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The political economy of Malaysian federalism: Economic development, public policy and conflict containment

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The Political Economy of Malaysian Federalism

Economic Development, Public Policy
and Conflict Containment

Jomo K. S.¹ and Wee Chong Hui²

November 2002

Abstract

Conflicts within the Malaysian federation have been rooted in socio-economic disparities and the struggle for control of natural resource rents, which State Governments previously had exclusive control over, as originally provided for by the federal constitution. The advance of fiscal centralization since then has also aggravated federal-state tensions, which have been relatively ignored due to the long-standing Malaysian pre-occupation with inter-ethnic tensions. Inter-regional resource transfers and central fiscal and political dominance have been used to undermine the more independent State Governments, especially those held by opposition parties. While the federal government is clearly dominant, central control over the State Governments has varied, especially in Sabah and Sarawak, with the continued hegemony of the national ruling coalition depending on successfully combining the carrot with the stick.

Keywords: conflict, fiscal policy, regional policy, Malaysia

JEL classification: O1, R58, O53, O23

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1 Introduction

This paper reviews the relationship between economic development, public policy and conflict containment in Malaysia, focussing especially on regional tensions within the Malaysian federation. The main focus of conflict containment efforts in Malaysia has been on inter-ethnic tensions, especially between the politically and demographically dominant Muslim ethnic Malays, who also comprise the vast majority of Bumiputera indigenes in Peninsular Malaysia, and the more business successful and ubiquitous ethnic Chinese, especially since the post-election riots of May 1969.

This paper suggests that while understandable, this singular public policy priority has neglected other potential sources of conflict, most importantly regional frustrations and tensions, which have long been important, though not unchanging. It goes on to identify poverty and fiscal discrimination as the likely sources of regional resentment, and suggests a likely vicious cycle of federal fiscal bias against opposition-controlled state governments reinforcing regional resentment expressed in support for ‘regional’ opposition. However, the federal government has sought to address this by seeking to control and claim control for federal government spending in such states in contrast to the opposition-held state government’s meagre budgetary resources.

2 Malaysia’s political economy

For over a century, Malaysian economic growth spurts have mainly been export-associated, if not led. The openness of the Malaysian economy – high even by developing country standards – is due to the structural transformation it has undergone, especially during and since the British colonial period. Like so many other ex-colonies, contemporary Malaysian history has also been complicated by the political developments of the colonial era. Of course, the reshaping of the Malaysian economy did not stop with independence, but continues to the present, accelerating in the post-colonial era, especially since the 1970s.

Malaysia’s export-led growth record in the last century has been quite impressive. During colonial times, Malaya was, by far, Britain’s most profitable colony, credited with providing much of the export earnings that financed British post-war imperial reconstruction. However, only a few industries were allowed to develop by the colonial authorities, who generally considered the colonies as suppliers of raw materials and importers of manufactured goods. Most industries then were set up to reduce transport costs of exported or imported goods, such as factories for smelting (refining) tin-ore and bottling imported drinks. Local industries often developed most when economic relations with the colonial power were weak, e.g. during the Great Depression and the Japanese Occupation.

The Malayan economy grew impressively, especially during the first quarter of the twentieth century, to become the single most profitable British colony. Malaysia’s economic infrastructure (e.g. railways, roads, ports, utilities, etc.) – so crucial for profitable capitalist investment – was generally more developed than in most other British possessions other than the settler colonies. Such infrastructure construction –

mainly using imported British materials – was paid for by taxes levied on the population by the colonial government.

Colonial monopolies thwarted the development of a strong local capitalist class producing for the domestic market; instead, local investors found it more profitable to engage in production for export, commerce and usury, i.e. largely complementing, rather than opposing colonial economic interests. Malays remained largely marginal to the growing capitalist sector, with the elite integrated into the colonial state apparatus, and the masses remaining in the countryside as peasants. Instead, emerging business opportunities were mainly taken by some of the more urbanized and commercially better-connected Chinese.

After their ignominious defeat by the Japanese at the beginning of the Pacific War in the early 1940s, the British returned to reclaim its possessions in 1945 in the face of strong, but ethnically segmented anti-colonial movements. The military repression of the communist-led armed insurgency from June 1948 was not especially successful in the early years until it sought to ‘win hearts and minds’ from 1951. The new strategy involved a range of political reforms to establish partially elected legislatures and municipal authorities for the first time, labour reforms to build and legitimize a ‘moderate’ and ‘responsible’ anti-communist trade union movement, agrarian reforms to reduce rural exploitation and poverty as well as to consolidate an ethnic Malay yeoman peasantry, and the beginnings of pro-Malay ethnic affirmative action programmes.

These reforms – mainly in response to a major threat to the security of the late-colonial state and associated colonial business interests – have had a profound and ongoing impact on the development-conflict containment nexus. The colonial authorities reluctantly responded to the challenge with rural development initiatives it had never previously considered, let alone implemented, as well as co-opting and legitimizing reforms allowing greater popular participation in politics and trade unions on the one hand besides ‘protecting’ the Malay community on the other.

In the post-Second World War period, Malaysia has experienced relatively rapid growth, particularly during the Korean War boom, the oil boom of the 1970s and with the relocation of East Asian industry into Southeast Asia for a decade from the late 1980s. Since 1955, the same ruling coalition has been continuously in power at the decisive federal level, though the nature and degree of state intervention and public sector expansion has changed considerably, almost coming full circle by the mid-1990s compared to the situation following independence for Malaya (now Peninsular Malaysia) in 1957, and fiscal expansion in the 1970s and early 1980s.

After independence in 1957, and especially during the 1960s, the Malaysian economy diversified from the twin pillars of the colonial economy, i.e. rubber and tin. The Malaysian economy continued to experience rapid economic growth in the first quarter century after independence. The average annual growth rate of the Gross Domestic Product (GDP) in Peninsular Malaysia was 5.8 per cent during 1957-70 (Rao, 1976), while the GDP for the whole of Malaysia rose by an average of 7.8 per cent per year between 1971 and 1980 despite greater economic instability (Malaysia, 1981).

Primary commodity production continued to dominate the economy in the early years after independence. In fact, Malaysia extended its colonial pre-eminence in rubber, tin

and pepper to palm oil, pepper, tropical hardwoods and cocoa. In the mid-1970s, petroleum production – off the East Coast of Peninsular Malaysia – began providentially, as oil prices soared after 1973. Since the early 1980s, petroleum gas production – almost exclusively for the Japanese economy – has come on stream, offering yet another primary commodity engine for the growth of the Malaysian economy. Cocoa production, mainly in Sabah, also became increasingly significant from the early 1980s.

Meanwhile, biased and conservative, but nonetheless pro-active post-colonial rural development efforts – arguably, mainly to secure rural electoral support – contrasted with British colonial neglect, especially in the pre-war period. Initially, such efforts were aimed at securing crucial electoral support from the Malay yeoman peasantry without drastic redistribution measures. Since the early 1980s, however, under Mahathir, official policy has sought to develop commercial agriculture – involving larger farms, using more profitable, productivity-raising and cost-saving modern management methods – for export markets. Agricultural diversification continues, but there is no obvious candidate for leading, let alone sustaining future growth.

After independence, the government encouraged industries to manufacture previously imported goods. Most of these import-substituting industries were set up as subsidiaries of foreign companies to finished goods produced with imported materials for very profitable sale within the protected domestic market. Many of these industries only replaced imports of finished goods with semi-finished goods (e.g. the motor car assembly industry). Since most of these industries are generally capital-intensive, not requiring many workers), unemployment as well as wage rates in these industries rose during this phase. The technology used, usually developed for and more suited to foreign conditions, was typically imported from the parent company abroad. Hence, these industries often generated relatively little employment, whether directly or indirectly, in linked industries.

Policies to attract such industries have often involved reduction of government tax revenue. The size of the local market was also limited by the level and distribution of income. By the mid-1960s, the problems of import-substituting industrialization had become quite apparent. In 1965, the Federal Industrial Development Authority (FIDA, now known as MIDA, the Malaysian Industrial Development Authority) was set up to attract industrial investment. By this time too, to reduce production costs, some trans-national corporations were planning to relocate their more labour-intensive production processes abroad, often to East Asia.

3 Regional tensions and federalism

Although the Malaysian economy has changed significantly since independence, many features reflecting uneven development can be traced to the crucial formative decades under colonial rule that shaped its economic structure. For instance, differences between the East Coast and the West Coast of Peninsular Malaysia can be traced to uneven regional growth dating back to the location of the early tin mines, staggered colonial annexation and infrastructure development, as well as subsequent economic growth reflecting prior unevenness.

Differences between the rice growing North and the rest of the peninsula are related to demographic history as well as the British policy of preserving Malay peasants as rice farmers, despite the rational peasant preference for rubber cultivation, which threatened British plantation interests. The urban-rural gap is, of course, reflective of the changing roles of town and country in Malaysian capital accumulation. The relative backwardness of the peasantry compared to plantations is only the most obvious of various differences in the rural economy. Ethnic differences have often coincided with class, occupational and other differences originating in the colonial economy.

Malaysia is now a federation made up of the eleven States of Peninsular Malaysia, the former Federation of Malaya (including the Federal Territory of Kuala Lumpur, the capital), plus the former British Borneo possessions of Sabah and Sarawak (Table 1). The peninsular States gained independence from the British in 1957 and formed the Federation of Malaya prior to the formation of the Malaysian Federation in 1963. Singapore, Sabah and Sarawak gained independence from Britain through the formation of Malaysia.

