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Reviving the Spirit of Federalism: Decentralisation Policy Options for a New Malaysia

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Introduction

Up to 2008, the spirit of Malaysia's federalism had all but faded, given the country's highly centralised institutions and system of political economy. It was only when five states fell to the then national opposition Pakatan Rakyat that same year that the discussion of federal-state relations, especially within Peninsular Malaysia, began to take on a more interesting tone. Over the following ten-year period up to 2018, states – not just those run by the national opposition – began to escalate their claims on a variety of policy issues, ranging to the demands for oil rights in Kelantan, Terengganu, Sarawak, and Sabah, to self-determination of companies selected to perform waste management services in Penang and Selangor as opposed to these being selected by the federal government. Where the federal government had previously typically responded to state complaints about funding gaps by allocating more funds, the relationship between the centre and the states required a maturing beyond such paternalistic reactions. The 2018 Pakatan Harapan general election manifesto contained a slew of offerings for such states in East Malaysia where the demands were the loudest, including returning Sabah and Sarawak to the status accorded by the Malaysia Agreement 1963, and Promise 24 even committed to “revive the true spirit of federalism”.

The new Pakatan Harapan-led federal government following the watershed election of 9 May 2018 has seemingly followed up on its commitment to this end, by forming a Parliamentary Select Committee on Federal-State Relations in December 2018. The select committee's members comprise many Members of Parliament from East Malaysia, presenting the committee's concerns as largely related to those of Sabah and Sarawak, although it remains unclear what the select committee's terms of reference will be as no further announcements have been made. These are positive steps in the right direction, but much more work will be required in order to truly restore the federalism spirit that formed the very basis of our nation. Already, there are signs of complexities; the current government has given lower allocations to opposition MPs (RM500,000 for government MPs and RM100,000 to opposition MPs), and some opposition leaders are not being allowed to attend state government events² and are blocked from entering schools³. There is a risk of the new government behaving in similar ways as its predecessor did in the past, and it is all the more important now to re-examine Malaysia's federal history in order that all states are given fair treatment regardless of the political leadership in power, for the sake of well-balanced regional growth and development and that of the nation at large. This paper aims to provide some solutions as a basis of this urgent discussion⁴.



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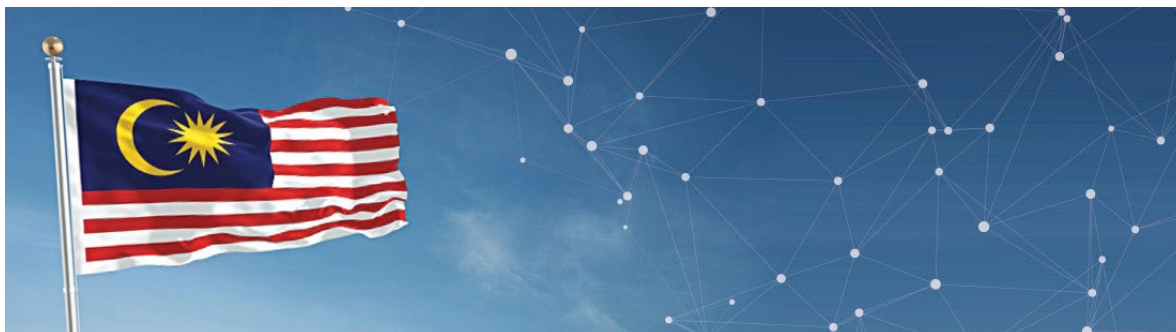
¹ The author would like to thank Lee Hwok-Aun for his helpful comments to an earlier version of this policy paper, and Aira Azhari for her comments and suggestions.

² 'Johor opposition leader returns opposition room, allowance to state govt', Bernama, 2 December 2018.

³ 'Govt slammed over restriction on opposition MPs entering schools', New Straits Times, 20 November 2018.

⁴ Due to the marked legal and administrative differences in Sabah and Sarawak, this policy paper does not seek to provide recommendations and solutions to promoting better federal-state relations for the two East Malaysian states.

Background: Malaysia as a constitutional federalism, but a highly centralised one



Malaysia is set up as a constitutional federalism, and when it was formed already had federal elements incorporated into its legal and constitutional framework. This spirit of federalism was indeed embedded in the country's history and infused into the Federation of Malaya Agreement 1948, when the disparate states came together; in which although it was agreed there would be established "a strong central government", it was also agreed that "the individuality of each of the Malay States and of the Settlements should be clearly expressed and maintained" (Pearn 2001). There was also meant to be machinery for consultation between the central government and the States and Settlements on certain financial matters⁵. This was a direct recognition of the individuality of the states. Nevertheless, a more cynical view as argued by Ooi (2013) is that this was merely 'nominal federalism' since it was more an expression of Malay ethnocentrism understood through its separate *kerajaan* domains, since state loyalties were primarily driven by allegiance to the royal families.

Despite the spirit of federalism, in reality, Malaysia has practised a highly unitary system, experiencing increasing centralisation within the federal government over time, starting with the abolishment of local council elections (Yeoh 2010). Local council elections began in Penang and Kuala Lumpur in 1951 and 1952 respectively, but were suspended as an emergency measure under the Emergency (Suspension of Local Government Elections) Regulations 1965 and have not been reinstated since (Harding 2015). The Local Government Act was passed in 1976, which ended local elections for good (Ooi 2013).

