

# **Enabling Decentralisation**

and Improving Federal-State Relations in the Federation of Malaysia



YB Gooi Hsiao Leung, Dato' Dr Ooi Kee Beng & Dr Francis Loh Kok Wah (Project Leader)

# Enabling Decentralisation and Improving Federal-State Relations in the Federation of Malaysia

Prepared by:

YB Gooi Hsiao Leung, Dato' Dr Ooi Kee Beng & Dr Francis Loh Kok Wah (Project Leader)



# **CONTENTS**

Executive Summary	1
Preface	7
Part One	9
The Global Trend towards Decentralisation	9
Part Two	11
Historical Origins of the Centralised Federal System	11
Centralised Constitutional Design	12
Part Three	19
A Centralizing Political Process under 60 Years of UMNO-BN Rule	19
The NEP, the Development Process and Centralisation	21
Part Four	25
The Case of Penang after 2008	25
Federal Government Allocation to Penang 2018-2021	27
Developing Public Transportation	29
Local Government and Restoring Local Government Elections (LGEs)	32
Social Welfare	34
Federal-State Relations during the Pandemic	35
Part Five	37
Recommendations for Enabling Decentralisation	37
References	39

# **EXECUTIVE SUMMARY**

#### A Global Trend to Decentralise

- With the political uncertainties experienced in recent years, along with the challenges visited upon all Malaysians during the Covid-19 pandemic affecting all aspects of the workings of governments and of society, the need for federal devolution in the country and for a rethinking and restructuring of federal-state relations has become increasingly strong.
- Federal devolution in various forms was one of the popular aims of the Pakatan Harapan government, and now when the pandemic is almost over, the Penang State Government, in keeping with those high ambitions and in preparation for future crises and to face the economic challenges of the coming decades, has commissioned this study to identify how decentralisation can be quickly, successfully and systemically achieved, and how federal-state relations can in concrete terms be made more effective and fairer.
- In line with the widespread global decentralisation trend, the PH federal government of 2018-2020 managed certain achievements where federal-state ties are concerned, and these should be duly noted, especially in how states in general benefited from them.
- The reasons for decentralisation are many, the most important of which are (1) subsidiarity, the principle that certain functions of states are best performed at the lowest level of authority; (2) that lower levels of government are more knowledgeable about what needs doing at the community level, and (3) that members of the public relate much better to governments at lower levels than at the central level.
- Due to the inter-ethnic nature of tensions in the years before independence, and the contest for incorporation of ethnic rights into the Constitution, little priority was given to empowering state governments, and subsequently and tellingly, sources of state

revenues are today generally limited to taxes over land, natural resources and forests, and fees relating to applications for development plans.

#### **Sustained Centralisation in Malaysia**

- As things stand, the Constitution (Article 109) stipulates that the federal government is
  obliged to provide two major grants to the state governments, namely the capitation
  grant which is based on the population size, and the state road grant.
- The redistribution of tax revenues back to the states has shown itself to be grossly unfair.
   In 2013, for example, Penang contributed RM5.7 billion in tax revenues to the federal government and only received back RM162.7 million in federal transfers (excluding the capitation grant)—representing only 2.85% of the revenue generated by Penang.
- Political expediencies added to the constitutional centrism in place, leading to manufactured domination by Umno-BN over the political process from Day One. Key institutions became politicised and even the civil service, through its career path necessities and other structural mechanisms, became extensions of the Umno-BN apparatus of power. Incompetence, partisanship and declining professionalism soon infected the bureaucracy.
- The development process, packaged within the tight confines of the New Economic Policy (NEP), further contributed to the consolidation of the central government and its control over the states. This has also led to enormous increases in the revenue gap between the federal and the state governments. States have also become increasingly indebted to the federal government.

#### Penang Perseveres after 2008

 Hasty damage control by the federal government in the wake of the change in government in five states in 2008 involved the channelling of development funds away from the new state governments to federally-controlled authorities at the state level. In effect, the BN federal government refused to acknowledge the necessary distinction that is necessary in federal systems between (federal) government-to-(state) government ties from party-to-party ties.

- Meagre development allocations, along with federal control over such basic matters as
  public transportation, have limited the capacity of Penang to plan, manage and provide
  for its population. Over recent years, however, much has been attempted, sometimes
  with some success, to provide services despite the endless constraints placed on the
  Penang State Government by federal authorities; this includes the provision of public
  buses, and even the power to decide where a bus stop should be placed.
- The Bridge Express Shuttle Service (Best) launched in March 2011 to ease traffic between Seberang Perai and Bayan Lepas Free Trade Zone (FTZ) is a good example of a state initiative that succeeded despite federal opposition. The service was smoothly replaced by the free CAT Bridge Bus service in 2020. Besides this, the Penang government also initiated the Central Area Transit (CAT) Georgetown, a free shuttle service that connects the major tourism attractions in central George Town.
- Following the Covid-19 pandemic, the state government decided to fully subsidise public bus transportation state-wide, by providing at a monthly cost of RM300,000, beginning 1 March 2021, free and unlimited rides on all Rapid Penang buses for all members of the public holding a Mutiara pass. In addition, the state has since July 2021 provided free ferry services for pedestrians traveling to and from the mainland, effectively making Penang the first state in the country to provide free public transportation service on land and sea.
- In the case of Penang's iconic ferry service, requests for it to be handed over to the state government were denied by the federal authorities, and the iconic ferries were sadly discontinued.
- Federal support for the Penang Transport Master Plan (PTMP) also proved unreliable. With the Sheraton move, many promising projects needing federal support were undermined by policy reversals by the new federal government.
- In 2008, then-Chief Minister Lim Guan Eng set up a working committee to look into the reinstatement of local government elections. Strongly supported by civil society organisations on this issue, the Penang State Government then pushed for federal

action. The then-EXCO for Local Government, Chow Kon Yeow, successfully moved in 2012 for the Penang State Assembly to pass the Local Government Elections (Penang Island and Province Wellesley) Enactment 2012. Again, the federal authorities disallowed continuance of the process. A legal suit followed, ending with the Federal Court deciding that the state government has no jurisdiction to conduct such elections.

 Social welfare is another area of great concern where improved federal-state relations would be of boon to all concerned.

#### **Recommendations for Enabling Decentralisation**

While acknowledging that Pakatan Harapan's aspirations at the federal level to revive the true spirit of federalism were not fully realised, Penang must nevertheless press on with its decades-long demand for greater decentralisation and for the fair and equal treatment of Penang and all other states in the Federation, by Putrajaya.

Ultimately, in order for states to be self-reliant, confident and pro-active in pursuing their long-term development goals, a thorough rethinking and restructuring of federal-state relations must be undertaken to correct existing imbalances and to empower the states with more direct responsibilities and funds. This Report presents the following recommendations, consciously envisioned to stimulate practical and immediate action on federal devolution—at the federal, inter-state and Penang state levels, connectedly.

#### 1 Establishing a Federal-State Relations Commission

The Penang State Government should advocate for the establishment of a national Federal-State Relations Commission to examine and review in entirety the working arrangements between the federal government and the states relating to powers, functions and responsibilities on all legislative, administrative, financial, and socio-economic matters within the constitutional framework. The terms of reference and the composition of this Commission should reflect the general needs and aspirations of the states.

In particular, the proposed Federal-State Relations Commission must address long-standing demands for greater devolution of financial powers to state and local governments (PBTs): on

revenue-raising, fiscal transfers, redistribution and sharing of taxes; the lifting of restrictions on borrowing by states, and; the equalising of the financial capacities of all states to address fiscal imbalances. To date, institutional bodies such as the National Finance Council have been ineffective in securing a fair deal for the states, but have instead functioned almost ceremonially as an extension of the federal government, with biased favour towards the centre. This disempowerment of such key institutions needs to be reversed.

#### 2 Establishing an All-States Collaboration Committee on Decentralisation

The Penang State Government should take the initiative to establish an All-States Collaboration Committee on Decentralisation. This process may involve certain more eager state governments before other states, but the process should be started with the ambition of involving all states in the Federation in the end. The purpose of the Committee will be to enhance both formal and informal cooperation and consensus building among the states to further their shared interests and to develop mechanisms to coordinate their collective response on federal-state issues.

Such an instrument for inter-state cooperation will facilitate greater engagement between the states, generate deeper understanding of the virtues of federalism to promote good governance, and strengthen the unity and integrity of the country.

#### 3 Establishing a Federal-State Relations Improvement Committee in Penang

The Penang State Assembly should inaugurate a standing / select committee (thus taking the lead in being the first state to do so) to manage federal-state relations in a concrete manner. This Federal-State Relations Improvement Committee will inquire into and report upon matters concerning all operational and administrative working arrangements between federal and state government agencies, on finance, health, social welfare, education, road works, disaster management, flood mitigation, trade and industry, the civil service, and so on.

The reports of the Committee will not only serve as the foundation upon which policy recommendations can be formulated to improve working relations between the federal and state government, and enhance the accountability and efficiency of good governance, they

will also increase awareness and understanding among government agencies and in the general public on key federal-state relations issues.

