



The Governance of Fiscal Transfers in Malaysia:

Is it rule-based, predictable, and transparent?

Sri Murniati Yusuf



Contents

Author	v
Acknowledgements	vi
Executive Summary	vii
1 Introduction	1
2 Fiscal Transfers in Malaysia: An Overview	3
3 The Governance of Malaysia’s Fiscal Transfer System	10
3.1 Is it rule-based?	10
3.2 Is it predictable?	28
3.3 Is it transparent?	33
4 Conclusion and Recommendations	39
References	41
Appendix 1	44
Appendix 2	47

Copyright © 2026 by IDEAS. All rights reserved.
First published in June 2026

Published by:
IDEAS Policy Research Berhad (IDEAS)
Suite 10-02, 10th Floor, Menara Atlan, 161B, Jalan Ampang, 50450 Kuala Lumpur, Malaysia

www.ideas.org.my
Reg No.: 1219187-V

The copyright of this research report belongs to the Institute for Democracy and Economic Affairs (IDEAS). All or any part of this research report may be reproduced provided acknowledgement of source is made or with IDEAS' permission. IDEAS assumes no responsibility, warranty and liability, expressed or implied by the reproduction of this publication done without IDEAS' permission.

Design and layout by Teck Hee

Author



Sri Murniati Yusuf

Sri Murniati Yusuf is a public policy researcher and governance specialist with over 15 years' experience in public finance, state-owned enterprise governance, transparency, and institutional reform in Malaysia and Indonesia. Her work focuses on improving accountability, transparency, and efficiency in government. She previously served as Chief Operating Officer and Senior Research Director at IDEAS Malaysia, where she led the organisation's research strategy, programme development, and fundraising. She also played a key role in advancing national policy discussions on political financing reform and budget transparency, including leading Malaysia's participation in the Open Budget Survey. Sri is a Senior Fellow in Governance, Transparency and Public Financial Management at IDEAS Malaysia and currently works as an independent policy consultant, supporting governance, public finance, and institutional reform initiatives for organisations including the World Bank Malaysia.

Acknowledgements

The paper benefited from the valuable insights and feedback shared by the academics, policymakers, and practitioners who attended the roundtable discussion organised by IDEAS on 1 October 2025, as well as those who submitted written comments. Given that the roundtable was conducted under the Chatham House Rule, participants' contributions are integrated into the report without attribution.

The author would like to thank Dr Stewart Nixon for his review of the paper and Nor Nazirah Mohamed for her feedback and assistance in ensuring the accuracy and integrity of the data. The author is also grateful to Alissa Marianne Rode, Priya Kaur Sachdev, Nischal Ranjinath Muniandy, Lekhaasini Gunasegaram, and Doris Liew for their support with data collection. Special thanks are extended to Nurul Aqilah Abdul Hadi for her assistance in finalising the paper.

The publication of this report was made possible through the support of the publications and communications team. We acknowledge Ryan Panicker and Norhayati Murni Misran for communications support, leading the publication process and design of this report, and social media promotion; Muhammad Zuhdi Farhan for overseeing event management and communications; and Amir Ridzuan Jamaludin and Faiz Zaidi for coordination and project management support.

This publication was funded by the European Union. Its contents are the sole responsibility of IDEAS and do not necessarily reflect the views of the European Union.



**Funded by
the European Union**

Executive Summary

Fiscal transfers (*Pemberian Kepada Negeri*) have become an increasingly important subject of debate in recent years. State governments are now more assertive in raising concerns regarding fiscal arrangements, and the federal government has become more responsive to these issues. These discussions are particularly significant within Malaysia's federal system and will shape the future development of intergovernmental fiscal relations.

This paper contributes to the ongoing debate by examining the legal foundations of fiscal transfers and assessing their predictability and transparency. It rests on the premise that the effectiveness of fiscal transfers depends not only on their design, but also on whether they are rule-based, predictable, and transparent. Concerns raised by state governments increasingly extend beyond the amount of allocations to include legal issues, such as the Sabah Special Grant, the transparency of allocation formulas, and the timeliness of disbursements. These concerns demonstrate that governance dimensions matter as much as the size of transfers themselves.

Using publicly available data, primarily budget documents of federal and state governments, this paper evaluates whether Malaysia's fiscal transfers are rule-based, predictable, and transparent. That is, whether transfers and allocation formulas have a clear and comprehensive legal basis, whether transfer amounts are consistent and reliable over time, and whether rules, formulas, and transfer amounts are published in an accessible manner and consistently reported in federal and state budget documents.

An analysis of the legal foundations of Malaysia's 23 active fiscal transfers shows that the country's fiscal transfer system is not fully rule-based. While ten of the 19 transfers listed in Lampiran E, Anggaran Perbelanjaan Persekutuan (Appendix E of the Estimates of Expenditure Document) have a constitutional basis, the legal justification for the remaining nine appears unclear or weak. While some transfers are governed by clear rules specifying allocation formulas and administrative procedures, others operate with minimal guidance or under poorly defined and non-public rules. This uneven regulatory landscape results in a transfer system that is only partially rules-based, with implications for predictability and perceptions of fairness among recipient governments.

Transfers are also highly unpredictable for state governments. Some year-to-year fluctuations can exceed 100 per cent, while discrepancies between estimated and actual transfers are substantial. In 2023, Sabah received nearly 50 per cent more than its projected transfers, whereas Terengganu received only 45 per cent of its estimated amount. Such volatility undermines subnational fiscal planning and weakens the credibility of state budgets.

Malaysia's transfer system is further constrained by limited transparency, with the legal justifications for many transfers not publicly available. Additionally, while the information on the actual amounts of most transfers is available in Lampiran E, discretionary transfers

to Kelantan and Terengganu are excluded. Federal budget documents also do not adequately disaggregate transfer estimates. At the state level, transfers are recorded in different accounts: some are reported under revenue accounts, while others are placed under trust accounts such as the Kumpulan Wang Amanah Pembangunan (KWAP) and the Kumpulan Wang Amanah Jalan Raya (MARRIS). While the separation of these transfers may be intended to improve accountability, the scattered records make it difficult to compare and reconcile federal and state numbers and to determine the full extent of federal transfers to state governments.

The National Finance Council (Majlis Kewangan Negara, NFC) has assumed an increasingly significant role in the governance of fiscal transfers. The NFC is a constitutionally established body comprising the prime minister, ministers appointed by the prime minister, and representatives from state governments to discuss fiscal matters. Since 2016, the Council has met annually and issued public statements outlining its decisions. The Council has also played a role in introducing new transfers, which may extend beyond its original constitutional mandate as a consultative body. In general, the NFC's growing role in transfers is positive. Yet, as it stands, it lacks the institutional support needed to be more effective as an intergovernmental forum.

Overall, Malaysia's fiscal transfer system would benefit from clearer legal foundations for all transfers, more consistent application of allocation formulas, and improved consolidation and disclosure of transfer data. Additionally, the NFC's increasing role could be further strengthened with institutionalised technical and working committees that would improve coordination, negotiation, and transparency between different levels of government.

1 Introduction

Fiscal transfers are a critical component of revenue for many subnational governments, including those in Malaysia, where limited revenue-generating capacity makes state governments dependent on federal allocations to fulfil their functions. These transfers are essential not only for sustaining state operations and reducing regional disparities but also for ensuring the consistent and equitable delivery of public services. The way transfers are allocated and managed has significant implications for state-level planning, service delivery, and public accountability.

Sound transfer design, incorporating governance principles such as transparency, predictability, and rule-based systems, is essential to achieving policy objectives and avoiding pitfalls such as limited effort in local revenue mobilisation. Scholarly studies demonstrate that intergovernmental transfer systems that are discretionary, opaque, or weakly rule-based tend to distort subnational incentives, undermine fiscal discipline, and increase the risk of fiscal and macroeconomic instability (Boadway & Shah, 2007; Bornhorst, Mercês, & Freire, 2018).

This paper aims to contribute to an increasingly vibrant discussion on fiscal transfer governance in Malaysia, amid a more fluid and dynamic political landscape. Concerns over the nature and administration of federal fiscal transfers to state governments have become more frequent and prominent since 2020 (Yeoh, 2020; Yeoh, 2024). Earlier debates were largely centered on oil royalties for oil-producing states, which are not classified as transfers in budget documents. Recent discourse, however, has expanded to include other types of transfers, such as capitation grants and special annual grants, particularly those involving Sabah and Sarawak. These concerns extend beyond the adequacy of allocations to encompass the transparency of allocation formulas, the timeliness of disbursements, and the clarity of administrative processes, emphasising the need for greater transparency and the institutionalisation of intergovernmental fiscal negotiations.

Nonetheless, there remains a need for deeper examination of issues relating to transparency and predictability in Malaysia's current transfer system. This study provides greater information and analysis of Malaysia's transfer framework governance and complements existing research, which has largely focused on the impact of transfers and their design on states' revenue capacity and levels of development. More recent policy commentary has also raised concerns regarding structural centralisation and opacity in certain federal grants (Lee, 2023). However, systematic assessment of the governance of Malaysia's transfer system with respect to rule-based allocation, transparency, and predictability remains limited.

Using publicly available budget data, particularly transfer data in the federal budget documents Appendix E of the Estimates of Expenditure Document (Lampiran E, Anggaran Perbelanjaan Persekutuan), from 1980 to 2024, and state government budget documents, this paper examines whether the transfers are rules-based, transparent and predictable.

It sheds light on why allocations remain highly contested and highlights areas where the system could be improved. However, assessing the effectiveness of the transfers' design is beyond the scope of this paper.¹

Despite the federal government having made some improvements to the system in the past few years, the analysis shows that Malaysia's fiscal transfer system is not fully rule-based, highly unpredictable for the state governments, and opaque. Some transfers do not seem to have a clear legal justification or a clear distribution formula, or the formula is not being used for disbursement. The arbitrary nature of some transfers limits state governments' ability to estimate revenue inflows, as their budget documents indicate they receive either substantially more or substantially less in transfers than expected. Lastly, the scattered recording of transfers in the budget makes transfer information difficult to access, undermining transparency. The findings provide stronger evidence for calls to improve the governance of Malaysia's fiscal transfer system, including strengthening the support system for the National Finance Council (NFC).

The paper begins with a brief overview of Malaysia's intergovernmental transfer system: its size, purpose, types of transfers, and changes over the years. The next section examines system governance, focusing on the extent to which these transfers are transparent, rule-based, and predictable. This includes key dimensions of transparency and predictability such as information accessibility, consistency, and the stability of transfer arrangements. Examples and figures from other countries, particularly federal systems with more centralised arrangements such as Australia, Canada, India, and Mexico, will be presented for comparative insight. The final section offers some concluding remarks and reform recommendations.

1 *IDEAS Policy Paper No. 91* (Nazirah, Lew, & Abdul Hadi, 2026) explores this through an equalisation lens.

2 Fiscal Transfers in Malaysia: An Overview

Fiscal transfers, officially termed *Pemberian kepada Kerajaan Negeri*, have been part of Malaysia's federal system since the 1950s. However, the number, types, and size of transfers relative to the overall budget have evolved.

As of 2024, *Lampiran E, Anggaran Perbelanjaan Persekutuan* (Appendix E of the Estimates of Expenditure Document) which documents the actual amount of transfer to each state, lists 15 types of transfers to state governments (19 if the annual grants for Kedah, Selangor, Sarawak, and Sabah are counted as a single type of transfer). Beyond these active transfers, six others that once existed are no longer in force.

Some transfers have existed since Tunku Abdul Rahman's time, notably those explicitly mentioned in the Constitution, such as the Capitation Grant (based on states' population) and the state road maintenance grant. Some transfers are modifications of other transfers, while others are new types created to address the states' financial needs. These modifications included changes to the scope of state road and local council maintenance grants, the consolidation or separation of funding related to local councils, the discontinuation of certain revenue assignments (assignment of export duty on tin, iron ore, and other minerals), and the introduction of innovative transfers such as the Ecological Fiscal Transfer (EFT).

Apart from the transfers listed in *Lampiran E*, there are other transfers to states that are not listed there but could be considered transfers. Oil-producing states, specifically Sabah and Sarawak, receive royalties, officially termed "Cash Payment"², from Petroliaam Nasional Berhad (PETRONAS). Although these payments are not recorded in *Lampiran E*, their nature as a revenue-sharing instrument suggests they can reasonably be considered part of the transfer system, as is the practice in some countries. Additionally, in the case of Kelantan and Terengganu, the payment of oil royalties to them has been contested. The two states receive a special payment (publicly known as "*Wang Ehsan*"), or discretionary grant from the federal government, which the governments of the two states have claimed as a replacement for the royalty payment.³

Another form of transfer that may occur is the transfer of development expenditure for state projects⁴. Given the limited availability of information, this is not examined in this paper.

If oil royalties and special payments to Kelantan and Terengganu are included, Malaysia has had 29 types of fiscal transfers throughout its history. The history and status of these transfers are detailed in Table 1.

2 Section 4 of the Petroleum Development Act 1974.

3 The federal government maintains that the two states are not entitled to royalty payment (The Budget Speech, 2000). However, an article (Yusoff, 2004) suggests that Terengganu received royalty payments between 1978 to 1999, but this payment stopped in 2000 and changed to *Wang Ehsan*.

4 The announcements from the National Finance Council indicate the existence of allocation of development expenditures to implement state development projects (Ministry of Finance, Malaysia, 2024). The Budget Documents (see for example *Penyata Kewangan 2024*, p. 105) reported special grants for Federal Territories and State Road Maintenance Grants for Federal Territories.

Table 1: Fiscal Transfers in Malaysia

	No.	Name of Grant	Start	End	Status (2024)
Listed in Lampiran E	1	Capitation Grant	1954 ⁵	-	Active
	2	State Road Maintenance Grant	1956*	-	Active
	3	Special Grant for Kedah	1996	-	Active
	4	Annual Grant for Sabah	1964*	-	Active
	5	Annual Grant for Sarawak	1964*	-	Active
	6	Special Grant for Selangor	1983	-	Active
	7	Revenue Growth Grant	1975 ⁶	-	Active
	8	Local Council Grant	1978 ⁷	-	Active
	9	Electricity Bill Grant for Local Council	2008	-	Active
	10	Concurrent List Grant	1996	-	Active
	11	State Library Grant	2012	-	Active
	12	State Museum Grant	2012	-	Active
	13	Current Account Deficit Grant	2007	-	Active
	14	Economic Development Grant (TAHAP)	1996	-	Active
	15	Compensation in lieu of Excise and Import duties on Petroleum Products for Sabah	2009	-	Active
	16	Compensation in lieu of Excise and Import duties on Petroleum Products for Sarawak	2009	-	Active
	17	Tourism Tax Grant	2019	-	Active
	18	Ecological Fiscal Transfer	2021	-	Active
	19	Service payment to State Governments	1996	-	Active
	20	Slope Maintenance Grant	2010	2012	Inactive
	21	Grant for Maintenance of Back Alleys	1980	1983	Inactive
	22	Assignment of Export Duty on Tin (<i>Serahan Cukai Timah</i>)	1957*	1995	Inactive
	23	Assignment of Export Duty on Iron Ore (<i>Serahan Cukai Bijih Besi</i>)	1957*	1995	Inactive
	24	Assignment of Export Duty on Other Minerals (<i>Serahan Cukai Lain-Lain Bijih Galian</i>)	1954 ²	1995	Inactive
	25	Advance payment to state governments	2007	2008	Inactive

5 The report of the Federation of Malaya Constitutional Commission (1957, p. 47, point no. 131): "A committee was appointed in 1954 to review the matter and as a result of its report a new system has been introduced : the grants and allocations now made to the States are: 1. Capitation grant; 2. Allocation of petrol and import duty; 3. Grants in respect of educational, medical and drainage and irrigation services, and in the case of some states; 4. Development grants; 5. Special transitional grant."

6 The Revenue Growth Grants Act 1977 (Act 181) was given royal assent on 2 March 1977 and published in the Gazette on 10 March 1977. However, Section 1 of the Act says that the Act "shall be deemed to have come into force on the 1 January 1975."

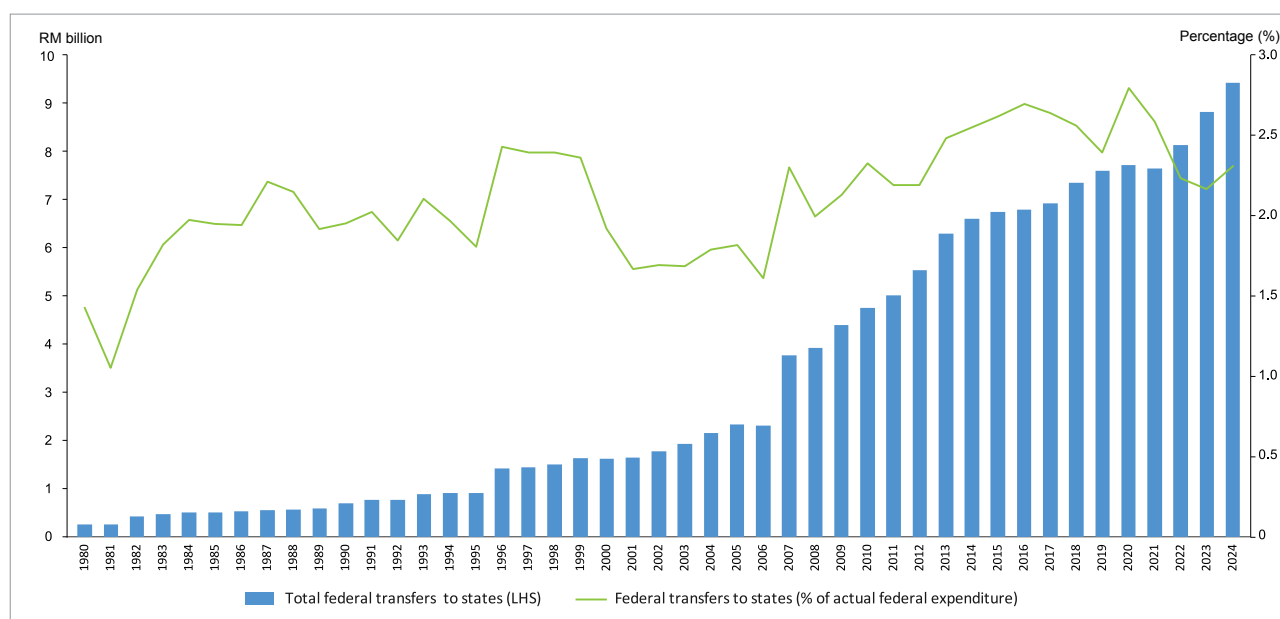
7 The State Grants (Maintenance of Local Authorities) Act 1981 was given royal assent on 12 February 1981 and published in the Gazette on 19 February 1981, but Section 1 of the Act says that the Act "shall be deemed to have come into force on the 1 January 1978".

	No.	Name of Grant	Start	End	Status (2024)
Not in Lampiran E	26	Oil and Gas Royalty to Sabah	1974 ⁸	-	Active
	27	Oil and Gas Royalty to Sarawak	1974 ⁹	-	Active
	28	Special Grants to Terengganu (<i>Wang Ehsan</i>)	2001 ¹⁰	-	Active
	29	Special Grants for Kelantan (<i>Wang Ehsan</i>)	2010 ¹¹	-	Active

Sources: Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan*; *Budget Speech 2021*; Author's compilation

The federal government budget documents suggest that transfers between 1980 and 2024 accounted for between 1.05% and 2.8% of federal government expenditure (see Figure 1). This percentage is substantially lower than in Australia and Canada, whose federal systems are more decentralised than Malaysia's (Watts, 2008).¹² The intergovernmental transfers in these two countries represent a substantial portion of their central government budgets: 19.2% for Canada (Canada Spends, 2025) and 25.5% for Australia (Commonwealth of Australia, 2024).