Table 1
Malaysia: area and population by State, 1999

State	Area (sq. km.)	Population (thousands)
Johore	18,986 (5.6%)	2,670.7 (11.8%)
Kedah	9,426 (2.9%)	1,579.8 (7.0%)
Kelantan	14,920 (4.5%)	1,522.2 (6.7%)
Melaka	1,651(0.5%)	593.2 (2.6%)
Negri Sembilan	6,643 (2.0%)	836.5 (3.7%)
Pahang	35,964 (10.9%)	1,291.5 (5.7%)
Perak	21,005 (6.4%)	2,118.1 (9.3%)
Perlis	795 (0.2%)	226.2 (1.0%)
Pulau Pinang	1,030 (0.3%)	1,246.8 (5.5%)
Sabah	73,619 (22.3%)	2,970.4 (12.7%)
Sarawak	124,449 (37.7%)	2,027.1 (8.9%)
Selangor	7,955 (2.4%)	3,188.7 (14.0%)
Terengganu	12,955 (3.9%)	1,033.5 (4.6%)
Malaysia	329,758 (100.0%)	22,710 (100.0%)

Source: Department of Statistics, *Handbook of Statistics, Malaysia, 1999*.

The British wanted to disengage from governing Sabah, Sarawak and Singapore, while safeguarding their interests in the region. Both British and local leaders perceived Peninsular Malaysia as Malay-dominated, and capable of containing leftist Chinese ascendancy in Singapore by incorporating the latter. The larger and more diverse indigenous populations of Sabah and Sarawak (Table 2) were also perceived as offsetting Chinese domination of the federation. Sabah and Sarawak were less developed than the other States and hoped for net transfers of development funds by joining the Federation.

Table 2
Sabah and Sarawak: population, 1999 (thousands)

Sabah		Sarawak	
Bumiputera*:		Bumiputera*:	
Malay	192.7 (6.5%)	Malay	435.0 (21.5%)
Dusun/Kadazan	529.4 (17.8%)	Iban	576.0 (28.4%)
Bajau	332.0 (11.2%)	Bidayuh	164.5 (8.1%)
Murut	863.0 (2.9%)	Melanau	112.8 (5.6%)
Other Bumiputera	393.4 (13.2%)	Other Bumiputera	117.4 (5.8%)
Non-Bumiputera	1436.6 (48.4%)	Non-Bumiputera	621.4 (30%)
Total	2970.4 (100.0%)	Total	2027.1 (100.0%)
Non-Malay Bumiputera	1341.1 (45.1%)	Non-Malay Bumiputera	970.7 (47.9%)
(% Malaysia's population)	(5.9%)	(% Malaysia's population)	(4.3%)

* Indigenous ethnic groups

Source: Department of Statistics, *State/District Data Bank, 1999*.

In 1961, the first Malayan Prime Minister, Tunku Abdul Rahman endorsed the British plan to form Malaysia to include the eleven states of Malaya, Singapore, North Borneo (now Sabah), Sarawak and Brunei, i.e. all the former British territories in the region. The oil-rich sultanate of Brunei withdrew before the new federation was established in September 1963. Before the Japanese Occupation (during the Second World War), North Borneo was run as a virtual fiefdom by a British chartered company, while Sarawak was ruled by a series of white rajahs from the Brooke family. After the Japanese Occupation, they were both administered by the British Colonial Office, but still quite separately from Malaya and Singapore.

Nevertheless, the formation of Malaysia was pushed through by the British, despite the serious difficulties involved, not least of which was the contrived nature of the new nation, convenient only to the former colonial power. Within less than two years, Singapore left the Federation in August 1965, after acrimonious conflicts with leaders in the peninsula. Singapore has since industrialized rapidly, while also developing as a major regional and global centre for financial services besides consolidating its position as a major international logistics centre.

Hence, since August 1965, Malaysia has included the eleven states of what was then called West Malaysia and the two Borneo states of East Malaysia. In the early 1970s, after the secession of Bangladesh from Pakistan, the official terminology changed to Peninsular Malaysia for the old Malaya, and Sabah and Sarawak, probably to limit any nascent sense of East Malaysian solidarity. After all, only about a third of those surveyed in Sabah (the former British North Borneo) and Sarawak had wanted to join Malaysia. Most Malaysians, especially in the peninsula, have long forgotten that both Borneo states joined with the former Federation of Malaya to form Malaysia, and that their leaders and people expected to enjoy privileged treatment within the new federation.

One of the major economically significant consequences of incorporation into Malaysia for the Borneo States was becoming part of the expanded federation's principal customs area, e.g. in terms of being subject to the same import and export duties. This has presumably limited the potential for import-substituting industrialization in the East Malaysian States, with protection extended instead to such industries established in the peninsula, with its larger market. Hence, the Borneo States have been obliged to pay higher prices for protected goods from the peninsula without being able to develop import-substituting manufacturing industries of their own, as infrastructure, cost and market size considerations favour such industrial location on the peninsula.

Natural resource exports from Sabah and Sarawak have ensured healthy trade surpluses for the federation as a whole (Wee, 1995). Malaysia's merchandise trade account would have had more modest surpluses, if not more frequent deficits, if not for the primary commodity exports from Sabah and Sarawak. On the other hand, most new import-substituting as well as export-oriented industries have been located in the peninsula.

Although the armed struggle led by the North Kalimantan People's Army (Paraku) petered out in the 1960s and 1970s, desires for greater autonomy, including flirtations with secession, continued into the 1980s. However, the federal government in Kuala Lumpur has successfully forged dominant Muslim-Chinese partnerships in both states, which have alienated many of the politically and economically un-influential, though demographically numerous, non-Muslim Bumiputeras. Most academic and political analyses of Malaysian unity have ignored the changing tensions involving Sabah and Sarawak, and the complexities of Malaysian federalism.

Instead, most analyses focus on the other important source of conflict in post-colonial Peninsular Malaysia. The ethnic conflict between the stereotyped politically dominant Malays and the economically successful Chinese dramatically came to a head with race riots in May 1969 (Butcher, 2001). This conflict is often articulated in terms of the rivalry between indigenous Bumiputera, literally sons of the soil – i.e. Malays, the aboriginal Orang Asli and the Muslim as well as non-Muslim indigenous communities of Sabah and Sarawak on Borneo island – and non-autochthonous non-Bumiputera, i.e. mainly ethnic Chinese and Indians.

4 Ethnicity and the New Economic Policy (NEP)

Helped by favourable commodity prices and some early success in import-substituting industrialization, the Malayan and then the Malaysian economy sustained a high growth rate with low inflation until the early 1970s. Official statistics – though strictly non-comparable for methodological reasons – suggests a worsening distribution of income over the 1990s, a growing gap between town and country, and growing inequality among all the major ethnic groups. Inequality in the Malay community increased most – from a situation of least intra-ethnic inequality in 1957 to greatest inequality in 1970.

This growing inequality did not only result in growing inter-class tensions, but was primarily perceived in ethnic terms, not least because of officially-sanctioned political mobilization along racial lines. Hence, Malay resentment to domination by capital was expressed primarily against ethnic Chinese, who comprise the bulk of the business community, while non-Malay frustrations were directed against the Malay-dominated

post-colonial state machinery, increasingly identified with United Malays National Organization (UMNO), the dominant partner in the ruling coalition.

Such popular ethnic perceptions resulted in widespread racially inspired opposition in Peninsular Malaysia to the ruling Alliance government of the 1960s. The decade had seen an import-substituting industrialization programme that generated relatively little employment and had largely petered out by the mid-1960s. Rural development efforts, initially inspired by counter-insurgency considerations in the early 1950s, increasingly emphasized productivity increasing measures, while avoiding redistribution in favour of the poorly capitalized land-hungry peasantry.

The general election results and 'race riots' of May 1969 reflected such ethnic consequences and dimensions of the new post-colonial socio-economic structure. Meanwhile, the emerging Malay middle class, who had nominal political control, perceived the gradual decline of British economic hegemony giving way to Chinese ascendancy. This 'political-bureaucratic' fraction became more assertive from the mid-1960s, establishing increased dominance after May 1969.

Foreign experts and international consultants encouraged the Malaysian government to switch to export-oriented industrialization, which it did from the late 1960s. The openness of the Malaysian economy has been deepened by new largely export-oriented industries established since then. The Industrial Incentives Act was passed in 1968, while labour laws were amended in 1969 to help create an investment climate more attractive to such industries. Together with other new incentives, free trade zones and other facilities were also provided for this purpose. These new export-oriented industries seeking cheap labour succeeded in reducing unemployment at the expense of wages until declining unemployment pushed wages up once again in the late 1970s and early 1980s, and again for a decade from the late 1980s.

Much of such manufacturing in Malaysia is still limited to relatively low-skill, labour-intensive aspects of production, e.g. electronic component assembly, though more skilled and complex production processes and training have developed, but somewhat behind Singapore, which has emerged as a sort of regional centre in the new international division of labour. The potential for and likelihood of such progress has been and will be determined by the interests and preferences of trans-national corporations, as well as their perceptions of likely prospects in alternative host countries.

Hence, export-oriented industrialization has significant, but nonetheless limited potential for sustained and integrated industrial development, especially because of the technological dependence involved. Yet, despite this impressive performance, largely attributable to favourable resource endowments and external conditions, it has become increasingly clear, especially since the mid-1990s, that many of the sources of export-led growth in the Malaysian economy are not indefinitely sustainable. On the other hand, the very success of export-led growth in the past has probably discouraged serious efforts to develop a more balanced and integrated national economy.

Much public policy since then, notably the New Economic Policy (NEP), first announced in 1970, has been dominated by inter-ethnic distributional considerations, and most public policy is widely seen through the lenses of ostensible ethnic interests. Malaysia has implemented the NEP since 1971. The NEP has the two-pronged

objectives of poverty reduction irrespective of race (ethnicity) and ‘restructuring society’ to eliminate the identification of race with economic function and location, i.e. reduce inter-ethnic socio-economic disparities between Bumiputera indigenes and the non-Bumiputeras.

The Bumiputera are to be protected with constitutionally provided ‘special privileges’, i.e. a form of positive discrimination or affirmative action. The ‘Bumiputera’ category includes the indigenous peoples of Sabah, Sarawak and the Orang Asli in Peninsular Malaysia, for whom the race riots of 1969 were largely irrelevant. The NEP is perceived to have done relatively little for non-Muslim indigenous minorities, mainly in the Borneo States of Sabah and Sarawak.