In short, this interim report and its recommendations point towards the creation of a common platform for all states in Malaysia to collaborate in restructuring federal-state relations, and to help realise the full potential of the federalist structure in the governance of what is an excitingly diverse country. Only with vibrant discussions and continuous adaptations can Federalism be the vehicle through which a more democratic, fair, just and equitable future be secured for all citizens and residents of all states in the country, as had been imagined from the beginning.

# **PREFACE**

During the short 22 months Pakatan Harapan (PH) was in government, before that administration's collapse following the Sheraton Move in February 2020, some notable reforms were undertaken in respect of federal-state relations which ought to be highlighted – the setting up of the Parliamentary Select Committee on States and Federal Relations, the Special Cabinet Committee on the Malaysia Agreement 1963 to provide for greater autonomy of Sabah and Sarawak, and the tabling of the constitutional amendment of Article 1(2) of the Federal Constitution 1957, to restore the status of Sabah and Sarawak as equal partners of Peninsular Malaysia.

Another outstanding development was the federal government's decision to share half of the tourism tax revenue collected by federal authorities; this was announced by the Finance Minister during his 2019 budget speech. This move is significant as it was the first time the federal government had undertaken tax distribution extra-constitutionally for states, outside of the fiscal transfers required under the Federal Constitution.

Under the PH government, states such as Perlis, Malacca and Negeri Sembilan saw their budgets increase, while longstanding disputes over unpaid oil royalties between Kelantan and Terengganu on the one hand and the federal government on the other, were resolved; consequently, Kelantan received RM16.79 million and Terengganu received RM1.27 billion. Poorer and less developed states such as Perlis, Kedah, Kelantan, Terengganu, Sarawak and Sabah also saw increased allocations for development. A total of RM13.05 billion were reportedly channelled to these states under the Shared Prosperity Vision (SPV) initiative launched by the PH government (Yeoh 2020).

Penang, too, obtained urgent federal funding under the PH government; in particular, funds much needed for flood mitigation projects which had not been approved previously by the Umno-BN government. The state's application to further expand Penang International Airport was approved while RM100 million was allocated for upgrading Penang Hill's cable car system. The federal government then also gave a guarantee of RM10 billion (Sukuk Islamic bonds) to pay for Penang's light rail transit (LRT) project under the Penang Transport Master Plan (PTMP).

Alas, this momentum towards revitalising federalism and revamping federal-state relations was nipped in the bud following the Sheraton backdoor takeover in February 2020. The Perikatan Nasional-Bersatu government that displaced the PH government held no interest to conduct a review of, and to reform Malaysian federalism. That being the case, the PH-initiated reforms have been put on hold.

Given the circumstances, it is an opportune time for an independent and thorough review of federal-state relations, given how governance in the country has been increasingly centralised since Independence.

Such a review needs to draw upon available research as well as the experiences of the short-lived PH federal government (2018-20), plus the waxing and waning of inter-governmental relations between PH-led states (like Penang and Selangor) and the Umno-BN federal government since 2008. From such a review, we can draw important lessons and make recommendations on how federal-state relations can be improved in order to promote equitable development, good governance and participatory democracy throughout the country.

Hence, unlike in 2018, this Report will provide future governments with informed recommendations and arguments on how federalism in Malaysia should and can be reformed.

This Report comprises five parts:

- 1. Part One discusses the trend towards decentralisation throughout the world;
- Part Two elaborates on the origins and constitutional design of Malaysia's federal system
  at the point of Independence. In essence, we designed for ourselves a rather centralised
  federal system;
- 3. Part Three discusses how federal-state relations have become ever more dominated by the central government. This was mainly due to two factors, namely 60 years of rule by a single party Umno-BN, and the implementation of the affirmative action New Economic Policy (NEP) (1971-90) which was planned, directed and monitored by the central government authorities to achieve ethnic-quota goals;
- 4. Part Four investigates the specific problems in federal-state relations faced by the Penang State Government, especially since 2008, and;
- 5. Part Five offers several foundational policy recommendations to the Penang State Government to implement and to share with other state governments and in parliament for the common goal of achieving effective and fair governance in the near future for the whole country.

# **Part One**

#### The Global Trend towards Decentralisation

A review and reform of federal-state relations in Malaysia are in keeping with a trend towards greater decentralisation throughout the world, in both developed as well as developing countries (forum of Federations Handbook 2020). Countries which in recent times have decentralised to share power, revenue, personnel, and other resources between the central and lower-level governments include the following: South Africa, Nigeria, Ethiopia, post-war Iraq, Mexico, Brazil, Argentina, India, Australia, Canada, Australia, countries of the European Union especially Germany, Spain and Switzerland, and also countries like the UK and South Korea which are not federal countries.

Why this sudden eagerness to decentralise?

First, decentralisation is in line with the principle of 'subsidiarity', a key concept in federalism. Simply put, the principle asserts that taxing, spending and regulatory functions should be performed by the lowest level of authority which is capable of performing the tasks competently, unless a convincing case can be made to assign these to higher orders of government. So, federal countries often disallow the central government from taking over or monopolising a particular task – say, delivering water supply or electricity, organising buses, ferries or other public transportation services, or even running schools and universities, if the task can be performed efficiently and economically by a lower level of government.

Second, on account of this principle of subsidiarity, certain basic and essential competences or jurisdictions are accorded to the state and local authorities. These competences include providing primary and secondary school education and health care; organising the labour force for local priorities; catering for welfare needs; emergency management; and organizing public transport for the local area or region (Watts 2008: Appendix A).

It is argued that state governments, even more so local governments, are more aware of local complaints and problems and are often more responsive to local needs. The planning

and delivery of goods and services can also be more easily attuned to local needs because those making policy purportedly have "local knowledge". Furthermore, it is difficult to make a central government more accountable and responsive. Not least of all, those at the national political centre might not be aware of, let alone understand local needs.

*Third*, it is also well known that ordinary people identify more with local and state governments than with central governments, the latter being often located "far away".

Consequently, decentralised governments tend to offer more opportunities for the local community to be involved in the planning, monitoring, and implementation of government policy, and in decision-making generally. In stimulating the state and the local community to work in tandem, decentralisation, it is further argued, fosters competency, accountability, and transparency (CAT), and good governance.

A good indicator of this is the higher turnout rates for local government and state-level elections as compared to their equivalents for national elections. Tellingly, interest in local government elections remain high while at the same time, disillusionment and cynicism with elections to parliaments, congresses and other central representative bodies have been growing.

Accordingly, decentralisation should be accompanied by the reinstatement of local government elections. These allow the community to participate in, if not take possession of the government machinery at least at a relatable level, and dismiss local politicians of the "no action, talk only" (NATO) variety, and those who indulge in corrupt practices.

As a federation, Malaysia finds itself in the company of Commonwealth countries such as Canada, Australia, India, South Africa and Nigeria. However, whereas in these countries, power, revenue and resources are shared between the central government and its constituent state governments, the constituent states in Malaysia have relatively limited access to the same. Indeed, the federal system in Malaysia has been described by researchers as "highly centralised", "coercive rather than co-operative", and even been dismissed by one analyst as a "flawed federalism" (Anderson 2008, Holzhausen 1974, Kitingan 1997 and Loh 2015). Significantly, the origins of this centralised federalism are related to the incessant focus during the march towards Independence on the ethnic dimensions of power-sharing rather than on power-sharing between the centre and the states.

### **Part Two**

#### **Historical Origins of the Centralised Federal System**

Malaysia's federalism is not derived from the geographical distribution of its ethnic groups; in fact, the major ethnic groups are distributed unevenly all over the peninsula. To be sure, the Chinese and Indians tend to reside in urban areas while the Malays predominate in rural areas. It is only in Sabah and Sarawak that there reside large concentrations of regional "native" minorities, namely the Kadazandusuns in Sabah, and the Dayaks in Sarawak.

Nor is the origin of Malaysia's federalism to be found in the principle of "subsidiarity", since Malaysia is a small country. Rather, the origin lies in the peninsula's historical legacy which, prior to colonialism, comprised distinct Malay states, each ruled by a sultan. British colonisation in the late nineteenth and early twentieth century reinforced these divisions by recognising these states as separate legal entities. The British attempted to centralise administration in the 1930s, but that proved unsuccessful due to strong objections from the Malay rulers. In this regard it is significant that the early civil society organisations, including those which advocated popular political participation, were state-based entities, too.

It was only after World War II that pan-Malaya political organisations and movements emerged. In 1946, the returning British colonialists proposed the establishment of the Malayan Union (MU) which would have done away with the separate Malay states and centralised administration all over British Malaya. The MU proposal also offered citizenship rights quite liberally to all then residing in British Malaya, an offer that would have benefited the immigrant Chinese and Indians.

Significantly, the British succeeded in pressuring the Malay rulers who had collaborated with the Japanese during the War, to support the MU proposal. However, the Malay aristocrats, as distinct from the rulers, mobilised the Malay population in opposition to the proposal, paving the way for the formation of UMNO and for political mobilisation along ethnic lines more generally.

