FISCAL DEFICIT AND THE IMPACT OF MACROECONOMIC VARIABLES ON INFLATION RATES IN MALAYSIA

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ABSTRACT

This study aims to examine the increasing government fiscal deficit as a fiscal expansion by increasing spending will increase aggregate demand. Where excessive aggregate demand will cause inflation. High inflation rateswill lead to lower economic growth and to affect the macroeconomic and financial instability (Fisher 1983; Sarel 1996; Khan & Senhaji 2001). Empirical analysis using a ARDL model (Autoregressive Distributed Lag) and the method of Bounds co-integration test supports the Keynesian view that fiscal policy is larger than the effect on output policy for the long term monetary of Malaysia during the period 1970 to 2006. Long-term relationship between fiscal deficits in countries such as debt, external debt and government budget deficits and macroeconomic variables on inflation. The variables studied are variable deficit, domestic debt and external debt in GDP, national income, government expenditure, aggregate demand, and prices outside the country. While the national interest, foreign interest and exchange rates as the basis monetary also identified. Elasticity of short and long term is considered to see the effects of changes in a variable on other variables. Finally, some policy implications are provided based on the available studies.

Keywords: budget deficits, national debt, external debt, GDP, national income, government spending, aggregate demand, international prices, exchange rates, interest rates, co-integration Bounds Test.

1. INTRODUCTION

In general, developing countries and includes developed countries, have problems in financing the budget deficit. Budget deficit can be seen from the difference in total net revenues in the amount of government spending, so there is a country practice is no exception Asean countries such as Indonesia, Malaysia, Philippines, Thailand, and Singapore. To overcome the problem of financing government budget deficits, governments often choose sources of national revenue by way of debt. Government debt may include debt in the country's external debt. External debt and bring the government budget deficit will cause the current account deficit and external debt problems lead to increased (Akhtar Hossain & Anis Chowdhury 1996).

The phenomenon of budget deficits with debt financing, either debt or debts in foreign countries, it requires the repayment of which will reduce the range of financial resources of a country. Apart from the change in sovereign debt that would result from changes in the money supply. This suggests that the government has the financial resources to finance the budget deficit, funding for the printing of money will have a big risk for the economy of a country. With that understood that fiscal policy has a strong relationship directly with economic growth and changes in price levels (inflation). At the Asean countries around the 1980s and early 1990s in countries like the kind found in Malaysia and Thailand have managed to grow its economy after the economic downturn results robust increase in government spending, particularly in the form of budget deficits (Hill 1996).

Consider the implementation of Keynesian fiscal policy by government spending and taxation and policy monetary through interest rate control is the most important macroeconomic stabilization policies to influence aggregate demand and economic activity rates. Application of offset policies monetary without an efficient fiscal policy and good management of the goods and services will actually create a business speculation, and the failure / fiscal illusion (Abrams 1999; Arestic et al. 2002; Boadway 2000; Dallen & Swank 1996; Karseno 1997 : 2).

Several such studies (Parkin & Bade 1992; Dornbusch & Fischer 1994) says this phenomenon proves that the increase in government fiscal deficit as a fiscal expansion by increasing spending will increase aggregate demand. Therefore, it can be argued that increasing the fiscal deficit may result from the growth of public spending in the next series (Rose & Hakes 1995, Fisher 1997, Swaroop & Rajkumar, 2000; Ahmad & Greene 2000). Excessive aggregate demand will cause inflation. In this case, the government should make fiscal policy contractionary in the form of reduced government spending or increase tax rates. The excess supply situation will lead to unemployment, and in such case the government should make an expansionary fiscal policy by increasing government spending or reducing tax rates. Thus the importance of clear fiscal policy actions such as public expenditure management in handling the economy (Ragayah 1995, Taggart et al. 1999).

Examples for Asean countries like Malaysia's economic growth has grown Average 6.80% in 1970-1989 and there was a slight decrease in the presence of economic missing to 6:42% in the year 1990-2006. So is the Philippines from 3.90% to 3.63%, Indonesia from 7.10% to 4.85%, Thailand from 7.40% to 5.17% and Singapore from 8.38% to 6.69%. Next of inflation in Malaysia is in an average of 5% occurred in 1970-1989 and a slight decrease to 3% in 1990-2006. Similarly, there decrease Indonesia from 13% to 12%, the Philippines from 15% to 8%, Thailand from 7% to 4%, and Singapore from 4% to 2%. It also shows that some of the Asean countries use fiscal policy through the budget deficit was also successful in stimulating the economic activity of the 1997 financial crisis.