Since Mahathir took over leadership of the government in 1981, he has introduced other public policy priorities, gradually diluting the previously almost single-minded NEP redistribution agenda. After some apparent (political and economic) success with partial economic liberalization after the 1985-86 economic recession, the shift was consolidated by declaring a broad new national project under the rubric of a new vision for the nation to be achieved by the year 2020. Vision 2020 has since been affirmed by the announcement of successor policies to the NEP in the form of the National Development Policy associated with the *Second Outline Perspective Plan, 1991-2000* (OPP2) and the National Vision Policy associated with the *Third Outline Perspective Plan, 2001-2010* (OPP3).

It is generally agreed that the NEP’s redistribution measures were conceived in response to the events of May 1969, i.e. the pre-election ethnic tensions, the ruling coalition’s electoral setback and the post-elections’ palace coup against the incumbent prime minister. While redistributive in intent, NEP social policy enhanced Malaysian human resources in ways that reduced poverty, especially among the children of the Malay peasantry (Jomo and Gomez, 1997). In particular, greater education enabled them to gain more remunerative modern sector employment. However, there is considerable evidence (Jomo, 1989; Jomo, 1990) that much of the expenditure ostensibly allocated for poverty reduction never really benefited the poor.

Instead, the NEP increasingly emphasized reducing inter-ethnic economic disparities, especially between ethnic Malays and ethnic Chinese, rather than poverty reduction (Gomez and Jomo, 1999). While the NEP probably reduced some ethnic Malay resentments of Chinese economic success by accelerating the advance of Malay middle class and business interests, it may well also have generated even greater Malay expectations of their rights, entitlements and privileges under the Malaysian sun, thus inadvertently fuelling inter-ethnic resentment at the same time.

Meanwhile, the same NEP probably fuelled non-Malay resentment of abuses associated with UMNO’s political hegemony and its main policy consequence, the NEP itself. While the NEP objectives of reducing poverty and inter-ethnic economic disparities were presented as means for achieving ‘national unity’, primarily understood in terms of ostensibly reducing Malay resentment against the Chinese, there is little real evidence that this has been achieved with implementation of the NEP. The virtual absence of a subsequent recurrence of inter-ethnic violence on a comparable massive scale is not necessarily evidence of greater ‘national unity’, even as narrowly conceived in terms of reduced inter-ethnic resentment.

Table 3
Malaysia: summary of Federal and State Government functions

Federal	State
1. External affairs	1. Muslim laws and custom
2. Defence	2. Land
3. Internal security	3. Agriculture and forestry
4. Civil and criminal law and the administration of justice	4. Local government
	5. Local public services: boarding houses, burial grounds, pounds and cattle trespass, markets and fairs, licensing of theatres and cinemas
5. Federal citizenship & alien naturalization	
6. Federal Government machinery	6. State works and water
7. Finance	7. State government machinery
8. Trade, commerce and industry	8. State holidays
9. Shipping, navigation and fishery	9. Inquiries for State purpose
10. Communication and transport	10. Inquiries for State purpose
11. Federal works and power	Creation of offence and indemnities related to State matters
12. Surveys, inquiries and research	
13. Education	11. Turtles and riverine fishery
14. Medicine and health	
15. Labour and social security	<i>Supplementary list for Sabah and Sarawak</i>
16. Welfare of aborigines	
17. Professional licensing	12. Native law and custom
18. Federal holidays; standard of time	13. Incorporation of State authorities and other bodies
19. Unincorporated societies	14. Ports and harbours other than those declared federal
20. Agricultural pest control	15. Cadastral land surveys
21. Publications	16. In Sabah, the Sabah Railway
22. Censorship	
23. Theatres and cinemas	<i>Additional shared functions for Sabah and Sarawak</i>
24. Co-operative societies	17. Personal law
25. Prevention of and extinguishing fires	18. Adulteration of foodstuff and other goods
	19. Shipping under fifteen tons
<i>Shared Functions</i>	20. Water power
1. Social welfare	21. Agriculture and forestry research
2. Scholarships	
3. Protection of wild animals and birds; national parks	22. Charities and charitable trusts
	23. Theatres, cinemas and places of amusement
4. Animal husbandry	
5. Town and country planning	
6. Vagrancy and itinerant hawkers	
7. Public health	
8. Drainage and irrigation	
9. Rehabilitation of mining land and land which has suffered soil erosion	
10. Fire safety measures	
11. Culture and sports, housing	

Source: Malaysia, *Constitution of Malaysia* – Ninth Schedule (Article 74, 77) on ‘Legislative Lists’.

To describe the NEP as Malaysia's second 'social contract' implies some parity among willing parties. Many non-Malays still complain that the NEP was imposed by a dominant UMNO on the ethnic minorities against their will. With a dominant, though unofficial ideology that has portrayed non-Malays as 'immigrant sojourners', exit – through emigration or by bypassing the government – has been the main alternative to resignation ('loyalty'). Voice has largely been left to a few braver souls between four to five yearly elections, when dissent can be secretly expressed at the ballot box, with little real consequence in a heavily gerrymandered and controlled electoral system.

5 Malaysian federalism

The Malaysian Constitution defines federal-state relations, the division of authority generally (Table 3) as well as over revenue sources (Table 4). Thus, the spirit and constitution of the Malaysian Federation imply complementary and shared functions for the Federal and State Governments. However, the expansion of the federation – and its subsequent contraction with the secession of Singapore in August 1965 – was contested from the outset¹ (Poulgrain, 1998), with lingering consequences for the present.

6 Socio-economic conditions by state

In general, one would expect state GDP per capita to reflect relative development and welfare by state (Table 5). At least since 1963, Kedah, Kelantan and Perlis have had lower per capita GDP compared to the national average, while Selangor's has been higher. The less developed states of Sabah and Pahang saw their ratios worsening, while the more developed states of Johor, Melaka, Negri Sembilan and Pulau Pinang experienced improving ratios. The high and rising ratios for the less developed states of Sarawak and Terengganu have been due to petroleum and related (gas) production in these states, with limited trickle-down effects perpetuating high rates of poverty in both states (Table 6). Meanwhile, the relative decline of Perak has been largely due to the collapse of tin mining in the 1980s (Jomo, 1990) as well as its limited industrialization.

With petroleum output capped since the mid-1980s, and related production (petroleum products, steel) levelling off soon after, GDP growth rates for Terengganu and Sarawak have slowed down in recent years. Terengganu had achieved a growth rate of 7.8 per cent per annum during 1971-90, i.e. the third highest state growth rate for the NEP's first Outline Perspective Plan (OPP) period. It had a growth rate of 8.0 per cent per annum during 1991-95, before dropping by almost half during 1996-2000. As Malaysia experienced its worst-ever post-war recession in 1998, Terengganu maintained sixth position among the states. Meanwhile, Sarawak had a growth rate of 5.4 per cent – ninth among the states – during the OPP era (1971-1990). The state's performance was relatively better in the 1990s, but its growth rate slowed down more than in most of the rest of the country in the late 1990s. This slowdown coincided with the decline of logging output as timber resources approached exhaustion (Table 7).

¹ The Sultan of Kelantan, then a member State of the Federation of Malaya, filed a suit in High Court against the Malaysia Act (*Straits Times*, 11 September 1963, cited in records of the Colonial Office).

Table 4
Malaysia: summary of Federal and State Government revenue

Federal		State	
<u>Tax revenue</u>		<u>Tax revenue</u>	
1.	Direct taxes	1.	Import and excise duties on petroleum products and export duties on timber and other forest products for Sabah and Sarawak, excise duty on toddy for all States
	i. Income tax		
	Individuals		
	Companies		
	Co-operatives		
	Petroleum tax		
	Development tax	2.	Forests
	ii. Taxes on property and capital gains	3.	Lands and mines
	Real property gains tax	4.	Entertainment duties
	Estate duty		
2.	Indirect taxes	<u>Non-tax revenue and Non-revenue receipts</u>	
	i. Taxes on international trade	1.	Licences and permits
	Export duties: palm oil, petroleum	2.	Royalties
	Import duties: tobacco, cigars and cigarettes, petroleum, motor vehicles, surtax on imports	3.	Service fees
	ii. Taxes on production and consumption	4.	Commercial undertakings, water, gas, ports and harbours
	Excise duties: heavy fuel oils, petroleum, spirits, motor vehicles	5.	Receipts from land sales
	Sales tax	6.	Rents on State property
	Service tax	7.	Zakat, fitrah and Bait-ul-Mal and similar Islamic religious revenues
	iii. Others	8.	Proceeds, dividend and interests
	Stamp duties	9.	Federal grants and reimbursements
	Gaming tax		
	Betting and sweepstakes		
	Lotteries		
	Casino		
	Pool betting duty		
<u>Non-tax revenue and non-revenue receipts</u>			
1.	Road tax		
2.	Licences		
3.	Service fees		
4.	Fines and forfeitures		
5.	Interests		
6.	Contributions from foreign governments and international agencies		
7.	Refund of expenditure		
8.	Receipts from other government agencies		
9.	Royalties		

Source: Constitution of Malaysia.