UMNO comprised numerous state-based organisations initially, but soon evolved into a pan-Malaya ethno-nationalist party, ultimately transcending state loyalties and appeal. Subsequently, the Malay rulers were rehabilitated by UMNO's aristocratic leaders. However, in the process, the former had been transformed into cultural icons of Malay identity, likened to the other icons – the Malay language and Islam. They were no longer absolute monarchs as before. Hence the rejection of the MU proposal and its replacement by the Federation of Malaya Agreement 1948, emblemised continuity with the past on the one hand, but also reinforced the claim by UMNO ethno-nationalists of Malay pre-eminence on the other, with the proviso that the Malays were no longer led by the traditional rulers.

As for the non-Malay immigrants, for whom state loyalty had little meaning in the first instance, the state order did not show itself to be useful for defending their interests either. Thus, the resulting countervailing mobilisation, and the political parties that the non-Malays formed, were pan-Malaya in nature. This followed naturally from the political contest for the incorporation of particular ethnic interests into a federal constitution that was finally adopted in 1957, following a contest that focused attention on the federal level of government.

Little priority was given to endowing the states with wide powers, and with commensurate revenue and other resources.

#### **Centralised Constitutional Design**

Hence, the 1957 Federal Constitution is decidedly top-heavy. This is evident in Part VI Articles 73 to 81 of the Constitution which discusses federal-state relations.

The Ninth Schedule of the Federal Constitution further details the distribution of legislative powers and responsibilities between the federal and state governments. There are three lists that demarcate federal, state and concurrent powers (concurrent powers can be exercised by either the state or federal government).

The federal list is a long one and includes the areas of 'high politics' – internal security, law and order, foreign affairs, defence, administration of justice and citizenship; and the macro-economic functions of trade, finance, commerce, industry, communication, energy, transport, surveys and research. The welfare functions and social development in the areas

of education, health, labour, social security, and disaster management such as fire prevention and extinguishment, which in most countries are usually assigned to the constituent states, come under the purview of the central government in Malaysia's case.

By contrast, the state list is short. The only important areas are lands and mines, Muslim affairs and customs, agriculture and forestry, local government, local public services: boarding houses, markets and fairs, licensing cinemas and theatres, burial grounds; and state works and water. The concurrent list covers social welfare, scholarships, town and country planning, drainage and irrigation, housing, culture and sports, fire safety measures, animal husbandry, and public health.

Under Articles 76(1)(b), and 76(4), State powers are qualified by granting legislative powers to the federal parliament for the purpose of ensuring uniformity of laws across states. In cases of conflict or inconsistency, federal legislation enjoys precedence (Article 75). Federal laws on local government and most important matters related to land do not even require adoption or passage by the state legislatures.

In the event of an Emergency, the federal government is allowed under Article 150 (2B) to legislate on all state matters. Article 71 (3)(4) further grants the federal government the power to intervene if there is non-compliance with the Federal Constitution by a state. However, some residual powers do remain with the states.

These provisions contained in the 1957 Constitution defined the scope of federal-state relations for the peninsular states, and after they were amended in line with the Federation of Malaysia Act 1963, for the two Borneo states of Sabah and Sarawak as well. Although the two Borneo states had proposed that a new Constitution be drawn up to accommodate their special interests, this was not realised due to the exigencies of the Cold War period, when Malaya was threatened by a "Confrontation" from a then left-leaning Indonesia.

The 1957 Constitution, nevertheless, was amended to accommodate to some extent the interests of the new states. Consequently, Malaysia's federal system can be considered asymmetrical; more rights and grants are accorded to Sabah and Sarawak than to the original eleven peninsular states. Indeed, political leaders in Sabah and Sarawak tend to consider the status of their state to be different from that of the peninsular states, at least in 1963. For them, Sabah or Sarawak was 'one of three' signatories to the London Agreement that paved the way to the formation of Malaysia in 1963.

Some 50 years later, most of these rights have been whittled away through a series of constitutional amendments resulting in Sabah and Sarawak looking more like 'one of the thirteen' states (Loh 2009: 144-53). Nonetheless, due to its separate history, a different demographic pattern, plus the special rights and autonomy granted to them in the 1963 amendments to the Constitution, a greater sense of regionalism and distinctiveness prevails in these two states.

The Tenth Schedule of the Federal Constitution elaborates on revenue assignment based on the division of jurisdictions spelt out in the Ninth Schedule. Hence it is heavily skewed in favour of the central government. In the Tenth Schedule, income tax, customs and excise duties, sales tax, licenses for motor vehicles, banking, foreign exchange, capital issues, passports, visas and other immigration charges are all assigned to the federal exchequer. Sources of state revenues on the other hand are generally limited to taxes over land, natural resources and forests, and to fees relating to applications for development plans (see Table 1).

Significantly, under the *Petroleum Development Act (PDA) 1974*, all states give up their rights to petroleum resources found within their states. Ownership and control of petroleum and gas, though these are natural resources, are transferred to the federally-owned company, Petronas, which is tasked with exploiting and mining the resource. Petronas pays the state and federal governments 5% royalty each (Petronas receives 49% while the producer-company receives the remaining 41%) of the gross value of petroleum production. Since the federal government also taxes the producer company (Sarawak Shell, Sabah Shell or Esso), it receives far more revenue from petroleum than do the petroleum-producing states. However, should the petroleum resources be located beyond the state's three-mile territorial waters, the federal government can choose to deny this royalty to the state government (Nambiar 2007:186). This stipulation was contested by Kelantan and Terengganu when led by Opposition parties. It was not until the Pakatan Harapan government came to power in 2018 that this matter was resolved. Subsequently, Kelantan received RM16.97 million and Terengganu RM2.7 billion.

Summa summarum, there are now glaring fiscal imbalances between the federal and state governments. The total revenue of all states combined in 2017 was RM21.7 billion,<sup>1</sup> or only

<sup>1</sup> State Socioeconomic Report 2018 Dept of Statistics Malaysia portal

9.8% of the federal revenue of more than RM220.4 billion.<sup>2</sup> Hence, presently, many state governments struggle to avoid operating deficit budgets and they find themselves having to depend on federal funding for development projects which are decided by the federal government on a discretionary basis. Whichever the case, the result is a very uneven distribution of revenue—and therein financial resources—between the federal and state governments. States that have little land and forest, no petroleum or mineral resources, can raise no more than limited revenue, enough for operations perhaps but not enough for development.

The Constitution (Article 109) stipulates that the federal government is obliged to provide two major grants to the state governments, namely the *capitation grant* which is based on the population size<sup>3</sup> and the *state road grant*.<sup>4</sup>

Apart from these two outright grants, there are about 10 other tax-sharing taxes and levies that the state is allowed to collect or where the federal government has to reimburse the state (see Table 2). The petroleum royalty is one such case. These statutory grants aside, the federal government has sole discretion over the disbursement of development funds, on which, in fact, the Ninth and Tenth Schedules are relatively silent (Wee 2006).

The redistribution of tax revenues back to the states is grossly unfair. For example, Penang in 2013 contributed RM5.7 billion in tax revenues to the federal government and only received back RM162.7 million in federal transfers (excluding capitation grant)<sup>5</sup>—representing only 2.85% of the revenue generated by Penang. If we take into consideration the total revenue generated from all states in 2013, totalling RM107.3 billion, Penang only received 0.15%

<sup>2</sup> The Malaysian Economy in Figures 2019. Ministry of Economic Affairs

The capitation grant is calculated on the basis of a state's population as recorded in the last Census and on the projection of that population in following years; it is assessed on a graduated basis and favours states with a small population. As of 2013, the details of the formula are: RM72.00 each for the first 100,000 residents; RM10.20 each for the next 500,000 residents; RM10.80 each for the next 500,000; and RM11.40 each for residents beyond that. The latest version of the formula was passed via Act of Parliament 622 in July 2002. The grants are given in January and June of each year. In 2007, Selangor, the state with the largest population received RM67,661,987; Perlis, with the smallest population received RM8,389,573. Penang received RM22,417,694. Dewan Rakyat 27 May 2008. See Wee 2006: 76-77 for capitation transfers during the early 1990s.

<sup>4</sup> Conceivably, the state road grant is for the maintenance of state roads. In fact, it takes into consideration the geographical size of the state, assuming that a larger state possesses more miles of road. The grant is calculated by multiplying an average cost per mile by the number of miles of road the state has.

<sup>5</sup> Written parliamentary reply to a question from YB Lim Guan Eng in 2015, source: pardocs.sinarproject.org

from the total revenue generated by all the states. In fact, only 5.5% of all federal revenues collected from the states were shared with them.<sup>6</sup>

To fund infrastructure projects in Malaysia, the constituent states are largely dependent on discretionary federal grants. Their grant applications are not always approved unless the state government is favoured by the federal government; in turn, that is dependent upon whether the state government is part of the ruling coalition or led by an Opposition party! It is well-known in Malaysia that Opposition-led states have been discriminated against by the ruling federal coalition.