Keynesian deficit continues says will also increase interest rates and inflation at the same time, which can negatively affect the stability of the economy in the long term. Essentially Keynesian view that fiscal policy a greater effect on output of basic monetary. While the monetarist understanding also acknowledges that fiscal policy can affect national income, is just basic monetary bigger and faster and more predictable effects. Although there is debate about the relationship of fiscal deficits and inflation, but to integrate them in a very minimal model monetary theoretical and empirical level.

In the perspective of economic, fiscal policy has various objectives in a country's economic activities, increasing economic growth, stabilizing prices, equality of income distribution and increased employment opportunities (Dornbusch & Fisher 1994, Taggart et al. 1999). However, other macroeconomic indicators that can be changed according to the fiscal policy is that private investment, private users and the current account. Thus the importance of clear fiscal policy actions such as public expenditure management in handling the economy (Ragayah 1995, Taggart et al. 1999).

2. SUMMARY OF LITERATURE REVIEW

The results of previous studies concluded that different relationships between the effects of fiscal deficits on inflation. Blinder and Solow analysis study was developed by Barth, Bennett and Sines (1980). They find that the expansionary fiscal policy by increasing debt will not only increase the net wealth of society, but also increase consumer spending and demand for money. At the same time, increased debt could increase the repayment amount and its use will decline. Thus, the effect of increased government spending on aggregate demand is vague (ambiguous) and can only be proven through empirical research.

While previous studies of other on the relationship of fiscal deficits and inflation (King & Plosser's 1985, Blanchard & Fischer's 1989; Montiel 1989, Dornbusch et al. 1990; De Haan and Zelhorst 1990, Romer 1993, Lane 1997, Campillo & Miron, 1997; Click 1998; Loungani & Swagel 2001, Fischer et al. 2002) was carried out on fiscal variables, inflation, changes in base money, the exchange rate shock, printing money (seigniorage). King and Plosser (1985) megkaji factors that determine the seigniorage to the U.S. and 12 other countries using OLS regression equation linear and VARs, shows that in general there is no cause between fiscal deficits and inflation with the

principles of money. Similarly, the study Montiel (1989) and Dornbusch et al (1990) find that fiscal deficits tend to accommodate to link a combination of rate changes and the weakness of inflation, rather than a cause of inflation. By using nonparametric correlation measures in 17 countries to grow and divide into groups of low and high inflation.

Review and Semudram Chye (1988) found that monetary policy certainly plays a role in influencing the rate of inflation. They estimate the three model equations to see whether the empirical results support the inflationary model of financial understanding or model of the Neo-Keynesian inflation understand the influence of inflation. The results showed that all three models to understand moneteri sided equation. Consistent with the findings Fischer et al (2002), using fixed effects in the assessment of the economy that is 94 and has been developed, concludes that the fiscal deficit is the main cause of high inflation (over 100% per year) and estimated that one percent increase in value (conditions deteriorate) in the fiscal balance to GDP ratio would lead to 4.25 per cent decrease (increase) in inflation, the other constant. However, they also found that changes in the budget balance has no effect on the country's low inflation or low inflation over the country that inflation is high.

Similarly, in line with the findings Luis AV Catao & Marco E. Terrones (2005) at intervals of 107 countries in 1960-2001 showed that there was a strong positive relationship between deficits and inflation in high inflation countries and groups of developing countries, but not in the group developed economy with low inflation. Ming Yu (1999), with quarterly data from 1973.I to 1997.II, analyzing the relative importance of factors contributing to inflation in each Asean country. Variables that were analyzed, namely the consumer price index, currency, interest rate income, private users, government expenditure, trade balance exchange rates, inflation and inflation Asean World. The results of this study showed that Singapore and Malaysia have a lower inflation rate and stable. This is due to external factors such as global inflation and inflationary other Asean countries and the exchange rate is more important to explain inflation, while the countries of Indonesia, Phillipina and Thailand experienced high inflation and unstable.

Study Turnovsky (2000), studying the relationship between fiscal policy and output in the USA, apparently the result of fiscal policy has no impact on the balance of long-term economic growth. The slow growth rate given the fact that fiscal policy is only effective in the short term, the transition. Variable increases in the number of fiscal variables were not too greatly affect the output. While Chang (2002) found different results in studies in South Korea, Taiwan and Thailand, which did not find a result that fiscal policy can boost economic growth.

