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# The Political Economy of Federal-State Relations: How the centre influences resource distribution to the periphery

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## Introduction

This is the second in a series of three policy papers on contemporary challenges surrounding federalism in Malaysia today, the first of which was Policy Ideas No. 59, titled "Restoring the Spirit of Federalism: Policy Options for a New Malaysia". This paper will explore more exclusively the political influences stemming from the federal government and how to mitigate for such effects for a more well-functioning, sustainable fiscal regime of the country's states.

The changes in Malaysia's recent political landscape are meaningful and consequential on the country's complex dynamics of federal-state relations. Historically a contested relationship where the centre influences much of the resource allocation and distribution to the periphery, this policy paper traces how this took shape during the early years of Malaysia's formation and brings to the fore current developments. It argues that the federal government has strategically determined resource allocation through a number of means including through party-centred state administrations, administrative encroachment for greater political control, constitutional and legal requirements and by use of the politico-bureaucratic complex. The paper ends by proposing several recommendations that the government should consider for future adoption.

The formation of Perikatan Nasional as Malaysia's new federal government on 1 March 2020, consisting of Parti Pribumi Bumiputera Malaysia (PPBM), the United Malays National Organisation (UMNO) and its other partners MCA and MIC within Barisan Nasional (BN), and the Pan-Malaysian Islamic Party (PAS), in one fell swoop dramatically altered the landscape of federal-state relations. Within one week, inter-party and intra-coalition dynamics meant that new negotiations took place alongside several elected representatives' shifting allegiances to new parties.

This resulted in three different state governments changing hands to the new PN government. Pakatan Harapan, with its remaining three parties Parti Keadilan Rakyat (PKR), Democratic Action Party (DAP) and Parti Amanah Negara (PAN) after the exit of PPBM, lost the states of Johor, Malacca and Perak in successive order. This is an overall gain by PN, now controlling seven states compared to PH's four. To recapitulate, following the collapse of the PH federal government, the PN-controlled states are now Kelantan, Terengganu, Perlis, Pahang, and the newly-acquired Johor, Malacca and Perak, while PH remains in control of Selangor, Penang and Negeri Sembilan. Initially maintaining its hold on Kedah, the PH government collapsed on 12 May 2020 after two PKR assembly persons defected to form a new PN government. Sabah is a PH-friendly state, and Sarawak is a PN-friendly state. Given that the Sarawak state elections will be taking place in 2021, such political support is also expected to change.

While the coalitions in some states like Johor and Malacca are still unstable, what is most interesting about these developments is that for the first time in the country's history, there exist different coalitions in different states. While the core PN parties of PPBM, UMNO and PAS typify the co-operation that exists within most of their states, this is not true for all of them. For instance, where PPBM formed government together with BN in the state of Johor, it originally maintained its co-operation with the PH parties in the state of Kedah until it changed hands in May. In Malacca, the two PPBM state elected representatives initially joined forces with the new PN partners alongside defectors from DAP and PKR, but later reversed their decision and PPBM hence now belongs in the state opposition. UMNO is still officially opposition in Kelantan and Terengganu, but may demand for Exco positions as they are in coalition with PAS at the federal level.

## Historical background

### Malaysia as a semi-democratic minimalist federation

Despite the legal-constitutional structure that defines Malaysia as a federation, the country has been commonly described as a "de jure federation which is a de facto unitary state" and "a semi-democratic minimalist federation" (Bhattacharyya 2010). Literature has described Malaysia in a number of other similar ways, including as a hybrid federalism that combines a unitary system with federalism, an asymmetric federalism in which indigenous groups are favoured at the expense of other communities, a dual or hold-together federalism where the East Malaysian states of Sabah and Sarawak were given special powers to control migration, an authoritarian federalism (He, Galligan and Inoguchi 2007; Shah 2007) and a minimalist federalism in which federalism is retractable, allowing means by which quickly to suppress secessionism (Case 2007). Indeed, Case (2007) argues strongly that federalism has done less to promote democracy than to reinforce semi-democratic politics, since state governments aligned with the central government serve their needs and in fact "dispense patronage along lines that resonate locally" hence bolstering the central government. The rest of this section describes how this has been practiced in reality.

Indeed, there have been multiple ways in which this semi-democratic minimalism has been displayed by the Barisan federal government since independence to the present. First and most evident has been its use of authoritarianism as a dominant single-party in power. In the wake of ethnic clashes in Kuala Lumpur in 1969 following disputed electoral outcomes in the state of Selangor, the Alliance declared emergency rule, and suspended both Parliament and the constitution for two years, during which time the National Operations Council (NOC), comprised of a small elite circle of individuals, governed the country. It is this NOC that later emerged with the First Malaysia Plan that contained the New Economic Policy (NEP) in 1971, an ethnic-based affirmative action policy that consumed and continues to shape the nation's political economy today.

The NEP, although having technically expired 20 years after its launch, in 1991, has continued in the form of the National Development Policy and the National Vision Policy. A range of similar policies based on the same theme of ethnic-based affirmative action continues to be practised today, including the Bumiputera Economic Empowerment Agenda, the Bumiputera Economic Community, and the Bumiputera Economic Transformation Roadmap 2.0. Lee (2010) argues that, contrary to South Africa's experience in which a negotiated transition to a democratic nation led to a more decentralised political structure in the way it deployed its statutes and codes, the consolidation of state power from the early 1970s in the wake of this 1969 political crisis in Malaysia was a political moment that led to a greater degree of discretionary and centralised authority, and an emphasis on "modes of state authority" that maintained its trajectory.

UMNO's position as the central party in the Alliance, renamed Barisan Nasional in 1974, was indeed solidified resulting from these political developments. Barisan has also made use of its first-past-the-post electoral system and constituency boundaries to its advantage, and up to 2008 had never lost its two-third majority in Parliament, allowing it to pass repressive legislation easily with little to no debate from elected opposition representatives.

A stable federation in fact requires a balance between self-rule and shared rule (Adeney 2007), but lawmaking had already become more centralised by the 1964 change of the Senate's composition, supposedly the house of the states, when the original proportion of state-appointed to centre-appointed senators was altered from 28:22 to 28:32 in 1963, which was further reduced to 26:32 in 1965, 26:40 in 1978, 26:42 in 1984, and 26:44 in 2001 (Bhattacharya 2010; Shad Saleem, 2016). Today, 44 of 70 (63%) senators are politically appointed.