Figure 1: Federal Transfers to States as a Share of Total Federal Expenditure (1980-2024)



Source: Ministry of Finance, *Anggaran Perbelanjaan Persekutuan* from various years

8 Based on the year of the Petroleum Development Act being passed by Parliament.

9 *ibid.*

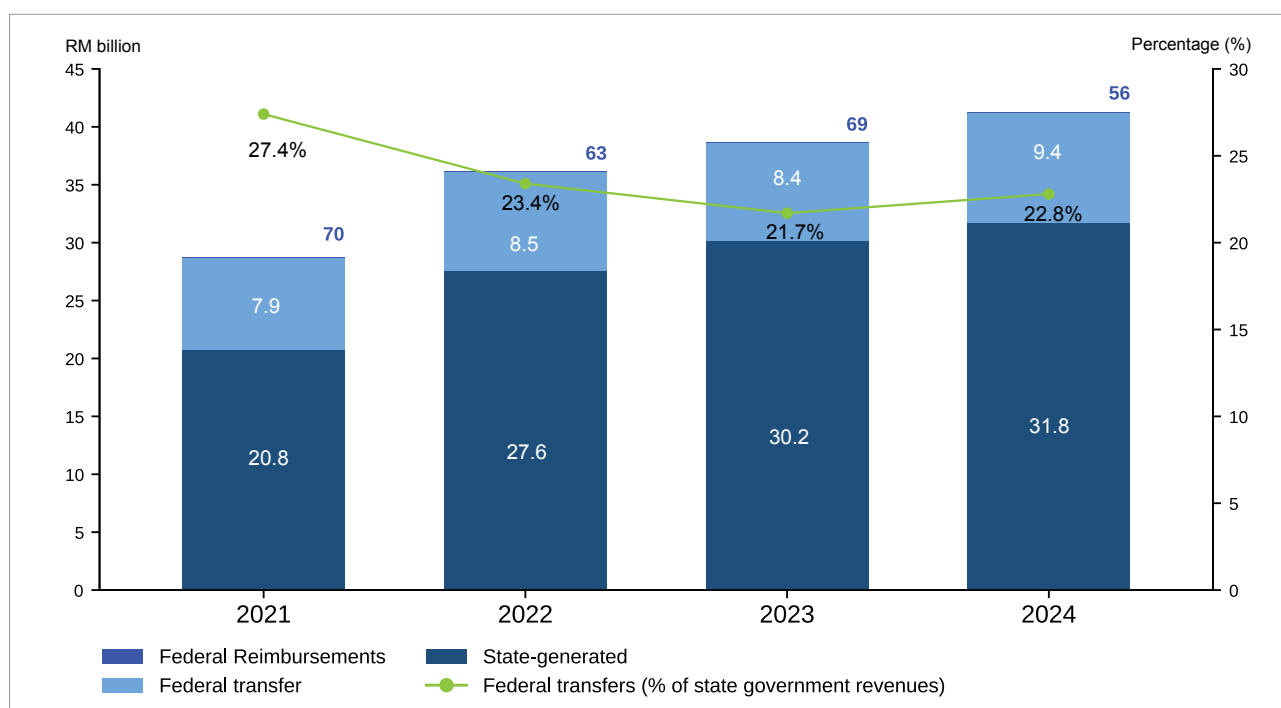
10 The year when royalty was changed to Wang Ehsan (Bernama, 27 October 2000)

11 mStar, 2009; Astro Awani, 2012; Bernama, 2023.

12 Watts (2008, p.177) mentions the following countries as highly centralised (in descending order): Venezuela, Pakistan, Malaysia, Nigeria, Argentina, Mexico, Russia. Malaysia is the most centralised in terms of financial arrangement.

However, transfers are an important source of revenue for subnational governments in Malaysia and elsewhere. A report by Organisation for Economic Co-operation and Development (OECD) suggests that in 116 countries, transfers (termed “grants and subsidies” in the report) accounted for about 51.5% of total sub-national revenue in 2020, or about 4.1% of GDP on average. In Malaysia, transfers constituted 27.4% of the state governments’ revenue in 2021, and only 21.7% in 2023 (see Figure 2), or about 0.4% of GDP. The remaining revenue comes from quit rent; forest produce-related revenue, such as royalties, premiums, and cess; entertainment sector-related revenue; rents; and permits.

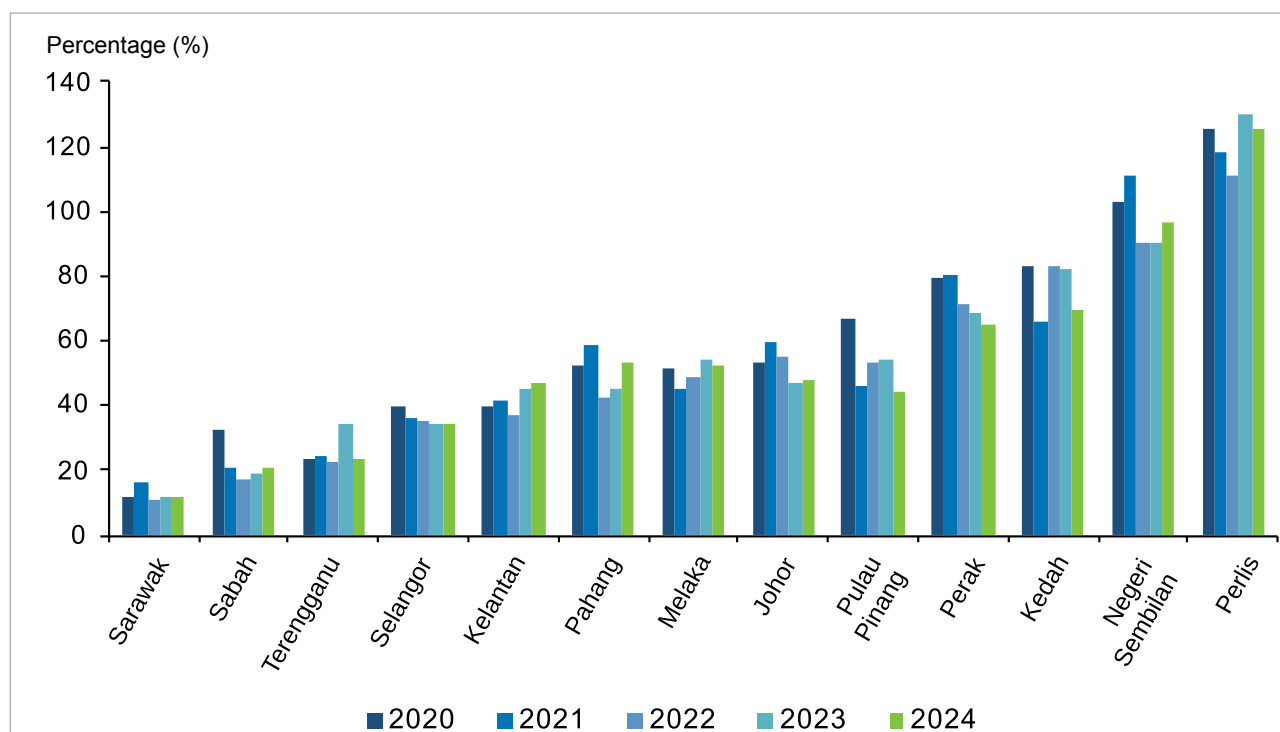
Figure 2: Composition of State Governments’ Revenue and Share from Federal Transfers (2021-2024) in RM Million



Source: Ministry of Finance, *Fiscal Outlook 2026*; Author’s calculations.

Malaysia’s relatively small share of transfers, at the aggregate level, may indicate that its subnational governments are less dependent on federal transfers. However, experts suggest that the smaller percentage could be attributed to the centralised nature of Malaysia’s federalism (Hutchinson, 2014; Ostwald, 2017), which confers limited responsibilities on state governments, thereby reducing the need for the federal government to transfer resources.

Comparing state revenue data (from Auditors General Reports for States) with transfer data from Lampiran E for individual states suggests that transfers account for a significantly larger share of revenue in some states. For all states, except Sabah, Selangor, Sarawak, and Terengganu, the transfer (as stated in Lampiran E) is more than 40% of their revenue (see Figure 3). Bear in mind that for Terengganu and Kelantan, the transfer figures in Lampiran E do not include special grants or the *Wang Ehsan* (discretionary grant).

Figure 3: Federal Transfers to States as % of State Revenue (2020-2024)

Sources: Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan*; Auditor General's Reports for the States.

Active grants are either conditional, which means they can be used only for specific purposes, or unconditional (see Table 2). Examples of conditional grants are the State Road Maintenance Grant, which can only be used to maintain state roads, and the State Library Grant and Museum Grant, which help states with the operating expenditures of their libraries and museums. Based on the amount (from the limited data in *Lampiran E*), the share of conditional transfers has been increasing over the years. The State Road Maintenance Grant, for example, has always been the largest transfer, but since 2008, it has accounted for more than half of the total transfers given to all states each year (see Figure 4). Meanwhile, the unconditional Capitation Grant was the second-largest in the early 1980s but now accounts for only 5% of the total transfer. While conditional transfers can help state governments to deliver services assigned to them by the Constitution, they leave little room for states to allocate the funds according to their own needs and priorities. It is important to note that unconditional grants are not always better than conditional grants. The design of transfers (whether unconditional or conditional) depends on the country's context and objectives (Lago, Lago-Penas, & Martinez-Vazquez, 2024). A separate study is needed to understand the challenges and opportunities of conditional and unconditional transfers in Malaysia.

Table 2: Categories of Active Transfers (based on conditionality)

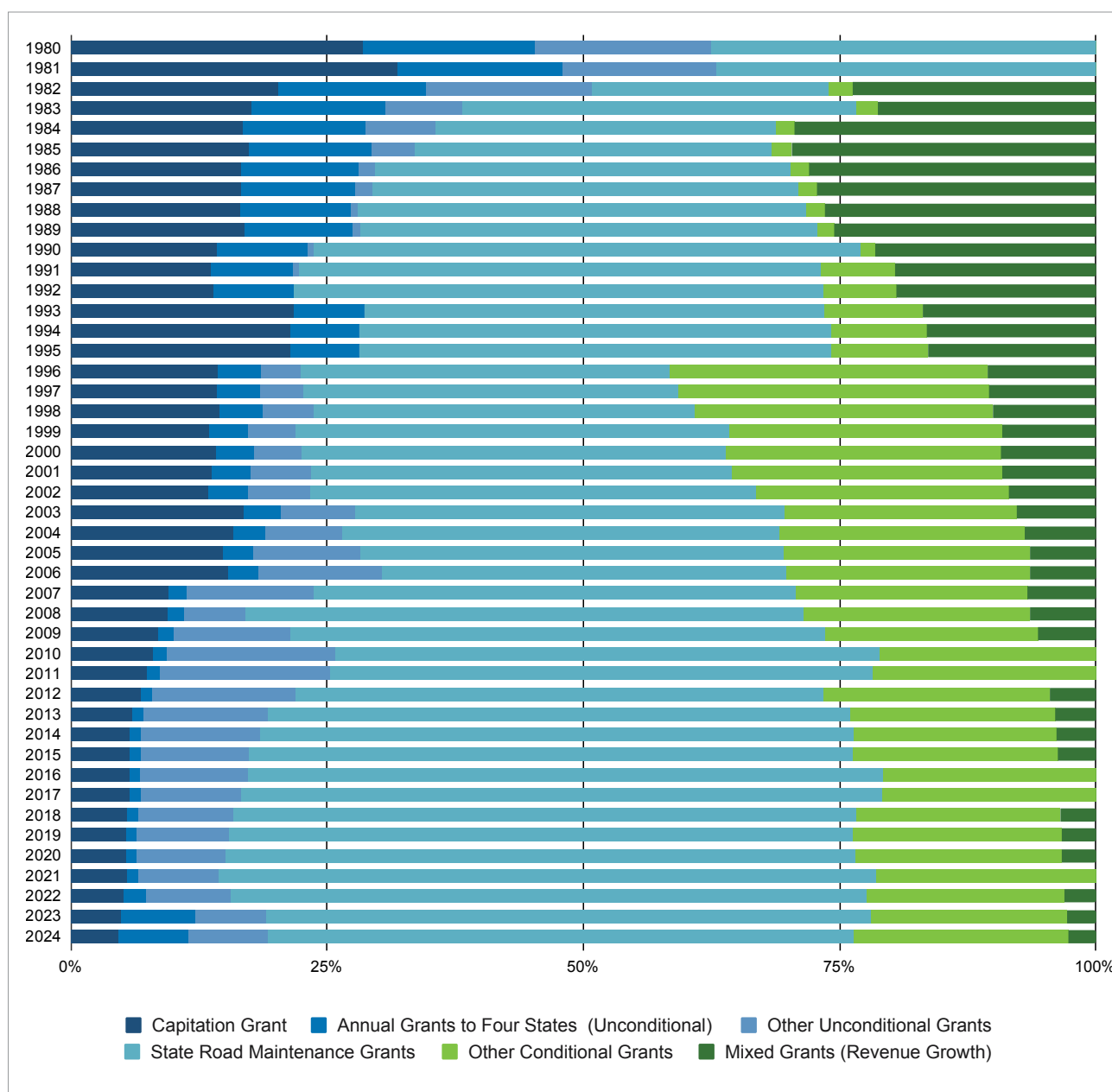
	Unconditional	Conditional	Mixed
Listed in Lampiran E	<ol style="list-style-type: none"> 1. Capitation Grant 2. Special Grant for Selangor 3. Annual Grant for Sarawak 4. Annual Grant for Sabah* 5. Annual Grant for Kedah 6. Import Duty and Petroleum Excise Compensation for Sabah 7. Import Duty and Petroleum Excise Compensation for Sarawak 8. Tourism Tax Return* 9. Current Account Deficit Grant 10. Service Payment to State Government 	<ol style="list-style-type: none"> 1. State Road Maintenance Grant 2. Local Council Grant 3. Local Council Electricity Bill Payment 4. Grant Under Concurrent List 5. State Library Grant 6. State Museum Grant 7. Economic Development Grant (TAHAP) 8. Ecological Fiscal Transfer 	<ol style="list-style-type: none"> 1. Revenue Growth Grant*
Not Listed in Lampiran E	<ol style="list-style-type: none"> 11. Special Grant for Terengganu 12. Special Grant for Kelantan 13. Oil and Gas Royalty to Sabah* 14. Oil and Gas Royalty to Sarawak* 		

Note: * Revenue sharing transfer in practice; others are grants

Sources: Ministry of Finance, Lampiran E of the Anggaran Perbelanjaan Persekutuan; Author's compilation.

These transfers are also mostly grant-based rather than revenue-sharing based on the apportionment of certain income. Of the 23 active transfers, only five can be considered revenue-sharing in nature: the tourism tax return, the annual grant for Sabah, the revenue growth grants, and the oil royalty to Sabah and Sarawak (see Table 2).

Figure 4: Composition of Transfers (1980-2024)



Sources: Ministry of Finance, *Lampiran E of the Anggaran Perbelanjaan Persekutuan*; Author's calculations. For the classification of grants, see Table 2.

To conclude, Malaysia's fiscal transfers have evolved over time in both scope and type. While the overall percentage of transfers from subnational revenue in Malaysia is lower than in other federal countries, data from individual states indicate that transfers are a substantial part of many state governments' revenue. As the largest share of the transfers is conditional and, state governments therefore rely on this revenue to deliver constitutionally mandated services, it is pertinent that the transfers be predictable and rule-based. The next section will discuss this in greater detail.

3 The Governance of Malaysia's Fiscal Transfer System

The study evaluates the governance of Malaysia's fiscal transfer system, focusing on whether the transfers are rule-based, predictable, and transparent.

To assess whether the system meets these three criteria, several questions were developed to provide a structured evaluation and identify areas for improvement. The development of these questions was informed by other studies (Boadway & Shah, 2007) and consideration of data availability. The authors recognise that additional parameters could be explored if more comprehensive information were accessible. The framing questions were:

- **To ascertain whether the system has been rules-based:** Is there a legal basis for the transfers? What are the rules outlined in the legal basis or other supporting documents (such as guidelines), and is there a provision for review? Does the transfer have a formula or any indication of amounts?
- **To ascertain whether the system has been predictable:** Is there a significant increase or decline in the amount and percentage of transfers at the federal and state levels? Is the actual transfer consistent with or different from the estimated transfer?
- **To ascertain whether the system is transparent:** Is the formula/rules/indication of amount published? Are the estimates and the actual amount published? Is the amount published by the federal government consistent with that published by state governments?

3.1 Is it rule-based?

The allocation of resources between federal and state governments is often a source of contestation. Without clear rules, the transfer process can appear biased, erode trust, and fuel political tensions. Transparent formulas and criteria, and the consistent use of those formulas in implementation, are therefore crucial for depoliticising transfers, strengthening institutional legitimacy, and limiting the scope for arbitrary or discretionary decisions. This section reviews the legal basis for the transfers, identifies the rules available under that basis and relevant guidelines, and provides insights into how these rules have been applied in practice.

Legal basis

Fiscal transfers to state governments in Malaysia are provided for under the Federal Constitution. The Constitution not only outlines the sources of transfer but also provides the institutional arrangements to govern them. The main provision for transfer is Article 109, which establishes the Capitation Grant, the State Road Grant, and the State Reserve Fund, which may be used to provide grants to state governments for development purposes and to supplement their revenues. Article 109 also allows Parliament to

legislate additional grants for specific purposes. Additionally, Article 110 and the Tenth Schedule, which specify the taxes and fees that may be retained by the states, assign state governments' entitlement to a share ("ten per cent or greater amount") of export duties on tin and other mineral resources and allow Parliament to assign "the whole or any portion" of revenue obtained by the Federal Government. Articles 112C and 112D provide Sabah and Sarawak with additional grants, revenue assignments, and a mechanism for periodic reviews of their fiscal arrangements.

Apart from articles stated above, there are two others that outline the source of the transfer: Articles 80(5) and 82 (Jabatan Akauntan Negara Malaysia, 2013). Article 82 provides for the financing of matters related to the Concurrent List, in which the Federal Government is required to bear the cost if such expenditures result from federal commitment or federal policy. Meanwhile, Article 80(5) provides for payments for the performance of any functions undertaken by authorities on behalf of others. For the governance of transfers, while giving Parliament the power to create new grants and revenue-sharing arrangements for the states, the Constitution, through Article 108, establishes the National Finance Council (NFC) as a platform for the government to consult state governments when making or revising grants and assigning new revenue arrangements.

Most of the active transfers in Lampiran E are constitutionally justified, but some do not appear to be explicitly or implicitly related to the above constitutional provisions. This section will discuss these legal bases and show how some of the justifications may be problematic, contributing to disagreement between the state and federal governments and to the perception that Malaysia's transfer system is less rule-based.

The articles in the Constitution mentioned in the first paragraphs provide justifications for the ten (10) transfers listed in Lampiran E and outline principles to govern them (see Table 3).

