIS	16
4.1 The Relationship between Budget Deficit and Economic Growth	16
4.1 The Causal Relationship between Budget Deficit and Economic Growth	19
CHAPTER 5: CONCLUSION AND RECOMMENDATION	20

REFERENCES.....	22
RESEARCH OUTCOMES.....	24
APPENDIX.....	25