These laws that were passed easily given control of both houses of Parliament were conveniently used to consistently silence critics, whether amongst civil society, opposition leaders, media practitioners or university students.

Centralisation in Malaysia is in large part also a concentration and personalisation of power within the inner core of the federal government, specifically the increasingly expanded Prime Minister's Department (PMD). Ostwald (2017) argues this centripetal dynamic is driven by a political calculus in which the Prime Minister and his allies lie at the pinnacle of UMNO and undermine challenges from both outside and within the party. The budget of the PMD indeed was ten times larger than the state budget of Selangor and fifteen times larger than Penang's in the 2012 budget (Yeoh 2011). In 2015, 25 percent of all development fund allocations went to the PMD (Lee and Lee 2016), which has had an increased number of agencies parked under its purview, thereby giving it abilities and powers to shape the economic, political and social environments of Malaysia.

### Party-centred state administrations: *'kerajaan berparti'*

Partly in response to its electoral setback in 1959, UMNO introduced a slate of new entities to shore up confidence in the rural areas it hoped to secure support in. Infusing the 'party' within the administration throughout the country is one of the core ways that UMNO cemented its control over policy and implementation.

In 1959, the federal government established state rural development committees (state RDCs) and district rural development committees (district RDCs) at the district level (Puthucheary 1970). The first State Development Officers (SDO) were officers of the Ministry of Rural Development, who were federal civil servants. Although state governments initially opposed the SDO, they accepted it because they were expected to bring federal funds (Shafruddin 1987). Then Prime Minister Razak reformed the administration by establishing top-down controls, getting projects done by setting up operations rooms at federal, state and division levels, and even empowered district-level organisations and curtailing states' control over them (Washida 2019).

The second wave of centralisation began in the early 1970s, once again following UMNO's electoral setback in 1969. Its strategy was to place the party at the very heart of running government policy. Prior to UMNO's General Assembly in 1971, Deputy Prime Minister Tun Dr Ismail said that "we must ensure that every government policy is determined by the party" (Lim 2008). Following his cue, Razak advocated the new idea of a *kerajaan berparti*, or a government based on the party, as the basis of reorganising the party (Torii 1997). The strength of government agencies would be therefore based on that of the party. With the exceptions of the Bureaus of Politics and Finance, all other five bureaus that were set up by UMNO were involved in the implementation of the NEP. Tun Razak also set up UMNO boards in all Alliance-controlled states to advise their chief ministers on the running of state governments and to reflect the "government's policy of giving the party a say in the implementation of policy" (Lim 2008).

The direct relationship between party and policy is evident here. Azeem's (2011) research also complements this, showing that although it started out as an umbrella for various Malay state-centred associations, over time UMNO centralised its organisational structure and decision-making processes, to directly control outcomes at the state level. For instance, the party's Central Executive Committee exerts discipline over the state branches, and its 1949 party constitution stipulated that the head of the state executive committee was to be appointed by the president.

By then, most states in Malaysia had already set up their state economic development corporations (SEDCs), beginning with Selangor in 1964, with the objective of promoting economic growth to achieve social and economic transformation of society at the state level (Puthucheary 2011). However, over the years there were centralising tendencies, such as the Emergency (Essential Provisions) Ordinance no. 87 of 1971 providing for federal involvement in state corporations established by state law, allowing federal authorities some control over state corporations by having the relevant federal minister approve these corporations' budgets and providing for at least three federal representatives on the boards (Thillainathan 1976). Administrative instruments used to control SEDCs from the centre were also used, such as bringing the coordination of SEDCs under the direct control of a federal committee for coordination of SEDCs in 1969 and then later the Ministry of Public Enterprises (1976) and the Ministry of Entrepreneur Development (1990), by which time control encompassed strategic, operational, financial and personnel matters (Singh 2011).

In addition to SEDCs, the federal government also set up regional development authorities in states like Penang, Kedah, Pahang, Johor, and Terengganu to have broader coordinating and supervision functions (Thillainathan 1976). Instead of coming under the Ministry of Land and Regional Development, regional development authority projects in the northern states of Perlis, Kedah and Penang came under the Prime Minister's Department. Essentially, federal institutions such as the Majlis Amanah Rakyat (MARA) and the Penang Bumiputera Participation Steering Committee were set up as an extension of federal government's power at the state level; they were to "promote the Bumiputera entrepreneurial class at the state level because the state government has not done so" (Halim 1992). The NEP was therefore considered to be a valid justification for federal intervention into state economic policy and development projects.

The State Economic Planning Units (SEPU) were also formed at the state level in 1972, which manages state planning proposals under the Economic Planning Unit (EPU)'s guidance (Shafruddin 1987: 193). In terms of planning and implementation of projects and resources from the federal centre to states and districts, the State Action Council and District Action Committees were created (Abdul Aziz 1974: 55), as were the *Jawatankuasa Kemajuan dan Keselamatan Kampung* (JKKK, or the Village Development and Security Committees). An elaborate bureaucracy was created between the 1960s and 1970s that would cement the federal's control over resource allocation and disbursement throughout the country. Some of these are further elaborated upon below in the section titled 'the politico-bureaucratic complex of federal agencies'.

## Administrative encroachments: greater central political control

The transfers of territories under federal government control were also ways in which the centre encroached upon what would have been under states' jurisdiction. This gave greater central political control to the UMNO-led federal government.

Labuan was transferred from Sabah to federal control in 1984, alongside several state departments and this was argued to be an enabling process for the federal government to achieve integration between the two levels of governments and rationalize federal-state relations (Lim 2008). In fact, Sabah was never compensated by the federal government for giving up its territory, unlike Kedah and Selangor, where Kedah continues to be compensated annually for territories handed over to the central British government in 1869, as well as Selangor for its cession of Kuala Lumpur in 1973, and Putrajaya in 2001 to the federal government (Wee 2011).

The carving out of Kuala Lumpur from Selangor was particularly contentious, as it was not only the state capital but also the federal capital, and this took place after the 1969 elections in which the opposition won one half of the state seats, and six months before the following general elections were held in 1974, therefore seen as a way to maintain Barisan control over the state of Selangor. When the Putrajaya Bill 2000 was presented to the Selangor state assembly for approval, all six opposition members walked out in protest of the speed at which it took place and the failure to consult the people, non-governmental organisations and the state assembly (Wee 2011).