Although a Royal Commission of Inquiry on Local Authorities recommended that local elections should be restored, this was rejected by the Development Administration Unit (DAU) of the Prime Minister's Department, saying that elected local government provided for "over-democratised over-government at the local level" and was not in keeping with the objectives of the redefined state under which resources would be devoted to development, democracy taking a subordinate position (Saravanamuttu 2000). This argument of ensuring the nation's efficient development has been consistently used to justify greater centralisation into the hands of the federal government.

⁵ Extracted from the report of the General Purposes Committee of the Conference Constitutional Commission.

For the purposes of public law and order, the federal constitution also permits the federal government to declare an emergency for the sake of maintaining security and public order in the federation. Articles 149 and 150 empower the Yang di-Pertuan Agong to proclaim a state of emergency if he is satisfied that the federation or any parts of it are threatened, and to extend the effect of this declaration to any matter within the legislative authority of a state. Article 150(8) in fact states that no court shall challenge the proclamation of emergency, nor will they have jurisdiction to entertain or determine any application, question or proceeding, in whatever form, on any ground. During an emergency, the federal government's powers are even more highly centralised, since its powers are extended to any matter within the state's legislative authority, as has been the case in the two states of Kelantan and Sabah historically. The 1964 change of the Senate's composition, supposedly the 'house of the states', further eroded states' representation in Parliament when the original proportion of state-appointed to centre-appointed senators was altered from 28:22 to 28:32, which was further reduced in 1965 to 26:32 (Bhattacharya 2010). Today, the Senate is made up of 70 individuals with a ratio of state-appointed to centre-appointed senators of 26:44.

Principles of federalism

Federations are political systems which allow a national government and their corresponding subnational governments to have legally-defined policy spaces which allow for substantial autonomy and meaningful responsibilities. The criteria for forming a federation are, according to Bednar (2009), having constitutionally-recognised, territorially-exclusive constituent units, independent sources of authority for federal and state governments, and policy sovereignty at each level. However, there are no further strict or fixed definitions, for instance in their allocations of powers between the centre and states, and "federations differ greatly in the formal apportionment of revenue sources and responsibilities between centre and states... varying also in their constitutional design and provision of safeguards and dispute resolution mechanisms" (Wong and Hutchinson 2017).

Federations vary widely, ranging from highly centralised to highly decentralised systems of government; some have prime ministers and parliamentary governments, whilst others have presidents and congressional institutions; some are stable and harmonious yet others are unstable and undivided. That said, the most common names of constituent units in federalisms are *states* (Australia, Brazil, Ethiopia, India, Malaysia, Mexico, Nigeria and the United States), *provinces* (Argentina, Canada, Pakistan, South Africa), *Laender* (Austria and Germany), *cantons* (Switzerland), *regions* and *communities* in Belgium and *autonomous communities* in Spain. Russia also has *regions*, *republics*, *autonomous areas*, *territories* and *cities* of federal significance (Anderson 2008).

The term 'federalism' has been used in different contexts to mean either centralisation or decentralisation, but this paper adopts the more contemporary academic definition of the latter⁶. The founders of the United States federation articulated the philosophy of federalism, considered to be the best way to preserve individual liberty and avoid concentrating power in a sole location. Instead, dividing power and attributing it to various authorities precludes

⁶ In Europe, 'federalist' is sometimes used to describe those who favour a common federal government that distributes power at regional, national and supranational levels. In the United States, where federalism originally referred to the belief in a stronger central government, the modern usage of the term federalism refers to limiting the powers of the federal government in favour of more powers at the subnational or regional level.

an unhealthy concentration of power in a single location (Peterson 1995). More importantly, federalism implies a normative approach to the functioning of government, in that there should be meaningful shared-rule and regional (or subnational) self-rule, based on the presumed value and validity of combining unity and diversity, and of accommodating, preserving, and promoting distinct identities within a larger political union (Watts 1999).

The principles of dividing power and responsibilities among different domains under different tiers of government ought to be pragmatic and determined by efficiency, equity and representation. Similarly, facilitating mechanisms such as ensuring a rules-based approach (transparency and accountability for the purposes of predictability), administrative neutrality (civil service, and the clear separation between the centre and states, as well as that of between the political party in power and in opposition) and conflict resolution.



An important element of the principles of federalism is how financial resources are adequately distributed to subnational units, based in part on how these resources are generated. There are certain principles by which a federalism that is structured well fiscally may adhere to, such as the home rule (where decision-making should occur at the order of government closest to the people for allocational efficiency), fiscal equivalency (where the jurisdiction determining the order of provision of each public good should include precisely the set of individuals that consume it), the decentralisation theorem (each public service should be provided by the jurisdiction having control over the maximum geographic area that would internalize the benefits and costs of such

provision) and the subsidiarity principle (taxing, spending and regulatory functions should be exercised by the lowest order of government unless a convincing case can be made for assigning these to higher orders of government) (Shah 2007).

However, despite the theoretical ideals of power sharing between the national and subnational levels in a federalist nation, there are bound to be contestations that take place. These competing considerations are affected by the country's political system, whether democratic or authoritarian in nature. Hence, in any federal system, there will be both cooperative and competitive relationships in the bargaining process, and each system must therefore develop its own balance in its intergovernmental relations, and on this point Watts (1998) goes on to say that the notion of interdependent federalism seems to be the more appropriate way of describing the simultaneous cooperation and rivalry dynamic between both levels of government.