Additionally, state governments are also prohibited from borrowing except from the federal government or with the consent of the federal government (Article 160). This has made states beholden to and ever more dependent on federal development funds. Evidently, power rests ultimately with the federal government. Apparently, it decides on development budgets and fiscal grants to the states without any clearly defined policies or structure to address fiscal imbalances faced by states, especially in raising revenue needed to provide basic services.

<sup>6</sup> By contrast, in Australia, tax revenue raised by its federal government (also known as the Commonwealth government) is considerably larger than that of its states, even if the states have greater sources of tax revenue income (for instance, the states themselves collect about 26% of all taxes in Australia), roughly 45% of all the states' spending is financed by the federal government in Australia.

In addressing fiscal imbalances in Australia between the federal government and the states, as well as economic disparities between the states themselves, an independent body was established since 1933 called the Commonwealth Grants Commission. It advises the government on federal transfers and distribution of revenue to the states to equalise financial capacities of all states, and to address fiscal imbalances.

**Table 1: Federal and State Government Tax Revenues** 

Federal		State			
Dir 1.	Direct taxes  1. Income taxes (individual, companies,		Import & excise duties on petroleum products, export duties on timber		
'	co-ops, Petroleum tax, film hire duty)		and other forest products for Sabah &		
2.	Taxes on property & capital gains		Sarawak, excise duty on toddy or all		
3.	Real property gains tax, Estate duty,		states		
	Share transfer tax on land-based coy	2.	Forests		
	•	3.	Lands & Mines		
Ind	irect taxes	4.	Entertainment duties		
1.	On international trade (export duties,				
	import duties, surtax on imports)	Other Receipts			
2.	On production & consumption (excise	1.	Licenses & permits		
	duties, sales taxes, service taxes)	2.	Royalties		
3.	On other matters (stamp duties, gaming	3.	Service fees		
	tax, betting & sweepstakes, lotteries,	4.	· · · · · · · · · · · · · · · · · ·		
	casino, pool betting duty)		ports & harbours		
		5.	Receipts from land sales		
Non-tax Revenue & Other Receipts		6.	Rents & sales from state property		
1.	Road tax	7.	Proceeds, dividends & interests		
2.	Licenses	8.	Federal grants & reimbursements		
3.					
4.	Fines & Forfeiture				
5.	Interests				
6.	Contribution from foreign governments				
7.	Revenues from federal territories				
8.	Refund of expenditures				
9.	Receipts from other government				
10	agencies				
10.	Royalties/gas cash payments				

Source: Federal Constitution, Tenth Schedule

Table 2: Federal Transfers to State Governments\*

General Grants	Special Grants	Tax-sharing Grants
Capitation grant (based on a state's population size	State road grant	Export duties on tin, iron & other materials (10%) 1
State Reserve Fund grant (deficit grant)	Service charge grant	Growth revenue grant 2
Development grant (conditional)	Cost reimbursement grant	
Contingency fund grant for unforeseen needs	Grants to religious institutions	
State advanced grant for cash flow difficulties	Only to Sabah & Sarawak as per MA63 <sup>3</sup>	
	For handing over territories in Kedah & Selangor 4	

- 1. The federal government may increase this grant for the peninsular states to more than 10% 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)
- 2. 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).
- 3. The grants to Sabah and Sarawak were given on the basis of the conditions for their incorporation into Malaysia. This 1963 Agreement was supposed to be reviewed but that has never been done. Currently, Sabah receives RM26.7 million and Sarawak RM16 million (Jomo and Wee 2002)
- 4. Kedah receives RM10,000 p.a. for territories handed over to the central British government in 1869. Selangor receives RM18.3 million p.a. for handing over Kuala Lumpur, and RM7.5 million for handing over Putrajaya to the Federal Government.

<sup>\*</sup> Sources: Jomo and Wee 2002 and Wee 2011.

# **Part Three**

#### A Centralising Political Process under 60 Years of UMNO-BN Rule

Apart from the federal bias in Malaysia's constitutional design, the *political process* that has seen a single political party, Umno-BN, controlling the central government and most of the 13 states for more than 60 years, has furthered the attainment of a centralised federalism.

In fact, centralised federalism is only one part of the semi-authoritarian political system that has been consolidated in Malaysia since Independence. Although regular elections have been conducted, the Umno-BN government has ruled by resorting to a wide array of coercive laws passed by parliament that allow for preventive detention; registration and strict control over civil society organizations, publications and printing, trade unions, universities and colleges, and; restrictions on peaceful assembly, on access to government information deemed 'official secrets' and on public discussion of issues deemed 'seditious' and 'sensitive'.

The roots of this domination of the political process go back to the pre-Independence era when the Emergency (1948–1960) occurred. With the uprising at an end, Emergency powers were incorporated into the 1957 Constitution and new laws were passed by the Umno-BN-dominated parliament. Through use of these coercive laws and constitutional provisions, the BN executive ensured uninterrupted control of Malaysian politics for itself. Local authority elections were suspended in the 1960s and abolished in the early 1970s. Consequently, all local government representatives have been appointed by the Umno-BN state governments. Via these Umno-BN-appointed councillors, the party was able to penetrate the municipalities, the town councils and the district councils as well.

Furthermore, regular amendments to the Constitution and to election laws soon resulted in the Election Commission (EC) losing its original autonomy, to the point where it would gerrymander in the delineation of electoral boundaries. Invariably, Umno-BN won the general elections time and time again. These undemocratic measures have been legitimised in terms of the need to ensure security, and to preserve unity and harmony in multi-ethnic, multi-religious Malaysia.

The end result of such uninterrupted Umno-BN domination of the Executive was also a politicised bureaucracy. Having served under a BN government for so long, it was perhaps inevitable that the federal, state and even the local government bureaucracies would become extensions of the ruling party and would lose their neutrality and professionalism.

The flip side to this was that the bureaucracy became uncooperative, sometimes hostile, towards the Opposition. This attitude persisted even after the Opposition took over control of the state governments. Indeed, there were numerous complaints of such hostility towards the Opposition-led governments after they had taken control over the states of Kelantan, Perak, Kedah, Penang and Selangor in 2008. The Opposition-controlled state governments complained that the upper echelon of the civil service comprising the State Secretaries, State Development Officers, State Legal Advisers, State Financial Officers, the Local Authority chiefs, the District Officers, and even the heads of department of Lands and Mines and Islamic affairs, the last two falling under the purview of the state governments, were uncooperative, even hostile to the state governments of the day, although these latter had been popularly elected.

This is unsurprising; these top civil service officers had been appointed to their posts in the various state governments by the federal authority that was responsible for assessing their performances for purposes of promotions and transfers. Hence, one of the priorities of the Opposition-led state governments after coming to power in 2008, 2013 and 2018, was to identify more professionally neutral top civil servants in their respective states so as to appoint them to top posts upon the retirement or transfer of incumbent pro-BN officers.

A related problem is how 60 years of Umno-BN rule allowed for several federal supervisory or policy making bodies set up under the Constitution whose advice are considered binding on the states, to encroach upon the jurisdictions of the states. These include the National Land Council, the National Finance Council and the National Council for Local Government (NCLG). Although these bodies were represented by the respective chief ministers of each state, the meetings of these bodies were ultimately chaired by the Prime Minister who now sets the agenda and direction of the Councils. In 2010, the two Opposition-led states of Penang and Selangor requested the Election Commission to conduct local government elections in their state. In response the Election Commission claimed that the NCLG would first have to grant permission for holding those elections; a clearly disputable point.

But this is only one aspect of the problem arising from Umno-BN's long period in control. The politicisation of the bureaucracy had resulted not only in a partisan bureaucracy, but one riddled with incompetency as well. Hence, the displacement of Umno-BN in Penang and Selangor in 2008 for instance, did not automatically result in a more 'competent, accountable and transparent' (or CAT) government, the proclaimed goal of these two new Pakatan Rakyat (PR) state governments.

The relationship between the Opposition-led state governments and the federal departments of Education, Consumer Affairs, MIDA, and even Health, Tourism, Culture and Welfare based in the states, remained tensed subsequent to the change of state governments. For example, the lightning speed with which the Malaysian Anti-Corruption Commission, a federal agency, conducted itself vis-à-vis allegations of corruption among PR politicians, is a reminder of this polarisation between the federal and the state authorities (more on this in Part Four).

Meanwhile, activities organised by state governments have also been boycotted by the federal departments. And since the federal departments have access to more funds than do their state counterparts, the federal departments often organise their own functions and projects to outdo those conducted by the latter, often in the same areas.

#### The NEP, the Development Process and Centralisation

The development process, underscored by the implementation of the New Economic Policy (NEP, 1971-1990) further contributed to the expansion and consolidation of the federal government, ultimately the centralisation of the federal system.

As clarified earlier, there exists a stark fiscal imbalance between the federal and state governments. The total revenue of all states combined in 2017 was RM21.7 billion,<sup>7</sup> or 9.8%, compared to the federal revenue of more than RM220.4 billion.<sup>8</sup> As a result, many state governments struggle to avoid operating deficit budgets and have to depend on federal funding for development projects which are decided by the federal government on a discretionary basis.