- Four transfers are explicitly established by the Constitution: the Capitation Grant, the State Road Maintenance Grant, and the Annual Grant for Sabah and Sarawak. The Constitution also sets out the disbursement formula and the procedures for revisions. Such explicit mention and discussion of rules mean that they are constitutionally mandated and, unless a legal exemption is granted, should be implemented in accordance with the constitutional provisions.
- Two transfers appear to meet the Constitution's requirement to establish the State Reserve Fund (*Kumpulan Wang Rizab Negeri*) under Article 109(6): the Economic Development Grant (TAHAP, *Pemberian Berdasarkan Tahap Pembangunan Ekonomi, Infrastruktur dan Kesejahteraan Hidup*) and the Current Account Deficit Grant (*Pemberian Defisit*). TAHAP was established in 1996 to provide grants to state governments to implement development projects in their areas, including road construction and maintenance, basic infrastructure, and initiatives that contribute to economic growth (Ministry of Finance, *Garis Panduan TAHAP*, 2023). The Current Account Deficit Grant was first disbursed in 2007 to ensure that states experiencing a deficit (having less revenue than their expenditure) maintain their services.

- Two other transfers appear to meet the Constitution's requirements under Articles 82 and 80(5): the Concurrent List Grants (*Pemberian di Bawah Senarai Bersama*) and the Service Payment Grants (*Bayaran Khidmat kepada Kerajaan Negeri*), respectively (Jabatan Akauntan Negara Malaysia, 2013). The Service Payment Grants are meant to compensate the state government for allocating resources, particularly their staff, to deliver the federal government's development projects, while the Concurrent List Grant is meant to help the states deliver services under the List, such as welfare and veterinary services.
- The remaining two transfers are created by legislation, as provided in Article 109: the Revenue Growth Grant (*Pemberian Pertambahan Hasil*) and the Local Council Grant (*Geran Tahunan kepada PBT*). The legislation governing the Revenue Growth Transfer (the Revenue Growth Act) was published in the Gazette in 1977, while the legislation governing local council grants, namely the State Grants (Maintenance of Local Authorities) Act 1981 [Act 130], was published in the Gazette in 1981. The Revenue Growth Grant was created to enable the federal government to share increased revenue collection with the state governments, while the Local Government Grant was to support the local councils in meeting their operating expenditures.

Table 3: Legal Basis of Active Transfers (as of 2023)

Legal Basis	Method of Justification	No	Name of Transfer (Detail of Legal Basis)	Additional document that explains rules*
<i>A. Transfers Listed in Lampiran E</i>				
Constitution	Explicit Mention	1	Capitation Grant (Article 109.1.b)	No
		2	State Road Maintenance Grant (Article 109.1.b)	Guidelines for disbursement (Treasury Circular 3.6)
		3	Annual Grant for Sabah (Article 112C.1.a)	No
		4	Annual Grant for Sarawak (Article 112C.1.a)	No
	Through State Reserve Fund (a constitutionally mandated Fund)	5	Economic Development Grant -TAHAP (Article 109.6) ¹³	Guidelines for disbursement (Treasury Circular 3.5)
		6	Current Account Deficit Grant (Article 109.6)	Guidelines for disbursement (Treasury Circular 3.7)
	Implicit	7	Concurrent List Grant (Article 82)	No
		8	Service Payments (Article 80.5) ¹⁴	Guidelines for disbursement (Treasury Circular 3.2)
	Legislation As provided by Article 109.3	9	Revenue Growth Grant (Act 181)	No
		10	Local Council Grant (Act 245)	No

¹³ Article 109(6) says the federal government may "make grants...to any State for the purpose of development or generally to supplement its revenues."

¹⁴ "... arrangements may be made between the Federation and a State for the performance of any functions by the authorities of the one on behalf of the authorities of the other and such arrangements may provide for the making of payments in respect of any costs incurred under the arrangements."

Legal Basis	Method of Justification	No	Name of Transfer (Detail of Legal Basis)	Additional document that explains rules*
Others	NFC's Decision	11	Tourism Tax (NFC's Meeting 2019)	No
		12	Ecological Fiscal Transfer (NFC's Meeting 2019)	Guidelines issued by NRES
		13	Grant for PBT's Streetlight and Traffic Lights Electricity Bill	No
	Non-implementation of constitutional provision	14	Compensation for the loss of Import and Excise Duties on Petroleum Products for Sabah	No
		15	Compensation for the loss of Import and Excise Duties on Petroleum Products for Sarawak	No
	Treaty	16	Special Annual Grant for Kedah (1869 Treaty between Great Britain and Siam)	No
		17	Special Annual Grant for Selangor (Treaty between Federal and Selangor State Government on 20 July 1995)	No
	No information	18	State Library Grant	No
		19	State Museum Grant	No
B. Transfers Not Listed in Lampiran E				
Others	Legislation (PDA 1974)	20	Oil Royalty for Sarawak	Yes
		21	Oil Royalty for Sabah	Yes
	Contested and unclear	22	Special Grant for Terengganu	No
		23	Special Grant for Kelantan	No

Source: Author's compilation

Note: * Those that are publicly available. Therefore, "No" refers to no publicly available document..

The legal justification for the remaining nine transfers listed in Lampiran E appears to be somewhat uncertain. Some of these transfers are based on an unknown and opaque legal basis; others are largely based on the NFC's decision.

- The Special Grant to Kedah (*Pemberian Khas Tahunan Kedah*). According to the Guidelines issued by the Accountant General Department of Malaysia (Jabatan Akauntan Negara Malaysia, 2013), the grant is based on a pre-independence treaty signed in 1869 for the creation of Pulau Pinang. It is unclear whether the document refers to the treaty mentioned on the Penang State Government website, which says that in 1800, Sultan Abdullah Mukarram Shah of Kedah agreed to cede control of Seberang Perai and the Island of Penang to the British East India Company in exchange for an annual payment of 10,000 *rials* (Portal Rasmi Kerajaan Pulau Pinang, n.d.). The data in Lampiran E, however, suggest that Kedah began receiving an annual payment of RM 10,000 in 1996, which was revised to RM 10 million in 2018. This raises questions about whether using the pre-independence treaty as the legal basis for this transfer is still relevant.
- Special Grant to Selangor (*Pemberian Khas Tahunan Selangor*). According to the Guidelines issued by the Accountant General Department of Malaysia (Jabatan Akauntan Negara Malaysia, 2013), this transfer is based on the Federal Territory (Planning) Act 1982 (Act 267) and a treaty signed between the Federal Government and Selangor on 1 February 1974 and 20 July 1995 for the creation of the federal territories of Kuala Lumpur and Putrajaya, respectively. The Act does not have a provision on the annual grant to Selangor, and the treaties are not publicly available. Lampiran E data show that the transfer has been ongoing since 1982, increasing from RM 18.3 million annually to RM 25.8 million in 2002, and continuing until 2024.
- Tourism Tax Grant (*Pemberian Pelancongan*) was disbursed in 2019, two years after the introduction of the Tourism Tax Act in 2017. The Act mandates the collection of a flat-rate tax on tourists staying at registered and unregistered accommodation premises across the country.¹⁵ The Act does not have a provision on revenue sharing with the State Government. However, in 2019, the federal government, in consultation with the NFC, decided to share 50% of the collected tourism tax revenue with the state (Siaran Media Kementerian Kewangan Malaysia, 2019). In March 2026, the federal government announced that it would disburse 100% of the tourism tax collected to the state governments (*The Edge Malaysia*, 2026).
- The Ecological Fiscal Transfer (*Insentif Kewangan bagi Konservasi Biodiversiti*) is an innovative fiscal tool designed to encourage states to play a more active role in protecting forest reserves. The EFT was announced in the 2021 Budget Speech in November 2020 as part of the TAHAP Grant and discussed at the NFC meeting in 2021 (Kenyataan Media Menteri Kewangan, 2021). No legislation was passed for this

15 The rate is RM 10 per night per room. See Tourism Tax (Rate of Tax) Order 2017 and Tourism Tax (Rate of Tax) Order 2025.

transfer, likely because it is part of the existing TAHAP, even though it serves different purposes.

- Compensation for the loss of Import and Excise Duties on Petroleum Products for Sarawak and Sabah (*Bayaran Pemansuhan Duti Import and Eksais atas Barangan Petroleum kepada Sarawak dan Sabah*). The Excise and Import Duty on petroleum products is one of the additional revenues assigned to Sabah and Sarawak by the Constitution (Part V of the Tenth Schedule). In 1999, Malaysia amended the Sales Act 1972 to remove import and excise duties for any goods, including petroleum products, to conform to the provisions of the ASEAN Free Trade Agreement.¹⁶ This transfer was created to compensate for the loss of this income source. However, it is unknown whether a bill has been tabled to remove this item from the Constitution. The Lampiran E data, however, suggests that the compensation payments began only in 2009, with RM 240 million for both states.
- Local Council Electricity Bill Payment (*Pemberian Bayaran Bill Lampu Jalan Lampu Isyarat PBT*). According to a document published by the Ministry of Housing and Local Government, this transfer was created based on the NFC's meeting on 21 September 2007. The grant was meant to help local councils settle the electricity bills for their road lights and traffic lights (Ministry of Housing and Local Government, 2023). The provisions of the State Grants (Maintenance of Local Authorities) Act 1981 are quite general and allow for the government to create new grants for the purpose without having to submit to Parliament or consult the NFC. However, the above document does not make reference to this legislation.
- State Library Grant (*Pemberian kepada Perpustakaan Negeri*) and State Museum Grants (*Pemberian kepada Muzium Negeri*). However, no information was found on the basis of these two grants.

The basis for four transfers not listed in Lampiran E is the Petroleum Development Act (PDA) 1974. This legislation enabled state governments in Malaysia to cede their rights to petroleum exploration and exploitation to PETRONAS. In turn, PETRONAS was obliged to provide cash payments (popularly known as oil and gas royalty) to the federal government and the relevant states (Section 4 of the PDA 1974). However, this legislation has been controversial. For Terengganu and Kelantan, although they receive annual grants from the federal government, the federal government still reluctantly refers to these payments as oil royalties. Hence, the basis for the current annual payment to these two states is not clear. For Sarawak and Sabah, while they receive royalty payments annually. Sarawak officials view that PETRONAS's rights over exploration and exploitation of petroleum resources, as granted under the PDA, should not override Sarawak's legislation that predates the PDA, such as the Oil Mining Ordinance 1958 (UKASNews, 2025).

16 Question from YB Chan Foong Hin in Parliament on 24 November 2021 (Syeksen Penyata Rasmi Parlimen Malaysia. 2021. *Penyata Rasmi Parlimen Dewan Rakyat Hansard Parlimen Keempat Belas, Penggal Keempat, Mesyuarat Kedua*, Rabu 24 November 2021, p. 33-34)

To conclude, the discussion of the legal basis for transfers in this section highlights several issues that could be addressed to improve the current system. First, the legal basis for at least 11 of 23 active transfers is unclear, and this opacity, in turn, undermines the system's rules-based nature. Some transfers appear to have an unknown basis, while others are justified only by the NFC's decision. These transfers would benefit at least from publicly available guidelines that outline the objective, the legal basis, and the formula for distribution.

Secondly, the increasing number of transfers resulting from the NFC's decisions shows the growing importance of this entity in Malaysia's transfer system. However, this raises the question of which entity has the authority to create new grants or revenue-sharing mechanisms. A more accurate line of question is whether the Constitution assigns this role to the NFC or to Parliament. Article 108 appears only to bestow the NFC with an advisory role to the federal government in the creation of new grants or revenue-sharing mechanisms, with the power to create such mechanisms resting with Parliament, which legalises them by law, as provided in Articles 109(3) and 110(4). The role of the NFC is discussed further in Box 1.

Lastly, the increasing use of NFC also means that Parliament is rarely utilised to create new transfers and revenue-sharing mechanisms. There is no hard rule on who should create a new transfer, as long as it is "objectively and transparently determined" (Choudhry & Perrin, 2007). The use of NFC to establish new transfers or revenue-sharing arrangements offers greater flexibility, allowing the government to create new transfers or modify the rules as needed. However, the transfers will be subject to extensive negotiation in the NFC risking less stable rules for the transfers. The establishment of new transfers or revenue-sharing arrangements by law would provide greater stability and signal the federal government's serious intent to create them. An innovative transfer mechanism, such as EFT, would benefit from this approach. However, should the government continue to use NFC as a platform for creating new transfers, the governance, transparency, and oversight of the NFC's decision-making processes must be significantly strengthened to balance flexibility with accountability. In Canada, where an entity like the NFC exists, it serves as a platform for consultation on transfers, even though the decision on transfers remains with Parliament (Shah, 2007).

Box 1: The National Finance Council (NFC)

The National Finance Council (NFC) is an entity established by the Constitution (Article 108) as a platform for the federal and state governments to discuss fiscal matters.

In relation to grants and revenue-sharing arrangements, the Constitution requires the federal government to consult the NFC on the following matters: (i) the making of grants by the Federation to the States" (Article 108 (4) (a)), (ii) "the assignment to the States of the whole or any portion of the proceeds of any federal tax or fee" (Article 108 (4) (b)); and any proposal to revise the capitation grant rate or the sharing of the export duty of tin, mineral ores, metal and mineral oils (Article 108 (4) (g)).

Other than grants and revenue sharing arrangements, Article 108 also requires the federal government to consult the NFC on the following matters: (i) the annual loan requirements of the federation and the states as well as exercise of the borrowing powers by these two levels of government, (ii) making of loans given to states, (iii) making of development plans which will result in the creation of development area according to Article 92, (iv) financial and accounting procedure, including procedure for the collection, custody and payment of the public moneys of the Federation and of the States, and the purchase, custody and disposal of public property other than land of the Federation and of the States (Federal List 7 (f)) and (v) audit and accounts of the Federation, the States, and other public authorities (Federal List 7 (g)).

The National Finance Council should also be consulted by the National Land Council when the latter formulates "a national policy for the promotion and control of the utilisation of land throughout the Federation for mining, agriculture, forestry or any other purpose, and for the administration of any laws relating thereto" (Article 91.5).

However, beyond fiscal matters, the federal government can also consult the Council "in respect of any other matter, whether or not it involves questions of finance", and for the state governments to consult the Council "in respect of any matter which affects the financial position of that State".

The National Finance Council consists of the Prime Minister, other federal ministers appointed by the Prime Minister to be members of the Council, and one representative of each State appointed by the Ruler or Yang di-Pertua Negeri. NFC can meet as often as the Prime Minister considers necessary and whenever the representative of three or more states demand a meeting, but at least once a year. The meeting of the Council can be presided over by the Prime Minister or any federal minister representing him.

From 2015 onwards, the NFC meetings appear to have taken place annually, and their records (in the form of Press Releases) are available on the MOF website from 2016 onwards. Unfortunately, records of earlier meetings are not available on the website. Since 2016, press statements issued after the meetings indicate that NFC meetings have largely focused on transfer-related matters, particularly the total amount of transfers, selected individual grants, and the rules governing them. The Economic Development Grant (TAHAP) and its funding source (*Kumpulan Wang Rizab Negeri*), and the State Road Maintenance Grant have been recurring items on the agenda. Discussions on road maintenance have centred on expanding the scope of eligible projects, improving implementation, and revising guidelines. For TAHAP, meeting outcomes have included decisions to increase allocations and, in 2022, the establishment of a committee to review the distribution formula. Other transfers have received only minimal attention: the return of the Tourism Tax was discussed in 2019, the Capitation Grant in 2025, and the amount of the Ecological Fiscal Transfer (EFT) in 2022, 2023, and 2025. Beyond these, other transfers do not appear to have been on the NFC's agenda. The press statements also suggest that the NFC does not appear to have held serious discussions on the governance of transfers as a whole or an overarching strategy for transfers.

Formula and Other Rules of Transfers

The second indicator of the rules-based system that this paper attempts to establish is the existence of rules governing transfers, including formula, the procedures for establishing and modifying transfers, including who is authorised to do so and how, as well as dispute resolution and adjudication.¹⁷ The purpose of this exercise is to establish the existence of these rules: the legal documents that establish the transfer and/or guidelines (see Table 3).

The basic rules that should be available for transfers to be rules-based are a formula or at least an indication of amount. Having a clear indication of transfer amounts, whether in the form of a formula, criteria, method of calculation, or a fixed sum, creates a transparent and predictable framework that reduces reliance on discretionary decision-making and limits arbitrariness. Stating the formula in official documents further enhances clarity and facilitates accountability by enabling stakeholders to verify that transfers are made in accordance with established criteria. Only 12 out of 23 active transfers have a publicly available formula. This means the formula is either stated in their legal basis, guidelines, or other publications on government websites. Some of the formulas are fixed sums, others are rates and their methods of calculation (see Table 4).

¹⁷ The definition of rules in this section has benefitted from the framework developed by Choudhry & Perrin (2007) to analyse legal framework in intergovernmental transfers in Belgium, Germany, India and South Africa.

Table 4: Publicly Available Formulas for Transfers

No	Name of Transfers	Formula
1	Capitation Grants	<p>(a) for the first 100,000 persons at the rate of RM102.00 per person; = 10,200,000 (b) for the next 500,000 persons at the rate of RM14.00 per person; = 7,000,000 (c) for the next 500,000 persons at the rate of RM13.50 per person; = 6,750,000 (d) for the remainder at the rate of RM13.00 per person</p> <p>Parliament can vary the rates, but the amount of grant received by any State in respect of any financial year "is not less than 90% of the amount received by that State in the preceding financial year".</p> <p>(Part I of the 10th Schedule of the Federal Constitution)</p>
2	State Road Maintenance Grants	<p>"The State road grant payable to each of the States of Malaya in respect of a financial year shall be calculated by multiplying— (a) the average cost to a State of maintaining a mile of State road at the minimum standard determined for State roads in those States by the Federal Government after consultation with the National Finance Council; by (b) so much of the mileage of State roads in that State as qualifies for grant."</p> <p>(Part II of the 10th Schedule of the Federal Constitution)</p>
3	Sabah Annual Grant	<p>"(1) In the case of Sabah, a grant of amount equal in each year to two-fifths of the amount by which the net revenue derived by the Federation from Sabah exceeds the net revenue which would have been so derived in the year 1963 if— (a) the Malaysia Act had been in operation in that year as in the year 1964; and (b) the net revenue for the year 1963 were calculated without regard to any alteration of any tax or fee made on or after Malaysia Day, ("net revenue" meaning for this purpose the revenue which accrues to the Federation, less the amounts received by the State in respect of assignments of that revenue").</p> <p>(Part IV of the 10th Schedule of the Federal Constitution)</p>
4	Sarawak Annual Grant	<p>"(1) In the case of Sarawak a grant of RM5,800,000 in each year. (2) In the case of Sarawak, a grant of which the amount in 1964 and each of the four following years shall be respectively RM3½m., RM7m., RM11½m., RM16m. and RM21m., and in later years shall be fixed on a review under Article 112d."</p> <p>(Part IV of the 10th Schedule of the Federal Constitution)</p>
5	Current Account Deficit Grant	<p>The State Government is eligible to apply for this grant when it records a shortfall in revenue compared to operating expenditure. The calculation must be based on the amounts stated in the Statement of Financial Performance audited by the Auditor General. The application is limited to the financial statements for the previous financial year (t-1) only.</p> <p>(based on Treasury Circular No. 3.7 on Procedure for Grants to States Facing Revenue Shortfalls Relative to Operating Expenditure (Deficit Grants)</p>

6	Service Payments	<p>The Federal Government will pay State Governments 10% of the construction cost of eligible federal development projects in Peninsular Malaysia, and 12% for Sabah and Sarawak, where state staff are involved in implementation. The payment applies only to physical construction and infrastructure projects funded under development expenditure, and excludes supply or service procurement.</p> <p>(Based on Treasury Circular No. 3.2 on Service Payment to State Governments for the Involvement of State Government Personnel in Implementing Federal Projects)</p>
7	Revenue Growth Grant	<p>If federal revenue increases from the previous year, the Minister may allocate up to RM250 million in grants to the States for the following year. The allocation will be divided into three parts:</p> <ol style="list-style-type: none"> 1. Up to RM50 million distributed equally and by population across all States. 2. Up to RM100 million for States with per capita GDP below the national average, based on the size of the gap. 3. RM100 million distributed according to each State's share of national GDP <p>(Based on the Revenue Growth Act 1977)</p>
8	Tourism Tax	<p>2019-2025: 50% of the collected tourism tax revenue with the state 2026: 100% of the collected tourism tax revenue with the state</p> <p>(Based on the Ministry of Finance's press statement after the NFC meeting)</p>
9	Ecological Fiscal Transfer	<p>The allocation is based on three criteria:</p> <ol style="list-style-type: none"> (i) Submission updated protected area data with supporting gazette documents: RM 200,000 (ii) Size of the protected area: 70% of the allocation (iii) Performance of EFT implementation in the previous year: 30% of the allocation <p>(Based on the guidelines issued by the Ministry of Natural Resources and Environmental Sustainability)</p>
10	Grant for PBT's Streetlight and Traffic Lights Electricity Bill	<p>Transfer based on claim of the previous year's electricity bill. 50% of the claim will be paid by Federal Government, the remaining 50% will be paid by state governments.</p>
11	Oil Royalty for Sarawak	<p>The rate of cash payments is 10% of the gross production; 5% is paid to the federal government and the remaining 5% is to the relevant state government (based on information on PETRONAS website and the Minister of Finance's answer in Parliament as reported by the Edge on 11 November 2025).</p>
12	Oil Royalty for Sabah	

Source: Author's compilation

Other useful rules that would help make transfers predictable include procedures for establishing and modifying transfers, including who is authorised to do so and how; the conditions or requirements for transfers; and dispute resolution and adjudication (Choudhry & Perrin, 2007). The legal justifications for transfers with a constitutional basis (the ten transfers, see Table 3) outline these other rules, though it is not necessary for each transfer to have these elements equally. Only the annual grant for Sabah and Sarawak has a specific provision for dispute resolution and adjudication. The legal justification for these transfers outlines the procedures and the actors responsible for modifying transfers. For example, for the Capitation Grant, Parliament is given the power to “vary the rates of the capitation grant” from time to time by law, while the total amount of money deposited into the State Reserve Fund (which would affect the TAHAP allocation) can be determined by the Federal Government in consultation with the NFC.