Table 5
Malaysia: ratios of per capita state GDPs to national averages, 1963-1975

	1963	1964	1965	1966	1967	1968	1969	1970	1975
Johor	0.97	0.95	0.99	0.97	0.93	0.90	0.97	0.98	0.96
Kedah	0.81	0.86	0.83	0.84	0.84	0.83	0.81	0.81	0.56
Kelantan	0.58	0.57	0.52	0.42	0.47	0.49	0.51	0.52	0.39
Melaka	0.82	0.75	0.73	0.79	0.70	0.69	0.79	0.69	0.81
N. Sembilan	1.30	1.06	1.11	1.18	1.14	1.14	1.16	1.16	0.92
Pahang	1.10	1.16	1.11	1.12	1.06	1.06	1.05	1.04	0.89
Perak	1.03	1.09	1.12	1.09	1.09	1.06	1.08	1.07	0.87
Perlis	0.70	0.77	0.76	0.81	0.84	0.91	0.85	0.80	0.56
P. Pinang	0.67	0.71	0.73	0.75	0.75	0.77	0.76	0.78	1.17
Sabah	n.a.	n.a.	n.a.	n.a.	1.18	1.22	1.21	1.25	1.12
Sarawak	n.a.	n.a.	n.a.	n.a.	0.87	0.93	0.92	0.99	0.80
Selangor**	1.53	1.56	1.47	1.48	1.56	1.52	1.49	1.49	1.88
Terengganu	0.69	0.68	0.61	0.57	0.61	0.58	0.57	0.60	0.52

(continued)

Table 5
Malaysia: ratios of per capita state GDPs to national averages, 1978-2000* (continuation)

	1978	1980	1983	1985	1986	1988	1990	1995	1998	2000
Johor	0.94	0.59	0.96	0.88	0.88	0.88	0.91	0.93	0.96	0.96
Kedah	0.54	0.65	0.59	0.63	0.63	0.63	0.59	0.59	0.66	0.61
Kelantan	0.38	0.46	0.48	0.46	0.42	0.40	0.40	0.42	0.33	0.43
Melaka	0.73	0.71	0.83	0.74	0.78	0.80	0.82	1.05	0.97	1.08
N. Sembilan	0.88	1.07	1.03	1.02	0.89	0.90	0.87	0.84	0.93	0.88
Pahang	1.04	0.99	1.03	0.93	0.80	0.76	0.75	0.7	0.81	0.71
Perak	0.84	0.89	0.89	0.85	0.78	0.77	0.76	0.86	0.86	0.90
Perlis	0.54	0.70	0.69	0.69	0.66	0.65	0.68	0.71	0.67	0.74
P. Pinang	1.13	1.13	1.22	1.10	1.05	1.09	1.12	1.4	1.37	1.47
Sabah	1.31	0.95	0.95	0.95	1.06	1.06	1.02	0.67	0.53	0.63
Sarawak	0.76	0.71	0.68	0.82	0.96	0.92	0.88	0.86	0.87	0.88
Selangor**	1.84	1.43	1.41	1.32	1.42	1.47	1.49	1.32	1.43	1.19
Terengganu	0.60	1.15	0.87	1.26	1.62	1.54	1.62	1.54	1.63	1.58

* Ratios for 1963-1970 refer to ratio to the mean for Peninsular Malaysia

GDP for 1983 in constant 1970 prices

GDP values for 1975-88 in constant 1978 prices

GDP values for 1990-2000 in constant 1987 prices

** Excludes Federal Territory of Kuala Lumpur

Sources: Calculated with data from Malaysia Plan documents and population statistics from Department of Statistics, Malaysia.

Table 6
Malaysia: incidence of poverty (%) by state, 1970-1999

	1970	1976	1984	1987	1990	1995	1997	1999
Johor	45.7	29.0	12.2	11.1	10.1	3.1	1.6	2.5
Kedah	61.1	61.1	36.3	31.3	30.0	12.2	11.5	13.5
Kelantan	74.1	67.1	39.2	31.6	29.9	22.9	19.5	18.7
Melaka	34.1	32.4	15.8	11.7	12.4	5.3	3.6	5.7
N. Sembilan	50.5	33.0	13.0	21.5	9.5	4.9	4.5	2.5
Perak	52.2	43.0	20.3	19.9	19.4	9.1	4.5	9.5
Perlis	63.2	59.8	33.7	29.1	17.2	11.8	10.6	13.3
Pahang	56.1	38.9	15.7	12.3	10.3	6.8	4.1	5.5
P. Pinang	52.7	32.4	13.4	12.9	8.0	4.0	1.6	2.7
Sabah	-	58.3	33.1	35.3	34.4	22.4	22.1	20.1
Sarawak	-	56.5	31.9	24.7	21.0	10.0	7.5	6.7
Selangor	42.7	22.9	8.6	8.9	7.8	2.2	1.3	2
Terengganu	65.1	60.3	28.9	36.1	31.2	24.3	17.3	14.9
Malaysia	56.7	37.7	20.7	19.3	17.1	8.7	6.8	7.5

* For Peninsular Malaysia only.

Sources: *Fifth Malaysia Plan, 1986-1990 (5MP)*, *Mid-Term Review of the Fifth Malaysia Plan, 1986-1990 (MTR5MP)*, *Second Outline Perspective Plan, 1991-2000 (OPP2)*, *Mid-Term Review of the Seventh Malaysia Plan, 1996-2000 (MTR7MP)*, *Eighth Malaysia Plan, 2001-2005 (8MP)*.

Table 7
Malaysia: average GDP growth rate by state, 1971-2000 (% per annum)

	1981-83	1971-1990	1991-95	1996-2000
Johor	5.4 (9a)	7.8 (3a)	10.0 (2a)	5.2 (3)
Kedah	4.4 (11)	6.9 (6)	9.9 (3)	4.8 (4)
Kelantan	5.4 (9b)	5.0 (11)	6.2 (9)	3.2 (10)
Melaka	6.2 (7)	7.0 (5)	9.6 (4)	3.9 (9a)
N. Sembilan	5.7 (8)	7.1 (4)	8.8 (5)	4.5 (5)
Pahang	7.3 (3)	5.3 (10)	7.5 (7a)	4.0 (8)
Perak	6.4 (6)	6.0 (8)	7.5 (7b)	3.9 (9b)
Perlis	5.1 (10)	6.7 (7)	7.0 (8)	3.9 (9c)
P. Pinang	6.9 (4)	8.0 (2)	10.0 (2b)	5.4 (2)
Sabah	7.7 (1)	4.9 (12)	5.0 (11)	4.1 (7)
Sarawak	6.8 (5)	5.4 (9)	6.0 (10)	4.2 (6a)
Selangor	5.4 (9c)	8.3 (1)	10.9 (1)	5.6 (1)
Terengganu	7.4 (2)	7.8 (3b)	8.0 (6)	4.2 (6b)
K. Lumpur	6.2	7.8	8.8	4.2
Malaysia	6.2	7.0	8.7	4.7

Sources: *Mid-Term Review of the Fourth Malaysia Plan, 1981-1985*, Table 5-2; *Seventh Malaysia Plan, 1996-2000*, Table 5-3; *Eighth Malaysia Plan, 2001-2005*, Table 5-4; *Third Outline Perspective Plan, 2001-2010*, Table 4-10.

In the *Eighth Malaysia Plan* for 2001-2005, Perlis, Kedah, Kelantan, Terengganu, Pahang, Sabah and Sarawak are categorized as less developed states, while Johor, Melaka, Negri Sembilan, Perak, Pulau Pinang, Selangor and KL are considered more developed. Using a national average development index base of 100 for 1990, the development indices for the less developed states ranged from 86.8 to 98.8 in 1990 and from 113.8 to 126.1 in 2000. The development indices for the more developed states were higher, ranging from 100.0 to 109.9 in 1990 and from 131.9 to 139.2 in 2000. Selangor and Pulau Pinang had the highest development index scores (Table 8).

The composite development index is constructed from an economic development index and a social development index. The less developed states had lower economic index ranges, i.e. 89.9 to 96.7 in 1990 and 100.6 to 117.1 to 125.0 in 2000, compared to 99.4 to 112.6 in 1990 and 129.7 to 142.1 in 2000 for the more developed states. Similarly, the social development indices for less developed states were lower during the period under review – 83.6 to 100.9 and 110.4 to 128.5 for the less developed states, compared to 100.6 to 108.3 in 1990 and 132.5 to 140.6 in 2000 for the more developed states.

The ratio of the average development index for the more developed states to that for the less developed states declined from 1.14 in 1990 to 1.10 in 2000. This suggests a modest narrowing of the gap between the more developed and the less developed states by four per cent in the decade under review. In fact, the average development index for the less developed states increased by only slightly more than that for the more developed states (29.2 per cent compared to 29.0 per cent). The ratio of the economic development index for the more developed states to that for the less developed states decreased slightly from 1.13 in 1990 to 1.11 in 2000 – i.e. narrowing the gap by a mere two per cent. Similarly, the ratio for the social development indices narrowed by four per cent from 1.13 to 1.09.

The incidence of poverty in Kelantan, Kedah and Terengganu has been highest among the Malaysian states since 1976 (Figure 1), with Sabah, Sarawak and Perlis not far behind. The poorest states seem to be characterized by greater persistence of subsistence and rice agriculture. The incidence of poverty in Sabah has been unexpectedly high since the 1980s. It is possible that massive immigration into the state – from the southern Philippines as well as Indonesian outer islands – have served to depress wage incomes, thus causing the state to sustain a relatively higher incidence of poverty despite relatively high growth rates.

There is, of course, a strong relationship between the incidence of poverty and low state GDP per capita, with the notable exceptions of the petroleum producing states of Terengganu, Sarawak and Sabah, suggesting that oil wealth, including the royalties accruing to the state governments (with the exception of Terengganu since 2000 after it fell into opposition hands), have not been deployed to reduce poverty in those states. Among the non-oil producing states, the relative positions of Kedah, Kelantan and Selangor have remained rather unchanged for more than two decades. In the early 1980s, Kedah and Kelantan – now categorized as less developed states – were categorized as low-income states. At that time, Selangor – now a more developed state – was categorized as a high-income state (Malaysia 1981, Chapter 5).