Organisational overlap also takes place when there are federal bodies set up to manage a geographical area within a state. In 2006, a large area of 23,000 acres of land in Johor was purchased by Khazanah Nasional, the federal government investment arm, to develop Iskandar Malaysia. The project is managed by the Iskandar Regional Development Authority (IRDA), a federal statutory body jointly chaired by the Prime Minister and Johor's chief minister, charged with planning, policy formulation and investment facilitation.

In this case, the state government was unable to alter the design and thrust of the project, but did succeed in its protest against some incursions by the federal government which was only partially accommodated (Hutchinson 2015). Other major federal projects requiring land approval from states such as major highways, railways and infrastructure development have almost always been smoothly facilitated, unless the states are held by the opposition, since according to Article 74 of the constitution land comes under state jurisdiction and is therefore one of the few bargaining tools available to states.

Privatisation is another means by which powers were greater centralised to the federal government. The federal government in its privatisation initiative throughout the 1980s and 1990s under the leadership of then prime minister Dr. Mahathir Mohamed was intended to release the full wealth of the nation, since the privatisation of state enterprises, assets, services and corporate equity provided a vehicle of distribution by which big Malay entrepreneurs and individuals of lesser wealth could get their share (Khoo 1995).

Tan (2008) however contends that the reasons were more political than economic, and that the allocation of resources already centralised through UMNO's control of the state became increasingly personalised around a few political leaders, resulting in a privatisation programme that was "characterised by a personalized, non-transparent selection process, weak regulation, and limited complete divestitures, together with continued state intervention and presence in many privatized former state enterprises".

Privatisation involved multiple sectors, including urban rail, the national airlines and national car, but it was the sectors of water, sewerage and solid waste management that specifically impeded upon states' policy space as these were previously governed by state governments. Under the privatisation drive, more than 500 government-linked companies (GLCs) were established. Dr. Mahathir also transformed the Economic Planning Unit (EPU) of the prime minister's department making it the centre of national planning, where all private project proposals would need to be cleared by the EPU first before they were submitted to the cabinet (Chin 2011).

## Resource distribution and allocations to state and local governments

This section lays out the current practice of how fiscal resources are distributed and allocated to the second and third tiers of government: the states and local governments. I hope to show by the end of this section that although federal-state transfers are constitutionally guaranteed, there are other types of resource distribution methods from the centre to the periphery that are easily influenced through political means. Hidekuni Washida's *Distributive Politics in Malaysia: Maintaining Authoritarian Party Dominance* (2019) has also presented evidence from the Third Malaysia Plan through to the Eighth Malaysia Plan (1976-2005) that the Barisan Nasional government exercised impartiality when *allocating* budgets to states, but that the *disbursement* was conditional upon the electoral outcomes in those states. Hence, "BN actually rewarded well-performing units at the actual disbursement stage" (p. 96) but those states that experienced opposition takeover suffered negative effects of budget disbursement.

### 1. Federal-state grants and loans

#### *Grants to state governments*

A previous policy paper[1] had already set out in detail the different types of federal-state transfers as guaranteed by the federal constitution. These are displayed again here within tabular form, but will not be further elaborated upon. Suffice to note that although some of these are fixed via a formula, for instance the capitation grant and export duties, many other grants are given on a conditional basis like the development grant.

It is also worth repeating here that the National Finance Council (NFC, as provided for in Article 108 of the federal constitution) is one of the available avenues for state chief ministers to negotiate for such development grants. Chaired by the prime minister, members include other federal ministers and a representative from each state. The federal government evidently dominates the NFC and therefore is hugely influential in determining the disbursement of conditional grants, or grants whose formulae are not fixed, despite the availability of which is constitutionally-guaranteed. Annual federal-state transfers are compiled within the federal government's annual budget (estimates of federal government expenditure).

[1] Policy Ideas No. 59, "Reviving the Spirit of Federalism: Decentralisation Policy Options for a New Malaysia"

**Table 1: Federal Transfers to State Governments**

| General Grants | Special Grants | Tax-sharing Grants |
|---|---|---|
| Capitation grants (based on a state's population size) | State road grant | Export duties on tin, iron and other minerals (ten percent)[2] |
| State Reserve Fund grant: deficit grant | Service charge grant | Growth revenue grant[3] |
| Development grant (conditional) | Cost reimbursement grant | |
| Contingencies Fund grant for unforeseen needs | Grants to religious institutions | |
| State advanced grant for cashflow difficulties | For Sabah & Sarawak as per Malaysia Agreement (no review after 1973)[4] | |
| | For handing over territories in Kedah and Selangor[5] | |

*Source: Federal Constitution of Malaysia*

### *Loans to state governments*

Article 111 of the federal constitution restricts the state government from borrowing unless it obtains the approval of the federal government. When permitted, a state is allowed to borrow from the federal government, private banks and other financial institutions for a period not exceeding five years and is subject to conditions as specified by the federal government. No guarantee is to be given by the state government unless the federal government approves so, and subject to certain conditions.

Federal loans to states have been given to cover state government fiscal deficits as a result of their development expenditures. The following table shows net federal loans to all states between 2010 to 2017, where there has been a significant increase from RM1.7 billion in 2010 to RM5.5 billion in 2017.