Review of Peter Claeys (2005), using indicators of inflation, GDP, the rate of payment, receipts and real exchange rates and debt, fiscal policy and possible interactions monetary determined by the debt. Means that the fiscal and debt sustainability monetary determine a country. Similarly, studies Amir Kia (2006) in his study found that, in the long term, the rate of change in higher inflation lead to higher prices too, and apparently very efficient fiscal policy to dampen inflation in Iran.

3. METHODOLOGY

This section discusses the data and the model framework to analyze the relationship that exists between the fiscal deficit and inflation and in turn will affect the economy. The selected variables of the variables in the GDP fiscal deficit, domestic debt in GDP, external debt in GDP, national income, government expenditure, aggregate demand and prices abroad. While the national interest, foreign interest and exchange rates as the basis monetary and taking into account the CPI inflation. The selection of these variables are consistent with previous empirical studies conducted by Amir Kia (2006). The main focus of the classical theory and monetary theory is that the relationship between fiscal deficits and inflation rates are dynamic.

The next section discusses in greater depth, each test will be conducted.

Unit Root Test

Unit root test conducted to examine the stationarity of each variable, the variable A is said to stall if the mean and its variants are constant through time. It can be either stationary menjadfi in the level (level), or differential (difference). Each variable in the regression equation should be stationary at the same level, ie saama have all the variables stationary in levels or all the variables stationary in the form of discrimination, such discrimination first. These conditions must be met for the estimates was found valid. If not, there will be false regression estimates, ie estimates obtained very good results, but the relationship does not actually exist. Granger and Newbold (1974) states that a case can be identified when R2 is greater than the Durbin-Watson statistics in which to see the existence of autocorrelation problems. In this study, unit root test method of Dickey Fuller (DF) or remuneration (Augmented) Dickey Fuller (ADF) and Philip Perrons be applied.

Co-integration Test

Co-integration tests done to see long-term relationship between variables. Co-integration tests that are commonly used to model a variety of variables, the equation is the Johansen co-integration test (1988). Co-integration approach used in this study is to use the ARDL approach, "Bound test 'in order to determine the existence of the relationship between the variables studied. Co-integration approach is also seen as a test of economic theory and is PART important in the formulation and estimation of a dynamic model (Engle and Granger 1987). This method can also be said to be able to avoid the regression is not uniform (spurious regression) that can lead to regression of the resulting inefficiencies.

The advantages of using ARDL approach to boundary testing (ARDL Bounds test) as the study conducted by Pesaran and Shin (1999), Pesaran and Pesaran (1997), Pesaran and Smith (1998) and Pesaran et al. (2001) developed a technique known as co-integration Autoregressive Distributed Lag (ARDL) tests the boundaries (Bound test). ARDL approach to boundary testing (ARDL Bound test) has several advantages compared to Johansen's co-integration method & Jusellus (1990) and Narayan and Smyth (2005) reveals several advantages ARDL. First, the ARDL co-integration relationship is very easy to determine the sample size without considering the small stationary variable whether it is stationary at the level I (0) or stationary at the level of first differentiation I (1) (Ghatak and Siddiki 2001, Tang 2003; Pesaran 1997). This contrasts with other techniques such as co-integration multi variations Johansen and Juselius (1990) for which the estimated common co-integrating relations, when the ranks of the statu lag model has been determined. Second, estimates of the model is consistent and normally distributed either without heed the relevant variables are I (0) or I (1).

Based on previous studies, the model of inflation which is formed by using the ARDL 'Bound test' is based on the OLS estimation provided UECM to see the existence of a long-term relationships and to explain the estimated coefficient of elasticity for the long term and short term (Shrestha and Chowdhury 2005; Tang 2003). From our ARDL error correction model to a dynamic following a simple linear transformation (Bannerjee et al. 1998).

The equation related to the fiscal deficits and inflation

$$INFLASI^{t} = \Phi(DEF_{t}, GDP, Y, G, pL)$$

The equation related inflation and printing money (basic monetary);

$$INFLASI^{t} = \Phi(i, iL, E_{t})$$
⁽²⁾

If equations (1) and (2) are combined into the equation containing all variables monetary fiscal policy and policy, as given below:

$$INFLASIt = \Phi(DEF_{t}, DEBT, FDEBT, GDP, Y_{t}, E, G, PL, iL, i)$$
(3)

To estimate the inflationary model of a linear equation of state of Indonesia and Malaysia, using the following ARDL