<sup>7</sup> State Socioeconomic Report 2018 (Dept of Statistics Malaysia portal)

<sup>8</sup> The Malaysian Economy in Figures 2019 prepared by the Ministry of Economic Affairs

Technically speaking, the federal BN government can deny development funds to a state government, particularly if it is controlled by the Opposition and is considered unfriendly or a threat to the federal power-holders. However, since the federal government wishes to win over the voters in these states, it continues to provide funds to these states but channels them through federally-controlled departments and agencies located in the states (especially the State Development Office which is not answerable to the government of the state where it is physically located, but to the Implementation Coordination Unit of the Prime Minister's Department, i.e., to the federal authority)<sup>9</sup>.

Shankaran Nambiar, an economist from the Malaysian Institute of Economic Research has observed that the total consolidated state government revenues (in absolute terms) for all the states have been rising since 1985 to the present. Yet, the average annual rate of growth of state government revenue between 1995 and 2000 was only about 4.9%. However, the average rate of growth of consolidated state government revenue from 2000 to 2005 declined to approximately 2.5%, indicating that the state governments' capacity for revenue collection had diminished. Meanwhile the average annual growth of federal government revenue rose from about 4.4% for 1995-2000 to 14.4% for 2000-2005. Accordingly, the researcher concluded that the state and federal governments are not subject to the same kind of circumstances: "The trend seems to indicate that those sources of revenue open to the federal government are growing, while those sources of revenue that the state governments can resort to are declining" (Nambiar 2007: 190).

This economist further highlighted that during the 1997-1998 regional financial crisis, the federal government took "complete control over the fiscal measures that were employed in response to the crisis... Clearly the participation of the state in fiscal remedies to the crisis was severely limited". Not only fiscal policy, but also budgetary allocations "were concentrated in the hands of the centre", first pushing for a contraction of the economy, and later, an increase in investments in infrastructure development and creating the social safety net (Nambiar 2007: 187). Consequently, the central government grew stronger and the state governments weaker, further widening the original vertical imbalance.

<sup>9</sup> In this regard it is noteworthy that the allocations to the Prime Minister's Department in the annual budget for the period 2011 to 2014 had been rising each year and totalled RM20 billion. In 2014, five of the items listed were: 'restructuring of society', 'development programmes', 'special projects', 'people friendly projects' and 'facilitation funds'. Allocation under these items totalled RM6.9 billion, accounting for 65% of the RM11 billion development allocation for 2014. PM's discretionary 'near slush funds', see Media Statement by Liew Chin Tong, MP for Kluang, 4 November 2013., cited in Loh 2018...

In this regard, it is noteworthy that financial support from the federal to the state governments has shifted from transfers in the form of "grants and reimbursements" to loans. In 1975, outstanding loans to the states totalled RM1.1 billion rising to RM6.1 billion in 1985, to RM7.3 billion in 1995, and reaching RM9.3 billion in 2000. Meanwhile, federal transfers to the states decreased from 43.8% of "state government consolidated operating expenditures" in 1975; to 20.9% in 1985; to 19.1% in 1995, before increasing to 48.8% in 2000. During this period, there has also occurred an increase in "contingency grants" to the states rising from RM262.1 million in 1985; to RM1.2 billion in 1995; before dropping to RM1.02 billion in 2000 (Jomo and Wee 2002 and Wee 2006: 84)<sup>10</sup>.

In a study of the Penang state budget, it was shown that the state's annual budget has been shrinking, not least because the federal grants to the two local authorities under its charge were transferred to them directly, bypassing the state government altogether (Narayanan, Lim and Ong, 2010: 199).

Additionally, in applying the affirmative-action NEP, the federal government established numerous statutory bodies and government-linked companies (GLCs) to promote bumiputera interests in the financial and banking, commercial and industrial, educational and media, mining and plantation agricultural sectors. Implementation and monitoring of the NEP required the expansion of the public sector and tight control by the central authorities which shifted even more power from the states to the federal authorities (Ooi 2013).

Among the most important was the land clearing and resettlement schemes in the various states, conducted by the Federal Land Development Authority (FELDA). These lands were subsequently planted with oil palms, whereupon processing of palm oil followed. Ultimately, FELDA's ventures were listed on the Kuala Lumpur stock exchange.

<sup>10</sup> See also Narayanan, Lim and Ong (2010: 199) for this switch.

Another case in point is the establishment of the Commercial Vehicles Licensing Board (CVLB), a federal authority charged with promoting bumiputera participation in the transportation industry via licensing commercial vehicles. Consequently, the licensing of taxis and buses, and even the routing of buses in the states came under the purview of federal authorities, in this case, the CVLB. Although the CVLB has been replaced by the Land Public Transport Commission, such regulatory control by the federal over transport matters in the states and in local areas persist, as they do over the government linked companies linked to the oil palm industry.

# **Part Four**

#### The Case of Penang after 2008

The loss of the five states in GE12 was a big surprise to the Umno-BN federal government. In the aftermath of the takeover of those states by the Opposition, the Umno-BN federal government moved quickly to consolidate its control over development funds. Evidently, measures were taken to bypass the Opposition-led state governments and re-channel development funds to federally-controlled agencies or departments at the state level instead. Some of the initial shifts in policies and administrative practices, developed in haste, were crude and crass.

For instance, the federal Minister of Tourism unilaterally cancelled all memorandums of understanding between the ministry and the Opposition-led state governments. The existing State Tourist Action Councils (TACs) were dissolved, and then reconstituted under the direct control of the Minister of Tourism. Thereafter, all federal funds spent to promote tourism-related projects were channelled directly to the new federal-controlled TACs (*Star 28* and 29 April 2008). Likewise, the federal Entrepreneur and Cooperative Development minister announced that funds for projects under his ministry would henceforth be distributed by MARA, a federal agency, rather than, as prior to 2008, by the State Economic Development Corporations in the Opposition-led states (*Star 27* April 2008).

At the same time, the Ministry of Rural and Regional Development requested all pro-BN village chiefs and Village Development and Security Committee (JKKK) members in PR-led states to resign from their posts, and then it reabsorbed (with salaries) about 2,000 of these former chiefs into new federally-sponsored JKKK under the said ministry. Meanwhile, the PR-led state governments appointed new village chiefs to head the JKKKs, resulting in a situation where there were two different sets of village heads and committees (*Star* 9 April 2008, 25 April 2008 and 16 May 2008).

In the same vein, the federal Minister of Housing and Local Government revived the JKKKs in the New Villages which fell under his ministry's purview. These were renamed JKKK Baru and federal funds for roads and drains to the NVs were channelled via these new JKKKBs (*Star* 29 March 2008 and *New Straits Times* 27 April 2008).

These silly episodes highlighted the Umno-BN federal government's attempt to prevent power and financial resources from being transferred from the centre to the states, despite the outcome of the polls. In effect, the BN federal government refused to acknowledge the necessary distinction in federal systems between (federal) government-to-(state) government ties from party-to-party ties. In federal systems all over the world, the norm is to anticipate and expect a mix of different parties coming to power at the different levels of government, and to recognise the rights of both the central as well as the lower order of governments to share power and funds accordingly, regardless of party affiliations.<sup>11</sup>

More importantly, the attitude of the federal government and its civil service appointees pitted the Chief Minister against the Penang State Development officer (SDO), a federal appointee. Initially, the dispute focused on the development of the Penang Botanical Gardens (PBG) for which RM7 million had been allocated. Plans were implemented without consulting the newly-elected State Government. In the unravelling of this incident, it was revealed by the SDO that RM7.6 billion allocated to Penang under the 9th Malaysia Plan, and another RM278 million under the Economic Stimulus Packages Phase 1 and 2 for 2009 and 2010, had been channelled to the SDO, bypassing the Chief Minister's Office altogether! Yet the SDO was not held accountable to the public; he only reported to his superiors in the federal government.

Below, we first present the federal allocations that have been granted to Penang by the federal government in recent years. Although several new allocations were provided after the PH government took over in Putrajaya, nonetheless, the total amount received remains inadequate. Next, we discuss in some detail two other major issues that have led to worsening federal-state relations since 2008.

<sup>11</sup> For instance, in Australia, the federal government can be Labour-led, while particular states might be in the hands of the Liberals. Or, as in India, the Bharatiya Janata Party might rule in New Delhi but particular states such as West Bengal might be ruled by the Communists, or like Uttar Pradesh, by the Congress Party. Hence the federal and the state governments must share power and revenue with one another, and co-operate as well. Indeed, in many situations, the state governments of different political hues might gang up against the federal government in order to enhance state rights, regardless of party background.

Not so in Malaysia. Used to dominating over the entire political system at all levels for some 50-odd years, the Umno-BN federal government continued to refuse to accept this distinction, and resorted to various machinations to bypass the PR-led state governments.

We shall discuss first the public transportation woes and then the problem of local government including a concerted attempt by the state government to bring back local government elections. The last two items discuss the provision of social welfare and the handling of the Covid-19 pandemic. Here, clearly, jurisdiction could be handed over to the Penang state and local government authorities; or if that is not on the cards, there is room for much cooperation in these areas.