Table 8
Malaysia: development composite index by state, 1990, 2000 (1990 = 100)

Indicator	Year	More developed states							
		Total	Johor	Melaka	Negri Sembilan	Perak	Pulau Pinang	Selangor	K.L.
Per capita GDP	1990	104.4	97.0	100.1	94.9	95.1	106.4	114.4	120.6
	2000	133.8	128.5	131.2	126.8	127.4	140.0	133.7	154.1
Unemployment rate	1990	106.2	108.0	104.6	106.6	102.2	107.6	110.0	104.2
	2000	133.2	132.5	132.5	131.8	128.4	138.0	130.4	138.7
Urbanization rate	1990	106.5	100.0	95.7	97.2	102.7	112.7	112.8	124.5
	2000	135.9	129.1	126.0	125.0	134.4	142.9	144.4	149.3
Registered cars & motorcycles*	1990	108.2	108.3	104.8	105.3	99.3	117.8	113.7	108.2
	2000	139.9	136.8	138.2	134.9	134.2	148.7	130.3	156.1
Telephones*	1990	106.6	101.2	99.0	99.7	97.9	108.6	113.3	126.4
	2000	134.2	130.9	130.7	129.9	130.5	140.8	147.8	128.8
Incidence of poverty*	1990	107.2	107.3	105.1	107.9	98.3	108.5	109.6	113.5
	2000	130.3	132.5	127.5	132.5	121.6	132.2	133.3	132.8
Piped water*	1990	108.1	101.2	108.7	105.5	104.1	112.6	110.4	114.2
	2000	142.2	141.1	142.0	142.0	142.9	142.9	142.0	142.9
Electricity*	1990	105.0	99.1	107.6	106.8	99.1	106.8	107.6	107.6
	2000	135.9	135.9	135.9	135.9	135.9	135.9	135.9	135.9
Infant mortality rate per 1000 live births	1990	106.0	102.5	107.1	104.3	103.4	108.9	105.9	109.7
	2000	133.4	139.2	125.2	134.0	138.2	136.6	144.4	116.4
Doctors per 10,000 population	1990	105.0	97.4	99.2	100.0	98.3	104.7	101.9	132.9
	2000	133.4	122.6	132.1	126.0	126.3	133.9	147.4	145.5
Economic development index	1990	106.3	102.9	100.8	100.7	99.4	110.6	112.6	116.8
	2000	135.5	131.6	131.7	129.7	131.0	142.1	137.3	145.5
Social development index	1990	106.2	101.6	105.5	104.9	100.6	108.3	107.01	115.6
	2000	135.1	134.3	132.5	134.1	133.0	136.3	140.6	134.7
Development composite index	1990	106.3	102.2	103.2	102.8	100.0	109.5	109.9	116.2
	2000	135.3	132.9	132.1	131.9	132.0	139.2	139.0	140.1
Change in index		29.0	30.7	28.9	29.1	31.9	29.7	29.1	23.9

(Continued)

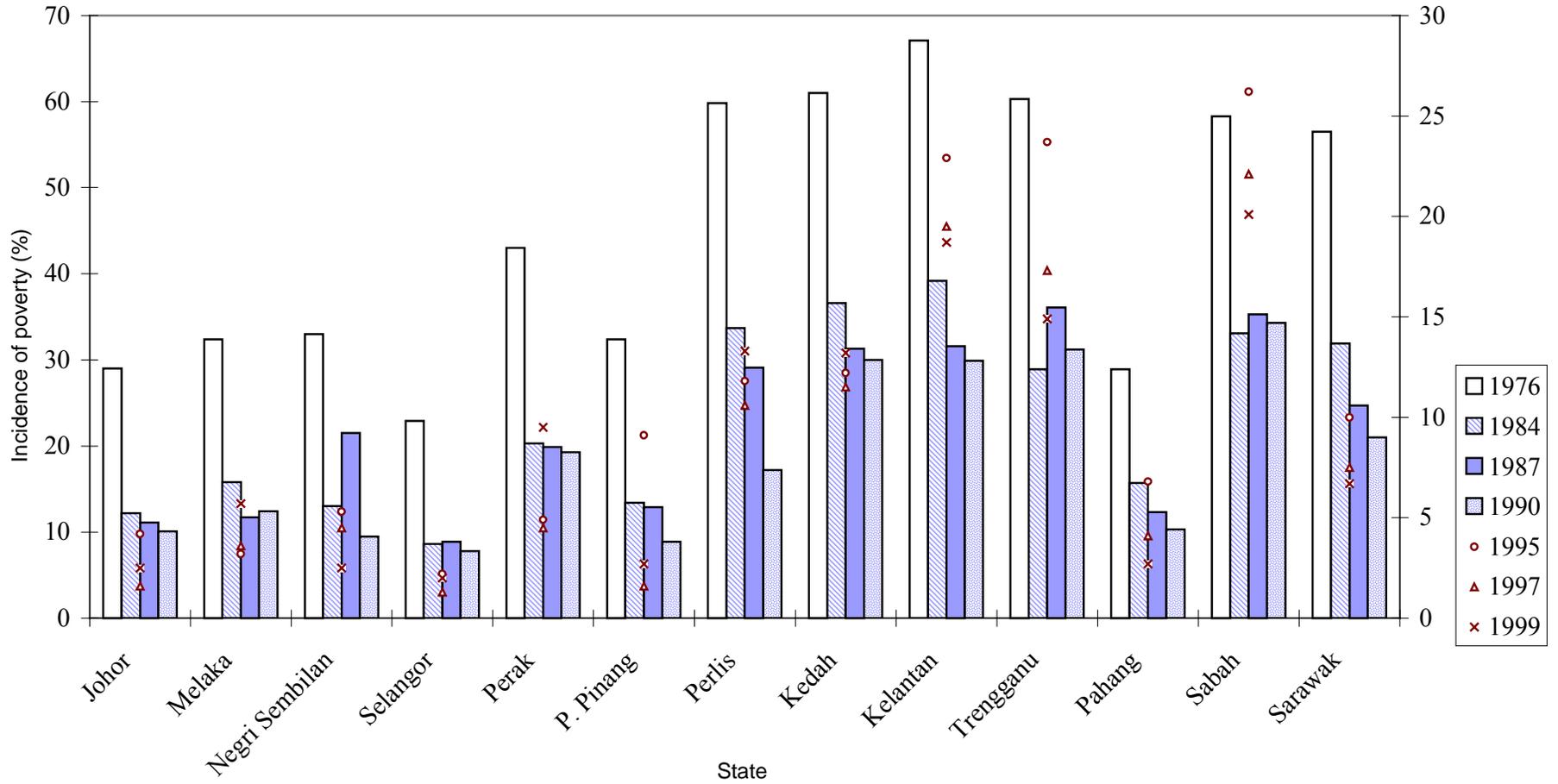
Table 8
Malaysia: development composite index by state, 1990 and 2000 (1990 = 100) (continuation)

Indicator	Year	Less developed states							
		Total	Kedah	Kelantan	Pahang	Perlis	Sabah	Sarawak	Terengganu
Per capita GDP	1990	94.6	88.3	84.3	94.2	90.1	96.3	99.2	108.2
	2000	123.9	120.9	116.8	123.1	123.7	121.2	126.7	142.3
Unemployment rate	1990	93.8	102.2	95.4	108.0	101.7	79.9	80.9	88.6
	2000	118.8	131.1	112.5	124.2	128.4	108.3	111.8	115.2
Urbanization rate	1990	93.5	92.8	93.2	91.8	90.0	93.1	95.2	98.4
	2000	121.8	122.5	121.2	118.6	119.4	120.7	126.4	124.1
Registered cars & motorcycles*	1990	91.8	94.5	89.5	96.3	98.1	84.4	91.0	88.9
	2000	125.4	127.9	123.8	127.8	128.5	119.6	125.6	124.2
Telephones*	1990	93.4	92.0	89.6	93.2	94.7	95.9	96.9	91.6
	2000	117.8	115.9	115.4	122.4	115.9	115.9	120.1	119.0
Incidence of poverty*	1990	92.8	87.8	87.9	107.1	100.3	83.5	96.6	86.5
	2000	115.7	115.3	107.2	127.8	115.7	105.1	125.9	113.2
Piped water*	1990	91.9	94.5	79.8	98.7	92.3	93.0	87.9	97.2
	2000	131.2	141.1	115.6	136.5	138.3	111.9	137.4	137.4
Electricity*	1990	95.0	100.9	95.0	103.8	106.8	77.2	79.5	102.1
	2000	128.1	135.9	135.9	135.9	135.9	107.7	109.1	135.9
Infant mortality rate per 1000 live births	1990	94.0	100.8	103.1	98.7	97.1	71.2	87.6	99.9
	2000	125.1	128.8	122.6	1210	131.3	113.3	140.8	117.9
Doctors per 10,000 population	1990	95.0	94.7	95.3	96.1	97.2	93.3	93.6	95.0
	2000	119.4	121.1	122.6	119.9	121.1	114.1	118.0	119.0
Economic development index	1990	93.4	93.9	90.4	96.7	94.9	89.9	92.6	95.2
	2000	121.7	123.7	117.9	123.2	123.2	117.1	122.1	125.0
Social development index	1990	93.8	95.7	92.2	100.9	98.7	83.6	89.0	96.1
	2000	123.9	128.5	120.8	128.2	128.5	110.4	126.2	124.7
Development composite index	1990	93.6	94.8	91.3	98.8	96.8	86.8	90.8	95.7
	2000	122.8	126.1	119.4	125.7	125.8	113.8	124.2	124.8
Change in index		29.2	31.2	28.1	26.7	29.0	27.0	33.3	29.2

Source: *Third Outline Perspective Plan, 2001-2010*, Table 4-8.