(1)

$$\Delta InPx_{t} = \beta_{0} + \beta_{1}t + \beta_{2}LnP_{t-1} + \beta_{3}DefGDP_{t-1} + \beta_{4}DebtGDP_{t-1} + \beta_{5}FDebtGDP_{t-1} + \beta_{6}LnY_{t-1} + \beta_{7}LnE_{t-1} + \beta_{8}LnPl_{t-1} + \beta_{9}i_{t-1} + \beta_{9}i_{t-1} + \sum_{i=1}^{p}\beta_{12}\Delta LnP_{t-1} + \sum_{i=1}^{q}\beta_{13}\Delta DefGDP_{t-1} + \sum_{i=1}^{r}\beta_{14}\Delta DebtGDP_{t-1} + \sum_{i=1}^{s}\beta_{15}\Delta FDebtGDP_{t-1} + \sum_{i=1}^{s}\beta_{15}\Delta FDebtGDP_{t-1} + \sum_{i=1}^{q}\beta_{16}\Delta LnY_{t-1} + \sum_{i=1}^{r}\beta_{17}\Delta LnE_{t-1} + \sum_{i=1}^{s}\beta_{18}\Delta LnPl_{t-1} + \sum_{i=1}^{t}\beta_{19}\Delta i_{t-1} + \sum_{i=1}^{p}\beta_{20}\Delta LnG_{t-1} + \sum_{i=1}^{q}\beta_{10}\Delta i_{t-1} + \mu_{t}$$

$$(4)$$

Where Δ is the first difference, β_2 , β_3 , β_4 , β_5 , β_6 , β_7 ,..., β_{11} is the coefficient of long-term and β_{13} , β_{14} , β_{15} , β_{16} , ..., β_{20} , is the coefficient of short-term ARDL and μ_t is the interference error of the white (White Noise) and all variables in logarithmic form naturalists, except interbank interest rates and budget deficits. Equation (4), describes a standard model ARDL (*p*, *q*, *r*, *s*, *t*). Dummy variable with a value of zero prior to the time period and the value of a financial crisis after crisis. So that equation (4) by rewriting the form;

 $\Delta InPx_t = \beta_0 + \beta_1 t + \beta_2 LnP_{t-1} + \beta_3 DefGDP_{t-1} + \beta_4 DebtGDP_{t-1} + \beta_5 FDebtGDP_{t-1} + \beta_6 LnY_{t-1} + \beta_7 LnE_{t-1} + \beta_8 LnPF_{t-1} + \beta_{10} LnG_{t-1} + \beta_{10} LnG_{$

$$\beta_{II}il_{tI} + \Delta DUM_{t} + \sum_{i=1}^{p} \beta_{12}\Delta LnP_{t-1} + \sum_{i=1}^{q} \beta_{13}\Delta DefGDP_{t-1} + \sum_{i=1}^{r} \beta_{14}\Delta DebtGDP_{t-1} + \sum_{i=1}^{s} \beta_{15}\Delta FDebtGDP_{t-1} + \sum_{i=1}^{s} \beta_{16}\Delta LnP_{t-1} + \sum_{i=1}^{r} \beta_{16}\Delta LnP_{t-1} + \sum_{i=1}^{r} \beta_{16}\Delta LnP_{t-1} + \sum_{i=1}^{r} \beta_{19}\Delta i_{t-1} + \sum_{i=1}^{p} \beta_{20}\Delta LnG_{t-1} + \sum_{i=1}^{q} \beta_{21}\Delta i_{t-1} + \mu_{t}$$
(5)

Lag structure is determined using Akaike's Information Criterion (AIC), considering the limited number of observations, the maximum lag pillhan 4 of Vang ARDL model studied. To estimate the lag ARDL equation is in accordance with the following general approach to specific model of Hendry's (1995), namely through the elimination of the lag is not an important variable in the model. Furthermore, to obtain long-term elasticity coefficient of the lag of the independent variables (multiplied by negative sign) divided by Lag structure is determined using Akaike's information criterion (AIC), considering the limited number of observations, the maximum lag pillhan 4 of Vang ARDL model studied. To estimate the lag ARDL equation is in accordance with the following general approach to specific model of Hendry's (1995), namely through the elimination of the lag is not an important variable in the model. Furthermore, to obtain long-term elasticity coefficient of the lag of the specific model of Hendry's (1995), namely through the elimination of the lag is not an important variable in the model. Furthermore, to obtain long-term elasticity coefficient of the lag of the independent variables (multiplied by negative sign) divided by the coefficient of the lag of the independent variables (multiplied by negative sign) divided by the coefficient of the lag of the dependent variable (Hardsen. 1989). While the effects of short-term flexibility is obtained with the first difference of equation (5).