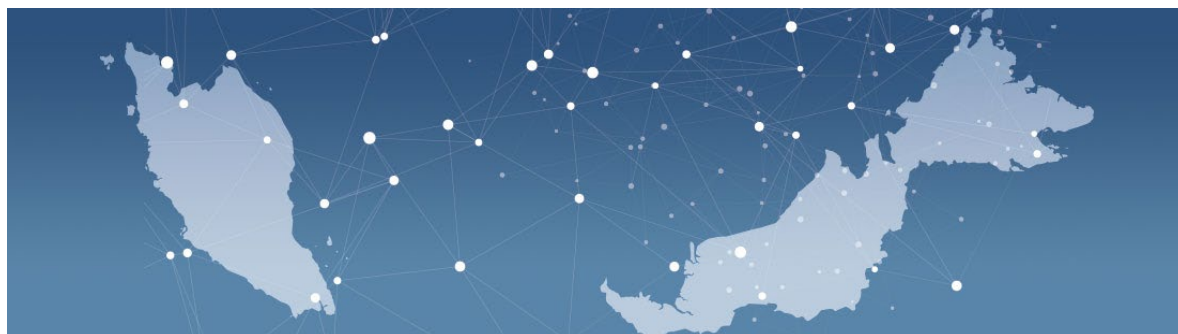
Under more authoritarian systems of government, the principles of pragmatism, efficiency, equity and representation are unlikely to be applied. Canada as a federation experienced conflict arising from the relationship between its federal and state governments, most commonly over (i) constitutional jurisdiction, (ii) revenue sharing or vertical imbalance, (iii) horizontal imbalance, (iv) federal spending power, (v) regional development policy, (vi) control of natural resources, (vii) social heterogeneity (cultural, linguistic

or religious), (viii) political ideology, (ix) clash of personalities among political leaders, and (x) the lack of intergovernmental consultation, most of which are actually issues surrounding intergovernmental fiscal relations (Meekison 2002).

Countries that display less democratic elements may well experience much more conflict than those listed above, particularly when subnational units are run by parties not aligned to the central government. For instance, Fessha and Kirkby (2008) in their survey of subnational autonomy in African states show that subnational governments led by opposition parties must resist central government incursions into their legislative domains, whilst at the same time fighting off attempts by the central government to increase local government dependence on the central government.

Likewise, Malaysian state governments run by the opposition face similar federal government interference and encroachment into their policy areas of jurisdiction, and worse, are fiscally punished for not being aligned to the central party as described in later sections below. Weingast (2014) aptly describes this phenomenon as one of 'tragic brilliance', namely how insecure and highly centralised governments use centralised fiscal control to create political dependence on incumbent regimes; it is tragic because it forces citizens to continue electing the regime in power, but at the same time brilliant because it creates citizen subservience while outwardly displaying the guise of democratic elections. However, in the study of federalism, it is equally important to note that, as Bhattacharya argues (2010), there is no ideal single model of federalism to emulate or copy, since most often multiethnic countries are confronted with the need for accommodation of serious ethno-regional and national considerations.

Decentralisation as a solution



A strategy that has been adopted widely in many countries to diffuse the negative effects of an overly centralised system of government, and in selected Southeast Asian countries over the last few decades, is that of decentralisation. Scholars have argued that administrative, fiscal and political decentralisation would bring about better productivity gains (Oates 1972), enable better policymaking (Besley and Coate 2003), combat corruption (Fisman and Gatti 2002; Bardhan and Mookherjee 2008) and possibly plant seeds of future democracy since it would ensure a more citizen-based participatory process (Fung 2004). In theory, this would lead to subnational units competing against the other to provide the best possible public service delivery outcomes to constituents (Weingast 1995; Montinola, Qian and Weingast 1995).

However, countries that adopted this strategy in the 1990s have had varied outcomes. In Indonesia, anticipated gains in service delivery and economic impacts have not materialised consistently (Ostwald, Tajima and Samphantharak 2016), while clan politics, corruption and local elite incompetence have constrained decentralisation's impacts in the Philippines (Shair-Rosenfield 2016). Within the region, similar challenges are being faced in Thailand and Cambodia, while Myanmar is just embarking on its decentralisation efforts and it is too soon to tell whether such plans will bear fruition.

Other scholars have noted that for decentralisation to work, there has to be an effective relationship between the political, fiscal and administrative aspects of central-local relations (Harding and Sidel 2015). Ultimately, decentralisation can promote development but this requires a state with tremendous organisational capacity, since as pointed out by Heller (2001), decentralisation without an effective state would in fact limit state capacity. Given the ununiformed outcomes of decentralisation efforts, it seems necessary to explore other strategies that subnational actors have adopted.

In countries where a high degree of centralisation exists, subnational units are therefore forced to emerge with policy strategies of their own to ensure the sustainability and success of the regions or states they govern. Aseema Sinha's extensive research on three regional states in India (2005) finds that the conduct of economic policy in these states is a political process in which central rulers and regional incumbents bargain over the output and rules of the game, but also create new institutions and new markets. State politicians adopt vertical strategies towards central government constraints by bargaining or opposing the centre, but simultaneously create new institutions to compensate for coordination and information dilemmas created by a strong centralist state.

However, Rudolph and Rudolph (2001) caution that a sufficient condition for what they call a ‘federal market economy’ in which emerged new patterns of shared sovereignty between states and the centre for economic decision-making was India’s party and government system being transformed from a one-party dominant majority party system to a regionalised multi-party coalition government system. In other cases, subnational actors adopt strategies that allow them to play off both local and national level politics to achieve better policy outcomes. For instance, Ardanaz, Leiras and Tommasi (2014) find that subnational political units in Argentina are powerful in shaping national policymaking, since successful governors are those who play a ‘two-level game of dominating local politics while milking the federal cow’. Similarly, in Russia, governors have to maintain social and economic stability in their subnational territories and at the same time deliver votes to the centre (Sharafutdinova 2009).