#### Federal Government Allocation to Penang 2018-2021

In 2018, the Pakatan Harapan federal government began making some positive contributions to the states. These included sharing the tourism allocation with them. This new allocation was intended to help the states maintain standards in infrastructure maintenance and invest in tourism development.

In 2021, the PH federal government included four so-called enhancement allocations channelled in various forms of grants and support to the state governments. The Ministry of Finance (MoF) said these included increasing the allocation of RM50 million to RM400 million under the Grant Based on Level of Economic Development, Infrastructure and Welfare (TAHAP) to all state governments.<sup>12</sup>

In November 2021, Penang CM Chow Kon Yeow demanded for fairer treatment in terms of allocations from Putrajaya. He noted that Penang only received RM996 million or 1.3% of the total RM75.6 billion allocation for development. Based on Penang's contribution to the Gross Domestic Product (GDP) over the past three years, which is between 6.7% and 6.9%, the state should have received an allocation of RM5.2 billion in the 2022 Budget.

In accordance with the Federal Constitution, the Penang State Government receives the annual capitation grant (based on population) and road grant from the federal government. We believe with Penang's GDP contribution of RM92 billion for 2020, Penang State Government deserves a larger annual allocation from the federal government for upgrading the road infrastructure and public transport and for flood mitigation projects.

<sup>12</sup> Federal government implements four enhancements to grants, support for states https://www.mof.gov.my/portal/en/news/press-citations/federal-govt-implements-four-enhancements-to-grants-support-for-states

As the state is an important E&E regional centre and logistics hub, Penang needs to remain competitive regionally and to attract investments for the country. It follows that the federal government must provide adequate financial allocations and grants. The upgrade of the Penang International Airport should also be the priority of the federal government in order to help Penang cater to industrial growth and to sustain jobs.

Table 3: Federal Allocation to Penang State from 2018 to 2021

	Federal Allocations	2018	2019	2020	2021
1	Capitation Grant	24,697,320.00	24,884,280.00	25,064,400.00	25,236,540.00
2	10% Service Tax Payment	15,260,077.00	10,655,653.00	5,152,586.71	8,183,162.43
3	Grant for Additional Revenue	11,714,155.00	11,725,253.00	11,755,764.00	-
4	Grant to Maintain and Manage Budget for respective departments (JKM, JPV, JPS, JPBD, MSN)	32,947,152.00	29,562,002.10	30,336,772.28	31,492,607.18
5	Tourism Allocation	-	10,984,390.00	10,065,021.00	3,298,111.40
6	Grant TAHAP Economic Development, Infrastructure & Welfare	13,516,000.00	15,966,000.00	15,966,000.00	16,310,300.00
	Total	98,134,704.00	103,777,578.10	98,340,543.99	84,520,721.01

<sup>\*</sup> excludes (the state road grant which appears in MARRIS -Malaysian Road Record Information System).

Source: Penang State Treasury Department

#### **Developing Public Transportation**

Under the Ninth Schedule of the Federal Constitution, traffic and carrying of passengers on land, air and water are the responsibility of the federal government, while the responsibility of planning and maintenance of roads, ferries, and bridges are divided between the central government and the state, according to whether they are gazetted as federal or as state roads.

As a result of the highly centralised control and management of the public transportation system by the federal government, Penang, for example, has no control over the number of public buses that should operate in the state, nor can it plan bus routes or even decide on where to put a single bus stop. Equally, the state has no rights over licensing of public buses and taxis, and no power to address public complaints on poor public transportation services provided by buses and taxis operating in the state, even though under Part XII of the Local Government Act, the local authority is empowered "to establish, acquire, maintain and carry on within or without the local authority area public transport services". Instead, the Commercial Vehicles Licensing Board (later SPAD), a federal agency, has monopolised the licensing of taxis and other means of public transport including services provided by the stage buses, even their routing and their bus stops.

One Penang initiative to ease traffic congestion, called the Bridge Express Shuttle Service (BEST) was launched in March 2011. This was a park-and-ride free bus shuttle service across the Penang Bridge between Seberang Perai and the Bayan Lepas FTZ. The service succeeded in easing traffic congestion on the Penang Bridge during peak hours and reduced the financial burden of commuters living on the mainland and working on the island. The Penang government paid RM10 million to Prasarana, the federal government-linked company (GLC) Rapid Penang for the provision of the service, which saw 800 commuters daily using the service during the two years it was running. The service was replaced in 2020 by the state government's free CAT Bridge bus service. Besides this, the Penang government also initiated the Central Area Transit (CAT) George Town, a free shuttle service that travels along major tourism attraction destinations in central George Town.

A related problem involved the cross-channel ferry service which was constantly breaking down and accumulating financial losses. This ferry service was under the charge of PPC, a federal agency which ran the Penang Port, whose CEO was traditionally appointed by the federal Minister of Transport as well. The ferry services were handed over to a new company

called RapidFerry, which was owned by the same federal GLC Prasarana which owns and operates the Rapid buses. The ferry service was next privatised to Syed Mokhtar Al-Bukhairy's Seaport Terminal (Johor) Sdn Bhd in 2010. At this point, the Penang State Government intervened, requesting that the PPC be privatised to the Penang State Government instead. Unfortunately, this did not occur. And in January 2021, the PPC stopped running the iconic ferry services which had been plying the Penang channel for 126 years, on the grounds that the ferry operations had proven unprofitable from their point of view.

Following the Covid-19 pandemic, the state government decided to fully subsidise public bus transportation state-wide by providing free unlimited rides on all Rapid Penang buses, beginning on 1 March 2021, for all Mutiara pass cardholders. This costs the state government RM300,000 a month. In addition, the state has since July 2021 been providing free ferry services for pedestrians travelling to and from the mainland, effectively making Penang the first state in the country to provide free public transportation service by land and sea.

To resolve the various problems related to public transportation, the Penang State Government ultimately proposed its Penang Transport Master Plan (PTMP) to develop an integrated state-wide transport infrastructure, consisting of the Bayan Lepas Light Rail Transit (LRT), the Pan Island Link highways, the construction of major roads, the third link connecting the island and mainland, and reclamation of the Penang South Islands.

The biggest challenge faced in implementing the PTMP has unquestionably been in obtaining the various approvals from federal agencies (such as the National Physical Planning Council's (NPPC), the DOE on the EIA reports, and the MOT's approval for the Bayan Lepas LRT project) and securing financing for the planned mega projects.

In 2019, following GE14, the Penang State Government announced that it had applied for an allocation of RM10 billion from the federal government to part-finance the PTMP and subsequently a special purpose vehicle, the Penang Infrastructure Corporation S/B was incorporated, in part to issue bonds to be guaranteed by the federal government as assured by then-Prime Minister Mahathir Mohamad to raise funds to pay for the Penang State Government's RM9.5 billion light rail transit (LRT) project.

However, after the Sheraton Move, the PN federal government backtracked and decided not

to grant the government guarantee for the USD\$500 million (RM2.04 billion) loan application made by Penang to the Asian Development Bank (ADB) to help finance the LRT project.

In fact, the construction of a monorail for Penang had been announced by the previous state government and by successive prime ministers since 2003<sup>13</sup> (and even in the Ninth Malaysia Plan) to overcome serious weaknesses in the public transportation system in the state. In 2014, then-Chief Minister Lim Guan Eng had written to the Prime Minister stating that if the federal government was not prepared to implement the promised LRT or monorail project, then the state government was prepared to take over the project, requiring only the permit from the federal government for the state to operate its own transportation system.<sup>14</sup>

Similarly, there were other long-pending infrastructure projects planned since the 1980s which were never implemented, possibly due to the lack of federal funding support. A major one, linking the townships of Paya Terubong and Balik Pulau, is the 3.8km Bukit Kukus Paired-Road project. This was finally undertaken by the current state government, and funded by the MBPP instead. It was completed at a cost of RM378.2 million.<sup>15, 16</sup>

The discussion above elaborated on how the Penang State Government first attempted to address the worsening traffic problems in the state. Unable to access the necessary federal funds to finance public transport plans, it then embarked upon an ambitious masterplan that depends on a public-private partnership and which entails reclamation to form several islands, an undersea tunnel, and raised paired roads.

<sup>13</sup> https://www.malaysiakini.com/news/67802 "Penang Monorail Project Derailed?"

