Econ Change Restruct
DOI 10.1007/s10644-010-9099-z

# Economic growth and government spending in Malaysia: a re-examination of Wagner and Keynesian views

**V. G. R. Chandran Govindaraju · Ramesh Rao · Sajid Anwar**

Received: 30 March 2010 / Accepted: 23 November 2010


**Abstract** By making use of annual data from Malaysia for the period 1970 to 2006, this paper examines Wagner's law and the Keynesian hypothesis concerning the link between real government spending and real GDP. Unlike most existing studies, we utilize both a bivariate and a multivariate model. In addition, we consider two cases: one that focuses on the link between aggregate government spending and GDP and the other where the link between government spending on education and GDP is considered. The use of a multivariate model serves to reduce the problem of serious misspecification which appears to have been ignored by most existing studies. The presence of cointegration is investigated by means of Auto Regressive Distributed Lag (ARDL) approach. This approach also allows one to distinguish between the short and the long-run relationships. Within the context of a bivariate model, our empirical analysis reveals that aggregate government spending Granger causes the real GDP which supports Wagner's law. However, in a multivariate framework, we found support for the Keynesian hypothesis suggesting that omitted variables bias can significantly alter the validity of Wagner's law.

**Keywords** ARDL bounds approach · Spending on education · GDP growth · Malaysia · Government spending

V. G. R. Chandran Govindaraju (✉)
Department of Economics, Universiti Teknologi Mara, 85009 Johor, Malaysia
e-mail: vgrchan@gmail.com

R. Rao
Department of Development Studies, Faculty of Economics and Administration,
University of Malaya, 50603 Kuala Lumpur, Malaysia

S. Anwar
Faculty of Business, University of the Sunshine Coast, Maroochydore DC, QLD 4558, Australia
e-mail: SAnwar@usc.edu.au

Published online: 04 December 2010