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Editorial committee:

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PENANG
INSTITUTE
making ideas work

10-12 Brown Road
10350 George Town
Penang, Malaysia

(604) 228 3306
www.penanginstitute.org
enquiry@penanginstitute.org

Beyond Fiscal Allocations: Greater Collaboration, Persistent Centralisation in Malaysia's Budget 2027

By **Chan Xin Ying** (Programme Coordinator, FLAG)

BUDGET ALLOCATIONS reflect not only the distribution of fiscal resources but also the institutional arrangements governing federal–state relations. Increased funding, however, does not necessarily translate into greater state autonomy. Against this backdrop, Malaysia's Budget 2027, announced on 9 October 2026, raises an important question: To what extent does it signal more substantive federal–state cooperation, or does it in effect reinforce Malaysia's traditionally centralised governance structure? This paper examines the budget through three dimensions—fiscal allocations, intergovernmental collaboration and devolution of authority—to assess whether its commitments represent meaningful changes in state discretion and the distribution of fiscal and administrative powers.

Devolution of Authority and Fiscal Autonomy: Sabah and Sarawak

The implementation of the Malaysia Agreement 1963 (MA63) remains an important dimension of federal–state relations in Budget 2027. Although Sabah and Sarawak were accorded special constitutional safeguards upon joining Malaysia, their autonomy has been gradually eroded through federal political intervention.¹ Sabah's longstanding dispute over its constitutionally guaranteed special grant further illustrates the gap between formal fiscal entitlements and their implementation.²

Against this background, Budget 2027 acknowledges longstanding shortcomings in the fiscal arrangements for Sabah and Sarawak. Prime Minister Anwar

¹ Andrew J. Harding, “A Measure of Autonomy: Federalism as Protection for Malaysia's Indigenous Peoples,” *Federal Law Review* 46, no. 4 (2018).

² Under Articles 112C and 112D and the Tenth Schedule of the Federal Constitution, Sabah's special grant is linked to a formula based on 40 per cent of the increase in net federal revenue derived from the state, subject to periodic review. The review due in 1974 was not undertaken. In October 2025, the Kota Kinabalu High Court ruled that the federal government had failed to fulfil its constitutional obligations concerning the grant, although aspects of the judgment were subsequently appealed. See Federal Constitution, arts. 112C–112D and Tenth Schedule; *Sabah Law Society v. Government of the Federation of Malaysia* (2025); Bernama, “Fed Govt Granted Stay on Sabah Special Grant Review,” 6 April 2026.

Ibrahim recognised that their Special Grants (*Pemberian Khas*) had long been inadequate to meet development needs. The budget highlighted a threefold increase in interim Special Grants to RM1.5 billion, alongside ongoing negotiations over a sustainable annual formula. Federal allocations for 2027 were also announced at RM18.7 billion for Sabah and RM16.2 billion for Sarawak, compared with RM17.6 billion and RM15.1 billion respectively in 2026.³ While these commitments signal greater federal recognition of longstanding fiscal grievances, their implications for state autonomy depend on whether these establish more predictable fiscal entitlements and greater state discretion, rather than rely further on negotiated allocations.

Beyond fiscal commitments, Budget 2027 highlights the resolution of 12 MA63-related matters, including the transfer of electricity regulatory authority to Sabah, the handover of Bintulu Port and MASWings to Sarawak, and permanent representation for both states on the Inland Revenue Board (LHDN). Federal support of RM600 million for Sabah's electricity supply and RM209 million in rural air service subsidies also demonstrates continued federal financial involvement.⁴ These measures nevertheless represent different forms of institutional change. Regulatory devolution directly redistributes governmental authority, whereas asset transfers and representation within federal institutions do not necessarily confer equivalent fiscal or policymaking autonomy.

Taken together, these developments suggest a gradual renegotiation of federal–state relations through the restoration of selected powers and

renewed fiscal commitments. However, these developments remain confined to select MA63-related matters, while major questions concerning fiscal entitlements and the broader distribution of governmental authority stay unresolved. Although some measures may involve meaningful transfers of regulatory authority, they do not amount to a comprehensive restructuring of federal–state relations. Budget 2027 may therefore strengthen the practical autonomy of Sabah and Sarawak in certain policy domains without fundamentally altering the wider institutional structure of Malaysian federalism.

Federal–State Collaboration and Subnational Governance

Beyond the restoration of selected powers to Sabah and Sarawak, Budget 2027 provides RM5.7 billion under the Malaysian Road Records Information System (MARRIS) for state road maintenance, and increases Ecological Fiscal Transfers (EFT) to RM270 million for environmental conservation and community-based ecotourism.⁵ These allocations illustrate the distinction between financing state responsibilities and devolving authority. Under the existing MARRIS arrangement, state road maintenance is partly financed through federal grants, with allocations determined by established criteria and subject to federal funding guidelines.⁶ Although state governments distribute these funds among implementing agencies, including state Public Works Departments (JKR) and local authorities, their discretion operates within federally prescribed conditions. Thus, the allocation sustains

³ Ministry of Finance Malaysia, *Ucapan Belanjawan MADANI 2027*, 9 October 2026, paras. 39–41, pp. 22–23.