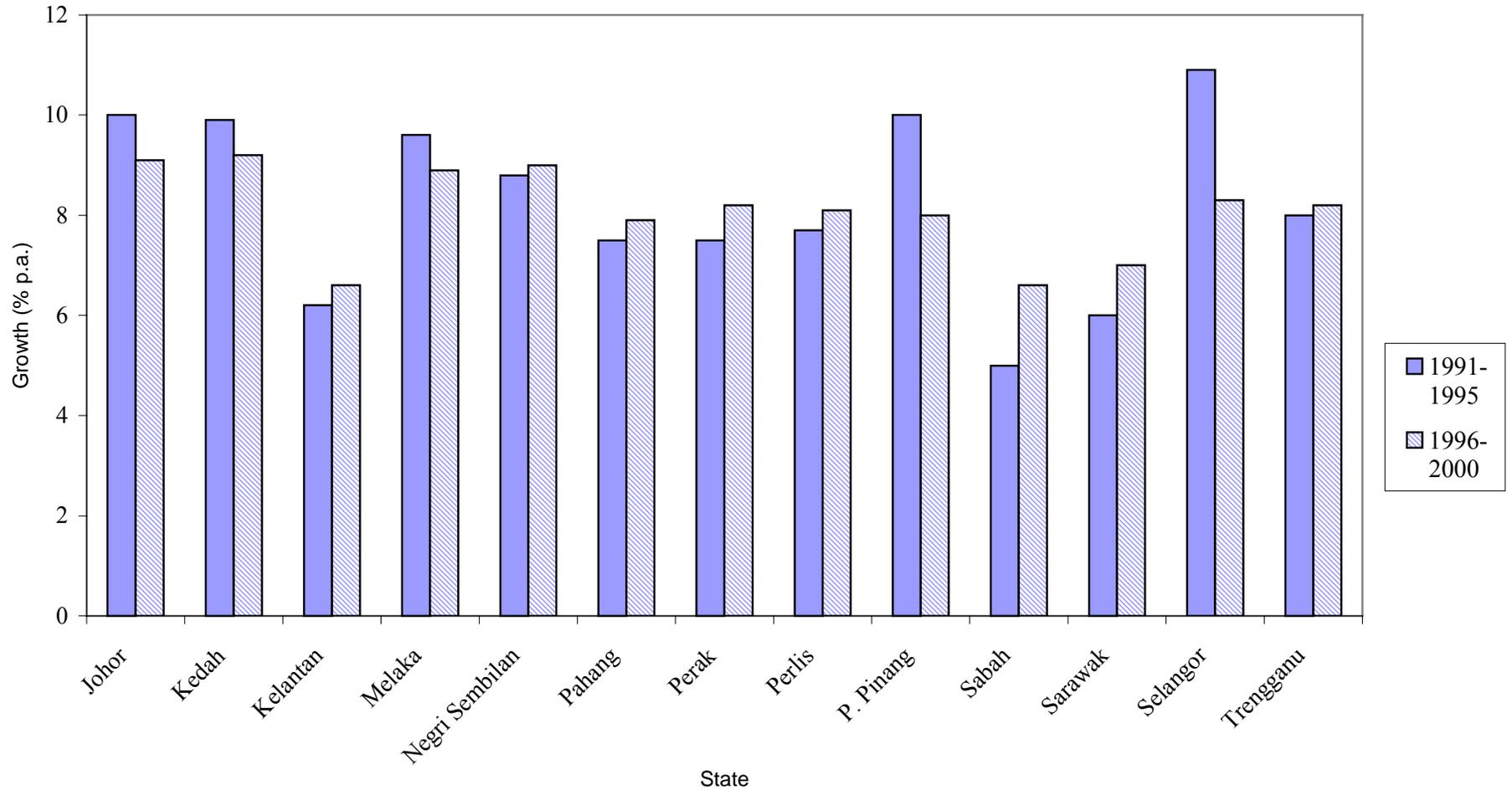
Note: * per 1000 population.

Figure 1: Malaysia: incidence of poverty by State, 1976-99



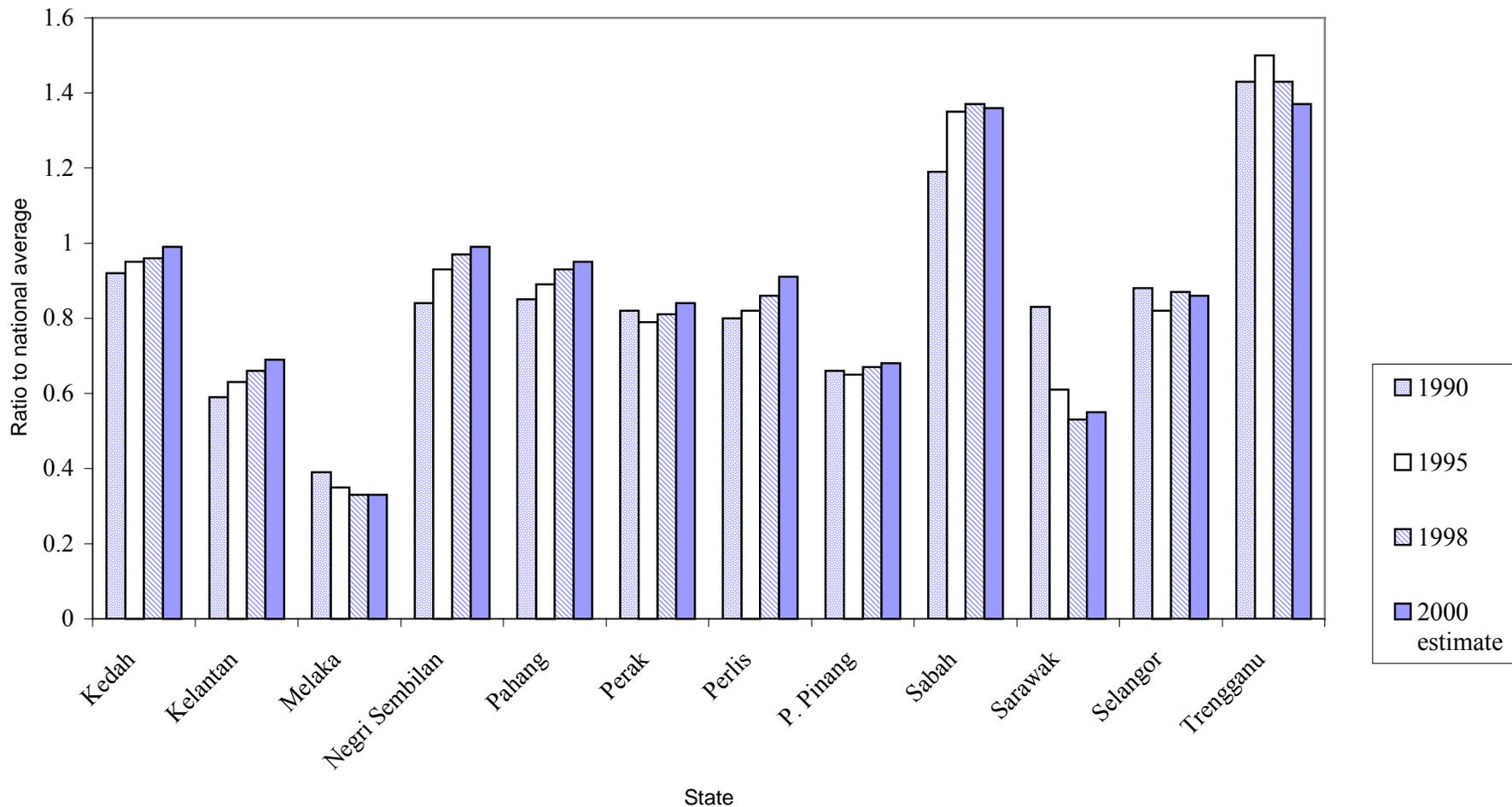
Sources: various Malaysia Plan documents.

Figure 2: Malaysia: gross domestic product growth rate by State, 1991-2000



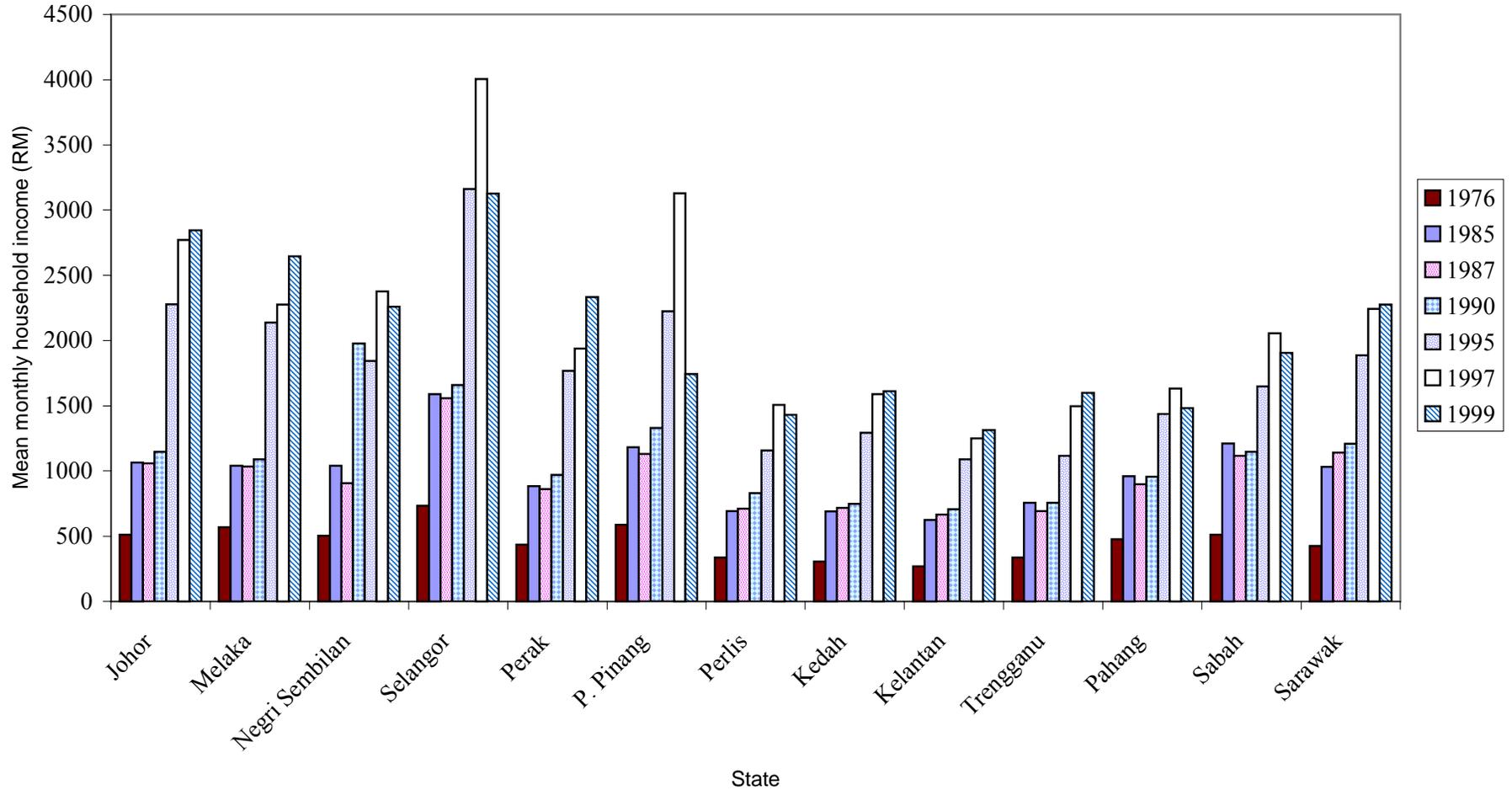
Source: *Seventh Malaysia Plan*, Table 5-2.