To estimate the inflationary model of the square equation (4) by using the following ARDL:

$$LnP_{t} = \beta_{0} + \beta_{1}t + \beta_{2}LnP_{t-1} + \beta_{3}LnP_{t-i}^{2} + \beta_{4}DefGDP_{t-1} + \beta_{5}DebtGDP_{t-1} + \beta_{6}FDebtGDP_{t-1} + \beta_{7}LnY_{t-1} + \beta_{8}LnE_{t-1} + \beta_{9}LnP_{t-1} + \beta_{10}i_{t-1} + \beta_{11}LnG_{t-1} + \beta_{12}il_{t-1} + \mu_{t}$$
(6)

Dummy variable with a value of zero prior to the time period and the value of a financial crisis after crisis. So that equation (6) can be modified into the following two equations, by rewriting in the form;

 $\Delta InPx_t = \beta_0 + \beta_1 t + \beta_2 LnP_{t-1} + \beta_3 LnP_{t-1}^2 + \beta_4 DefGDP_{t-1} + \beta_5 DebtGDP_{t-1} + \beta_6 FDebtGDP_{t-1} + \beta_7 LnY_{t-1} + \beta_8 LnE_{t-1} + \beta_9 LnPF_{t-1} + \beta_1 LnG_{t-1} + \beta_1$

$$\beta_{12}il_{tl} + \Delta DUM_{t} + \sum_{i=1}^{p} \beta_{13}\Delta LnP_{t-1} + \sum_{i=1}^{p} \beta_{14}\Delta LnP_{t-1}^{2} + \sum_{i=1}^{q} \beta_{15}\Delta DefGDP_{t-1} + \sum_{i=1}^{r} \beta_{16}\Delta DebtGDP_{t-1} + \sum_{i=1}^{r} \beta_{17}\Delta FDebtGDP_{t-1} + \sum_{i=1}^{q} \beta_{18}\Delta LnY_{t-1} + \sum_{i=1}^{r} \beta_{19}\Delta LnE_{t-1} + \sum_{i=1}^{s} \beta_{20}\Delta LnPl_{t-1} + \sum_{i=1}^{t} \beta_{21}\Delta i_{t-1} + \sum_{i=1}^{p} \beta_{22}\Delta LnG_{t-1} + \sum_{i=1}^{q} \beta_{23}\Delta il_{t-1} + \mu_{t}$$

$$(7)$$

The model is a multivariate model. The symbol Δ is the first distinction. The reference is a reference to the delayed error correction error of the equation cointegration vectors produced by the Johansen cointegration test. If the cointegration tests which have been described above proves that there is no cointegration, error correction term is retained will be removed from the equation in the VECM. In addition, since each equation has the same set of variables, a torch, then using OLS estimates of the VECM model will produce efficient estimators (Enders, 1995, 2004).

Vector Error Correction Model (VECM)

Vector error correction model is the behavior of long-term constraints in order to focus on the endogenous variable's co-integration relationships while providing an avenue for short-term dynamic adjustment. In other words, this model is to see how long the shocks that occur can be corrected so as to achieve balance through short-term adjustment. On the basis of the relationship between the causes of inflation (LNPT) the fiscal deficit (deft) by way of debt in the country (Debtt) and external debt (FDebtt) and macroeconomic variables, it is explained fully in the form of the following functions:

Tests for Granger-causes should be estimated in the version vector error correction model (VECM) as follows:

$$Inflas_i = F(Def_p, i, iL, E_i)$$
(8)

$$Def_{i} = F(Inflas_{i,t}, i, i, L, E_{t})$$

$$\tag{9}$$

On the basis of modeling the relationship of inflation (LNPT) and the budget deficit (deft) in equation (8), (9) and (10). Then test the cause should be estimated in a test version of the ARDL boundaries as follows:

$$\Delta \ln P_{t} = \beta_{0j} + \beta_{1j} + \sum_{i=1}^{n} W_{i} \Delta \ln Def_{t-1} + \sum_{i=0}^{n} \gamma_{i} \Delta \ln P_{t-1} + \delta_{t}$$
(10)

$$\Delta \ln Def_t = \beta_{0j} + \beta_{1j} + \sum_{i=0}^n \beta_i \Delta \ln P_{t-1} + \sum_{i=0}^n \gamma_i \Delta \ln Def_{t-1} + \delta_t$$
(11)