Interestingly, the Regional Authority Index, which captures the formal authority of subnational governments on 10 distinct dimensions, ranks Malaysia as the most decentralised country in Southeast Asia (Shair-Rosenfield, Marks and Hooghe 2014).

Federal-state administrative and fiscal systems in Malaysia

Federal-state Administrative System and Conflict

The Federal Constitution of Malaysia lays out the distribution of legislative powers and responsibilities between federal and state governments, more specifically within the ninth schedule. The federal government’s purview includes trade, commerce and industry, foreign affairs, defence, internal security, law and order, physical development (communication and transport), and human development (education, health and medicine). State governments are left with very little such as lands and mines, Muslim affairs and customs, Native laws and customs, agriculture and forestry, local government and public services, burial grounds, markets and fairs, and licensing cinemas and theatres. The concurrent list covers social welfare, scholarships, town and country planning, drainage and irrigation, housing, culture and sports, public health and water services (Yeoh 2012).

Table 1: Areas of concurrent and state responsibilities

Concurrent List	State List
Social welfare Scholarships Protection of wild animals and wild birds and national parks Animal husbandry Town and country planning Vagrancy and itinerant hawkers Public health and sanitation Drainage and irrigation Rehabilitation of mining land and land with erosion Fire safety measures Culture and sports Housing Water supplies and services Preservation of heritage	Islamic law and Malay customs Land matters Agriculture and forestry Local government Other services ⁷ State works and water ⁸ Machinery of the state government State holidays Creation of offences on state matters Inquiries for state purposes Indemnity for state matters Turtles and riverine fishing Libraries, museums, ancient and historical monuments and records and archaeological sites and remains

Source: Federal Constitution, Ninth Schedule

⁷ Boarding houses and lodging houses, burial and cremation grounds, pounds and cattle trespass, markets and fairs, and licensing of theatres, cinemas and places of public amusement.

⁸ Includes rivers and canals, excludes water supplies and services; Control of silt and riparian rights.

Although state governments' jurisdictions seem to be clearly spelt out above, other parts of the constitution also provide for national councils that impede upon this space. First, Article 95A of the constitution gives the National Council for Local Government power to formulate policy for local government nationally. It was also for this reason that when the two then opposition-led state governments of Selangor and Penang under the Pakatan Rakyat coalition requested that the Election Commission hold local council elections in their states in 2010, the Election Commission held that the NLGC would first have to grant permission for this (Harding 2015). In fact, Article 119 provides that the right to vote relates only to the federal and state legislatures.

The Federal Constitution also contains several provisions that give federal government law primacy over state government law, which is a source of potential conflict. For instance, Article 75 provides that if any state law is inconsistent with a federal law, the federal law shall prevail, whilst Article 76 allows the federal government to make laws pertaining to state matters if it promotes the uniformity of laws, or is requested to do so by states.

In practice, administrative conflict between the two levels of government have also often resulted in the state government's decisions being superseded. The Malaysian Civil Service emerged from the British Public Service, which began in the late 1700s after the British East India Company acquired Penang. In the late 1800s, the Federated Malay States' separate civil services (Selangor, Perak, Negeri Sembilan and Pahang) were combined with that of the Straits Settlements (Penang and Malacca) into a unified Federated Malay States Civil Service (FMS). The FMS later introduced the Malay Administrative Service and together they refined new standards for public service.

The Unfederated Malay States (Johor, Kedah, Kelantan and Terengganu) on the other hand formed and today still maintain their own State Public Services under the authority of their respective chief ministers and Sultans, where most of their state civil servants are employed by the state. Other colonial services like that of the Police, Medical, Education and Legal were brought together over the years, forming the Colonial Administrative Service that the Malaysian Civil Service (MCS) was part of, the latter of which is known today as the Administrative and Diplomatic Service mentioned above. This is considered a prestigious level of service which fills almost all senior positions at the federal and state levels.

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The Malaysian public service today has a total of 1.2 million employees covering 28 schemes of service. Public service policies are crafted by the Public Service Commission (Suruhanjaya Perkhidmatan Awam) and thereafter executed by the Public Service Department (Jabatan Perkhidmatan Awam), although neither of these have jurisdiction over the public services of former members of the Unfederated Malay States. This federal-level Public Service Department is responsible for the appointment and promotion of officers higher than Grade 17, which is the entry point for those with high school certificates (Yeoh 2012).

As a result of these developments, many state government senior administrative positions such as the state secretary, state financial officer, state legal advisor and the state economic planning unit director are occupied by members of the federal civil service, seconded to the states. Although their salaries are paid by the state governments, their appointments and promotions are determined by the federal government. The exception for this is for UMS states like Johor, which has its own civil service and able to retain its control over senior administrative posts (Shafruddin 1987). Mayors of local councils are conventionally also appointed from the federal service. On two occasions when the Selangor government protested the federal government's decisions on senior appointments in the state, this was ignored by the federal government; first in the selection of the state secretary in 2011⁹ and then the 24-hour notice of the Petaling Jaya City Council mayor's transfer in 2012¹⁰.