Figure 3: Malaysia: gross domestic product per capita by State, 1990-2000



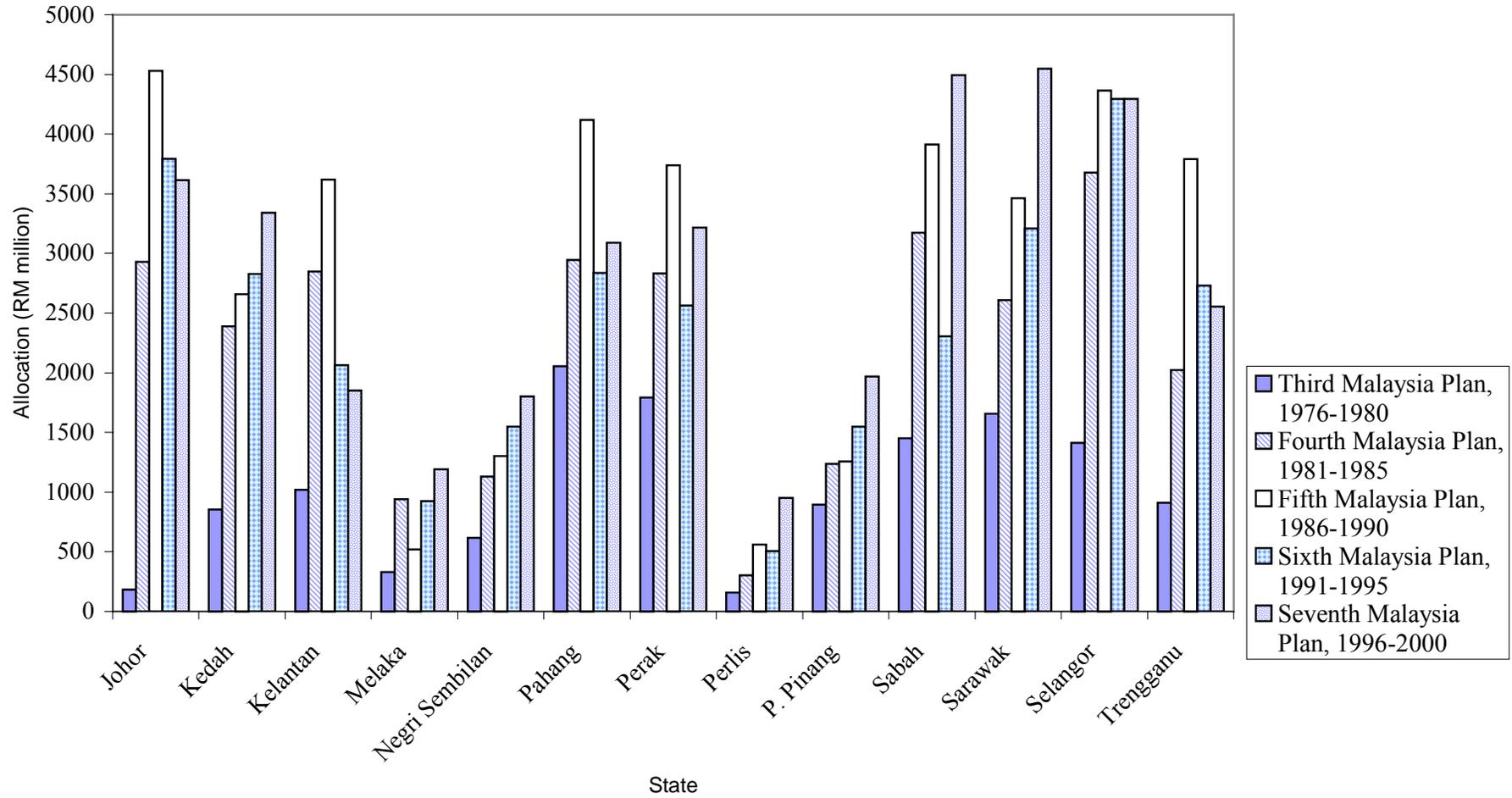
Source: *Seventh Malaysia Plan*, Table 2-7.

Figure 4: Malaysia: mean household income by State, 1976-1999



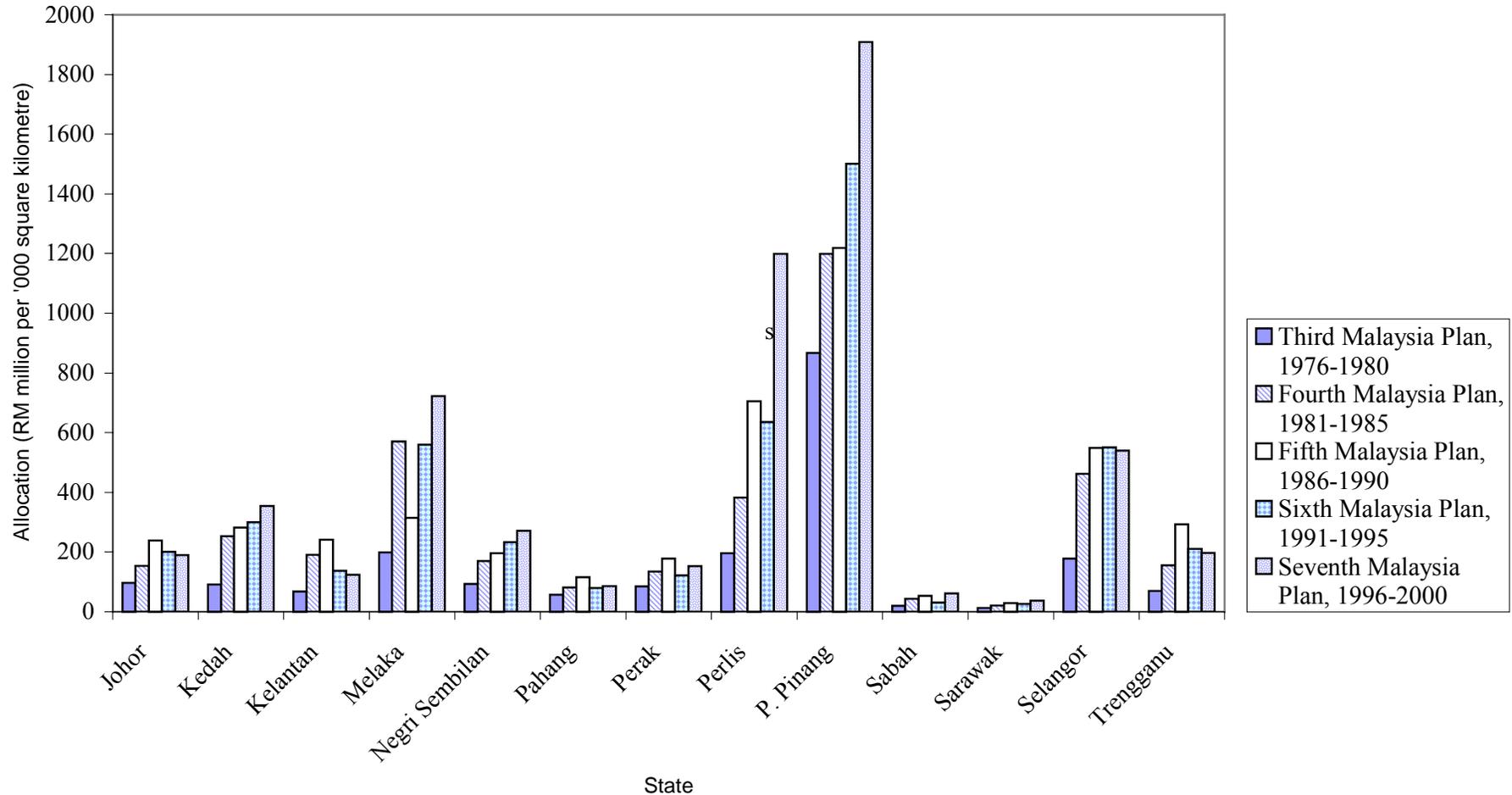
Sources: various Malaysia Plan documents.