The symbol Δ is the first differential reference, the error correction term is retained, namely the error of the equation cointegration vector. To determine whether there is cointegration between the variables by using the solution of simultaneous equations (UECM). The existence of cointegration is indicated by the F-test statistics (Wald-coefficient test) that will give the F-statistic (Wald-coefficient test) over the Bazaar of the critical value F-statistic ARDL 'Bound test. For example, from equation (10), (11) to be equation (12) and (13), the rejection of H0.: $\emptyset 12$ $\emptyset 11 = = ... = \emptyset 1n = 0$ means that the inflation tax is a Granger cause of the short-term government budget deficit, while from equation (9) and (10) rejection of H0.: $\delta 21 = \delta 22 = ... = \delta 2n = 0$ will mean the budget deficit Granger

causes short-term inflation tax. Finally, to show the existence of long-term relationship between all variables in the equation estimated VECM.

Squares equation:

$$\Delta \ln P_{t} = \beta_{0j} + \beta_{1j} + \sum_{i=1}^{n} W_{i} \Delta \ln Def_{t-1} + \sum_{i=0}^{n} \gamma_{i} \Delta \ln P_{t-1} + \alpha_{i} \Delta Ln P_{t-1}^{2} + \delta_{t}$$
(12)

$$\Delta \ln Def_{t} = \beta_{0j} + \beta_{1j} + \sum_{i=0}^{n} \beta_{i} \Delta \ln P_{t-1} + \sum_{i=0}^{n} \gamma_{i} \Delta \ln Def_{t-1} + \alpha_{i} \Delta Ln P_{t-1}^{2} + \delta_{t}$$

$$\tag{13}$$

ARDL test the boundaries. Long term effects of variables on the dependent variable illumination can be determined by the error correction term retained. Coefficient ΔDef will measure the effects of long term financing of budget deficit on inflation, the coefficient is to measure the long-term effects of inflationary financing of budget deficits. This long-term effects exist if the test statistic t for the coefficients are significant at a certain level of significance.

4. FINDINGS STUDY

Unit Root Test and Co-integration Test in this study can be seen in Table 1.

Table 3a shows the relationship ARDL-ECM variable budget deficit on inflation, the balance of a long explanation for a country with a long-term relationships have been conducted and the results show a balance in the long-term coordination of Malaysia which is equal to 0.227 (22.7 percent) at the one percent level . While the short-term test showed no correlation deflationary impact of short-term or Granger Cause, so it appears that inflation for Malaysia is not affected by the fiscal deficit. While Indonesia did not exist for the country's long-term relationship for both variables are studied. For Malaysia the country is a significant correlation between the fiscal deficit on inflation in the long run, while Indonesia did not have a significant relationship for the long term.

The results of this study, consistent with the findings Luis AV Catao & Marco E. Terrones (2005) at intervals of 107 countries in 1960-2001 showed that there was a strong positive relationship between fiscal deficits and inflation in high inflation countries and groups of developing countries, but not in the group developed economy with low inflation.

However, unlike the findings Click (1998) gives OLS estimates of the factors that determine the seigniorage on majority 78 developing countries and found that fiscal variables have no significant role. Similarly, the findings Montiel (1989) and Dornbusch et al (1990) find that fiscal deficits are likely to accommodate any combination of links and weaknesses of the inflation rate changes, rather than a cause of inflation.

Malaysia is not a long term relationship exists between the short-term and fiscal policy variables and policy monetary against inflation. So that does not have a significant relationship between fiscal policy and monetary policy on inflation in the long run, so no significant correlation was found between the variables and fiscal policies on inflation monetary policy.

When testing the inflation of two, then found as follows shown in Jaual 3c.

Many researchers also believe that the relationship of money supply (or demand for money) and nominal interest rates using linear co-integration is an interconnected process. The assumption was made as the result of the review of Stock & Philip (1993), Ball (2001), Anderson & Rasche (2001), and Hu & Philip (2004). Where Hu & Philip (2004) believes that the nominal interest rate applicable to the non stationary. This assumption makes a lot of researchers make the alternative assumption that the logarithm of the nominal interest rate is a process of inter-related. Current assumptions, stating that the nominal interest rate is the exponential function of inter-related

processes, and means that the percentage change in a stationary distribution. It may be assumed to be true for a variety of macroeconomic variables such as GDP and CPI. Non-linear dynamics in short-term model, the estimation of money demand has been studied in the framework of an error correction model (ECM) and smooth transition regression (STR) (Terasvirta & Eliasson 2001, Chen & Wu 2005).