Additionally, the then Minister of Agriculture Noh Omar issued a circular forbidding all its officers (including those stationed at the state office) from attending any meetings or courses sponsored by the Pakatan Rakyat state governments (Yeoh 2010). Schools in Selangor were also directed not to invite state legislators from the Pakatan coalition to functions, and a Selangor senator claimed that the Chief Secretary to the federal government instructed civil servants in opposition-led states to prioritise the instructions and policies of the federal government in their work (Syed Husin 2010). The Ministry of Tourism also cancelled its memorandums of understanding with Selangor and other opposition state governments and dissolved the state-controlled Tourist Action Councils, placing them under the federal ministry instead (Ostwald 2017).

Setting up separate and distinct development offices and neighbourhood committees in states under the opposition has also been common practice by the federal government. Funds are channeled to these federal offices directly from the centre, therein bypassing the state governments.

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⁹ The federal government appointed the new Selangor state secretary Khusrin Munawi without taking into consideration the Selangor Menteri Besar's preferred candidate. The federal government's chief secretary claimed he was not required to consult the Selangor government on this appointment, and that the consent given by the Sultan was a courtesy and not a legal necessity.

¹⁰ The Petaling Jaya City Council mayor, Mohamad Roslan Sakiman, was given 24 hours to be transferred to Putrajaya, without the knowledge of the Selangor government. Constitutionally, local councils are under the jurisdiction of state governments.

Federal funds for federal development projects were given to State Development Offices (SDOs) set up in Sabah, Kelantan (Musa et al 2014), Penang, and Selangor (Yeoh 2010) when the states were taken over by the opposition, no longer monitored by nor reported to the state governments. Falling under the Prime Minister's Office under its Implementation and Coordination Unit (ICU), the SDOs were also physically removed out of the state government buildings. Of note are also the Village Development and Safety Committees set up by the federal government's Ministry of Rural and Regional Development in opposition states (*Jawatankuasa Kemajuan dan Keselamatan Kampung Persekutuan*), as well as the Residents' Representation Committee (*Jawatankuasa Perwakilan Penduduk*), where compared to opposition-aligned states these bodies by-pass the state governments, in federally-aligned states these two bodies also exist but information and resources flow through the state governments.

Federal-state Fiscal System and Conflict

Because state governments are only able to derive the bulk of their revenues from limited sources such as land, property, agriculture and forestry, states depend heavily on the federal government for funding. State governments receive statutory grants from the federal government, which are governed by the federal constitution and an array of other laws, as well as non-statutory grants, loans and advances based on circulars and selected development projects.

The National Finance Council makes the decisions on such grants, in consultation with state chief ministers, but in reality, the centre controls this since the prime minister can appoint various ministers to the council (Jomo and Wee 2002). Article 108 provides for this National Finance Council, which is made up of the prime minister, federal ministers he appoints and a representative from each state, given the mandate to coordinate financial relations between the centre and the states. The council's recommendations are not binding as ultimate responsibility rests with the prime minister (Shafruddin 1987). Because the NFC only has consultative authority, it is the Economic Planning Unit (EPU) in the Prime Minister's Office together with the federal Ministry of Finance that have in practice determined public revenue distributions and economic goals (Watts 2003). State governments can only borrow from the federal government or from sources approved by the federal government for up to five years.

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The Federal Constitution's Tenth Schedule lays out the specific revenue sources available for the federal and state governments respectively. The table below (Table 2) shows the revenue sources for both the federal and state governments, where states are limited in the tax revenues that states are able to raise compared to that of the federal government. Grants to states take the form of general grants, special grants, and tax-sharing grants. Table 3 shows the breakdown of the types of grants within each category that the federal government provides to states.

Table 2. Federal and State Government Revenues

Federal Tax Revenue	State Tax Revenue
<p>1. Direct taxes</p> <p>i. Income taxes:</p> <ul style="list-style-type: none"> - Individual - Companies - Cooperatives - Petroleum tax - Film hire duty <p>ii. Taxes on property & capital gains:</p> <ul style="list-style-type: none"> - Real property gains tax - Estate duty - Share transfer tax on land-based companies <p>2. Indirect taxes</p> <p>i. Taxes on international trade:</p> <ul style="list-style-type: none"> - Export duties - Import duties - Surtax on imports <p>ii. Taxes on production & consumption:</p> <ul style="list-style-type: none"> - Excise duties - Sales taxes - Service taxes <p>iii. Others</p> <ul style="list-style-type: none"> - Stamp duties - Gaming tax - Betting & sweepstakes - Lotteries - Casino - Pool betting duty <p><i>Non-tax Revenue and Other Receipts</i></p> <p>Road tax</p> <ol style="list-style-type: none"> 1. Licences 2. Service fees 3. Fines & forfeitures 4. Interests 5. Contributions from foreign governments 6. Revenues from federal territories 7. Refund of expenditures 8. Receipts from other government agencies 9. Royalties/gas cash payments 	<p>1. Import & excise duties on petroleum products, export duties on timber & other forest products for Sabah & Sarawak, excise duty on toddy for all states</p> <ol style="list-style-type: none"> 2. Forests 3. Lands & mines 4. Entertainment duties <p><i>Other Receipts</i></p> <ol style="list-style-type: none"> 1. Licences & permits 2. Royalties 3. Service fees 4. Commercial undertakings: water, gas, ports & harbours 5. Receipts from land sales 6. Rents and sales from state property 7. Proceeds, dividends & interests 8. Federal grants & reimbursements