Additionally, the legal justification outlines the conditions and requirements for transfers. For example, the Revenue Growth Act outlines the conditions for the use of the transfer, which are to supplement states’ revenue and to carry out development projects. For transfers with specific guidelines, these documents outline the disbursement procedures and processes. For example, the State Road Maintenance Grant requires state governments to establish a trust fund (*Kumpulan Wang Amanah Jalan Raya*) to receive grants. The guidelines outline the governance of the trust fund, including the requirement to comply with relevant public financial management laws and regulations. Another good practice is for accompanying guidelines to document changes in the rules. For the State Road Maintenance Grants, the guidelines stated that the requirement to establish a trust fund took effect in 1994. The Concurrent List Grant, despite its constitutional justification, is the only transfer for which no specific guidelines have been issued to provide readers with information on which policy area in the Concurrent List is allocated the grants and the formula for that allocation.¹⁸

Such rules are also not available for transfers without a constitutional basis. Grants for the four states (Annual Grant for Kedah and Selangor, and the Special Grant for Kelantan and Terengganu) lack documents outlining formulas, let alone the disbursement process and procedures for modification. This is also the case for the State Library Grant and State Museum Grant. The absence of written rules creates uncertainty because the federal government may change the formula at any time, with or without consultation with the NFC. In the case of State Library and State Museum Grants, for example, the initial arrangement was for the federal government to transfer the same amount the state spent to operate the two entities. However, in recent years the formula has changed to 50%, but in reality, the state government has received less than 50% (IDEAS Roundtable Discussion, 1 October 2025).

18 The Concurrent List Grant is intended to assist the state government with the operating expenditures of the following departments: Jabatan Pengairan dan Saliran (JPS), Jabatan Perkhidmatan Veterinar, JKM (Jabatan Kebajikan Masyarakat), and PlanMalaysia. The allocation is set to cover 50% of the cost, but the state receives less due to the MKN rule that the increase should not exceed 10% annually (IDEAS Roundtable Discussion on 1st October).

The discussion of the rules above shows that some transfers are governed by clear rules specifying allocation formulas and administrative procedures. Unfortunately, a significant number of transfers operate with minimal rules or under poorly defined or not publicly accessible rules. This uneven regulatory landscape results in a transfer system that is only partially rules-based, with adverse implications for predictability and perceptions of fairness among recipient governments, as discussed in the next section.

The implementation

In light of concerns raised by various stakeholders regarding different transfers, it's important to present the implementation of transfers using publicly available data. Lampiran E data, collected from 1980 to 2024, provide information on individual transfer trends over the years. For transfers with clear rules and where the data required to calculate the transfer are available, calculations can be made to see whether the results are consistent with the official data. For the Capitation Grant, for example, such a calculation can be made using population data available from DOSM, while Tourism Tax returns can be compared with federal-level Tourism Tax collection. The discussion on the trends and results of the calculation, however, should not be construed as a judgement on whether the rules have been applied or followed; this paper recognises its limitations in undertaking such an exercise. Nevertheless, the calculation may provide insights into why concerns about certain transfers are raised and whether discrepancies exist between calculations herein and official numbers, helping to understand nuances in the implementation.

Lampiran E data show that while the amounts for most grants increased gradually, with some adjustments in certain years, some transfers fluctuated over the years, and others stagnated for years before rising dramatically in certain years (see Figure A1 in Appendix 1).

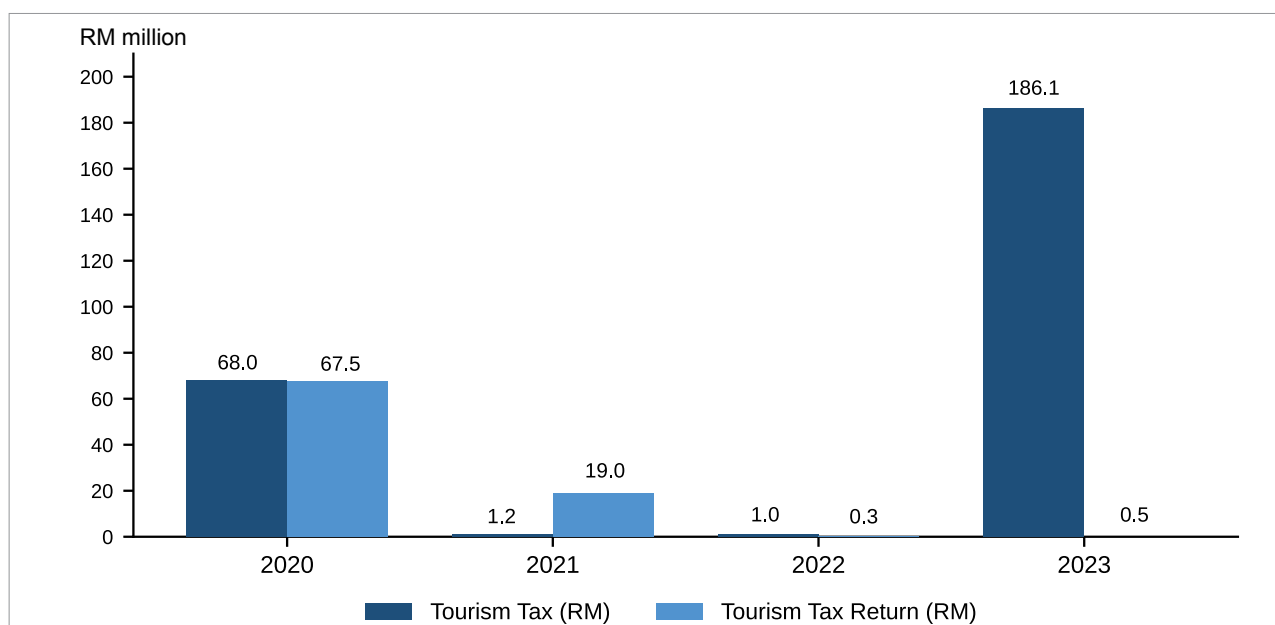
Among transfers that have stagnated over the years before a sudden recent increase are the Annual Grants to Sabah and Sarawak. For Sabah, the stagnation seems to be at odds with the rule that requires the Federal Government to give Sabah 40% of "the amount by which the net revenue derived by the Federation from Sabah exceeds the net revenue which would have been so derived in the year 1963". While the amount was increased to RM125.6 million in 2022 and further raised to RM300 million and RM306 million in 2023 and 2024, respectively, the fact that the grant remained flat for more than four decades strongly suggests it was not determined in accordance with the constitutional formula. Kota Kinabalu High Court has ruled that the federal government has failed to fulfil this constitutional obligation and ordered a review (Malay Mail, 2025). In May 2026, while awaiting the review, Sabah was promised an interim RM 1.5 billion annual grant (Astro Awani, 2026). In the case of Sarawak, while the provision for the Annual Grant to Sarawak differs from that of Sabah, in 2023 and 2024 it received the same amount as Sabah, following a flat rate of RM 16 million from 1980 to 2022 (see Figure A1 in Appendix 1). For 2025, both states were to receive RM 600 million (Bernama, 2024) regardless of their different constitutional arrangements. Unfortunately, this flat rate is also used

to compensate for the loss of another constitutionally established source of revenue: import and excise duties on petroleum products.

The Current Account Grant is among those that have fluctuated since their implementation. The nature of the grants, including their specific rules, may contribute to these trends. The Current Account Grant is intended to assist states that experience deficits (their revenue is less than their operating expenditure), and, given that states' financial situations may fluctuate, this grant is expected to fluctuate as well. Since its creation in 2007, only five states have benefited from this grant: Perlis, Kelantan, Kedah, Melaka and Pahang. Perlis has received this grant annually since 2008, and the amount has increased, which may indicate greater reliance on federal transfers to cover its operating expenses (although a comparison of Perlis's operating expenses would be the most accurate way to see this). Other states received it on and off over the years.

So far, only five states have received the grant, which may suggest that the remaining states have not faced fiscal deficits requiring such assistance. However, a check of the 2023 auditor's report for all states' budget documents shows that Perlis, Kedah, Kelantan and Pulau Pinang experienced current account deficits in 2023, with Pulau Pinang facing the largest shortfall (see Table A2 in Appendix 2). Only Perlis received the grant in 2023, while the others did not. There is no publicly available information on why the other three states did not receive the grant. However, as the disbursement is by application (see the Guidelines for this transfer), it is possible that the three other states did not submit an application.

Another grant that has a fluctuating trend is the Tourism Tax Return. The arrangement is for the federal government to share 50% of the tax it collected with the states. The comparison between federal tourism tax collections and the returns to the state is not straightforward (see Figure 5). In 2020, the tourism tax return was nearly equal to the amount collected at the federal level, and even much higher in 2021. In 2022 and 2023, the return is less than the promised 50%. It should be noted here that the lower collection of Tourism Tax in 2021 and 2022 was due to the lower number of tourists coming to the country as well as the suspension of collection between 1 July 2020 and 31 December 2022 as part of the government's tourism-sector relief measures during the Covid-19 period (Bernama, 2024).

Figure 5: Tourism Tax Collection by Federal Government and Tourism Tax Return (2020-2023)

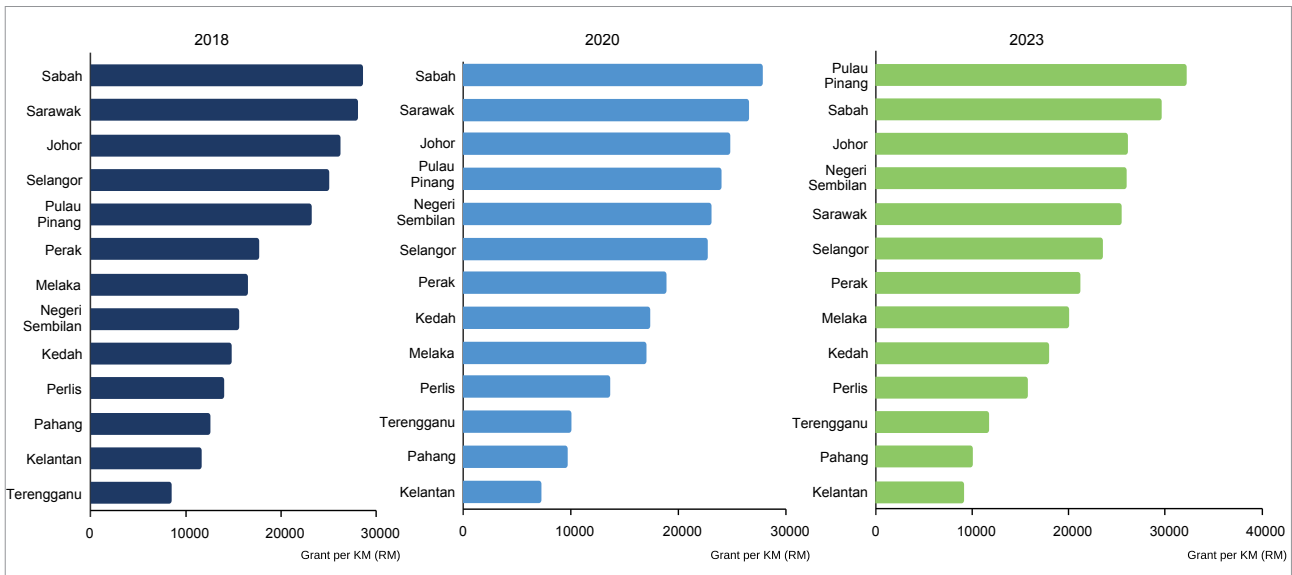
Sources: Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan*; *Fiscal Outlook 2020-2023*; author's calculations.

The Capitation Grants are among the transfers that have increased gradually over the years, with significant increases in 1993 and 2002 due to rate revisions. Concerns have been raised about this constitutionally established transfer due to a lack of review and the nature of the grant itself, which appears to benefit more populous states (New Straits Times, 2023). However, the grant's tier-rate design does provide a lower per capita amount to more populous states (see, for example, the calculation by the Pakatan Harapan Team in 2022). The revision of the rate, which was passed by the Dewan Rakyat in March 2026, along with the requirement to conduct a periodic review of the grant every 10 years, may address the concern about a lack of review, but is unlikely to address the second concern, as the revision was meant to prioritise poorer regions. IDEAS's calculations show that the per-person rate increase for less populous states is higher than for more populous states; the per-person rate in Perlis will increase from RM31 to RM43.50, while Selangor's increase is from RM12.10 to RM14.30 (Nixon and Nazirah, 2026).

Another transfer that has increased gradually is the State Road Maintenance Grant. As mentioned earlier, this constitutionally established grant has become the largest component of transfers to states. For the State Road Maintenance Grant, allocations are intended to follow a formula based on each state's road mileage and maintenance costs. To understand cost variation, the grant allocated to states was calculated using road mileage data published by the Jabatan Kerja Raya. While some variation across states is expected due to differences in terrain, traffic intensity and level of development, the pattern observed in the data is not entirely straightforward (see Figure 6). States with the highest maintenance costs over the 3 years have changed: Sabah in 2018 and 2020, and Penang in 2023. However, states such as Kelantan consistently remain at the lower

end of allocations. Given that changes in road infrastructure are typically gradual, these movements are unlikely to be driven solely by changes in road length or maintenance needs. This suggests that allocations may not be fully explained by the underlying formula alone, and that undocumented additional adjustments in practice cannot be ruled out. Recent developments also point to a possible broadening of the grant’s scope. The NFC has expanded the grant’s use to include components such as the procurement of modular steel-panel bridges and drainage works (Bernama, 2026). While this reflects a wider infrastructure objective, it also makes the allocation framework less transparent. Without clearer information on how these additional components are factored into disbursement, it becomes more difficult to assess whether allocations remain consistent and rules-based across states.

Figure 6: State Road Maintenance Grant Allocation per KM by State (2018, 2020 and 2023)



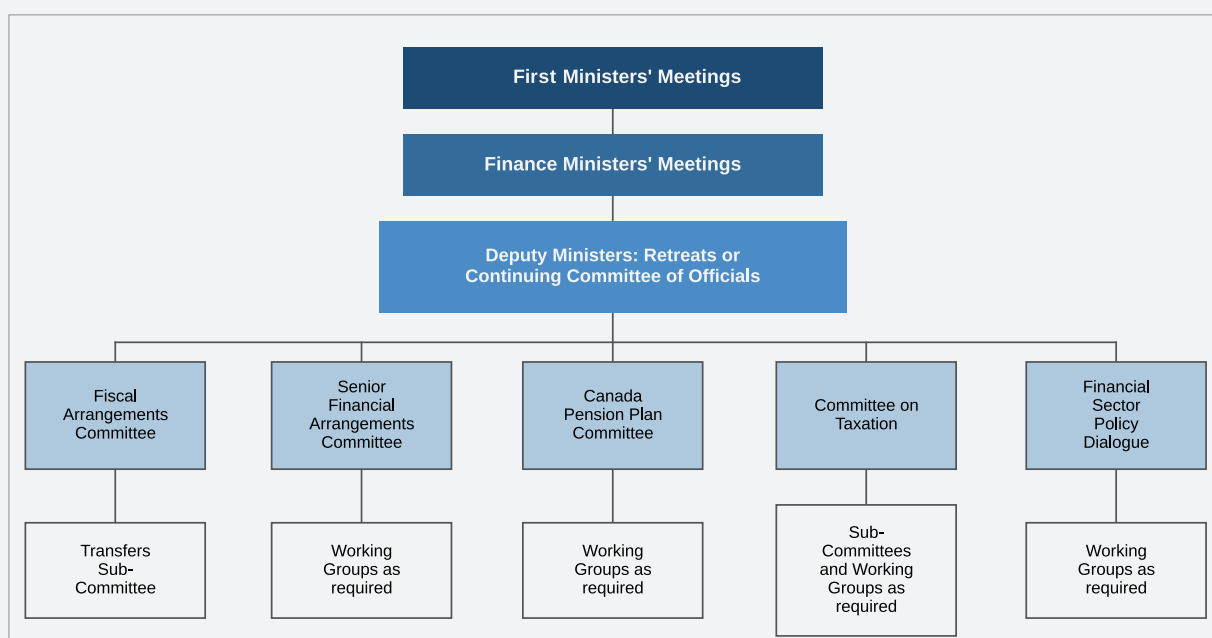
Sources: JKR’s Road Statistics Handbook 2024; Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan*; Author’s calculations.

The discussion of selected transfer implementation above shows that while rules are crucial, their implementation is far more nuanced. The positive aspect of having the rule is that it enables stakeholders to monitor implementation and raise concerns when it appears inconsistent with the rules. This kind of monitoring would be difficult for transfers with no rules or with unpublished rules.