⁴ Ministry of Finance Malaysia, *Ucapan Belanjawan MADANI 2027*, para. 40, p. 23.

⁵ Ministry of Finance Malaysia, *Ucapan Belanjawan MADANI 2027*, 9 October 2026, p. 51 and para. 162.

⁶ Federal Constitution, art. 109 and Tenth Schedule; Ministry of Finance Malaysia, Treasury Circular PB 3.6, concerning grants for the maintenance of state roads.

an existing arrangement in which states undertake road maintenance with federal financial support, rather than introducing new fiscal or administrative powers. Similarly, the increased EFT allocation provides additional support for environmental conservation but does not, in itself, alter the underlying distribution of fiscal authority.

A similar distinction applies to collaborative development initiatives. Budget 2027 provides RM300 million for federal–state agri-food projects and highlights a strategic investment fund involving Khazanah Nasional and InvestPenang, alongside federal facilitation of a 40-year bulk water supply agreement between Perak and Penang.⁷ These initiatives must be understood within Malaysia's existing development administration, where federal institutions retain significant roles in coordinating and monitoring development expenditure. State Development Offices (*Pejabat Pembangunan Negeri*), operating under the Implementation Coordination Unit of the Prime Minister's Department (ICU JPM), coordinate and monitor federal development projects at the state level. Their institutional position illustrates how decentralised project implementation can coexist with centralised federal oversight.⁸ While these offices do not necessarily administer the collaborative initiatives announced in Budget 2027, their role illustrates the broader institutional context in which federal development expenditure is coordinated and monitored. The budget offers little indication that the new initiatives substantially alter existing arrangements for determining development priorities or controlling fiscal resources.⁹

This distinction also extends to local governance. Budget 2027 provides nearly RM700 million for infrastructure projects in local authority (PBT) areas, approximately RM320 million for slope and drainage improvements, and RM40 million to strengthen District Engineers' capacity to expedite minor road repairs. These commitments may improve local service delivery, but expenditure within local jurisdictions should not be conflated with fiscal transfers to local authorities. Whether such initiatives strengthen subnational governance depends on which institutions control project selection, funding and implementation.

These limitations reflect the broader structural imbalance in Malaysia's fiscal federalism. As Lee (2023) observes, state governments possess relatively limited functional responsibilities and revenue-generating powers, with substantial reliance on land-related revenue.¹⁰ This is particularly evident in industrialised states such as Penang and Selangor, where economic development does not necessarily generate proportionate state government revenue because major taxes, including corporate and personal income taxes, remain under federal jurisdiction. Lee also identifies EFT as an important mechanism for compensating states for environmental conservation, although such transfers cannot substitute for broader reforms to state fiscal capacity. The central issue is therefore not simply whether states receive more resources, but whether they possess the fiscal and institutional capacity to determine and finance their own development priorities.

⁷ Ibid., paras. 37, 50 and 115.

⁸ Francis E. Hutchinson, "Malaysia's Federal System: Overt and Covert Centralisation," *Journal of Contemporary Asia* (2014), 11.

⁹ Malaysia's development planning has historically been dominated by the federal government, particularly through national development plans, federal development expenditure and the centralisation of major taxation powers. Although states retain constitutional responsibilities in areas such as land and local government, their comparatively limited fiscal resources constrain their capacity to independently determine and finance development priorities.

¹⁰ Lee Hwok Aun, "Insufficient States: Revisiting the Roles and Resources of Malaysia's Subnational Governments," *ISEAS Perspective*, no. 2023/98 (14 December 2023).

Conclusion

Budget 2027 signals continued efforts to strengthen federal–state cooperation through fiscal transfers, joint development initiatives and improvements in local service delivery. However, these measures largely operate within existing institutional arrangements, with limited evidence of substantive reforms to the distribution of fiscal and administrative authority. Even in Sabah and Sarawak, progress under MA63 remains selective, focusing primarily on longstanding constitutional commitments and specific transfers of authority rather than comprehensive institutional restructuring. While these initiatives may improve intergovernmental coordination and subnational implementation capacity, they do not represent a systematic departure from Malaysia’s centralised federal framework. Budget 2027 thus illustrates how greater intergovernmental collaboration can coexist with the persistence of centralised governmental authority.



Chan Xin Ying is FLAG Programme Coordinator, an NUS PhD candidate in Political Science, and former Programme Manager at PWDC.