Table 3b and 3c shows the results of estimation of ARDL-ECM model of the relationship of external debt effect on inflation and related impact on inflation in the country due to the use of non linear equations (of two), as follows:

Malaysia every year to the speed of adjustment towards long-term balance between external debt variables on inflation in Table 3b of 6.206% at intervals 1 and 10% level of significance. And there is no short-term relationship between two variables that are tested. In line with Malaysia every year it also made adjustments to the speed of long-term equilibrium between the variables in the country due to inflation on the table at 20.02% at the interval 1 and the level of significance 10%. While short-term relationship exists between variables found in (2.89%) at intervals 1 and 5% significance level and short-term relationship exists between variables found in (3.57%) at intervals 1 and 5% significance level.

5. SUMMARY AND IMPLICATIONS

Based on empirical studies of linear equations, obtained results that Malaysia is cointegration between the budget deficit is only really effective with inflation. While the inflation equation of the two countries found that for the cointegrating relationship was found between the budget deficit, domestic debt and external debt effectively correct for inflation. The findings are most consistent with a study conducted by Montiel (1989) and Dornbusch et al (1990) find that fiscal deficits are likely to accommodate any combination of links and weaknesses of the inflation rate changes, rather than a cause of inflation. This finding is also consistent with the view that the basic Keynesian fiscal policy effects on output is greater than moneteri policy.

Based on the results of the model used, the level of output is known, in which fiscal variables, such as deficits, debt payable in the country and abroad have an impact on inflation. In fact, it affects the price of goods, while the deficit and national debt is a measure for determining the tax and inflation, so its contribution to GDP to influence prices. This shows that fiscal policy through the financing of the deficit is resilient to economic growth and stability. Knowledge of researchers, so far in so many highlights of a literature review there is no study to assess the effect of all the factors mentioned above, so is the impact of fiscal policy variables and the variables studied monetary corresponding overall financial model, to determine the effects of method of financing government budget deficits on inflation in Asia.

The results show the existence of the cause of two-way relationship in the short term or long-term inflation and the method of financing the deficit by printing money and debt in a country. This means that the percentage increase in national debt good debt, external debt and increasing the money supply have a significant impact on inflation that occurred disesebuah countries, and vice versa. Although no doubt that the various internal and external factors as the prevailing macroeconomic indicators in the countries can also affect the relationship.

Therefore, the government should immediately reduce the deficit continues, so the government should make an efficient selection of the fiscal policy and increased supply of money and debt management in the long term, so the impact of inflation that arise as to regulators. In addition the government increased the budget deficit per GDP will lead to tax increases and eventually will lead to higher prices (inflation). According to Ghosh et al. (1997), a consistent system of government that can take a role in reducing inflation, which is a way to maintain a certain rate of inflation in the country to conduct business related to the countries with low inflation, so the economy becomes more conducive to the implementation of policy and fiscal monetary. While the results of different studies by Fatas and Rose (2001) that the making of national policy to reduce inflation, while fiscal policy without appropriate adjustments, the permanent changes that occur affect the fiscal performance and eventually lead to inflation.

According to Granger (1986), it should be noted that a small error in the equilibrium can be ignored, while the great balance, an error correction equation is non-linear. All types of non linear as possible, which includes the promotion of two, three and four of the equilibrium error (the coefficient of statistical significance) and the balance of

manufacturer error. Until the results of this study showed that Indonesia and Malaysia have been there a long term relationship and short variable budget deficit, national debt, external debt on inflation. This existence implies that the fiscal deficit with the debt owed both locally and overseas debt can be used by the government as an alternative revenue to finance government budget deficits. While fiscal policy has important macroeconomic implications, we can not ignore the implications of the budget deficit to finance the deficit of the printing of new money. From the study found that Indonesia is only the government can regulate the impact of inflation on the choice of fiscal policy and increased supply of money and debt management in the long term.

In Malaysia, studies Ansari (2002) tried to see the effect of financial development, money and public spending to national income. This study uses time series econometric methods, including Johansen cointegration test, vector error correction model (VECM), variance decomposition tests and response functions. The study found significant financial development affects economic growth

LIST OF TABLES:

Coutries	Variables	Lag					First difference			
		$ au_{\mu}$	$ au_t$	$ au_{\mu}$	$ au_t$	$ au_{\mu}$	$ au_t$	$ au_{\mu}$	$ au_t$	
		$ au_{\mu}$	$ au_t$	$ au_{\mu}$	$ au_t$	$ au_{\mu}$	$ au_{_t}$	$ au_{\mu}$	$ au_t$	
Malaysia	LnP	-1.403(9)	-3.142(1)	-9.162	-1.678(3)	-1.147(6)	-26.728	-10.074	-12.051	
	LnP^2	-1.403(9)	-3.142(1)	-9.162	-1.678(3)	-1.147(6)	-26.728	-10.074	-12.051	
	DefGDP	-2.014(0)	-0.271(0)	-2.011(3)	0.069(3)	0	0	-16.668	-19.017	
	DebtGDP	-1.880(0)	-1.795(0)	-1.875(3)	-1.900(3)	0	0	-15.837	-16.278	
	FDebtGDP	-2.226(1)	-1.989(1)	-1.870(3)	469(3)	-3.93	-4.093	-9.654	-10.083	
	i	-6.662	-6.928	-17.331	-17.241	0	0	-36.024	-35.376	
	LnY	0	-1.215(0)	-12.699	-1.229(3)	0	0	-12.642	-16.791	
	LnE	-0.576(0)	-2.479(0)	-0.792(3)	-2.475(3)	0	0	-13.353	-14.091	
	iF	-2.690(1)	-3.080(1)	-2.199(3)	-2.469(3)	0	0	-14.376	-14.244	
	LnPF	-9.202	-47.952	-10.716	-0.817(3)	-2.683	-5.053	-1.918(3)	-2.810(3)	
	LnG	-1.050(0)	-2.565(4)	-0.960(3)	-2.225(3)	0	0	-12.63	-12.666	

Table 1: Results of Unit Root Test ADF and Philip Perrons

Table 2a: Co-integration Test Results of the Fiscal Deficit, National Debt, External Debt and Inflation

Coutry	Fiscal Deficit	Internal Debt	External Debt
Malaysia	Yes	No	No

Note: 'Yes' shows the testing of the F statistic is significant at the significance level 10% Upper Bound means that there is a long term relationship between variables in the ARDL model, 'No' means no long-term relationship between variables.

Table 3a: ARDL-ECM between Defisit Expenditure and Inflation

$\Delta ln P_{t-1}$ $\Delta ln P_{t-2}$		∆defgdp _t	$\Delta defgdp_{t-1}$	Ecm _{t-1}
0.422***	-0.254*	-0.094		-0.227***
(0.141)	(0.138)	(0.076)		(0.059)
	0.422*** (0.141)	0.422*** -0.254* (0.141) (0.138)	0.422*** -0.254* -0.094 (0.141) (0.138) (0.076)	Mill t-1 Mill t-2 Mdelgdpt Mdelgdpt 0.422*** -0.254* -0.094 (0.141) (0.138) (0.076)

Note : the sign ***, **, * is significant at the level 1%, 5% dan 10%

Table4a: Relationship between internal debt, external debt and deficit in Malaysia



Table 4b: Relationship between Inflation and economic growth in Malaysia



Table 2b: Cointegration Test Results of the Fiscal Deficit, Internal Debt, External Debt and Inflation

Country	Fiscal Deficit	Internal Debt	External debt
Malaysia	Yes	Yes	Yes

Note: 'Yes' indicates testing of the F statistic is significant at the significance level 10% Upper Bound means that there is a long term relationship between variables in the ARDL model.

Jadual 3b: ARDL-ECM Related External Debt Effects on Inflation Squares

]	Negara	$dLNP_{t_0}$	$dLNP_{t-1}$	$dLNP_{t-2}$	dFDeb.	dFDeb.	dFDeb.	Intercep	ECM_{t-1}
		0			GDP_t	GDP_{t-1}	GDP_{t-2}		
Malaysia		.40264 ^a	.13038 ^a	054746 ^a	.00249			.14013 ^a	062065 ^a
		(.14389)	(.0019497)	(.019259)	(.0018742)			(.046354)	(.022093)

Note : sign ***, **, * and a,b and c is significant at level 1%, 5% dan 10%

Jadual 3c : ARDL-ECM Related Internal Debt Effect on Inflation Squere

Negara	$dLNP_t$	$dLNP_{t-1}$	$dLNP_{t-2}$	dDebt.	dDebt.	dDebt.	Intercep	ECM_{t-1}
	ı			GDP_t	GDP_{t-1}	GDP_{t-2}		
Malaysia			.12819 ^a	.028966 ^b	035688 ^b		.42784 ^a	20017 ^a
			(.0016550)	(.014624)	(.013781)		(.055026)	(.026929)

Note : sign ***, **, * and a,b and c is significant at level 1%, 5% dan 10%.

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