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*[2] The Federal Constitution allows the Federal Government to increase this grant for the peninsular States to more than the minimum 10 percent of export duties on minerals. This tax-sharing grant was created at the same time that State royalty rights to minerals were prohibited unless provided for by federal law (Jomo and Wee 2002).*

*[3] If federal government revenue other than export duty on tin and revenues under the Road Ordinance (1958) grows by more than 10% in any particular year, the increase will be allocated to the state government in the form of a growth revenue grant. The growth revenue grant suggests tax-sharing expected of a federation, but it is subject to a maximum of RM150 million in any one year. The increase in revenue is only shared for the year concerned (Wee 2011).*

*[4] The grants to Sabah and Sarawak were given on the basis of the conditions for incorporation into Malaysia that were supposedly subject to later review, which has never taken place. Currently, RM26.7 million goes to Sabah and RM16 million to Sarawak (Jomo and Wee 2002).*

*[5] Kedah receives RM10,000 a year for territories handed over to the central British government in 1869, while Selangor receives annually RM18.3m for handing over Kuala Lumpur and RM7.5m for handing over Putrajaya to the federal government.*

**Table 2: Net Federal Loans to all States**

| RM million | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017* |
|---|---|---|---|---|---|---|---|---|
| Net Federal Loans | 1,757 | 18 | 115 | 2,049 | 2,742 | 5,565 | 5,477 | 5,556 |

**Estimate* *Source: Economic Report 2014*

In May 2017, the Penang state government through its legislative assembly passed a law allowing it to borrow money from a bank or financial institution to pay for new public infrastructure and other projects, called the Loan (Bank and Other Financial Source) Enactment 2017. Under the law, all loans by the Penang government will be charged to the state's Consolidated Fund. Then Chief Minister Lim Guan Eng said the enactment was primarily to allow the state government to borrow money from the Export-Import Bank of China (Exim Bank of China) to finance the Penang Transport Master Plan (PTMP) (Nambiar, 2017).

As clarified earlier, the federal constitution makes it clear that any state government loan must first be approved by the federal government. Penang made the request, but BN then controlled the federal government and hence it is unsurprising why the loan was not approved. It is also interesting to note that the PH after ascending to the federal government in mid-2018 also did not yet approve the loan, possibly due to intra-coalition discussion over what was considered to be a highly controversial project[6].

The Penang state government had then also requested that the federal government guarantee up to RM10bn of *sukuk* or Islamic bonds to pay for its elevated light rail transit (LRT) as part of its PTMP. In November 2019, the Chief Minister said the prime minister had written to confirm the federal government sovereign guarantee for bonds issued under the state's special purpose vehicle to raise money for the LRT project (Mok, 2019). The guarantee will likely be reversed now, given the change in the federal government as at March 2020, and the loan or *sukuk* issuances stalled.

[6] *The PTMP has raised ire from local civil society groups such as Penang Forum, claiming that the Penang state government's financing solution for the mega-project in the form of land reclamation will have grave social and environmental impacts. This is disputed by the Penang government.*

**Box 1: Can state government-linked companies (GLCs) raise their own financing?**

State governments must obtain federal government approval for any loans or funds they raise. However, this rule is not so clear when it comes to state government-linked companies (GLCs). The general understanding is that the same approval must be obtained as long as the state GLC's operations impact upon the state balance sheet. However, a more careful inspection is required of the respective establishing legislations of each of the GLCs. For instance, some state statutory bodies (those set up by way of state enactment) explicitly require federal government approval. This would include the State Economic Development Corporations (SEDCs) that were the earliest form of GLCs set up within states. However, other state statutory bodies do not explicitly state this requirement, like Selangor's Menteri Besar Incorporated (MBI) and Penang's Chief Minister Incorporated (CMI), for instance.

Furthermore, numerous other state-owned companies exist today whose balance sheets operate completely separate from the state governments'. As these are not guaranteed by the state government, the conditions for raising financing are not as clear. For instance, many of the second and third-tier state GLCs are incorporated under the Companies Act 2016. Governed by company law, it is assumed that they would have the rights of any other such company with respect to financing.

Another route is for any corporate body to be included under the list of gazettes under the Loans Guarantee (Bodies Corporate) Act 1965 (Revised 1972). Once included, the federal government is confirmed to provide federal government loan guarantees to the entities, at which point the bodies are permitted to raise their own financing via bond issuances or otherwise. The four state-linked companies that are listed within the gazette between 2011 and present are Johor Corporation, Pulau Melaka Ltd., Sarawak Hidro Sdn. Bhd. and the Pahang State Development Corporation (Federal Gazette, 2020).

Several state GLCs have in the past issued bonds and *sukuk* (Islamic bonds), but it is unclear if this was done with the clearance of the federal government or not. In these circumstances, they would however need to obtain approval from the state government and would be rated on their own financial strength, the project's financial viability. If they had not received federal government guarantees, they would require state government's guarantees based on land concession, land use rights and so on. Finally, they would also need to register with the Securities Commission for corporate bonds issuance. Examples of state GLCs that have raised bonds and/or *sukuk* are Johor Corporation, the Selangor State Development Corporation (PKNS), Penang Port Sdn. Bhd., Teknologi Tenaga Perlis Consortium Sdn. Bhd., Sarawak Energy Berhad, Cahya Mata Sarawak Berhad, Sarawak Power Generation Sdn. Bhd., and Sabah Development Bank Berhad (Bond and Sukuk Information Exchange, 2020).

## 2. Ministries and federal bodies

### *Ministries and related ministerial bodies*

Federal ministries whose functions are to provide public service delivery such as the Ministries of Health, Education, Home Affairs, Environment, Agriculture, and Rural Development have federally-seconded offices based within each of the states in Malaysia. The following table illustrates examples of federal ministries and their corresponding federally-seconded state agencies. These bodies report primarily back to their federal headquarters in Putrajaya and although physically located within states, the state governments have no decision-making mandate over them.

**Table 3: Selected federal ministries and corresponding federal departments within states**

| Selected Federal Ministry | Selected corresponding federal departments within states |
|---|---|
| Health | State Health Department<br>District Health Office<br>Public Hospitals<br>Health Clinics (*Klinik Kesihatan*)<br>Community Clinics<br>Dentistry Clinics |
| Education | State Education Departments<br>District Education Offices<br>Public Schools/Vocational Colleges<br>Teacher Training Institutes |
| Home Affairs | Royal Malaysian Police: State Police Contingents<br>Immigration Offices<br>National Registration Offices |
| Environment | State Department of Environment |
| Agriculture | State Department of Agriculture |
| Rural Development | Village Community Centres |

These are included here to demonstrate one of the main ways through which the federal government disburses resources downwards, but these are financed directly through the federal departments and do not flow through state government finances in any way. As such, fiscal expenditure on these departments are not recorded within federal-state transfer accounts.

The only relationship between these federal departments and the state governments lies in their representatives being present at state government meetings that are pertinent to their specific policy area of work. For example, the state government may call for a meeting to discuss the potential impact of a large development project taking place within a certain area, and representatives of the state departments of health, environment and the police force may be invited to attend to provide feedback on their respective domains.