Source: Federal Constitution, Tenth Schedule

Table 3: Federal Transfers to State Governments

General Grants	Special Grants	Tax-sharing Grants
Capitation grants (based on a state's population size)	State road grant	Export duties on tin, iron and other minerals (ten percent) ¹¹
State Reserve Fund grant: deficit grant	Service charge grant	Growth revenue grant ¹²
Development grant (conditional)	Cost reimbursement grant	
Contingencies Fund grant for unforeseen needs	Grants to religious institutions	
State advanced grant for cashflow difficulties	For Sabah & Sarawak as per Malaysia Agreement (no review after 1973) ¹³	
	For handing over territories in Kedah and Selangor ¹⁴	

Source: Federal Constitution, Tenth Schedule

The disparity between the federal and state governments' budgets is stark. Between 1985 and 1999, the central government's revenue increased from four times the consolidated state-level government revenues to seven times. Federal government revenue contributed from 77 to 91 percent of total government revenue since 1963, and federal government operating expenditure made up more than 70 percent of total government operating expenditure from 1963-80, more than 50 percent in the 1980s and 40 percent in the 1990s (Jomo and Wee 2002).

In addition, federal government financing for state governments has shifted from grants to loans, which is unrealistic since states have limited revenue sources and hence repayments would be challenging. This has further reinforced federal control over the states (Jomo and Wee 2002). However, Hutchinson (2017) argues that states actually do enjoy some degree of financial autonomy, where between 2005-2014, state governments generated between 77 and 80 percent of their own revenues, the rest being made up by federal transfers.

The federal government capture of state governments is more apparent when these are less developed states, where they are denied their due reward for resources obtained from their territories when such returns add substantially to the federal government's revenues (Nambiar 2007). For instance, the federal government secured the bulk of petroleum rents extracted from oil-producing states Sabah, Sarawak, Kelantan and Terengganu, which also happen to be the states with among the highest poverty rates in Malaysia. The Sarawak state assembly

¹¹ The Federal Constitution allows the Federal Government to increase this grant for the peninsular States to more than the minimum 10 percent of export duties on minerals. This tax-sharing grant was created at the same time that State royalty rights to minerals were prohibited unless provided for by federal law (Jomo and Wee 2002).

¹² 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).

¹³ The grants to Sabah and Sarawak were given on the basis of the conditions for incorporation into Malaysia that were supposedly subject to later review, which has never taken place. Currently, RM26.7 million goes to Sabah and RM16 million to Sarawak (Jomo and Wee 2002).

¹⁴ Kedah receives RM10,000 a year for territories handed over to the central British government in 1869, while Selangor receives annually RM18.3m for handing over Kuala Lumpur and RM7.5m for handing over Putrajaya to the federal government.

passed a motion in 2014 to increase its petroleum royalty claim to 20 percent, instead of the 5 percent that it currently receives as part of the production sharing agreements with oil companies, Petronas (the national oil company) and the federal government, and has negotiated for bigger concessions such as for Petronas to employ more local workers (Yeoh and Toroskainen 2017).

Most recently, the Sarawak state government has set up its own oil and gas exploration company, PETROS (Petroleum Sarawak Berhad), to work with Petronas and seeks to become an active player in the oil and gas industry by 2020. Part of the reason the previous federal government was willing to accede to Sarawak's demands is because the state was of great political significance to the survival of the Barisan coalition, given that it contributed almost 14 percent of the national parliament's lower house, or 31 out of 222 seats, prior to the country's 14th general election in 2018. For all other well-resourced states such as Kelantan and Terengganu on the east coast of Peninsular Malaysia, the federal government under Barisan was not as open to negotiating on such level-playing grounds.

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Table 4 below shows the transfers made from the federal government to individual states between 1998 and 2016.

Table 4: Federal Transfers to State Governments, 1998-2016 (RM million)^a

States	1998	2000	2004	2005	2006	2007	2008	2009	2010	2011	2012	2014	2015	2016
Johor	134.7	138.1	190.2	183.3	182.0	381.1	393.1	462.9	520.4	544.9	597.7	755.2	780.4	802.9
Kedah	136.4	130.9	180.5	191.1	190.9	251.6	268.7	276.8	296.8	321.2	331.4	390.0	369.2	373.3
Kelantan	122.7	122.6	139.4	145.8	148.3	270.5	260.3	288.3	287.8	329.7	362.9	427.6	400.7	397.9
Melaka	49.2	47.6	74.6	81.2	81.2	111.7	118.2	116.3	121.3	126.3	146.1	168.6	173.3	190.2
Negeri Sembilan	64.6	62.1	86.7	91.9	96.6	143.9	215.1	212.1	224.7	237.2	234.7	292.8	305.9	313.6
Pahang	99.1	96.5	132.6	162.5	169.8	271.5	232.0	265.7	293.6	282.7	356.5	359.5	367.8	391.1
Perak	147.0	146.3	190.3	206.2	196.8	327.7	311.3	322.1	342.7	355.8	415.8	560.5	665.1	657.1
Perlis	53.0	53.4	55.7	69.3	72.6	86.8	86.4	94.8	101.2	83.8	125.1	127.5	103.6	126.0
Pulau Pinang	66.6	64.3	89.3	102.5	105.5	126.9	118.4	133.2	144.3	152.2	170.0	206.0	235.7	216.8
Selangor	213.6	208.0	316.9	322.9	291.1	585.2	550.6	563.2	589.8	604.5	689.4	808.1	758.5	761.8
Terengganu	95.9	94.2	123.8	122.6	120.7	206.2	213.8	240.1	232.7	280.9	274.3	302.7	316.3	313.3
Sabah	271.4	281.0	339.9	395.5	405.3	516.3	603.6	701.0	804.5	825.0	893.1	1,051.0	1,098.1	1,086.3
Sarawak	181.5	205.9	227.7	252.0	248.4	482.9	541.5	720.5	791.7	864.4	930.4	1,147.6	1,163.0	1,159.3
Total	1,635.7	1,651.0	2,147.7	2,326.7	2,309.3	3,762.2	3,912.9	4,396.9	4,751.5	5,008.6	5,527.4	6,597.1	6,737.7	6,789.7

(Source: Estimates of Federal Government Expenditure, Ministry of Finance, Various Years)

^a Figures for 1998 to 2007 are estimated expenditure, whereas figures for 2008 to 2016 are actual expenditure, as contained in official documents.