The nuanced implementation discussed above would require greater coordination between federal and state governments, and the NFC’s role would become crucial. To strengthen the NFC’s capacity for coordination, it could be supported by a working-level committee, as in other intergovernmental fiscal forums in countries such as Canada (see Box 2). In fact, the Malaysia Agreement 1963 Implementation Action Council (MTPMA63), established in 2023, appears to have a more structured supporting

working committee than the NFC. At the highest level is the MA63 Implementation Action Council (MTPMA63), chaired by the Prime Minister, together with the Premier of Sarawak, Tan Sri Abang Johari, and the Chief Minister of Sabah, Dato' Sri Hajiji Noor. Supporting this council is the MA63 Technical Committee, chaired by Deputy Prime Minister Fadillah Yusof. At the administrative level, the MA63 Working Committee, made up of government officials, was established to support coordination and implementation efforts. While meetings between state finance offices do take place prior to the NFC (IDEAS Roundtable, 1 October 2025), there is minimal recognition of these practices, with institutionalisation remaining limited. A more institutionalised working committee would improve coordination between state and federal governments.

Box 2: The Structure of Canada's Intergovernmental Forum



Sources: Finance Canada, *Transition Binder* (December 2024); *Intergovernmental Relations in the Canadian Context*.

Canada has established a structured system of federal–provincial–territorial consultations on many matters including on finance. Fiscal transfers and tax coordination is part of the finance committee whose secretariat is at the Ministry of Finance.

- At the apex of the structure is the First Ministers' Meetings (FMMs). The meetings are attended by senior political leaders who; are the Prime Minister and provincial and territorial Premiers. The agenda is not only on finance matters but to discuss matters of national significance. Discussion that can't be resolved at the Finance Ministers Meeting will be brought to this meeting (Shah, 2007)

- Finance Ministers' Meetings are typically held once or twice a year to discuss major issues such as transfer, and broader economic and fiscal developments.
- The Continuing Committee of Officials, comprising federal, provincial, and territorial Deputy Ministers of Finance, which meets as required to consult on fiscal, taxation, and transfer issues and may establish technical sub-committees and working groups. This meeting sometimes is also held as Retreat.
- At the Assistant Deputy Minister level, the Fiscal Arrangements Committee and its transfer sub-committee meet regularly, generally once or twice annually, to discuss transfer arrangements and federal–provincial fiscal relations. As seen in the diagram, there are other committees that are formed to discuss other finance matters including Tax and Pension Plan.

If we draw a comparison to Malaysia, the membership of the NFC is more akin to FMMs in the Canadian system, not the focus of conversation is more narrow; the NFC focuses mostly on finance matters.

3.2 Is it predictable?

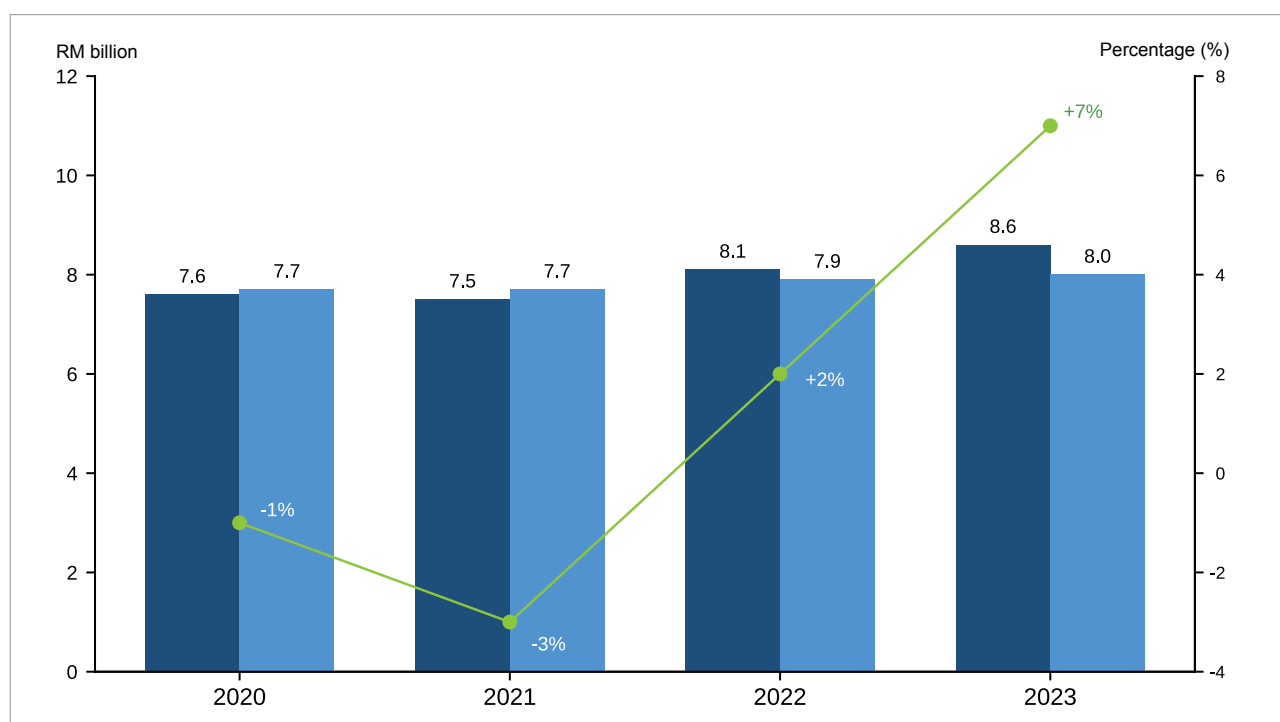
This section aims to provide insights on whether the transfer practices from the 1980s onward have been predictable for both federal and state governments. This means: (i) whether there have been significant increases or declines in the amount and percentage of transfers on the part of federal and state governments; and (ii) whether the actual transfers do not differ much from the estimated transfers. Predictability matters because it allows both levels of government to plan effectively, allocate resources more efficiently, and sustain essential commitments without disruption. Unpredictability, on the other hand, can force abrupt fiscal adjustments, delay planned projects, or compromise ongoing service delivery. Conversely, while unexpected windfalls, such as revenue excess transfers, may ease fiscal pressures in the short term, they can also introduce volatility if states come to rely on them for recurrent expenditure.

One might say that predictability does not matter much for the federal government because it decides the transfers. However, this perception may not be entirely accurate because the federal government must consult the NFC on transfer matters. While the federal government may have the upper hand in the negotiation process in the NFC, the final decision may not be the initial proposal it put forward at the NFC meeting. Changes to the scope of the State Maintenance Grants, for example, which would affect the size of the grant, point to the not-so-dominant position of the federal government in deciding on the transfer. As the role of the NFC becomes more prominent in transfer decisions and the political situation points to a stronger bargaining position for state governments,

predictability matters to the federal government as much as to state governments.

At the federal level, Lampiran E data from 1980-2024 show fluctuations in yearly amounts, with notable variations in 1982, 1996, and 2007 (see Figure 7). For example, in 2007, the total amount of transfer allocated by the federal government was 60% higher than in 2006. However, these differences account for only 1.1% to 2.8% of total federal government expenditure (see Figure 1 above). It remains to be seen whether this range will persist, as the federal government has committed to increasing Sabah's interim annual grant from RM 600 million to RM 1.5 billion this year (Astro Awani, 2026). Additionally, the difference between the transfer estimates and the actual values for at least 2020-2023 is not significant (see Figure 7). However, this figure may or may not include the special grants given to Terengganu and Kelantan.

Figure 7: Estimates and Actual Federal Transfers to States (2020-2023)



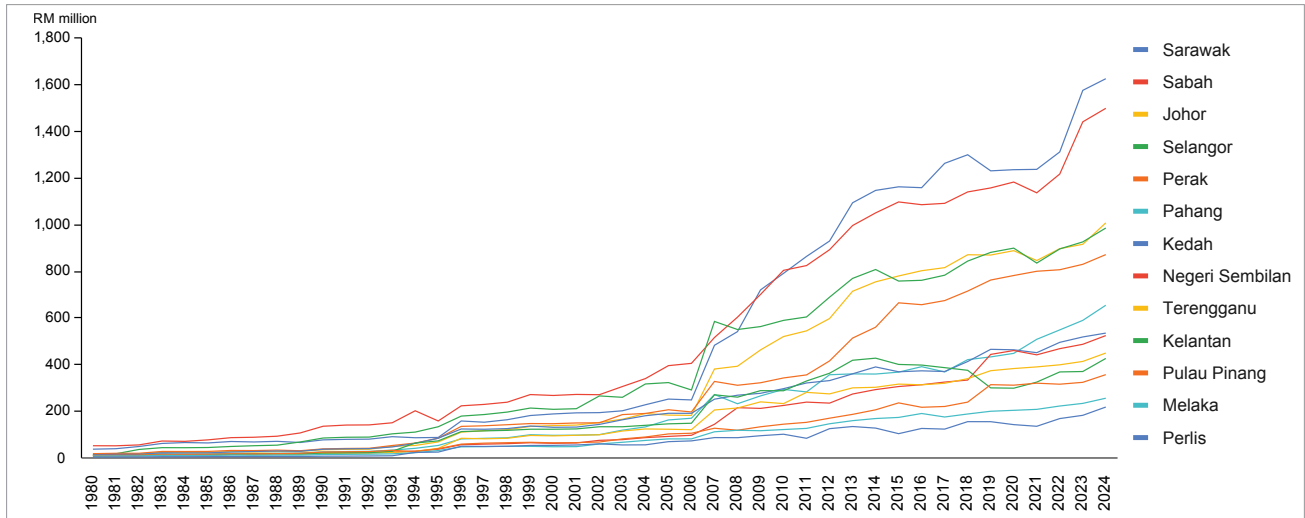
Sources: Ministry of Finance, *Fiscal Outlook and Federal Government Revenue Estimates 2025*; Authors' calculations.

Note: $\text{Difference (\%)} = (\text{Actual} - \text{Estimated}) / \text{Estimated} \times 100$

For the states, while the overall trend shows a steady increase (see Figure 8), the year-to-year amounts fluctuated more significantly (see Figure 9). Some states received more than 50% or even more than 100% of the previous year's amount (for example, Selangor in 1982 and 2007, Kelantan and Perlis in 1994, and Johor in 2007), while some received less than the previous year (for example, Penang in 1994, Sabah in 1996, Kelantan in 2019). Unfortunately, it is not possible to measure this amount against state expenditure using the available data, including whether they spent more or less, given the significant increase or decrease in the transfer they received from the federal government. However,

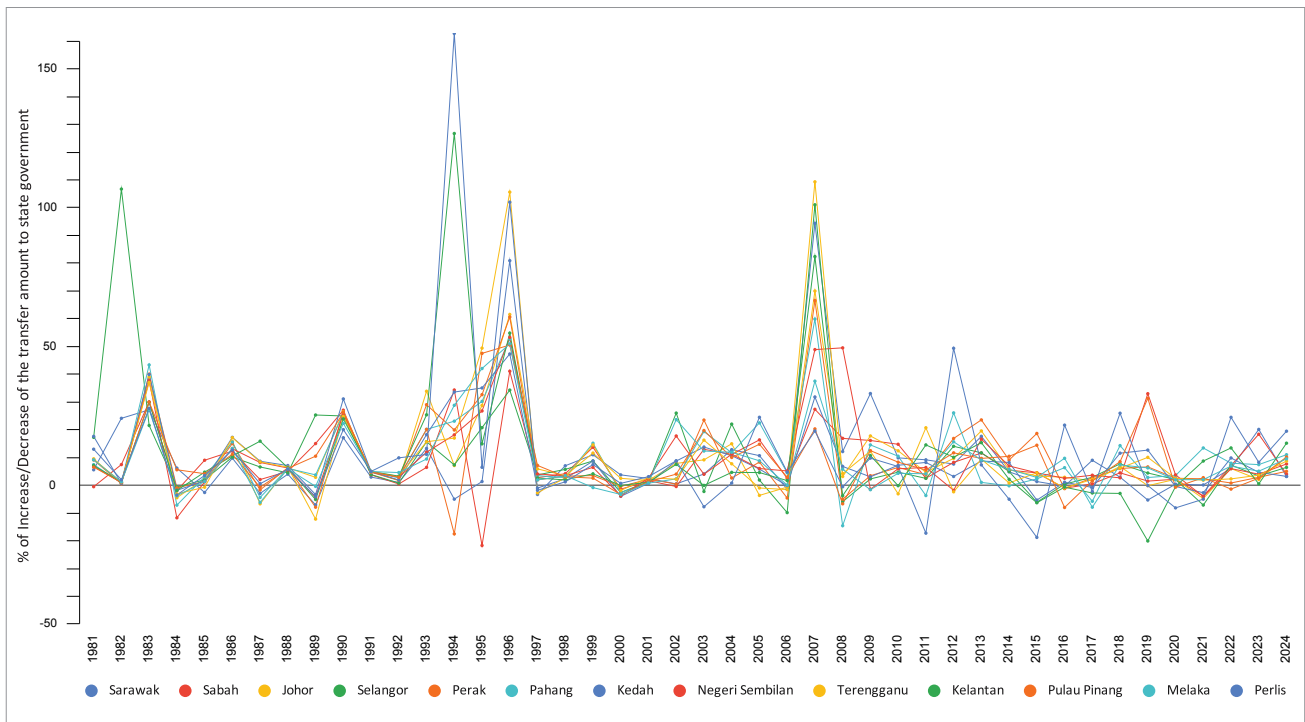
given some state governments' reliance on transfers, the significant year-to-year differences in amounts would have a significant impact on their budgets. The significant increases in these years were aided by the creation of new transfers, such as the Revenue Growth Grant in 2007, the Annual Grant to Selangor in 1982, and Service Payment Grants, Concurrent List Grants and TAHAP Grants in 1996.

Figure 8: Amount of Transfer for States in RM Millions (1980-2024)



Source: Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan*; Author's calculations.

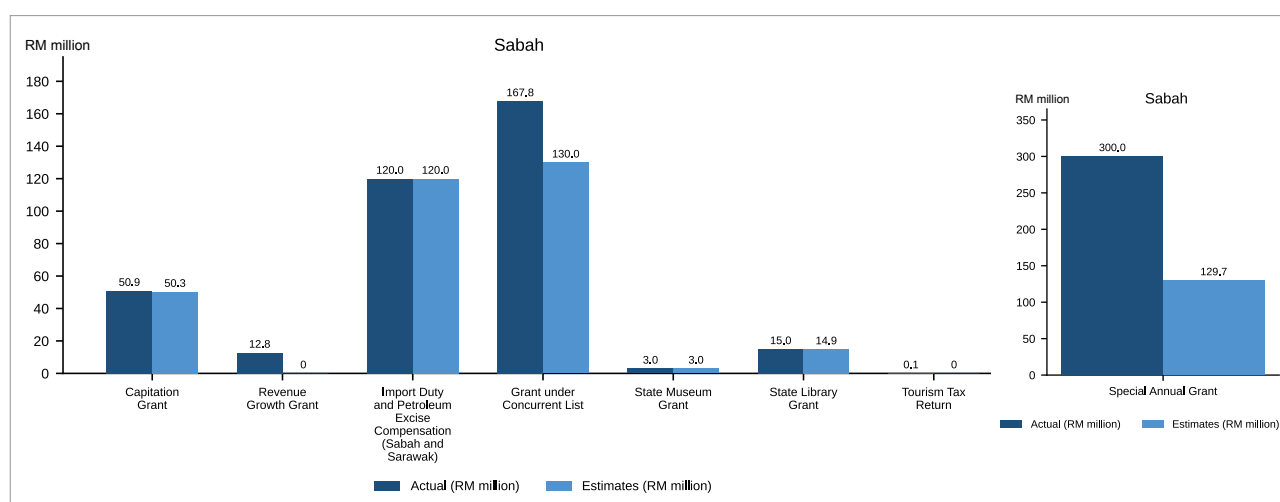
Figure 9: Year-to-year Variation in Transfers by State



Source: Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan*; Author's calculations.

Additionally, states, at least in the case of Terengganu, Sabah and Selangor (where data is available), do not always receive transfers in line with their estimates. For nearly all transfer types, discrepancies exist between estimates and actual receipts (see Figure 10, 11, and 12). In some cases, the difference is not merely 10–20 per cent, but more than double the estimated amount. For example, Selangor estimated it would receive RM 5 million in tourism tax return, but only received around RM 53,000. However, some of these differences may reflect placeholder or administrative recording practices rather than genuine forecasting deviations. For example, Sabah estimated it would receive only RM10 for both the revenue growth grant and the tourism tax return, but instead received RM12,838,862 and RM63,746.50 respectively.

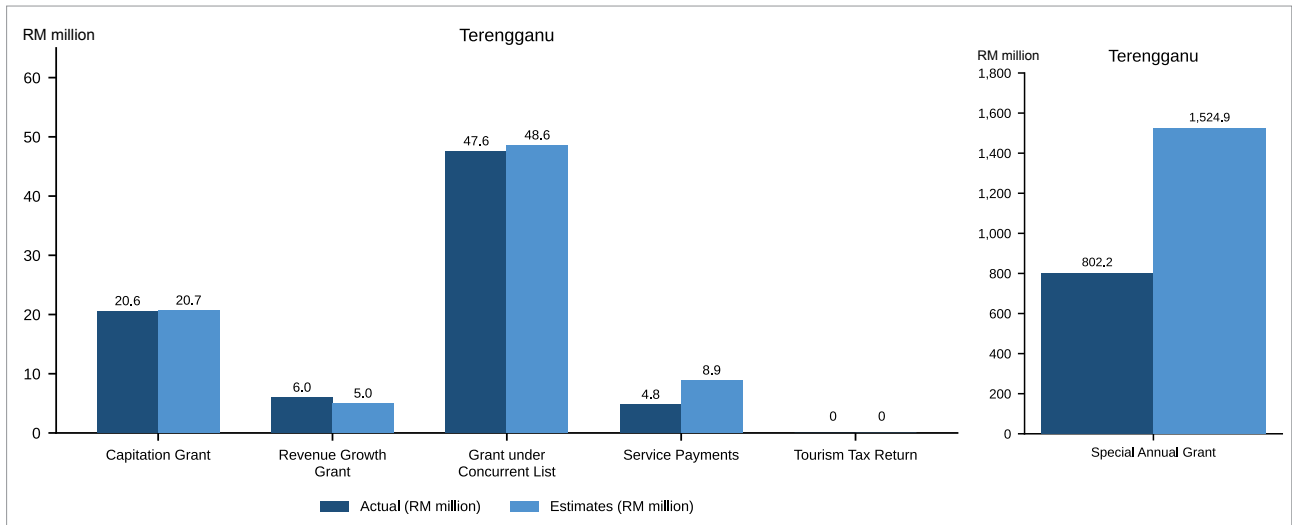
Figure 10: Differences between Actual and Estimated Transfers as Recorded in Sabah Budget Documents in 2023



Sources: Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan; Belanjawan Sabah 2023*, Author's calculation.