### *The 'politico-bureaucratic complex' of other federal agencies*

There are other federal agencies that disburse resources downwards, three important ones of which are described here, namely the functioning of the Implementation and Coordinating Unit (ICU), the Federal Development Offices (previously called State Development Offices) and the *Jawatankuasa Kemajuan dan Keselamatan Kampung* (JKKK, or the Village Development and Safety Committees). All of these bodies have a similar mandate of ensuring that federal resources are planned for and spent at the state and district levels, well-coordinated to ensure that their efforts combine well with local machinery.

The introduction of these methods came about during Barisan Nasional's height of single-party dominancy and were therefore "integrated into the administrative and party hierarchy" (Washida 2019: 53). Shamsul (1986: 201) aptly termed the refined combination of such planning and implementation functions with party machinery (politicians, party members, supporters) especially within BN-controlled states as "the politico-bureaucratic complex".

### (i) Implementation and Coordinating Unit (ICU)

Simultaneous to the introduction of the New Economic Policy (NEP), the Implementation Coordination and Evaluation Unit (ICEU) was first established within the Prime Minister's Department (PMD) in June 1971 under the National Development Working Committee (NDWC) and then later merged with the Development Administration Unit to become the Implementation Coordination and Development Administration Unit (ICDAU) in January 1972 (Washida 2019: 53). The ICDAU's tasks were to act as secretariat for the National Action Council (chaired by the prime minister), and to supervise and coordinate projects and policies of "all ministries and departments at federal, state, and local levels including state public corporations and operations room (Abdul Aziz 1974: 54-6).

Today renamed as the Implementation and Coordinating Unit (ICU), it coordinates resource planning and distribution between the federal and state governments, and manages the relationships among various ministries, departments and agencies alongside the Economic Planning Unit, also under the PMD[7]. In states controlled by the national opposition, the ICU rarely works directly with the state government and would coordinate any expenditure directly with the Federal Development Offices (FDO). For instance, although Minister of Economic Affairs Azmin Ali and the ICU met with the Kelantan State Action Council (SAC) in March 2019, together with 350 Kelantan federal department officers within the state, this was to update them of latest federal government policy, not necessarily to work with and through the Kelantan state government for development projects (Implementation and Coordination Unit, 2019).

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*[7] The Economic Planning Unit (EPU) which prepares the country's annual budgets has historically been parked under the Prime Minister's Department (PMD). For a brief period under the Pakatan Harapan government from May 2018 to February 2020, it was removed from the PMD and absorbed into a new ministry entirely, the Ministry of Economic Affairs. As of March 2020, it has been restored to the PMD under the Perikatan Nasional government.*

**Box 2: Constituency Development Funds (CDF), a form of direct political financing**

With the introduction of the Constituency Development Fund (CDF) in 1971, this allowed BN politicians the opportunity to apply for minor development projects within each constituency (Washida, 2019). Still very much in existence today, these are an important source of funds for politicians within the state, given that constituency demands for elected representatives to provide for a range of items are prevalent, whether to fix flood-affected roofing or build futsal pitches for local communities. This way, they can be seen to be performing their duties as expected of them within the Malaysian political environment, especially important within the semi-urban and rural areas.

These CDF funds are however not given to opposition members of parliament. In 2017, opposition parliamentarian from Kedah Gooi Hsiao Leung attempted but failed to table a private member's Bill, the "Constituency Development Fund Bill 2017" after the then-Kedah Menteri Besar threatened to halt development funds to his constituency. Among Gooi's proposals were the creation of a constituency development fund to be coordinated by the Federal Development Office in each state; a formal committee chaired by the parliamentarian on all projects within the constituency; a twice-yearly public forum for feedback purposes; and a bipartisan parliamentary select committee to oversee and review the allocated funds (Malay Mail, 2017).

After 2008, Pakatan Rakyat-led state governments provided constituency development funds not only to their state legislators but to members of parliament within their states. They also similarly denied such funds to their state opposition on the grounds that their parliamentarians were not receiving constituency funds at the federal level. Although BN state legislators expressed unhappiness at not having received development funds from the Pakatan-led state governments, they were actually able to obtain funds directly from the ICU, which were in fact more efficient at allocating funds compared to state-monitored funds via the District Offices.

### (ii) Federal Development Offices (FDO)

As mentioned in an earlier section above, the State Development Officer (SDO) position was established as early as 1959, representing the then Ministry of Rural Development to gain access to state governments, whilst supervising the implementation of projects at the state and district levels and disbursing federal resources by bypassing the existing state bureaucracy (Shafruddin 1987: 190-1, 241-2, 247-9). The State Development Office, later renamed as the Federal Development Office (FDO), reports to the ICU as described above. However, note that in Sabah and Sarawak, these officers are known as 'federal secretaries', with the express function of improving relations between the states and the federal government.

Today, the FDO performs similar functions in planning and implementing development projects within states but does not necessarily do so with the consent of, and cooperation of, the state governments themselves. This is highly dependent on the political affiliation of the state government, so for states controlled by the national ruling party, representatives from the FDO would attend common planning meetings within the state, where in fact resources are also coordinated. However, within national opposition-controlled states, the opposite is true.

When Parti Bersatu Sabah (PBS) controlled Sabah, then in national opposition from 1985 to 1994, even the Sabah BN called for the closure of the Sabah FDO, claiming function duplication and that it was an "insult to Sabahans" (Loh 2010: 139). The federal government argued that it was only through BN rule that Sabah would experience development. Evidently, development credit-claiming had been a fundamental part of assuring voters of the federal government's performance legitimacy, especially since the local BN chapter had also resisted FDO funds.

Similarly, as described in Policy Paper No. 59, the FDO was physically removed from the official state buildings in the states of Selangor and Penang when they were taken over by Pakatan Rakyat in 2008. However, interestingly, the District Action Working Committee (*Jawatankuasa Kerja Tindak Daerah*) meetings chaired by the District Officer that were held in Selangor during Pakatan Rakyat's (later Pakatan Harapan) second term in government were an important platform during which FDO officers would attend, providing updates on upgrading and repairs, and development projects funded by the ICU within the state[8].

Under the Pakatan Harapan government, the FDOs continued to exist and were especially important bodies in states it did not control, Perlis, Pahang, Kelantan, Terengganu and Sarawak. Given the change in government to Perikatan Nasional as at March 2020, the FDOs are likely to continue the practice of bypassing state governments, particularly within states it does not control such as Selangor, Penang, Negeri Sembilan and Sabah.