Policy Recommendations

This paper has thus far covered two aspects of federal-state relations in Malaysia; administrative and fiscal systems, and conflicts that have occurred as a result of the often-vague interpretations of what is allowed for within the law and regulation, which therefore leads to conflict in practice. The recommendations below are based on these two policy areas, and a general principle to uphold is that the federal government should apply a rules-based system and equal treatment to all states, regardless of their political alignment. Below are specific policy recommendations.

Federal-State Administrative System

In recent years, there have been calls for large policy areas such as education, healthcare and the police force to be decentralised to the states. However, the current Ninth Schedule in the Federal Constitution would not permit this to take place in the immediate future. Such major policy changes would first require adopting a new philosophy of empowering states instead of centralising power at the centre. It would also require tremendous reforms within the federal government, particularly from the Prime Minister's Office. In this paper, initial steps are proposed that aim at providing some alignment based on what is constitutionally allowed for, but simultaneously with the goal of restoring the rights and ownership that state governments have over their own states.

Policy Recommendation 1: Perform a review of the Ninth Schedule in the Federal Constitution with the aim of decentralising some key policy functions



A thorough review of the Federal Constitution's Ninth Schedule should be conducted to re-examine the policy functions held by the federal and state governments, with the eventual aim of decentralising some key policy functions. This 'decentralisation review' would be timely under the new federal government, and will also demonstrate policy commitment to the promises contained within the Pakatan Harapan manifesto to revive the spirit of federalism. The manifesto promised to give state governments the authority to govern over public transportation, social welfare, social services, agriculture and environmental protection. However, a review (ideally conducted by the Parliamentary Standing Committee on Federal-State Relations, inviting civil society and professional organisations to provide input) would be necessary prior to making these decisions that would result in major implications at all levels of government. Other policy functions such as education may also be worth exploring, in addition to these policy functions as described in the manifesto. More broadly, the role of state governments in determining national policy should also be discussed in this review.

Policy Recommendation 2: States to form their own full civil service



It is recommended that state governments are permitted to form their own full civil services, similar to what Johor currently practises. This would allow states to recruit, train, pay and promote their own civil servants including senior civil servants that occupy the positions of state secretary, state financial officer, legal advisor and heads of key departments such as the state economic planning units. States without the capacity to conduct the necessary training would still be able to second their officers to the federal-level body National Institute of Public Administration (INTAN), which is the training arm of the Public Service Department. Smaller states like Perlis and Kedah that may not have the capability of paying their own civil servants can either form joint civil service agencies, or continue to rely on a scaled-down version of the federal civil service. The implementation stages of this recommendation would need to be phased over a period, since states might not be immediately able to cope with the administrative and financial burdens required. This would allow for greater state autonomy in the hiring and firing practices of their own civil service. States can be given the option to form their own civil service, or draw all or some (perhaps the more senior-level) staff from the central service.

Policy Recommendation 3: Federal government to consult state governments for major administrative appointments



In cases where states do not have the capacity to form their own full civil service for various reasons, the federal government must be legally obliged to consult with state governments for any major and senior administrative appointments. The final decision on the said appointment must be conclusively made by both parties. This would avoid any potential disagreement or conflict arising from these appointments. If either party disagrees with the nominated individual, the appointment should therefore not take place and another individual should be put forward as the recommended name for the said position.

Policy Recommendation 4: State Development Offices (SDOs) to be reformed as state bodies



When the Pakatan Harapan coalition took over the federal government in May 2018, it made several quick institutional reforms, including abolishing of the Federal Village Committees (JKKK) within the states of Selangor, Penang and Kelantan (that were previously held by the then-opposition coalition). This is a positive move, as it was duplicating efforts and resources flowing into existing village committees. However, there remains the federal body of the State Development Offices (SDOs) that still exist as extensions of the federal government. The SDOs report to the Implementation and Coordination Unit under the Prime Minister's Department. The SDOs serve the purpose of providing development funds to states, and in states run by the national opposition (for instance, the states of Kelantan and Terengganu at present) funds would effectively bypass the state governments altogether. It is proposed that the SDOs are reformed as state bodies regardless of political alignment. Funds should continue to be channeled to these bodies following a pre-determined formula, and with the additional oversight and governance of the state governments. They can continue to be liaison points of information between the state and federal governments, but appointments and instructions should be made by state governments.

Policy Recommendation 5: Restore local council elections



Local council elections are crucial in ensuring democratic governance in its true form through transparency, accountability, competence and elective representation at the grassroots level. The Pakatan Harapan Manifesto stopped short of promising to restore local council elections, but does commit to strengthening local democracy, adding that local council accountability to the local community will be improved so that they become more accountable to local people and the Local Government Act 1974 will be amended towards that purpose.