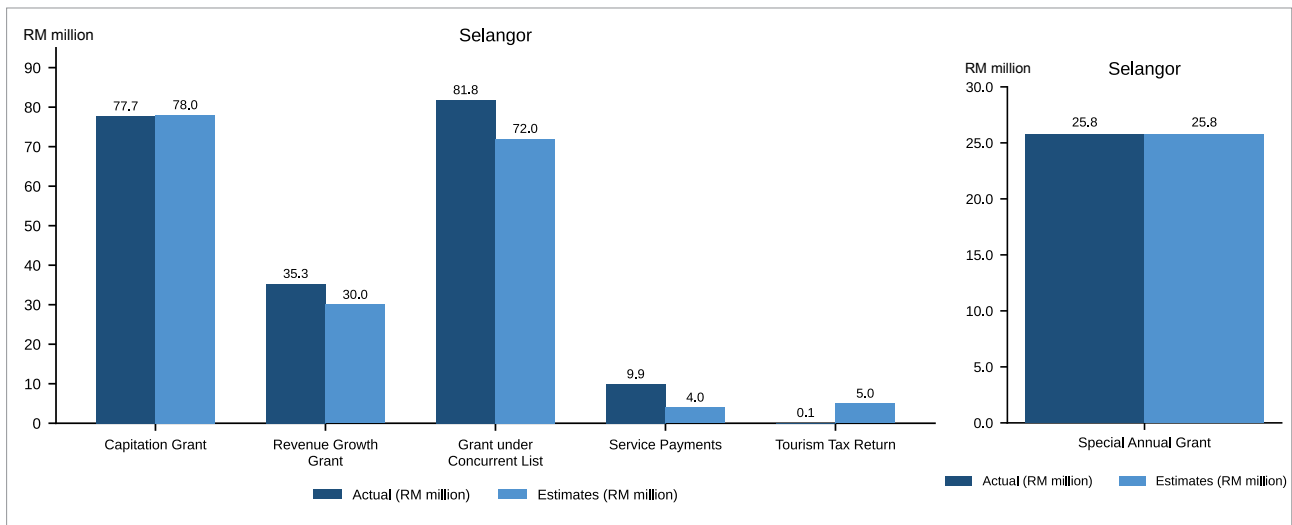
Overall, Sabah received significantly more than its estimates across almost all transfer categories, resulting in a windfall amounting to nearly 50 per cent above its total estimated transfers. Terengganu, by contrast, experienced the opposite: it received only about 45 per cent of its estimated transfers (see Figure A1 and Table A2 in Appendix). Given that Terengganu had projected that almost 90 per cent of its 2023 revenue would come from federal transfers, this shortfall created a substantial gap in its budget.

Figure 11: Differences between actual and estimated transfers in 2023 as recorded by Terengganu budget document



Sources: Ministry of Finance, Lampiran E of the Anggaran Perbelanjaan Persekutuan; Auditors General Reports for State 2023; Author's Calculation.

Figure 12: Differences between actual and estimated transfers in 2023 as recorded by Selangor budget document



Sources: Ministry of Finance, Lampiran E of the Anggaran Perbelanjaan Persekutuan; Auditors General Reports for State 2023; Author's Calculation.

Based on data from these three states, the Capitation Grant appears to be the most predictable for the states, with relatively small differences between estimates and actuals. This may be because its formula is explicitly tied to state population, with demographic data relatively accessible to state governments and the formula publicly available. Even so, states still struggle to provide precise estimates. By contrast, Tourism Tax returns are highly unpredictable. This unpredictability could be due to its dependence on actual tourist inflows and the federal distribution process.

3.3 Is it transparent?

Transparency has been widely recognised in the literature on intergovernmental fiscal transfers as a critical element of an effective transfer system. It is essential for enhancing accountability, enabling informed public scrutiny, and ensuring the equitable and efficient allocation of resources. International frameworks such as the Public Expenditure and Financial Accountability (PEFA) assessment, the Open Budget Survey (OBS), and the IMF's Fiscal Transparency Code (FTC), all incorporate specific criteria or indicators to evaluate the openness, clarity, and comprehensiveness of transfer allocation and execution.

Across these standards, transparency is understood as the timely publication of complete, accurate, and accessible information on intergovernmental transfers, including both actual and planned amounts. It requires clear disclosure of allocation criteria, consistent classification of transfer types, and reconciliation of figures across different official documents. Transparency also entails ensuring that the information is sufficiently detailed and presented in a way that allows stakeholders, including subnational governments, oversight bodies, and the public, to monitor allocations, assess fairness, and hold decision-makers accountable.

While this section will focus mainly on the quality of published information on transfers, it should be noted that concerns about several transfers indicate that stakeholders also need clarity on the formula's implementation. The Sarawak state government, for example, has called for greater clarity on how its special grant is calculated. Sarawak's Premier has emphasised that Sarawak cannot agree to a formula for the special annual grant unless it first has access to comprehensive data on revenue collected both nationwide and within the state, so that the basis for calculation is transparent and equitable. Without that information, Sarawak argues, it is difficult to determine how much of the federal revenue should be returned under Article 112D of the Federal Constitution, or to ensure that any formula reflects the state's actual fiscal contribution and needs rather than being subject to ad hoc negotiation.

At the federal level, the federal government budget document presents the actual transfers made to the states (Lampiran E). However, there are several areas where transparency could be improved.

- First, as indicated earlier, only 12 of the 20 active transfers have their formula or rules publicly available. Such a significant gap in transparency about the formula would make it difficult for states and the public to understand how allocations are determined, thereby limiting accountability in the transfer system and creating room for perceptions of arbitrariness or political influence in the distribution.
- Secondly, while actual transfers to each state are reported in Lampiran E of the budget estimates document (*Anggaran Perbelanjaan Persekutuan*), estimates of state-level transfers for the budget year are not disclosed. Additionally, only the aggregate of estimates for 14 Lampiran E transfers is presented in the budget document (see Table

5). The remaining five (Service Payment Grants, State Library Grants, State Museum Grants, Tourism Tax Return Grants, and EFT), which are supposed to be part of Supply Expenditures of Treasury (B11) according to Lampiran E, are not included. This limitation contributes to Malaysia’s weak score (only 33) on the relevant Open Budget Survey (OBS) indicator (question No. 35 on fiscal transfers), suggesting much scope for improvement in the presentation of transfer information.

Table 5: Presentation of Transfer Estimates in 2026 Budget Document

Vot	No.	Name of Transfer
Charged Expenditures of Treasury (T12)	1	Capitation Grant
	2	State Road Maintenance Grant*
	3	Sarawak Special Grant
	4	Sabah Special Grant
	5	Revenue Growth Grant
	6	Local Council Grant
	7	Selangor Special Grant
	8	Kedah Special Grant
Supply Expenditures of Treasury (B11)	9	Concurrent List Grant
	10&11	Import and Excise Duty Compensation for Sabah and Sarawak
	12	Grant for Local Council’s Electricity Bill
Expenditure for Trust Fund (B12)	13	Economic Development Grant (TAHAP)**
	14	Current Account Deficit Grant**

Source: Ministry of Finance, *Anggaran Perbelanjaan Persekutuan 2026*.

* The State Road Maintenance Grant is divided into three budget items in the document: *Pemberian Jalan Raya Negeri yang Mencapai Mutu Minimum*, and *Penyelenggaraan Jalan Raya Negeri yang Substandard and Penyelenggaraan Jalan Raya Negeri Jalan Sehalu di Pulau Destinasi Pelancongan*. But there is also an allocation for *Pemberian Penyelenggaraan Cerun Jalan Raya Negeri* in B11

** under *Kumpulan Wang Rizab Negeri*

At the subnational level, transparency also needs improvement. The main transparency problem is that not all states publish their budget documents. Only four states (Terengganu, Selangor, Negeri Sembilan and Perak) achieved Malaysia’s Open Budget Index (MyOBI) substantial disclosure standard in 2024 (Rode & Muniandy, 2024). This means that these states make almost all their budget documents publicly available, and these documents provide a detailed breakdown of revenue and expenditure. The remaining nine states have minimal or insufficient disclosure, meaning most of their budget documents are not publicly available, and when they are, they lack sufficient detail. For that reason, only data from selected states is presented in this section.

Another problem, more pertinent to this paper, is that not all federal transfers are recorded in the States' Consolidated Revenue Account (*Akaun Hasil*), one of three accounts in the Consolidated Fund (the other two are Consolidated Trust Account (*Akaun Amanah*) and Consolidated Loan Account (*Akaun Pinjaman*)).¹⁹ Analysing the budget documents of Terengganu, Selangor and Sabah indicates that only eight types of transfers are recorded as grants from the federal government in the revenue account (*Akaun Hasil*) (See Table 13). These include: (i) Capitation Grants, (ii) Revenue Growth Grants, (iii) Service Payments for Federal Projects, (iv) Concurrent List Grants, (v) Tourism Tax Return, (vi) Annual Grants (in the case of Sabah and Selangor), (vii) State Museum Grant and (ix) State Library Grants (only recorded by Sabah), and (x) Compensation in lieu of Import and Excise Duties on Petroleum Products (Sabah). The remaining transfers are disbursed to two trust funds, which are included in the Trust Account. The Economic Development Grant (TAHAP) and Ecological Fiscal Transfers, at least for peninsular states, are disbursed to the Development Expenditure Fund (*Kumpulan Wang Amanah Pembangunan*), which is used mainly to fund development spending. Similarly, state road maintenance is transferred directly to the State Road Maintenance Fund (*Kumpulan Wang Amanah Jalan Raya*), which every state is required to establish to receive the grants. Meanwhile, grants to local councils, whether general purpose or for electricity bills, seem to be disbursed directly to the councils and therefore never recorded as revenue or receipts by state governments. Further complexity arises in Terengganu, where the special grant is reported in the *Akaun Hasil* as a federal transfer, even though this allocation does not appear in Lampiran E.

Table 6: Types and Transfers and how they are recorded in state budget documents

Where they are recorded	Name of Transfers
Trust Account (specifically in Trust Fund for State Road Maintenance)	1. State Road Maintenance Grant
Trust Account (specifically in Kumpulan Wang Amanah Pembangunan)	2. Economic Development Grant (Terengganu & Selangor) 3. Ecological Fiscal Transfer (Terengganu & Selangor) 4. Revenue Growth Grant (only Sabah)

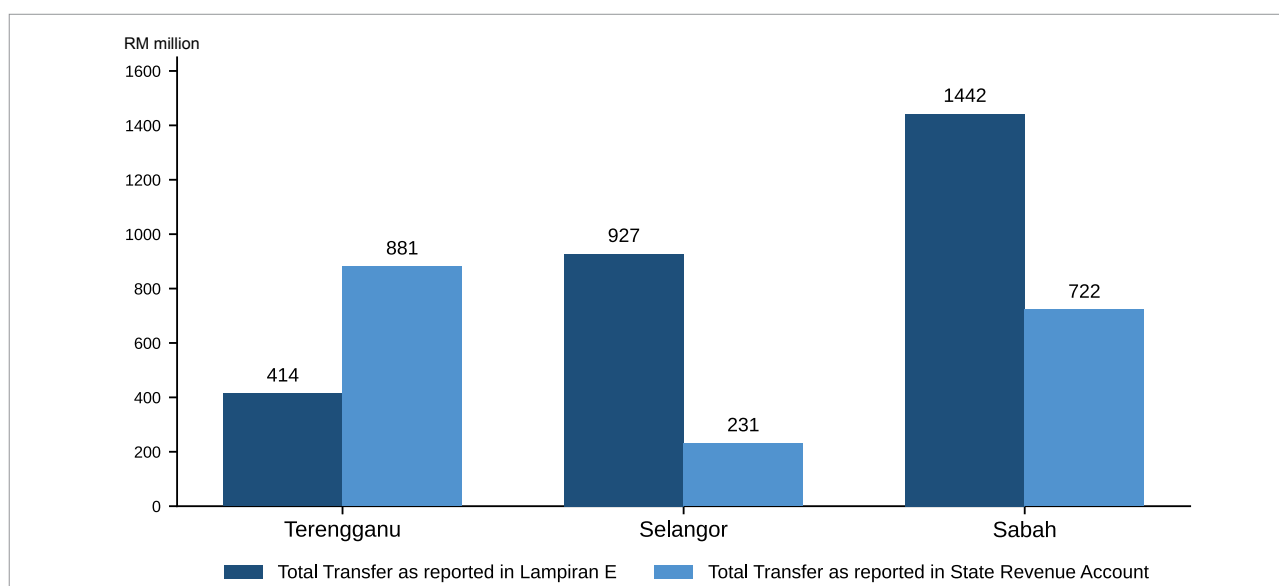
19 The Consolidated Revenue Account is to keep all money other than money in the other two accounts; Consolidated Loan Account is to keep all moneys received by way of loan by the government; and Consolidated Trust Account is to keep all moneys related to trust funds established by the government (see Financial Procedure Act 1957).

Where they are recorded	Name of Transfers
Revenue Account	5. Capitation Grant 6. Special Annual Grant (only applicable to Sabah and Selangor) 7. Revenue Growth Grants (Terengganu) 8. Compensation of Duties on Petroleum Products (only applicable to Sabah) 9. Service Payments 10. Concurrent List Grants 11. State Library Grant (only Sabah discloses it) 12. State Museum Grant (only Sabah discloses it) 13. Tourism Tax Grant 14. Special Grant/Wang Ehsan (Terengganu)
Unknown	15. Local Council Grant 16. Grants for Local Councils' Electricity Bills 17. Current account deficit grant (the three states do not receive the grant in 2023)

Sources: *Penyata Kewangan Sabah 2023; Belanjawan Terengganu 2024; Belanjawan Selangor 2024.*

As a result, the amount reported in Lampiran E is not readily identifiable in the states' revenue account. In fact, the amount reported as transfers from the federal government in the states' revenue accounts would differ from the total transfers reported in Lampiran E (see Figure 16 for example from 2023). One cannot rely on revenue data in state budget documents alone, or on Lampiran E alone, to gain insight into the total transfer.

Figure 13: Total Transfers Reported in Lampiran E and State Revenue Accounts for Terengganu, Selangor and Sabah in 2023 (in RM Million)

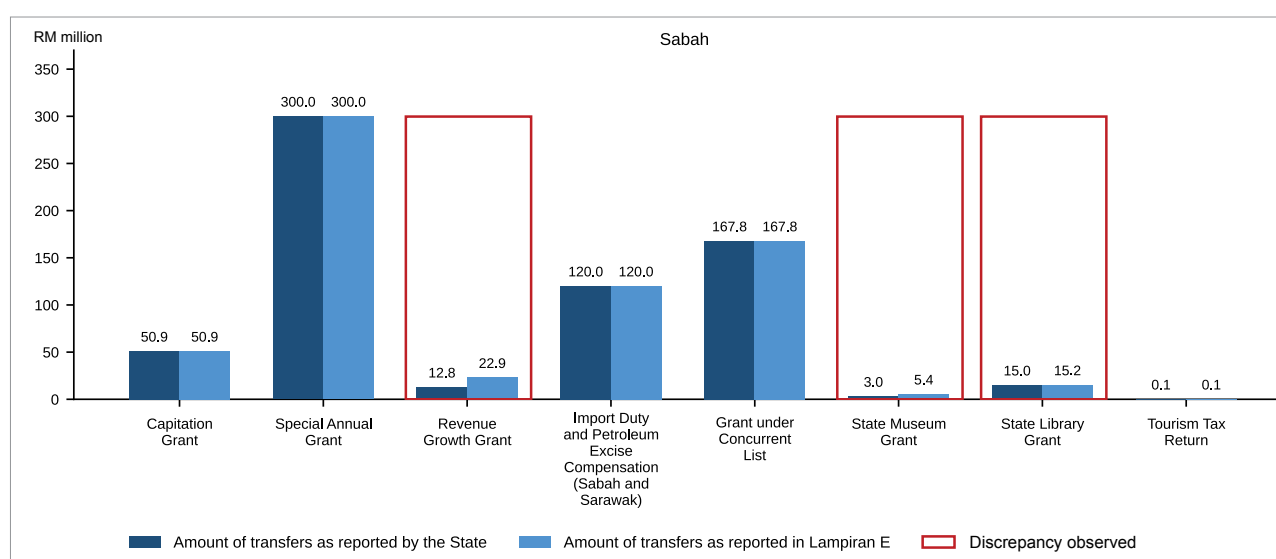


Sources: *Ministry of Finance, Lampiran E of the Anggaran Perbelanjaan Persekutuan, Auditors General Reports for State 2023.*

The direct transfer of funds to the *Kumpulan Wang Pembangunan* and *Kumpulan Wang Jalan Raya* may be intended to improve accountability, as state governments must produce separate financial statements (*penyata*) for these funds. However, this practice complicates the reconciliation of transfer figures between federal records (*Lampiran E*) and state accounts. As a result, the true magnitude of fiscal transfers to states is obscured, and the separation of reporting streams creates differing layers of accountability that may weaken transparency at the aggregate level. The problem is particularly evident with the *Kumpulan Wang Jalan Raya*, which is only presented as part of “miscellaneous” or “other remaining” funds in the States’ Financial Statement (*Penyata Kewangan*), except in Sabah. Given the size of state road maintenance, this mode of presentation diminishes the visibility of a grant that constitutes a significant revenue source for states, thereby undermining its fiscal significance and weakening the intended accountability gains.

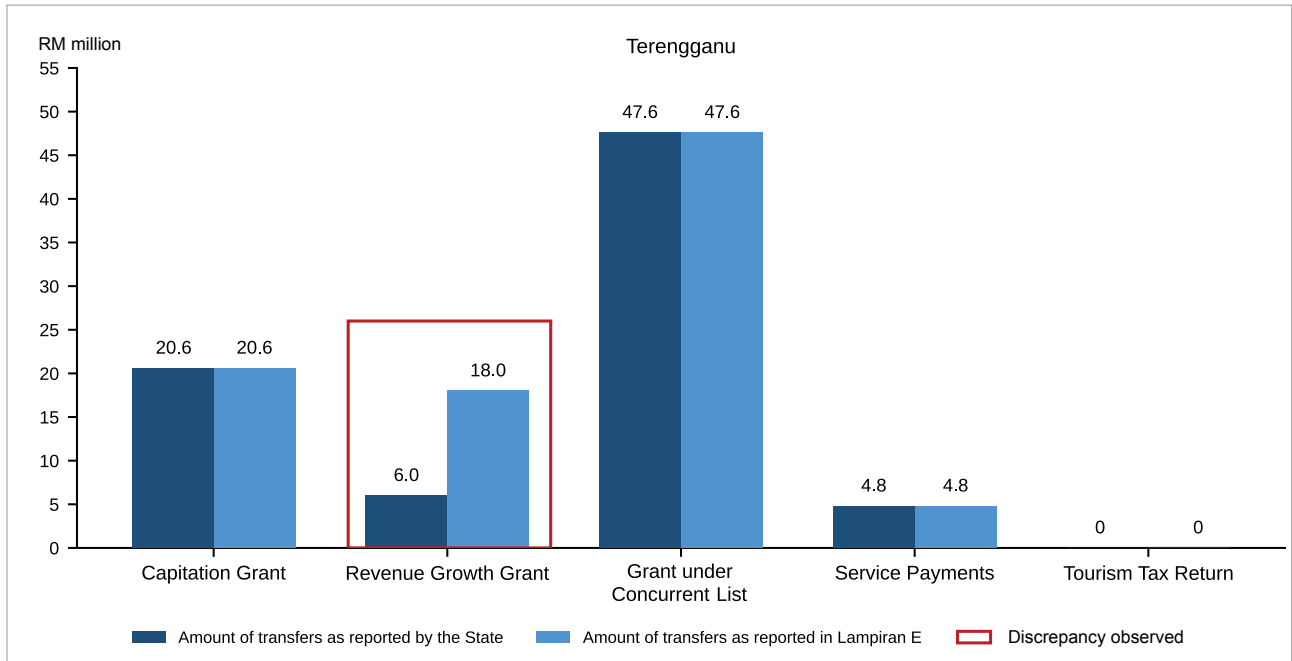
Adding to this complication is the different amounts for some types of transfers recorded by these three state governments from those recorded in *Lampiran E*. Figures 14, 15 and 16 compare selected transfers recorded in *Lampiran E* against those reported in the state revenue accounts for Sabah, Selangor and Terengganu. Based on the comparison using 2023 data, Selangor appears to be relatively consistent with the amounts recorded in *Lampiran E* and reported in the state revenue accounts (see Figure 16). In contrast, Sabah and Terengganu show some discrepancies across selected transfer categories. For Sabah, differences can be observed for the Revenue Growth Grant, State Museum Grant and State Library Grant (see Figure 14). Meanwhile, for Terengganu, based on the available data, the main discrepancy appears to be related to the Revenue Growth Grant (see Figure 15).

