

Executive Summary

The Governance of Fiscal Transfers in Malaysia: Is it rule-based, predictable, and transparent?

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 rule-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.