<sup>14</sup> https://www.malaymail.com/news/malaysia/2014/06/17/let-us-build-Irt-if-you-wont-penang-tells-putra-iava/688929

<sup>15</sup> https://www.freemalaysiatoday.com/category/nation/2022/01/13/penangs-bukit-kukus-bypass-road-finally-opens/

<sup>16</sup> Another project the Penang State Government wanted was to build a new Penang Hill Cable Car. The PH federal government had announced a RM100 million allocation for the project after it came to power following GE14. However, after the PH government fell, the new PN government unilaterally withdrew funding for the project in April, 2020 without any prior consultation with the state government. See https://www.nst.com.my/news/nation/2020/06/597293/putrajaya-cancels-rm100mil-penang-hill-cable-car-project

# Local Government and Restoring Local Government Elections (LGEs)

The Penang State Government had indicated that it desired to reinstate local elections once it took office in 2008. To this end, then-Chief Minister Lim Guan Eng set up a working committee to look into the matter. He was duly advised that the federal law regarding local government elections needed to be changed for a reinstatement of local elections. Penang State Exco Chow Kon Yeow who held the Local Government portfolio then, wrote to the NCLG on 14 July 2009 requesting that the matter of restoring local government elections (LGEs) be put on the agenda of the NCLG's next meeting.

However, the NCLG cited LGA 1976 S15(1) which states that LGEs had been abolished with the passing of the Local Government Act (LGA). So, Chow's request was not entertained. Chow next moved a motion in the Penang State Assembly to bring back LGEs; this was duly passed by the House. Over the following months, the Chief Minister wrote to the Election Commission asking them to conduct LGEs in Penang to which the federal agency demurred, stating that LGA 1976 disallowed them to do so. Finally, on 9 May 2012, the Penang State Assembly passed the Local Government Elections (Penang Island and Province Wellesley) Enactment 2012, which was gazetted on 5 July 2012. The Election Commission was once again requested to conduct elections within 180 days, now that the new LGE law had come into operation. Again, the SPR demurred whereupon the Penang State Government (with Aliran president P Ramakrishnan) sued the federal government and the SPR for not conducting LGEs as applied for, and sought a declaration from the Federal Court that Sec 15 of the LGA which purported to abolish LGEs was invalid and inoperative in Penang. It was not until a year later, on 14 Aug 2014, that the Federal Court ruled that Penang State Government did not have jurisdiction to conduct LGEs.

Following the victory of the PH government in GE14 in 2018, there were hopes that the new federal government would now accede to the demand of the Penang State Government to restore local government elections; after all, restoring LGEs and making local authorities more accountable were part of the PH's electoral manifesto. Indeed, the new PH federal Minister of Housing and Local Government pledged publicly to restore local government elections within three years. However, following the Sheraton backdoor takeover, the succeeding Perikatan Nasional administration shelved the idea of reinstating local elections even though the new PN minister in charge of local government was the very same person who, as the PH minister, had pledged to restore local elections within three years.

What then can be done to improve the efficiency and effectiveness of our unelected city councils in Penang?

It is paramount that our city councils are well funded. Available studies indicate that about 32% of local authority revenues in the country are derived from rents and fees for services; 51% from taxation of property assessments; and 17% from state and federal fiscal transfers (Harding 2012). Payments from fiscal transfers for example, in the form of equalisation grants from the federal government only represent about 10% of the shortfall in revenue against local authorities' assessed needs. The lack of adequate revenue has naturally resulted in many local authorities (PBTs) focusing only on maintaining services as opposed to development activities.

The Annual Reports of the department of local government for 2010 and 2011 (the only years the Annual Reports are available on the Ministry of Housing and Local Government's website<sup>17</sup>) indicate that the amount of federal grants transferred to the local governments in Penang were amongst the lowest received, as compared to other states. Penang's local governments also received the smallest amount of federal allocation for infrastructure, public amenities and socio-economic projects in 2011.

In an interview, former MBSP Mayor, Datuk Rozali Mohamud stated that the annual revenues of local authorities were simply not sufficient to cover recurring operational costs. Hence the local authorities have to seek out alternative sources of revenue to fund development activities. In this regard, he said that the federal government ought to allocate annual grants targeted at specific areas of development and services, with emphasis given to affordable housing, infrastructure, flood mitigation, public transportation, solid waste management, tackling climate change and reducing carbon emissions.

He also agreed that certain federal powers and funding, such as public transportation and the maintenance and upgrading of federal roads, should be devolved to the state government and to the local authorities respectively.

<sup>17</sup> https://jkt.kpkt.gov.my/en/LaporanTahunanJKT.

<sup>18</sup> Based on the Annual MBSP Report 2020, revenue collected for 2020 (RM258.47 million) and 2019 (RM277.56 million) were insufficient to meet the expenditure costs of RM283.23 million and RM278.47 million for 2020 and 2019 respectively.

In particular, he highlighted that the MBSP should be given full responsibility as the local planning authority, as envisaged under the Town and Country Planning Act, to implement and realise long-term development goals as set out in the Seberang Perai Draft Local Plan 2030, to transform Seberang Perai into a smart sustainable city by 2030. He lamented the "silo working mentality of federal agencies", the reluctance to share information and data, and the snail-paced decision-making process at the federal level, which cause delays in the implementation of key projects, and the state losing its competitiveness in attracting investments.

It is clear from the above that the potential for growth of our city councils is dependent ultimately upon their capacity and capability to implement their services and development goals - and thus, upon the need for federal assistance.

#### **Social Welfare**

Social welfare is a responsibility shared between the federal and state governments under the concurrent list in the Ninth Schedule of the Constitution. Arguably, the social welfare system has been given the least attention in our national development agenda, compared with health, education and economic development. Between 1997 to 2014, the federal government only spent an average of 1% of GDP on social welfare expenditure, which is much lower than in many developed nations, and even lower than some neighbouring countries.<sup>19</sup>

The department of social welfare itself has tellingly been transferred from one ministry to another, demoted to the level of department, and reorganised ten times in the course of 70 years. The highly centralised policy-making processes, with the decision makers seated far away from where the actual social welfare work takes place, have also led to structural inefficiencies in the provision of social welfare services.

For example, various streamlined federal financial assistance programmes administered by the social welfare department in the state do not account for disparities in the different costs of living between states. Penang, on its part, allocates RM8 million a year to the state social welfare department, to top up existing federal welfare payments, called "Bantuan Agenda Ekonomi Saksama" (BAES). In addition to BAES, the state government also introduced a

<sup>19</sup> Farrah Shameen Bte Mohamad Ashray, Social Welfare Services in Malaysia: The Role of Government

programme called I-Sejahtera in 2008, which provides yearly one-off cash payments for senior citizens, single mothers, OKU and children, including death / funeral expenses; in fact, from 2008 to October 2021, it expended over RM137 million to as many as 983,070 recipients in the state<sup>20</sup>.

Be that as it may, the provision of institutional care services remains the most critical support system in Malaysia. Cash assistance alone is often insufficient to provide care for vulnerable groups such as senior citizens and children who are either elderly, sick or disabled and unable to care for themselves.

In 2015, there were only 66 public welfare institutions (for juveniles, children, the elderly, disabled and destitute) directly administered by the department of social welfare compared to 1,212 privately registered / NGO-run welfare institutions in the country. Alas, Penang does not have any home at all run by the social welfare department to provide care and protection for the elderly; thus far, the federal government, which runs the "Rumah Seri Kenangan" and "Rumah Ehsan", has not provided for the same in the state.

In conclusion, the Penang State Government must advocate for impactful structural changes to our social welfare system, aimed at making it more inclusive and responsive to local needs, and ensuring that social welfare services and assistance are equitably extended to all—and received as a matter of right rather than of need. The shared responsibility with the federal authority appears to hamper proper provision of services. With funds properly provided, there is no doubt that the Penang State Government can provide for its needy competently.

#### Federal-State Relations during the Pandemic

The COVID-19 crisis has offered an important study of the legality and constitutionality of Malaysia's three-tiered system of government. When the federal government made the decision to open up the economy, nine out of 13 states attempted to disregard the order including three that were aligned with the PN government (Pahang, Kelantan and Sarawak).<sup>21</sup> To be sure, these states would be considered in contravention of federal law because the

<sup>20</sup> Written Penang State Assembly answer to YB Gooi Hsiao Leung's question on 26/11/2021

<sup>21</sup> Federal-state friction amid Malaysia's dual political and pandemic plight: https://www.newmandala.org/federal-state-friction-amid-malaysias-dual-political-and-pandemic-plight/

decision to open up the economy was carried out under the Prevention and Control of Infectious Disease Act 1988 (Act 342), a federal law. The Constitution also requires that states do not "impede or prejudice" the federal government's exercise of power. A related federal order defines an "infected area" to include all states and federal territories in Malaysia.

At the same time, the Federal Constitution defines "public health, sanitation and prevention of infectious diseases" within the Concurrent List, where authority is shared between the federal and state governments. Furthermore, the Local Government Act 1976 gives local governments the right to enforce and preserve public health, and prevent the outbreak and spread of diseases. We did see during the pandemic that the local governments worked together with the police and the state health departments to ensure that the strict SOPs were followed.

To an extent, many state governments took COVID-19 management into their own hands, to meet local needs. In Penang, the government disbursed its own aid packages, developed its own communication strategies, created state-level COVID-19 crisis teams and cooperated well with federal health agencies to achieve effective allocation of resources. To plan the state's economic recovery, the Penang Socio-Economic Recovery Consultative Council (PSERCC) was formed and included members from the private sector, the state government, think tanks and federal agencies as well. The Penang State Government also approved an allocation of about RM175 million through five Penang People's Aid Packages to help those badly affected, including assistance to other related sectors.