### (iii) *Jawatankuasa Kemajuan dan Keselamatan Kampung* (JKKK)

As referred to above, this committee was originally launched as the *Jawatankuasa Kemajuan Kampung* (JKK) in 1962 alongside Order No. 3 under the rural development programme, but was later renamed as the JKKK when security became a more crucial issue in 1975 (Shamsul 1988: 223-5). The structure of the JKKK was as such: it would be chaired by the village head (or *ketua kampung*), members of whom would be appointed by the district rural development committees (RDCs) and endorsed by the respective state chief ministers (Ness 1967: 202). Alliance members of parliament and state legislators were part of these committees and hence had significant influence over the location and types of projects within their own constituencies (Esman 1972: 103; Washida 2019: 49)

The BN later went on to establish the Federal Village Development and Safety Committees (*Jawatankuasa Kemajuan dan Keselamatan Kampung Persekutuan*, JKKKP) within the states that it did not control, in essence a complete duplication of the existing JKKK system in place. Because the village heads (*ketua kampung*) are nominated and appointed by the state government of the day, along with the corresponding committee members, it was considered important for the BN to have such a parallel committee to first, appoint loyalists into positions who would receive allowances[9], and second, ensure a platform existed for the disbursement of community-oriented funds. One example of such funds is the Social Amenities Programme under

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*8. FDO officers would more likely attend the meetings chaired by the District Officer held within the Land and District Offices than, say, those hosted by the state government itself. A likely reason for this is that these meetings would be attended by the locality's Orang Besar Daerah, the official representative of the Ruler within the state, a position that while is arguably a historic relic of the past, continues to be highly respected by Malay communities within the rural and semi-urban areas.*

*9. Small allowances were provided for each JKKK and JKKKP, funded by the Ministry of Rural and Regional Development: RM900/month for the Chair, RM300/month for the Secretary, RM100/month for meeting expenses, RM50 for attending meetings and, exclusive to the JKKKPs, hospital stay and treatment coverage (Ministry of Rural and Regional Development, 2017).*

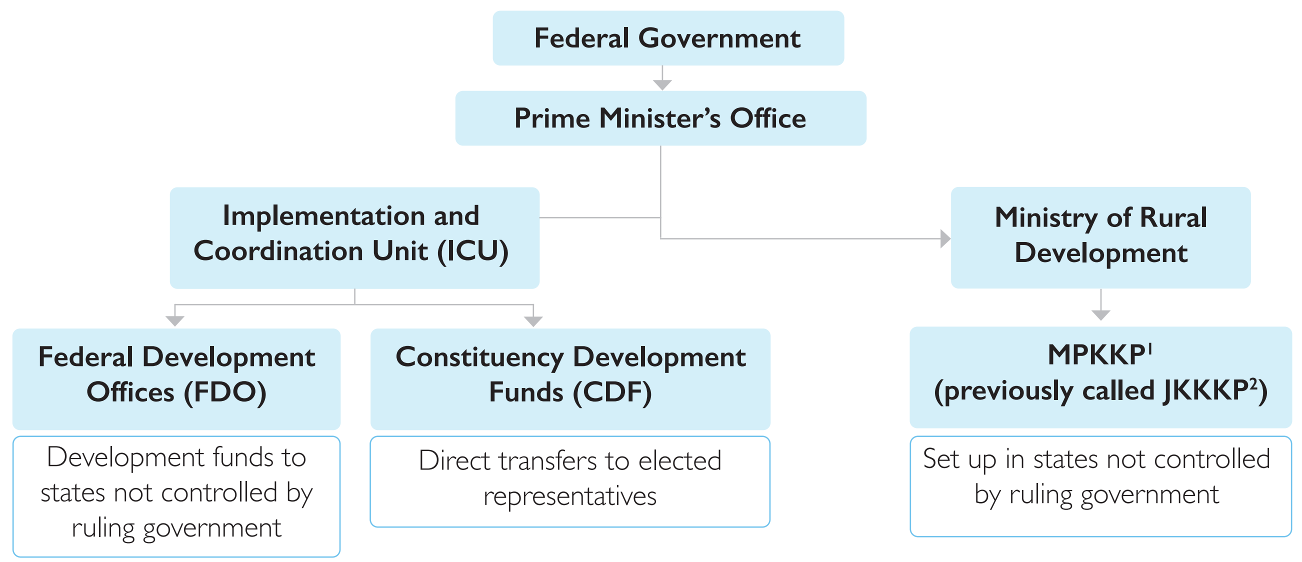
the Ministry of Rural and Regional Development worth RM500,000 and below[10]. Both the JKKKs and JKKKPs were administered by the Rural and Regional Development Ministry.

When the Pakatan Harapan government took over in May 2018, it removed existing JKKK members within the states it controlled. To its credit, it also abolished the JKKKPs and introduced the new Village Community Management Council (*Majlis Pengurusan Komuniti Kampung*, or MPKK), which it activated in all states, including those controlled by the opposition to avoid the problem of parallel committees as described above.

However, reportedly due to the fact that the MPKK were "allegedly involved in political activities" (Ong, 2019) presumably that of then-opposition UMNO, in specific reference to the Pahang state government, the federal government set up the Federal Village Community Management Council (*Majlis Pengurusan Komuniti Kampung Persekutuan*, or MPKKP) to the resistance of the opposition-led states. This is precisely the duplication that the Pakatan coalition had experienced when it was in the national opposition.

There was also conflict between the centre and the Sarawak state government. Although the Ministry of Rural Development agreed for Sarawak to maintain its original JKKK (as opposed to changing it to the MPKK), the PH government reduced the monthly allowance of MPKK chairpersons nationwide from RM900 to RM500, possibly as part of its massive cost-cutting measure given it was faced with the problem of a growing fiscal deficit. The Sarawak state government topped up the remainder allowance of RM400 per JKKK chairperson[11] (Borneo Post Online, 2019). It is clear that the JKKK, or now-renamed MPKK system, has been a crucial instrument of the 'politico-bureaucracy complex' especially useful for the federal government to maintain its interactions with the lowest parts of its constituents. And as such, influence continues to be wielded from the centre for the same reason.

