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"FISCAL POLICY: A STUDY ON THE RELATIONSHIP BETWEEN GOVERNMENT EXPENDITURE WITH GROSS DOMESTIC PRODUCT, NATIONAL INCOME, AND UNEMPLOYMENT IN MALAYSIA"

NIK NOR AZIZI BINTI NIK MOHD SALLEH
2004337724

BACHELOR OF BUSINESS ADMINISTRATION WITH (HONOURS) FINANCE
FACULTY OF BUSINESS MANAGEMENT
MARA UNIVERSITY OF TECHNOLOGY
MACHANG CAMPUS
KELANTAN

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ABSTRACT

The purpose of this research is to observe the relationship between economic indicators with government expenditure. The economic indicators are Gross Domestic Product, private consumption, and unemployment. The data from the year 1996 to 2005 by using quarterly basis were collected to determine whether the variables have significant relationship or not. Through the previous research, there are different results obtained. Some of the researchers found that there is no significant relationship between government expenditure and GDP, and the others found there is a significant relationship between government expenditure and GDP. Based on the literature review, majority of the researchers found there is a significant relationship between government expenditure and private consumption. Private consumption is expected to decline after a positive government spending shock. It is very hard to proof the relationship between government expenditure with unemployment. However, the result from regression analysis shows that both variables have significant relationship.

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CHAPTER ONE: INTRODUCTION

1.1 BACKGROUND OF STUDY

This study focuses on fiscal policy, which refers on how the government makes a decision about spending and taxes. However, this study only focuses on the government spending (expenditure). This study discusses about the relationship between government expenditure with Gross Domestic Product (GDP), private consumption and unemployment.

Government often uses their fiscal policy to influence the economy towards economic objectives such as higher growth, low unemployment, low inflation and interest rate. Normally, changes in public expenditure would also influence the changes in private consumption. Therefore, the researcher is interested to find how much changes in government expenditure can affect the changes in other variables such as gross domestic product (GDP), private consumption and unemployment.

According to Keynesian economics, high government spending, funded by deficit, can be beneficial to the economy by stimulating growth and decreasing unemployment, during a recession. Besides that, to stop government's over-borrowing to meet short-term objectives, private consumption should be increased to cover the country's expenditure.