Figure 14: Comparison of Transfers Recorded in *Lampiran E* and Reported by the Sabah State Government in 2023



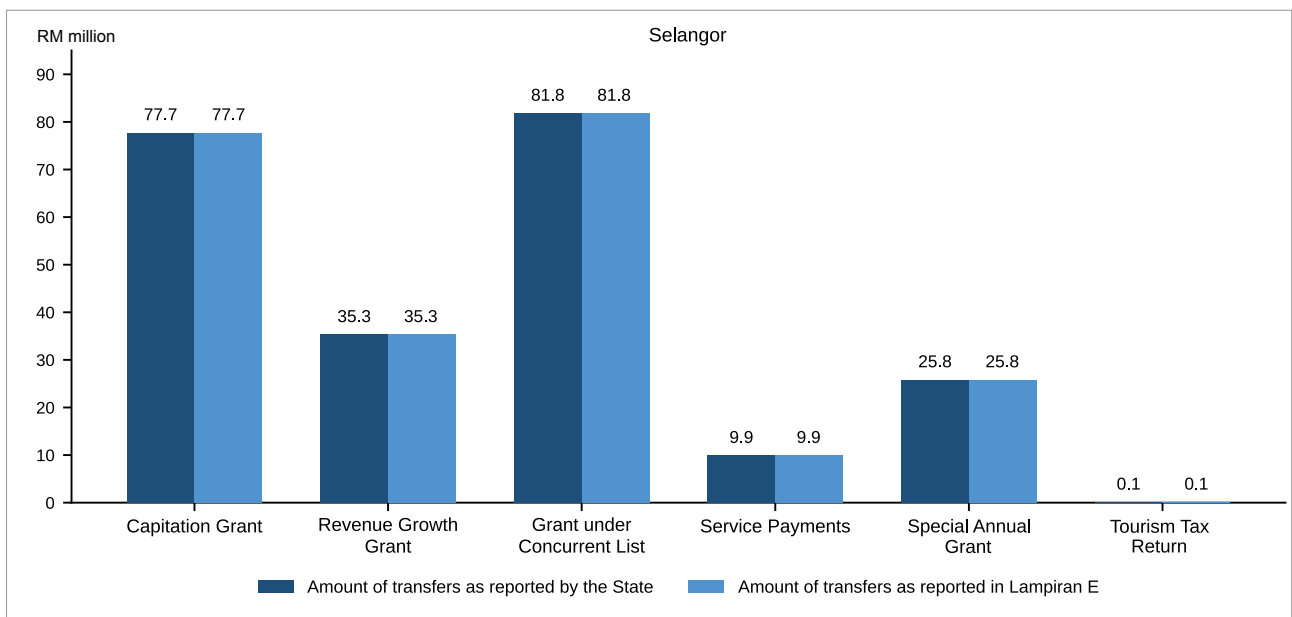
Sources: Ministry of Finance, *Lampiran E of Anggaran Perbelanjaan Persekutuan*; Auditors General Reports for State 2023; Author’s calculations.

Figure 15: Comparison of Transfers Recorded in Lampiran E and Reported by the Terengganu State Government in 2023



Sources: Ministry of Finance, Lampiran E of Anggaran Perbelanjaan Persekutuan; Belanjawan Terengganu 2024; Author's compilations

Figure 16: Comparison of Transfers Recorded in Lampiran E and Reported by the Selangor State Government in 2023



Sources: Ministry of Finance, Lampiran E of Anggaran Perbelanjaan Persekutuan; Belanjawan Selangor 2024; Author's calculations.

4 Conclusion and Recommendations

Upon examining their legal basis, guidelines, and relevant government documents, it is evident that Malaysia's transfer system is not fully rules-based, is highly unpredictable for the states, and is partially opaque. Some transfers do not appear to be firmly rooted in constitutional provisions, and most lack a clear formula or any explicit indication of the amounts involved, making it difficult for governments and stakeholders to predict and verify transfers. Even where formulas exist, implementation has been inconsistent. Major transfers, such as the annual grants to Sarawak and Sabah, have not followed the established rules. While the transfer has been predictable for the federal government, this is not the case for state governments, at least based on the budget documents of the three state governments explored in depth. Transparency of the transfers needs to be improved, not only in terms of public availability but also in consistency across budget documents, which may require a closer look at accounting standards. The National Finance Council has been a useful platform for governing fiscal arrangements between the federal and state governments (at least based on the decisions taken on transfers in the past 10 years). However, coordination remains limited, as engagement is confined to an annual NFC meeting and lacks sustained technical-level support comparable to the institutional arrangements of intergovernmental forums in other countries, or even to the MTPMA63 structure.

To address these issues, several reforms should be considered to strengthen predictability, rules-based design, and transparency of fiscal transfers:

- **Strengthen the legal, formula-based, and guideline framework of transfers** by ensuring
 - All transfers are explicitly anchored in constitutional or statutory provisions,
 - All transfers are supported by clear and publicly available guidelines
 - All transfers should have well-defined eligibility criteria and transparent calculation formulas.
- **Establish a dedicated technical secretariat or committee under the National Finance Council, similar to the MA63 Technical Committee**, to provide continuous technical engagement, monitor implementation, and resolve inconsistencies in transfer execution. This would improve predictability in fiscal transfers and reduce variation in the implementation of transfer formulas across time and across jurisdictions. The technical committee could be housed at the Ministry of Finance, and could also be responsible to ensure all transfers meet the requirements stated in the first recommendation above.

- **Enhance the transparency and comparability of fiscal data by harmonising the reporting of transfers across federal and state budget documents**, potentially through revised public sector accounting standards or reporting templates. At the federal level, reporting could be strengthened by introducing a dedicated budget paper on transfers that includes not only actual expenditures but also forward estimates of transfers and related fiscal aggregates. Australia's Budget Papers (see for example Budget Paper No.3 for 2026-27 Budget) provide a useful reference point, as they systematically present intergovernmental payments alongside multi-year projections, improving transparency and fiscal predictability.

References

- Abdul Jalil , A., & Abdul Karim, N.-H. (2009). Understanding Malaysian State Governments Fiscal Behaviour: The Role of Intergovernmental Transfer. *Chulalongkorn Journal of Economics*, 20(2), 85-111.
- Abdul Jalil, A. Z. (2010). Fiscal Efficiency of Malaysia State Governments: Effects of Intergovernmental Grants. *Malaysia Journal of Economic Studies*, 47(1), 55-72.
- Astro Awani (2012). Wang Ehsan di Kelantan Dibuat Secara Telus. Astro Awani. <https://www.astroawani.com/berita-malaysia/wang-ehsan-di-kelantan-dibuat-secara-telus-1860>
- Bernama (2000). Kerajaan Pusat Ikut Wang Ihsan Minyak. Perdana Leadership Foundation Archive. http://lib.perdana.org.my/PLF/Digital_Content/Prominent_Leaders/Mahathir/News_1968-2004/1999-2000/2000ko/kerajaan%20pusat%20ikut%20uang%20ihsan%20minyak.pdf
- Bernama (2023). MOF to Redraft Policy on Wang Ehsan Payments to Kelantan, Terengganu. Ministry of Finance. <https://www.mof.gov.my/portal/en/component/content/article/mof-to-redraft-policy-on-wang-ehsan-payments-to-kelantan-terengganu>
- Bernama. (2023). Steven Sim: Distribution of Capitation Grant to States Not Based on Political Affiliation. Bernama. <https://www.nst.com.my/news/nation/2023/06/917500/steven-sim-distribution-capitation-grant-states-not-based-political>
- Bernama. (2024). Rm308.33 Mln Tourism Tax Collected From 2018-2022 - Tiong. Bernama. <https://www.bernama.com/en/news.php?id=2321509>
- Bernama. (2024). MA63: Govt Increases Interim Special Grant For Sabah, Sarawak To RM600 Million - DPM Fadillah. <https://www.bernama.com/en/news.php?id=2339805>
- Bernama. (2026). Federal Grants To State Governments Expected To Hit RM10.5 Bln This Year – PM Anwar. Bernama. <https://www.bernama.com/en/news.php/?id=2530766>
- Bernama. (2026). Bayaran Interim Sabah Naik Kepada RM1.5 Bilion Bukti Komitmen Kerajaan MADANI - Mustapha Bernama Bernama. Bernama. <https://www.astroawani.com/berita-malaysia/bayaran-interim-sabah-naik-kepada-rm15-bilion-bukti-komitmen-kerajaan-madani-mustapha>
- Malay Mail. (2025). High Court Rules Federal Government Unlawfully Withheld Sabah's 40pc Share of Federal Revenue for 50 Years. Malay Mail. <https://www.malaymail.com/news/malaysia/2025/10/17/high-court-rules-federal-government-unlawfully-withheld-sabahs-40pc-share-of-federal-revenue-for-50-years/194943>
- Boadway, R., & Shah, A. (2007). Overview. *Intergovernmental Fiscal Transfers: Principles and Practice* (R. Boadway & A. Shah, Eds.). Washington D.C.: The World Bank .
- Bornhorst, F., Mercês, G., & Freire, N. (2018). The Subnational Fiscal Crisis. In A. Spilimbergo, K. Srinivasan, A. Spilimbergo, & K. Srinivasan (Eds.), *Brazil: Boom, Bust, and the Road to Recovery* (pp. 207–222). Washington, DC: International Monetary Fund.
- Canada Spends. (20 March , 2025). *Finance Canada*. Retrieved from Canada Spends: <https://canadaspends.com/en/spending/departement-of-finance>

- Choudhry, S., & Perrin, B. (2007). The Legal Architecture of Intergovernmental Transfers: A Comparative Examination. In R. Boadway, & A. Shah, *Intergovernmental Fiscal Transfers: Principle ad Practice* (pp. 259-292). The World Bank. https://commons.allard.ubc.ca/fac_pubs
- Commonwealth of Australia. (2024). *Final Budget Outcome 2023–24*. https://archive.budget.gov.au/2023-24/fbo/download/00_fbo_2023-24.pdf
- International Budget Partnership. (2020). *Open Budget Survey 2019*. https://internationalbudget.org/sites/default/files/2020-04/2019_Report_EN.pdf
- International Budget Partnership. (2022). *Open Budget Survey 2021*. <https://internationalbudget.org/wp-content/uploads/Open-budget-survey-2021.pdf>
- International Budget Partnership. (2024). *Open Budget Survey 2023*. <https://internationalbudget.org/wp-content/uploads/IBP-OBS-Global-Report-2023-v4-Final-Artwork.pdf>
- International Budget Partnership. (2025). *Open Budget Survey*. International Budget Partnership.
- Hutchinson, F. E. (2014). Malaysia's Federal System: Overt and Covert Centralisation . *Journal of Contemporary Asia Vol.44*, 422-442.
- International Budget Partnership. (2020). *Open Budget Survey 2019*. https://internationalbudget.org/sites/default/files/2020-04/2019_Report_EN.pdf
- International Budget Partnership. (2022). *Open Budget Survey 2021*. <https://internationalbudget.org/wp-content/uploads/Open-budget-survey-2021.pdf>
- International Budget Partnership. (2024). *Open Budget Survey 2023*. <https://internationalbudget.org/wp-content/uploads/IBP-OBS-Global-Report-2023-v4-Final-Artwork.pdf>
- International Budget Partnership. (2025). *Open Budget Survey*. International Budget Partnership.
- Jabatan Akauntan Negara Malaysia. (2013). *Penyata Kewangan Kerajaan Persekutuan 2013*.
- Jabatan Kerja Raya Malaysia. (2023). *Statistik Jalan Malaysia Edisi 2023*. <https://www.kkr.gov.my/sites/default/files/2023-10/Buku%20Statistik%20Jalan%20Malaysia%20Edisi%202023%20JKR.pdf>
- Lago, M. E., Lago-Penas, S., & Martinez-Vazquez, J. (2024). Background Paper: Side Effects in Designing Intergovernmental Transfers. *20th Annual Meeting of the Network on Fiscal Relations Across Levels of Government* . OECD.
- Lee, H.-A. (2023). *Insufficient States: Revisiting The Roles and Resources of Malaysia's Subnational Governments*. (ISEAS Perspective No. 97). ISEAS – Yusof Ishak Institute.
- Ministry of Finance Malaysia. (2024). *Economic Outlook 2025*. <https://belanjawan.mof.gov.my/pdf/belanjawan2025/economy/economic-2025.pdf>.
- Ministry of Finance Malaysia (2024). *Mesyuarat Majlis Kewangan Negara Tahun 2024*. <https://www.mof.gov.my/portal/ms/berita/foto/mesyuarat-majlis-kewangan-negara-tahun-2024>
- Ministry of Finance Malaysia. (2024). *Fiscal Outlook and Federal Government Revenue Estimates 2025*. https://belanjawan.mof.gov.my/pdf/belanjawan2025/revenue/fiscal_outlook_2025.pdf

Ministry of Finance Malaysia. (2024, April 4). *Federal Govt To Allocate RM8.9 Bln Development Grants For States This Year – Anwar*. Ministry of Finance Malaysia. <https://www.mof.gov.my/portal/en/news/press-citations/federal-govt-to-allocate-rm8-9-bln-development-grants-for-states-this-year-anwar>

Ministry of Finance Malaysia. (2025). *Fiscal Outlook and Federal Government Revenue Estimates 2026*. https://belanjawan.mof.gov.my/pdf/belanjawan2026/revenue/fiscal_outlook_2026.pdf

Mohamed, N. N., Lew, Z. S., & Abdul Hadi, N. A. (2026). *Policy Paper No. 91: Federal Transfer and Fiscal Capacity in Malaysia: Evidence on Equalisation across States*. Kuala Lumpur : IDEAS Malaysia.

OECD, & UCLG. (2022). *2022 Synthesis Report: World Observatory on Subnational Government Finance and Investment*. <http://www.oecd.org/termsandconditions>.

Ostwald, K. (2017). *Federalism without Decentralization: Power Consolidation in Malaysia*. *Journal of Southeast Asian Economies*, 34(3), 488–506. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3048550

Perbendaharaan Malaysia. (2016). *Bayaran Kepada Kerajaan Negeri Kerana Penglibatan Kakitangan Kerajaan Negeri di Dalam Melaksanakan Projek-Projek Persekutuan*.

Perbendaharaan Malaysia. (2022). *Garis Panduan Pemberian Berdasarkan Tahap Pembangunan Ekonomi, Infrastruktur dan Kesejahteraan Hidup (Pemberian TAHAP)*.

Perbendaharaan Malaysia. (2024). *Garis Panduan Tatacara Pengurusan Pemberian Penyenggaraan Jalan Negeri 4.0*.

Perbendaharaan Malaysia. (2024). *Tatacara Pemberian Kepada Negeri yang Menghadapi Kekurangan Hasil Berbanding Belanja Mengurus (Pemberian Defisit)*.

Schatzenstaller, M. (2015). Reforming Austrian Fiscal Federalism: Options, Obstacles, and Pitfalls. In G. Bischof, & F. Karlhofer (Eds.), *Austrian Federalism in Comparative Perspective (Vol. 474, pp. 54–69)*. University of New Orleans Press.

Shah, A., & Kincaid, J. (Eds.). (2007). *The Practice of Fiscal Federalism: Comparative Perspectives*. Montreal: McGill-Queen's University Press.

Watts, R. L. (2008). *Comparing Federal System (3rd Edition)*. Kingston: School of Policy Studies Queen's University .

Yeoh, T. (October, 2020). Federal-state relations under the Pakatan Harapan government. *Trends in Southeast Asia*. Singapore: https://www.iseas.edu.sg/wp-content/uploads/2020/09/TRS12_20.pdf.

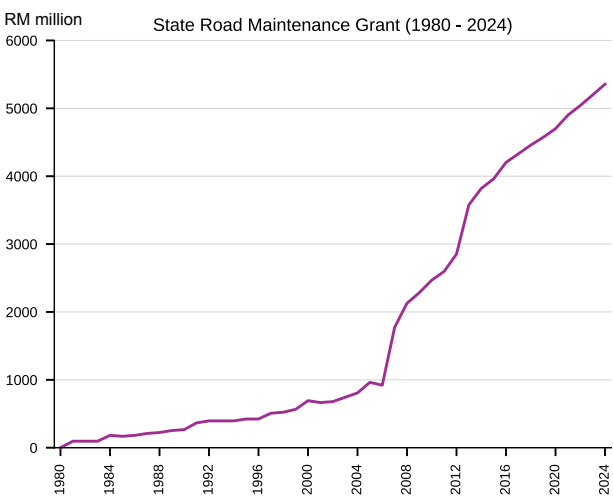
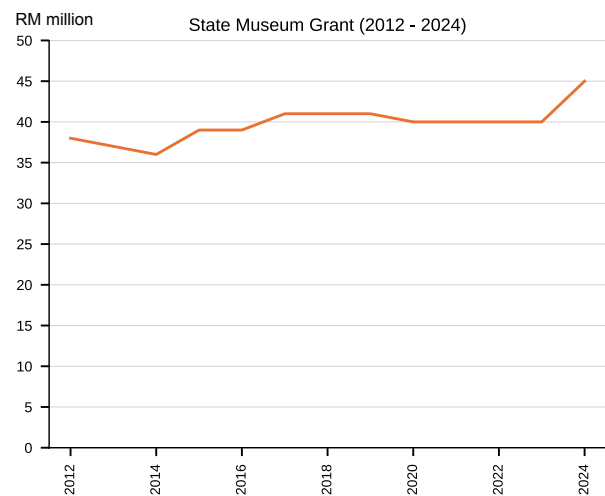
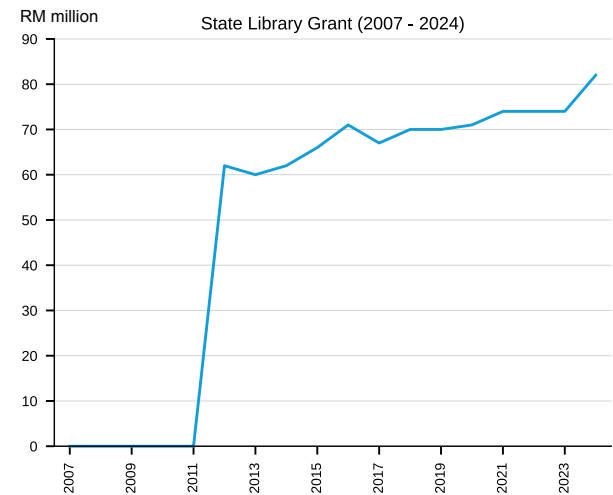
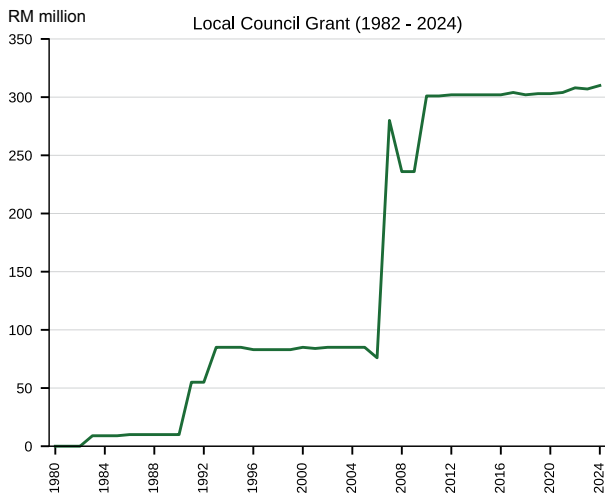
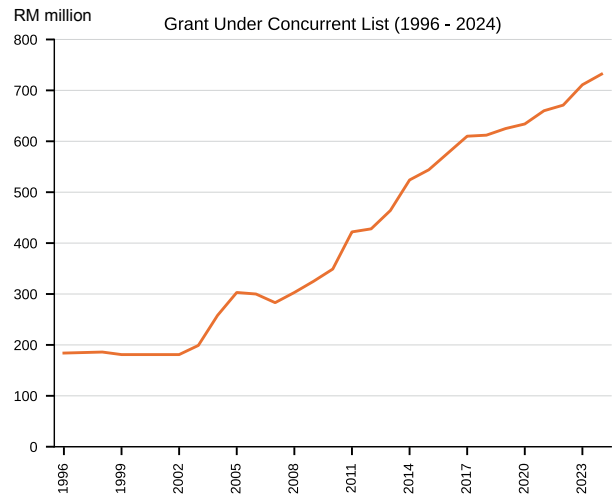
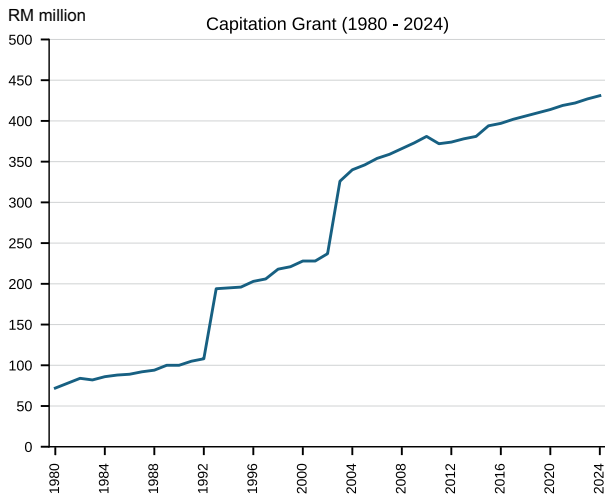
Yeoh, T. (2024). Managing State-Federal Relations: Growing Pressure on Malaysia's Madani Administration. *Trends in Southeast Asia*. 33. https://www.iseas.edu.sg/wp-content/uploads/2024/11/TRS25_24.pdf.