**Figure 1: Federal ministries and agencies that disburse funds downwards**




1. *Majlis Pengurusan Komuniti Kampung Persekutuan*
2. *Jawatankuasa Kemajuan dan Keselamatan Kampung Persekutuan*

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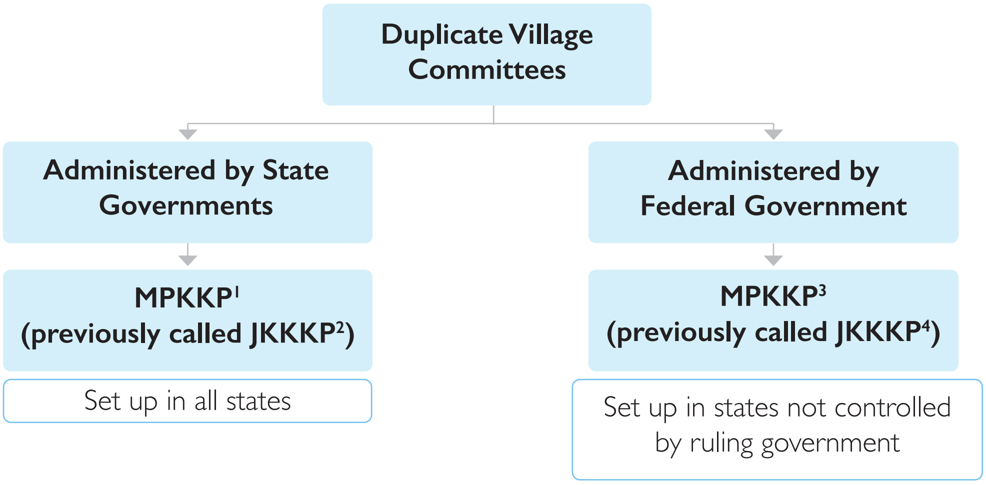
*[10] Project applications can be received from parliamentarians, state legislators or chairpersons of JKKK at the state level, and district officers at the district level but implemented by the Federal Development Office (FDO).*

*[11] The JKKK chairpersons in Sarawak are the 'Ketua Kaum' comprising Tuai Rumah, Ketua Kampung and Kapitan, all significant figures within the local communities.*

**Figure 2: Duplication of Village Committees**




[1.] *Majlis Pengurusan Komuniti Kampung*
[2.] *Jawatankuasa Kemajuan dan Keselamatan Kampung. JKKK is maintained in the state of Sarawak.*
[3.] *Majlis Pengurusan Komuniti Kampung Persekutuan*
[4.] *Jawatankuasa Kemajuan dan Keselamatan Kampung Persekutuan*

## 3. Transfers to local governments

Local governments are governed by the Local Government Act 1976 (Act 171). Local governments receive their revenues primarily from property assessment fees (also known as *cukai pintu*[12]), as well as tax on entertainment activities. Another form of direct tax is in-aid tax on government property. Their non-tax revenue sources are from licenses and permits, services fees, property sale receipts, rents, interests and dividends, fines and penalties and other forms of non-tax revenue.

Finally, non-revenue receipts is a third category of revenue sources, consisting of reimbursements and refunds, receipts from government agencies and grants from the federal government and other government agencies. However, grants from the federal government to local governments are relatively insignificant when compared to grants to state governments, as seen in the table below.

**Table 4: Federal grants to state and local governments**

| Federal Grants to State and Local Governments | 2017 |
|---|---|
| Percentage of Consolidated State Revenue | 33% |
| Percentage of Consolidated Local Revenue | 4% |

*Source: Economic Report, 2018; Estimates of Federal Government Expenditure 2019*

[12.] *This should be distinguished from cukai pintu, or quit rent, which is collected by state governments, imposed on any landed property. Payment for strata properties is called parcel rent, or cukai petak.*

As set out in Sections 41, 46 and 47 of the Local Government Act 1976, local governments are permitted to raise loans only upon state government approval (all local governments come under the jurisdiction of the respective state government), but only for the purposes of defraying expenses incurred and paying off existing loans. Loans can be made from the federal, state governments, or from the private sector, while total loans of a local authority cannot be more than five times the value of the current valuation list of the authority and with a tenor of not more than 60 years. However, interestingly, the Pasir Gudang Municipal Council in Johor issued a *sukuk* of RM80 million in 2005 via a Special Purpose Vehicle (SPV) established as a Trust, after receiving approvals from the Ministry of Finance and the Johor state government.

Most grants to local governments come from the federal government, whereas state governments only support local governments that are not financially able to cover basic costs. This would apply to the most rural of local governments, whose property rates are not high enough that receipts can cover local government expenditure. In Selangor, for example, the state government would not need to support the wealthier City Councils of Petaling Jaya and Subang Jaya, but may have to contribute to those in the hinterland such as the District Councils of Sabak Bernam and Kuala Selangor. Another form of support to local government may also come in the form of state governments paying for state policy, for instance the Penang state government deciding to bear the costs of the Goods and Services Tax (GST) on fees of its two local governments on the Penang island and in Seberang Perai.

## Policy Recommendations

This set of policy recommendations should be viewed in conjunction with those offered in Policy Ideas No. 59. The relevant recommendations there were: *1) Perform a Review of the Ninth Schedule in the Federal Constitution with the aim of decentralising some key policy functions, 2) States to form their own full civil service, 3) Federal governments to consult state governments for major administrative appointments, 4) Reform the FDOs as state bodies, 5) Restore local council elections, 6) Increase proportion of state-appointed senators*[13], *7) States to receive consumption tax proceeds; and 8) An apolitical Grants Commission to be established to determine a fixed formula for federal-state transfers*[14]. Four more policy recommendations are made in this paper, where proposals are made explicitly to remove the possibility of political bias in resource allocation from the centre to the periphery, as follows:

### Policy Recommendation 1: Provide greater fund-raising flexibility for state and local governments

Financially sound state and local governments should be given greater fund-raising flexibility, to be able to obtain loans and raise funds from banks and bond issuances. Strict financial and other regulatory controls can be put into place to ensure that these loans do not become bad debts of state or local governments, based on eligible collaterals such as cash flow or other assets. States and local governments can jointly determine the economic need of proposed projects. These can be evaluated on a case by case basis, ensuring the availability of feasible instruments e.g. whether SPVs are necessary, what the legal liabilities are to state and federal government, investors' perception and so on. With greater flexibility, states and local governments especially in the more remote parts of the country may consider obtaining loans for development purposes. Local authorities in China are permitted to raise their own funds, and as a result have been able to experience rapid

13. *Another possibility beyond the scope of this paper is to consider election of senators, such as is carried out in Australia.*

14. *See Policy Paper No. 59: Reviving the Spirit of Federalism: Decentralisation Policy Options for a New Malaysia, IDEAS, for the complete elaboration of these recommendations.*

development within regions that are far removed from the larger city centres or the administrative capital of Beijing. With these flexibilities, the state governments do not have to rely so heavily on the federal government, which, as this paper has shown, is subject to political bias and uncertainty.