It is recommended that the National Council for Local Government places on its agenda for immediate discussion the eventual objective of restoring local council elections in Malaysia. The decision of the National Council for Local Government would pave the way for new federal legislation that would clearly grant the Election Commission its mandate to carry out local council elections across the country, possibly starting with larger states such as Selangor, Johor, Perak and Penang to begin with and eventually implementing this across the country. The Local Government Elections Act 1960 may also need to be revised for this purpose.

Policy Recommendation 6: Increase proportion of state-appointed senators



The Dewan Negara (Senate) together with the Dewan Rakyat form the highest legislative bodies in Malaysia. The Dewan Negara performs a critical role in providing a check and balance to the elected representatives in the Dewan Rakyat, and was originally conceived of as the 'house of the states'. Article 45 in the Federal Constitution states that the Senate shall consist of two members for each state, and 44 members as appointed by the Yang di-Pertuan Agong (2 representing Kuala Lumpur, 1 representing Labuan and Putrajaya respectively, and 40 other appointed members).

The number of state-appointed Senators has remained at two each, but the number of Senators appointed by the Yang di-Pertuan Agong has grown from 22 (when Malaysia was formed in 1963) to 44 today, essentially reducing the proportion of state representation. This reduction is contrary to the "spirit of the original constitution which established the Dewan Negara to protect in the federal Parliament, state interests against federal encroachments" (former Lord President of the Federal Court Tun Mohamed Suffian Mohamed Hashim).

It is recommended here that to revive the spirit of federalism, and in keeping with the principle of shared rule, the proportion of state-appointed senators to centre-appointed senators is increased from the current 26:44 ratio¹⁵, which would in fact restore the Dewan Negara's proportion to its original form and function of ensuring state voice and representation in the lawmaking process.

¹⁵ See IDEAS Report titled "A New Dawn for the Dewan Negara? A Study of Malaysia's Second Chamber and Some Proposals for Reform" by Tunku Zain Al-'Abidin Muhriz, 2012 for details of more policy recommendations on reforming the Dewan Negara in Malaysia, including having a chamber that represents the states only, and introducing an elected chamber.

Federal-State Fiscal System

Policy Recommendation 7: States to receive consumption tax proceeds



The principle behind reforming the federal-state fiscal system is that it allows states greater access to financial resources for several reasons. First, this will be required in order to fund the new operational functions as outlined above. For real decentralisation to take place meaningfully, there must also be the financial ability for states to do so. Second, with greater autonomy, states would no longer have to depend on natural resources as their sole source of income, which as outlined above presents some problematic challenges for the environment.

The Pakatan Harapan manifesto proposes that in order to finance the responsibilities that will be returned to the states, at least 10 percent of income tax generated in a state will be returned to that state. However, this may present a complication given cross-state corporate operations – it will be difficult to determine the quantum of income tax generated in a particular state, and the costs of executing this might be too high. Instead, it is proposed that states will eventually receive the proceeds of consumption tax (the currently collected sales and service tax, having reverted from the goods and services tax in September 2018). One justification for consumption tax to be collected by states as opposed to the central government is that it is derived from daily transactions that are largely local in nature – the purchase and travel from a local store, for instance, as opposed to income tax that is dependent upon national public services and hence paid to the federal government. This will require a more in-depth study, to compare between systems used in other countries (such as the USA and Canada) wherein states collect a percentage of consumption tax and the tax rates vary across states.

Policy Recommendation 8: An apolitical Grants Commission to be established to determine a fixed formula for federal-state transfers



A Grants Commission is proposed to be established, which would consist of members of both sides of the political divide. The Grants Commission would exist separate from the National Finance Council, where the NFC may have advisory functions but the Grants Commission determines a fixed formula for federal-state transfers. One example would be an equalization formula similar to that used in Australia that factors in population, poverty, area development, cost, human development and gross revenue per capita indices.

Conclusion

Federal-state relations in Malaysia have evolved over the years, where although the country was formed as a federalism, it has increasingly become highly centralised in its administrative and fiscal practices. This paper has presented a thorough background of Malaysia as a constitutional federalism and the principles of federalism, outlined the challenges of practices in reality of the relationship between the two levels of government within both administrative and fiscal policy areas, and finally proposed seven policy recommendations that can be considered by the federal government.

Understandably, these changes will take time, and it is recommended that steps are taken for these policy changes to take place over the next 10 years. For these recommendations to work, states must be well-equipped with a robust civil service, which means the appropriate training and capacity building must be conducted. Coordination must also be done smoothly between each level of government, where the principle of equal and fair treatment is upheld regardless of states' political alignment. It is also important that both administrative and fiscal decentralisation steps take place simultaneously, or with the aim that both will eventually take place. This is because administrative decentralisation without fiscal decentralisation is unlikely to succeed, since the states would be required to fund the administrative functions that it eventually takes responsibility for.

Malaysia was formed as a federation but in recent decades has experienced rapid centralisation at the federal government. This paper has outlined examples of such centralisation and highlights the problems faced when states become stripped of their decision-making abilities. Finally, this paper has proposed several steps forward in reversing this trend, to restore state autonomy and give greater responsibilities to local actors both administratively and financially. A fine balance will need to be struck in order to maintain cohesion and harmony between the centre and its periphery, and negotiated and phased decentralisation is one possible way to achieve this for Malaysia in the long run. It is hoped that the newly-formed Parliamentary Select Committee on Federal-State Relations can consider these recommendations, and initiate public discussions with interested parties on these important matters.

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Notes:

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