States are playing a crucial but underreported role in managing the twin public health and economic crises, so much so that their experiences put into question whether the constitutional boundaries continue to be relevant. States, despite not having full legal control over public health and the economy, proved able to meaningfully contribute in these areas, and this was often despite federal constraints.

# **Part Five**

#### **Recommendations for Enabling Decentralisation**

While acknowledging that Pakatan Harapan's aspirations at the federal level to revive the true spirit of federalism were not fully realised, Penang must nevertheless press on with its decades-long demand for greater decentralisation and for the fair and equal treatment of Penang and all other states in the Federation, by Putrajaya.

Ultimately, in order for states to be self-reliant, confident and pro-active in pursuing their long-term development goals, a thorough rethinking and restructuring of federal-state relations must be undertaken to correct existing imbalances and to empower the states with more direct responsibilities and funds. This Report presents the following recommendations, consciously envisioned to stimulate practical and immediate action on federal devolution—at the federal, inter-state and Penang state levels, connectedly.

#### 4 Establishing a Federal-State Relations Commission

The Penang State Government should advocate for the establishment of a national Federal-State Relations Commission to examine and review in entirety the working arrangements between the federal government and the states relating to powers, functions and responsibilities on all legislative, administrative, financial, and socio-economic matters within the constitutional framework. The terms of reference and the composition of this Commission should reflect the general needs and aspirations of the states.

In particular, the proposed Federal-State Relations Commission must address long-standing demands for greater devolution of financial powers to state and local governments (PBTs): on revenue-raising, fiscal transfers, redistribution and sharing of taxes; the lifting of restrictions on borrowing by states, and; the equalising of the financial capacities of all states to address fiscal imbalances. To date, institutional bodies such as the National Finance Council have been ineffective in securing a fair deal for the states, but have instead functioned almost ceremonially as an extension of the federal government, with biased favour towards the centre. This disempowerment of such key institutions needs to be reversed.

#### 5 Establishing an All-States Collaboration Committee on Decentralisation

The Penang State Government should take the initiative to establish an All-States Collaboration Committee on Decentralisation. This process may involve certain more eager state governments before other states, but the process should be started with the ambition of involving all states in the Federation in the end. The purpose of the Committee will be to enhance both formal and informal cooperation and consensus building among the states to further their shared interests and to develop mechanisms to coordinate their collective response on federal-state issues.

Such an instrument for inter-state cooperation will facilitate greater engagement between the states, generate deeper understanding of the virtues of federalism to promote good governance, and strengthen the unity and integrity of the country.

#### 6 Establishing a Federal-State Relations Improvement Committee in Penang

The Penang State Assembly should inaugurate a standing / select committee (thus taking the lead in being the first state to do so) to manage federal-state relations in a concrete manner. This Federal-State Relations Improvement Committee will inquire into and report upon matters concerning all operational and administrative working arrangements between federal and state government agencies, on finance, health, social welfare, education, road works, disaster management, flood mitigation, trade and industry, the civil service, and so on.

The reports of the Committee will not only serve as the foundation upon which policy recommendations can be formulated to improve working relations between the federal and state government, and enhance the accountability and efficiency of good governance, they will also increase awareness and understanding among government agencies and in the general public on key federal-state relations issues.

In short, this interim report and its recommendations point towards the creation of a common platform for all states in Malaysia to collaborate in restructuring federal-state relations, and to help realise the full potential of the federalist structure in the governance of what is an excitingly diverse country. Only with vibrant discussions and continuous adaptations can Federalism be the vehicle through which a more democratic, fair, just and equitable future be secured for all citizens and residents of all states in the country, as had been imagined from the beginning.

# References

Federal Constitution of Malaysia, 1957

Anderson, George (2008) *Federalism: An Introduction*, Oxford and Ottawa: Oxford University Press and Forum of Federations.

Farrah Shameen Bte Mohamad Ashray (2018), "Social Welfare Services in Malaysia: the Role of Government", *Advances in Social Science, Education and Humanities Research* vol 191, (Asian Association for Public Addministration), pp. 427-36.

Forum of Federations. The Global Network on Federalism and Devolved Governance: <u>www.forumfed.org.</u>

\_\_\_\_\_. *The Handbook of Federal Countries 2020.* Edited by Ann Griffiths, Rupak Chattopadhay, John Light, Carl Stieren, Palgrave Macmilan (eBook).

Jomo KS and Wee Chong Hui (2002) *The Political Economy of Malaysian Federalism: Economic Development, Public Policy and Conflict Containment*. Discussion Paper No 2002/1/3 United Nations University, World Institute for Development Economics Research.

Harding, Andrew (2012), *The Constitution of Malaysia, A Contextual Analysis*, Oxford: Hart Publishing.

Holzhausen, W. (1974) Federal Finance in Malaysia, Kuala Lumpur: University of Malaya Press.

Hutchinson, Francis (2014), pp. 1-21, 'Malaysia's Federal System: Overt and Covert Centralisation', *Journal of Contemporary Asia* DOI:10.1080/00472336.2013.878374.

Kitingan, Jeffrey G. (1997) "Thorny Issues in Federal-State Relations" in Tan Chee Beng (Ed.) *Reflections on the Malaysian Constitution*, Penang: Aliran, pp.149-68.

Loh Kok Wah, Francis (2010) 'Restructuring Federal-State Relations in Malaysia: From Centralised to Co-operative Federalism?' <i>The Round Table</i> vol 99, no 407, pp. 131-40.
(2009) Old vs New Politics in Malaysia, Petaling Jaya: SIRD.
(Ed.) (1997) Sabah and Sarawak; The Politics of Development and Federalism, Penang; Universiti Sains Malaysia.
(1996) "A New Sabah and the spell of development; resolving federal-state relations in Malaysia", <i>South East Asia Research</i> 4(1), 1976-85, pp. 63-84.
(2015) "Centralised federalism in Malaysia; Is change in the offing?" In Meredith Weiss (ed.) <i>Routledge Handbook of Contemporary Malaysia</i> , London and New York: Routledge, pp. 72-82.
(2015) "Malaysia: From Political Ferment to Restructuring Federalism", In Klaus Detterbeck et al (eds) <i>Political Parties and Civil Society in Federal Countries</i> , Don Mills, Ontario: Oxford Uni Press, pp. 147-70.
Mohamad Agus Yusoff (2006) Malaysian Federalism: Conflict or Consensus, Bangi: Penerbit

Mohamad Agus Yusoff (2006) *Malaysian Federalism: Conflict or Consensus*, Bangi: Penerbit Universiti Kebangsaan Malaysia.

Mohd Salleh bin Abas (1978) "Federalism in Malaysia-Changes in the First Twenty Years". In Mohammed Suffian, H P Lee and F A Trindade (eds.) *The Constitution of Malaysia: Its Development 1957-1977*, Kuala Lumpur: Oxford University Press, pp.163-91.

Nambiar, Shankaran (2007) "The Practice of Fiscal Federalism in Malaysia" in Anwar Shah (Ed.) *The Practice of Fiscal Federalism: Comparative Studies*, Montreal and Kingston: McGill-Queen's University Press, pp.178-203.

Narayanan, Suresh, Lim Mah Hui and Ong Wooi Leng "Re-examining Penang State Finances and Governance". In Ooi Kee Beng and Goh Ban Lee (eds) *Pilot Studies for a New Penang*, Singapore: Institute of Southeast Asian Studies, pp. 189-222.

Ng, Cecilia (2012) "Gender and Governance: The Politics of Federalism in Malaysia" *Kajian Malaysia* vol 30, no 2, pp. 1-26.

Ooi Kee Beng (2013) "The New Economic Policy and the Centralisation of Power". In E T Gomez and J Saravanamuttu (eds) *The New Economic Policy in Malaysia: Affirmative Action, Ethnic Inequalities and Social Justice*, Petaling Jaya: SIRD, pp. 317-335.

Shanmugam, N. and Siow Chen Ming (2008) "Funding the Opposition State" *The Edge Malaysia*, March 17, pp. 72-77.

Watts, Ronald (2008) *Comparing Federal Systems*, Third Edition, Montreal and Kingston: McGill-Queen's University Press.

Wee Chong Hui (2006) Regional Disparities and Federalism in Malaysia, Kuala Lumpur: University of Malaya Press.

\_\_\_\_\_ (2011) "Federal-State Relations in Natural Resource Management in Malaysia". In *Policies and Issues in Economic Development*, Kuala Lumpur: Institute of Strategic and International Studies.

Yeoh, Tricia (2012) States of Reform: Governing Selangor and Penang, Penang: Penang Institute.

\_\_\_\_\_ (2019) Reviving the Spirit of Federalism; Decentralization Policy Options for a New Malaysia, IDEAS No 59, April.

\_\_\_\_\_ (2020) Federal-State Relations under the Pakatan Harapan Government, in Trends in Southeast Asia. Singapore: ISEAS Publishing 12/2020