### Policy Recommendation 2:
### Constituency Development Fund (CDF) allocations to be given regardless of party affiliation

Constituency Development Fund (CDF) allocations should be given on the basis of becoming an elected representative in parliament, provided to all regardless of their party affiliation. This rule should apply both at the federal and state levels, where state governments should also provide such allocations to all state legislators alike. Both the federal and state governments should also legislate for such a requirement, to ensure the equal application of this rule regardless of political leader. This would remove the uncertainty of not receiving development funds and allocations if the elected representative falls into the 'wrong' political coalition. These are important funds, which politicians depend on to service their own constituents. Further, strict conditions can be attached to the disbursement of funds to ensure that they are not misused. A review should be conducted to evaluate the CDF system, in light of the country's rapid urbanisation, where CDFs may be useful in rural areas, and urban areas may rely on more institutional funding mechanisms via local councils.

### Policy Recommendation 3:
### Table a Constituency Development Fund (CDF) Bill in Parliament

The Constituency Development Fund Bill should not only mandate that CDFs are given to all elected representatives regardless of political affiliation, but it should also regulate the manner through which the funds are coordinated, allocated, disbursed and integrated with other forms of development funds at the lower levels. It is proposed that the CDF fund should be coordinated jointly between the state government and the Federal Development Office in each state, regardless of which political party (or coalition) the state government falls under. Second, the state government should be consulted when formulating these development fund allocations. Third, a formal committee should be chaired by the parliamentarian on all projects within the specific constituency to coordinate all such funds, with the involvement of the state government. Fourth, a twice-yearly public forum should be organised for feedback purposes to ensure public participation in the development fund allocation process. Finally, a bipartisan parliamentary select committee should oversee and review the allocated funds. (Some of these proposals were included in the proposed private member's bill by Gooi Hsiao Leung in 2017, which was never tabled).

### Policy Recommendation 4
### Abolish the duplicate MPKKPs across all states

The new Perikatan Nasional government should resist political duplication of resources. It should abolish the existing Federal Village Community Management Councils (*Majlis Pengurusan Komuniti Kampung Persekutuan*) in all states that it does not control (currently, Selangor, Penang, Negeri Sembilan, Sabah and Sarawak). A better, more institutional approach is to channel those resources to the existing Village Community Management Councils (*Majlis Pengurusan Komuniti Kampung*) that are already set up in these states. By doing so, the MPKKs, which are appointed via the state governments, can continue to benefit from federal resources for functional reasons, such as ensuring community problems are resolved.

## Conclusion

The objective of this policy paper is to document how the resources flow from the centre to the periphery, in this case from the federal government to state governments and local governments, and from there to local communities. The paper argues that although there are some institutional safeguards in place (the federal constitution and other legislations) to ensure there is stability and continuity regardless of the government of the day, the reality is that these decisions are arbitrary and therefore highly influenced by political affiliation. This does not bode well for the political and economic stability of the country's many states.

The events of February and March 2020 and the accompanying political turmoil are a testament to Malaysia's weak existing structures and systems, which in turn affect predictable fiscal conditions so inherently crucial to sustain regional development across the country. Because politics influences resource allocation and disbursement, the market cannot accurately predict performance of state-run projects, for instance, which may depend on federal guarantees, loans or grants. States are ultimately at the mercy of the federal government of the day, and along with them even the constituency development funds, which ultimately affect constituents' livelihood – especially the lowest-income communities, who are the hardest hit.

States that are politically aligned with the federal government also play an important role in lobbying for development funds and projects; as such, the state chief ministers and Menteri Besars also coordinate upwards by placing pressure on the ministries and ministers they may have good relationships with, through the leverage of constituency votes, legal administrative domains (such as land and local government), as well as via influence from the private sector and in certain cases, the Rulers. However, even under such circumstances which have been termed by Washida (2019) as "collusive agency", they cannot be considered as reliable and predictable systems since again, decisions are arbitrarily made.

If the previous policy paper called for a restoration of the spirit of federalism and a return of more autonomy to state governments, this paper seeks a less politicised environment through which resources are allocated downward. It is clear that changing the rules of the game to ensure greater predictability involve institutionalising systems at both the federal and state governments. While it will be challenging to abolish entire government bodies, for instance the ICU within the Prime Minister's Department, it will still be possible to urge that they coordinate with state-level bodies to avoid duplication.

Up to the 14th general election, the two-coalition system seemed to be relatively stable having been established for a decade between 2008 and 2018. Even Muafakat Nasional that saw UMNO and PAS joining hands was also a move towards the two-coalition system. The events of February 2020 have thrown the notion of this two-coalition system at both the federal and state levels into disarray[15], where different coalitions exist in different states as pointed out in the introduction. Although different governing coalitions at different levels of government is the mark of democracies, Malaysia is still in the process of democratic consolidation and is not yet a mature democracy. Hence, the current situation is still tenuous. However, because even the current federal government is weak and may find themselves in the opposition at any time, this may increase the political incentives for them to ensure equitable constituency allocations.

[15] *The author thanks Ong Kian Ming for highlighting this point.*

The subject of federalism is often subsumed under the subject of public administration in academic literature. In Malaysia however, it is a less predictable affair due to the influence of politics, and analysts ought to examine resource allocation and disbursement through the lens of the political economy. It is hoped that the paper has provided a background for deeper understanding of how historical events shaped federal-state relations, and that its policy recommendations will be considered for public discussion and adoption, more important today than ever before given the political conditions that surround us.

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## Notes

## Notes

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