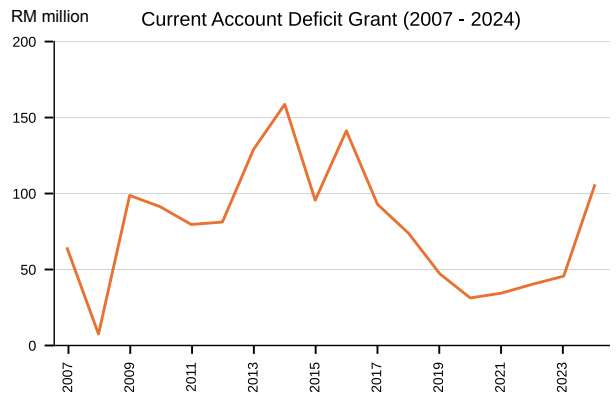
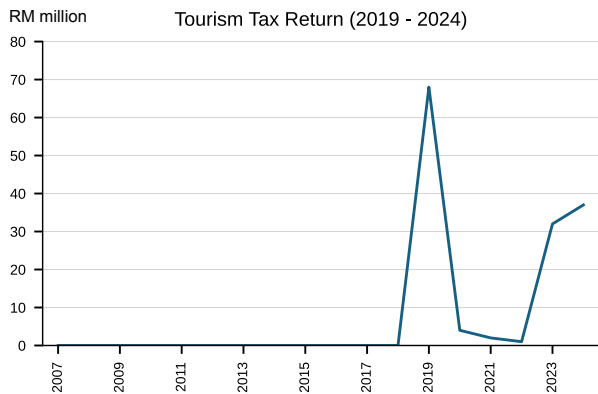
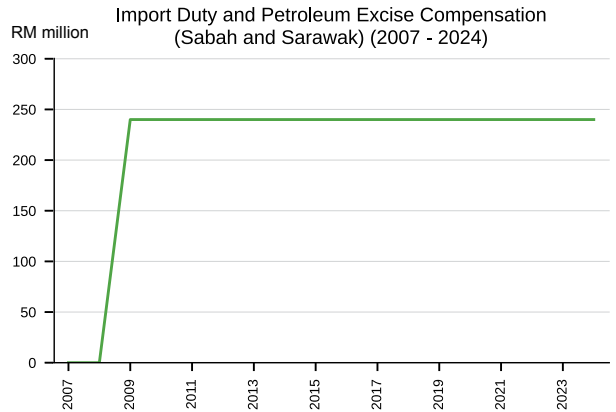
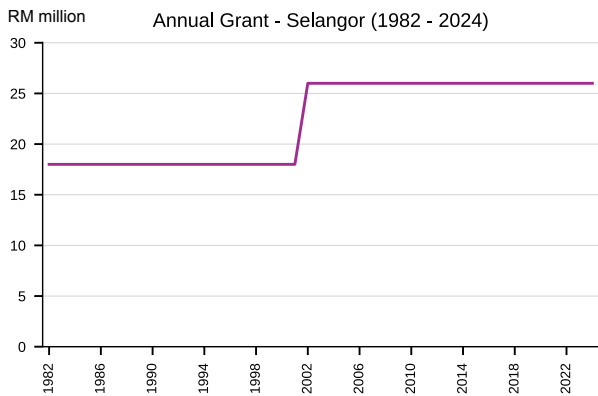
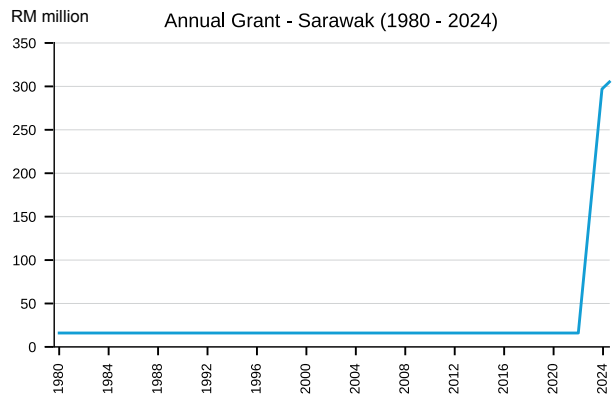
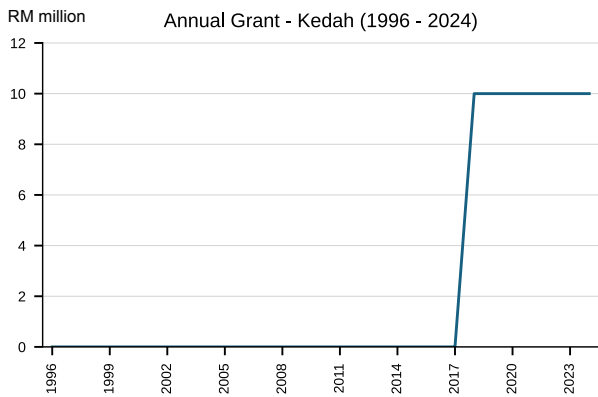
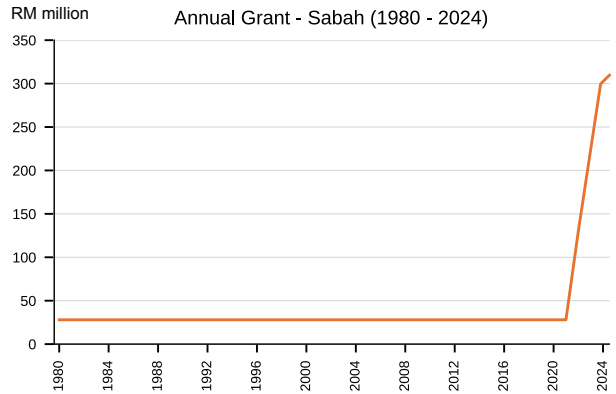
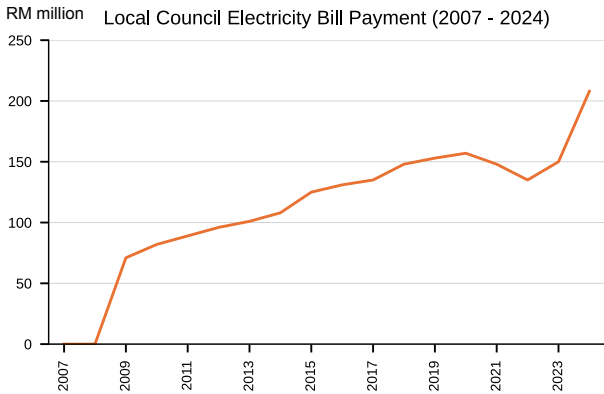
Yusof, Y., Kalirajan, K., & Mohamad, A. (2022). Fiscal Decentralization and Convergence in Government Spending In Malaysia. *International Journal of Finance and Economics*, 27, 2669–2681.

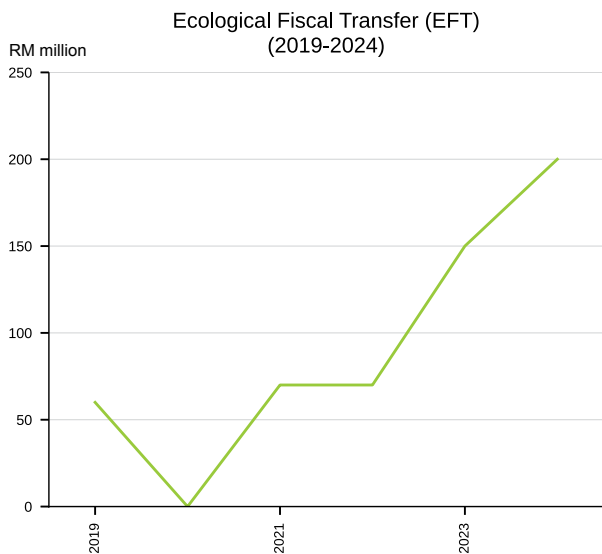
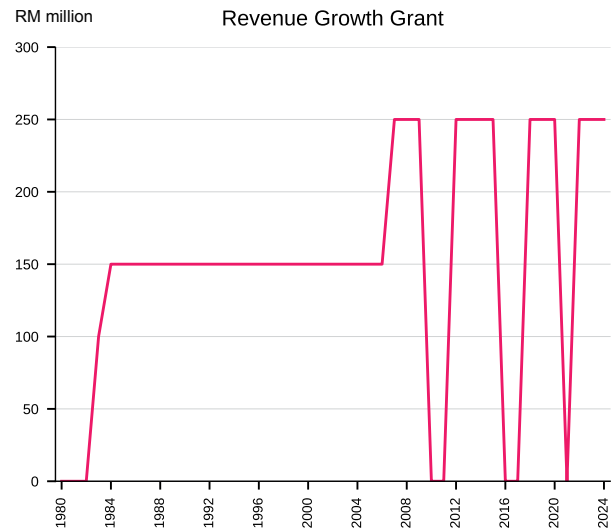
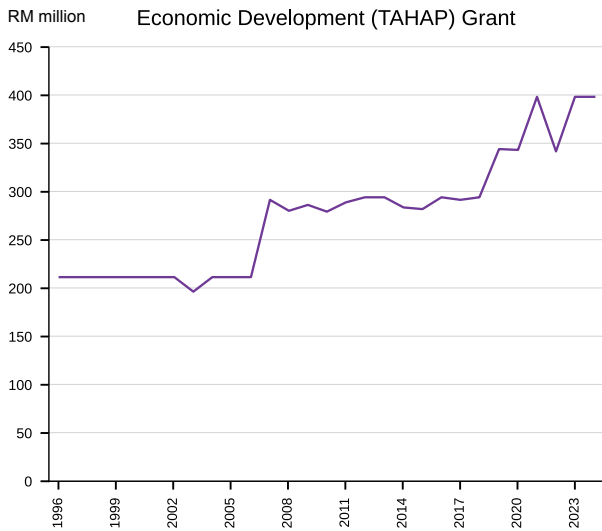
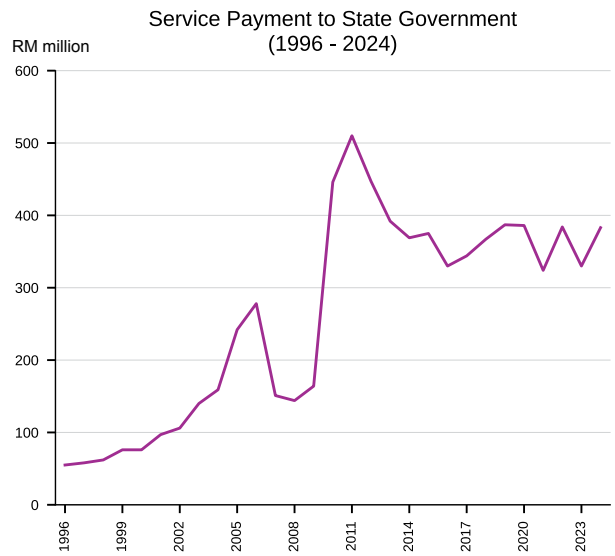
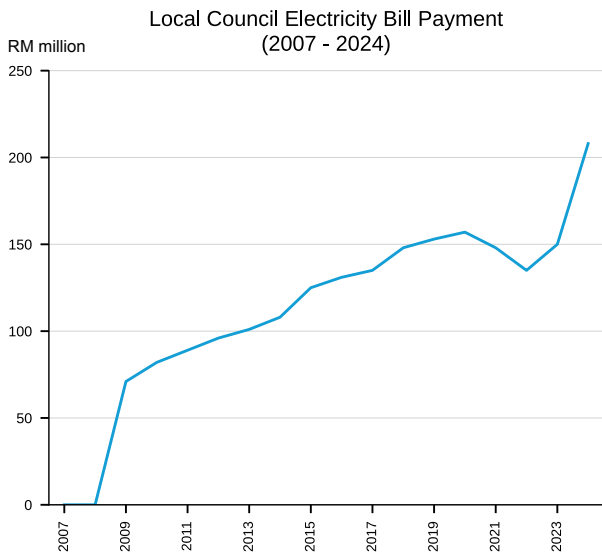
Yusoff, M. A. (2004). Politik Terengganu selepas Pilihan Raya Umum 1999: Dari royalti ke wang ehsan. *Jebat: Malaysian Journal of History, Politics & Strategic Studies*, 31, 87–107.

Appendix 1

Figure A1: Trends of Active Transfers from their establishment until 2024







Sources: Ministry of Finance, Lampiran E of Anggaran Perbelanjaan Persekutuan; Author's compilations.

Appendix 2

Table A2: Comparison between States that receive Current Account Deficit in 2023 (Lampiran E) vs those that experience deficit in the same year (Audit Report)

State	Lampiran E	Audit Report		
	Current Account Deficit Grant 2023 (RM million)	Revenue (Actual) (RM million)	Operating Expenditure (Actual) (RM million)	Current Account Deficit/Surplus (Actual) (RM million)
Johor	0	1,936	1,211	725
Kedah	0	629	642	-13
Kelantan	0	825	862	-38
Melaka	0	428	407	21
Negeri Sembilan	0	541	454	88
Pahang	0	1,306	1,106	200
Perak	0	1,214	806	408
Perlis	45	141	163	-22
Pulau Pinang	0	593	712	-119
Selangor	0	2,709	1,404	1,305
Terengganu	0	1,210	1,178	32
Sabah	0	7,606	4,883	2,723
Sarawak	0	13,311	4,570	8,742

Sources: Ministry of Finance, Lampiran E of Anggaran Perbelanjaan Persekutuan 2023.



The Institute for Democracy and Economic Affairs (IDEAS) is a nonprofit research institute based in Malaysia dedicated to promoting solutions to public policy challenges. Our work is independent of vested interests and partisan influences. Our vision is :

“A Malaysia that upholds the principles of liberty and justice”

We achieve our goals by:

- Publishing cutting-edge research work.
- Initiating dialogues with government, lawmakers, businesses, and civil society.
 - Providing thought leadership.
- Facilitating networking between like-minded individuals.
 - Organising educational programs.

We act as an intellectual centre, creating space for cross-partisan, principles-centric, and results-oriented dialogue

Our work focuses on three overarching missions:

- Advancing a competitive economy,
- Ensuring trust in institutions, and
- Promoting an inclusive Malaysia.

Please support us by making a donation. You can make a contribution by cheque payable to “IDEAS Policy Research Berhad” or by transfer to our account CIMB 8008852042.

© 2026 IDEAS. All rights reserved.

IDEAS Policy Research Berhad
Suite 10-02, 10th Floor, Menara Atlan, 161B, Jalan Ampang, 50450
Kuala Lumpur

www.ideas.org.my
Reg No.: 1219187-V

Selection of IDEAS' Publications (2025 - 2026)

Policy Ideas

Policy Paper 93 – Guidance for Malaysia's Caretaker Government: Lessons From Four Commonwealth Jurisdictions by Wo Chang Xi (May 2026)

Policy Paper 92 – How Costly are Political Parties? Exploring Political Expenses and Implication for Democracy by Muhammad Nur Syazwan Zainal Abidin, Sabrina Firdaus Aloysius and Mohammad Imamul Ariffin (May 2026)

Policy Paper No 91 – Federal Transfers and Fiscal Capacity in Malaysia: Evidence on Equalisation Across States by Nor Nazirah Mohamed, Zheng Sheng Lew, Nurul Aqilah Abdul Hadi (April 2026)

Policy Paper No 90 – The Bumiputera Vendor Development Programme (VDP) in Practice: Selection, Development and Graduation by IDEAS Research Team (March 2026)

Policy Paper No 89 – From Support to Success: Refocusing Bumiputera Trade Policies on Enterprise Outcomes by IDEAS Research Team (March 2026)

Policy Ideas No. 88 – Who Sits at the Table? From Political to Public Appointees in Malaysia's Federal Statutory Bodies (FSBs) by Priya Kaur Sachdev and Alissa Marianne Rode (March 2026)

Policy Ideas No. 87 – Reporting and Disclosure Practices of Subnational Constituency Development Funds (CDF) in Malaysia by Sabrina Firdaus Aloysius and Priya Kaur Sachdev (January 2026)

Brief Ideas

ASEAN and OECD Alignment on State-owned Enterprise Governance Reforms by Alissa Marianne Rode and Ng Chien Chern (January 2026)

Future-proofing Investment Regulation Across ASEAN by Mohammad Jamil Hilmi bin A Ghani and Dr Stewart Nixon (January 2026)

Divided We Fall: ASEAN's Response to Trump's Illiberal Trade Agenda by Dr Stewart Nixon (January 2026)

Report

ASEAN Integration Report 2025: Challenges and Opportunities for ASEAN MSME Trade – Insights from the Food and Beverage Industry by Sharmila Suntherasegarun, Amir Najmi, Priya Kaur Sachdev, and Nimitraa Youganesparan (November 2025)

Policy IDEAS are IDEAS' regular publications that introduce and propose policy reforms based on analysis of existing policies and best practices.

Institute for Democracy and Economic Affairs (IDEAS)
Suite 10-02, 10th Floor, Menara Atlan, 161B, Jalan Ampang, 50450
Kuala Lumpur