Figure 5: Malaysia: development allocation by State, 1976-2000



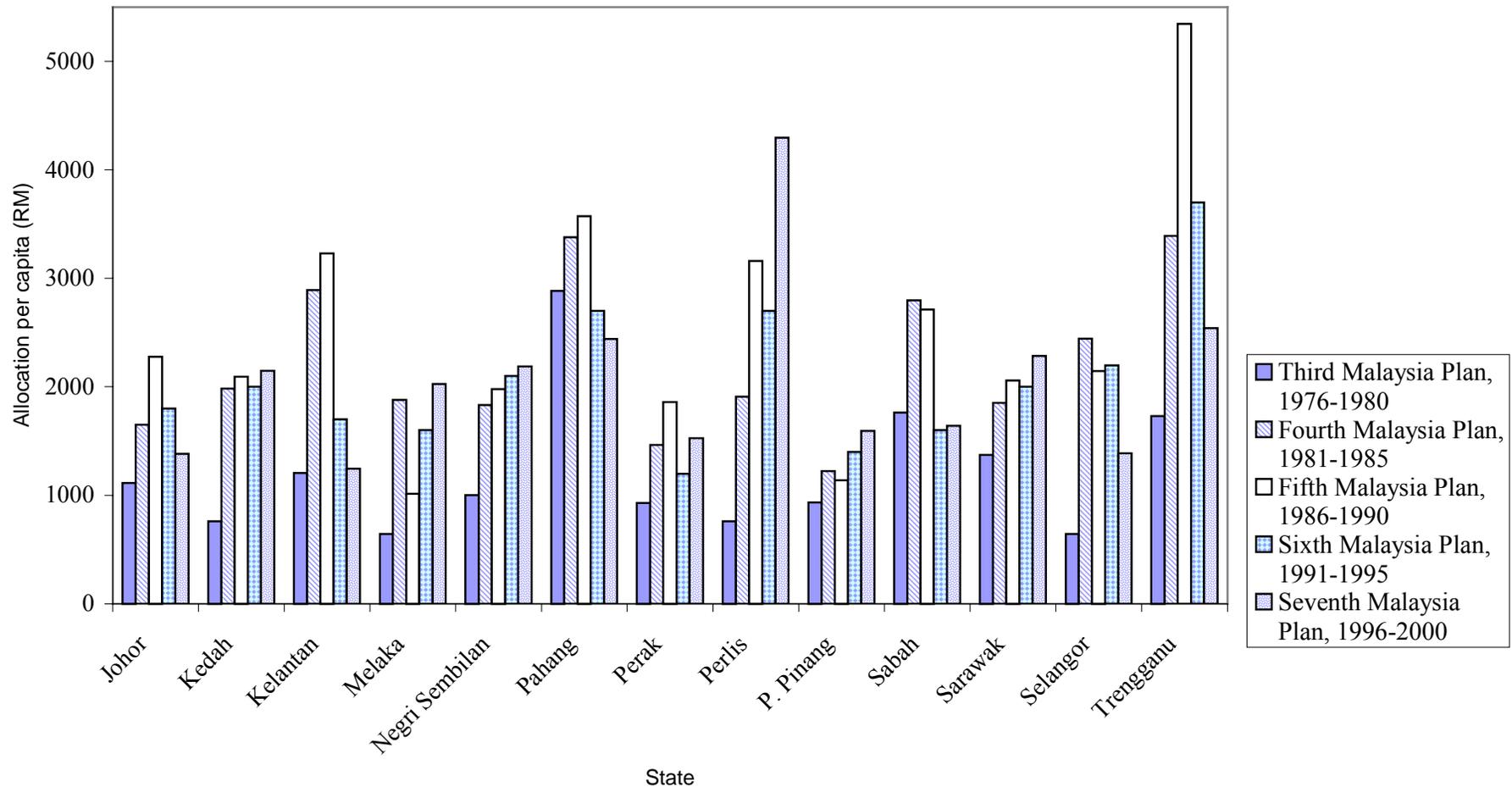
Sources: various Malaysia Plan documents.

Figure 6: Malaysian States: development allocation by area , 1976-2000



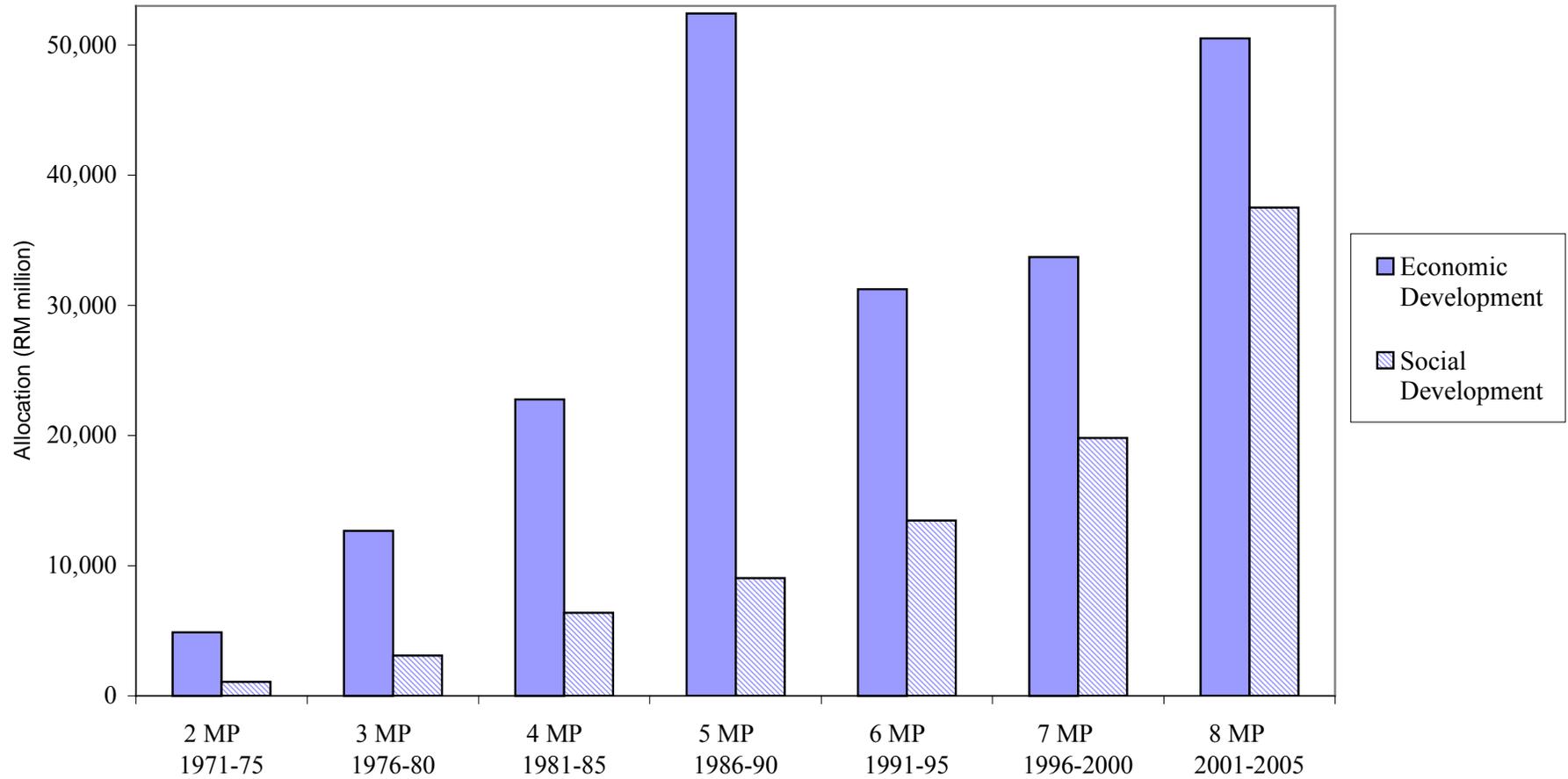
Sources: various Malaysia Plan documents.

Figure 7: Malaysia: development allocation per capita by States, 1976-2000



Sources: various Malaysia Plan documents.

Figure 8: Malaysia: five year development plan allocations, 1971-2005



Sources: various Malaysia Plan documents.

The poverty rates in Sabah and Sarawak have been higher than the average in the peninsula,² though Sabah and Sarawak had higher growth rates than the peninsula during the 1971-90 period. In fact, Sabah had the highest growth rate of all the States (Wee, 1995: 56-58). The growth rates of the Borneo States were boosted in part by the production of petroleum, the benefits of which have mainly accrued to foreign production companies and the Federal Government since the Petroleum Development Act of 1974.

The last decade saw Malaysia's gross domestic product (GDP) growing at an average 8.7 per cent per annum for 1991-1995 and by 8.0 per cent for 1996-2000 despite the deep national recession in 1998. Meanwhile, Kelantan, Sabah and Sarawak grew slower than the other States in the 1990s (Figure 2). Together with the northern States of Kedah and Perlis, they have had consistently lower per capita GDPs compared to the national average (Figure 3). The decline in Sabah's growth rate to lag behind the peninsula can be attributed to declining natural resource extraction, especially of timber.

The Northern and East Coast States of Kedah, Perlis, Kelantan and Terengganu have also had relatively low household incomes (Figure 4). Although household incomes for the Borneo States of Sabah and Sarawak have been comparable with most other States, the costs of living in the Borneo States have been much higher, requiring higher poverty lines than in the peninsula. Poverty has also been reflected in their higher infant mortality rates and fewer motorcycles, motorcars and telephone services per capita (Table 9).

² Some predominantly Malay States in northern Peninsular Malaysia and on its East Coast also have high poverty rates, while there are also pockets of poverty in the more developed States, especially among urban squatters and Orang Asli communities.

Table 9
Malaysia: socio-economic indicators by State, 1999

State	Infant mortality rate#	Population per motorcar	Population per motorcycle	Population per telephone
Johor	1865 (8)	6 (7a)	3 (6a)	6 (7a)
Kedah	1882 (7)	13 (3)	5 (5)	7 (6a)
Kelantan	2099 (5)	16 (2a)	7 (3a)	13 (2)
Melaka	1242 (12)	5 (8)	3 (6b)	5 (8a)
N. Sembilan	1505 (10)	6 (7b)	3 (6c)	5 (8b)
Pahang	2300 (4)	10 (4)	6 (4a)	9 (5)
Perak	1498 (11)	7 (6)	3 (6d)	6 (7b)
Perlis	1895 (6)	29 (1)	8 (2a)	7 (6b)
P. Pinang	1061 (13)	4 (9)	2 (7)	5 (8c)
Sabah	4249 (1)	16 (2b)	42 (1)	19 (1)
Sarawak	2585 (2)	9 (5)	7 (3b)	11 (3)
Selangor	1584 (9)	6 (7c)	6 (4b)	4* (9)
Trengganu	2467 (3)	16 (2c)	8 (2b)	10 (4)
Malaysia	1477	8	5	7

No. of deaths of infants less than 1 year old per 1000 live births, for 1998.

* Excludes Multi-media Super-corridor (MSC).

Note: Figures in parentheses show ranks.

Sources: Department of Statistics, Malaysia, *Social Bulletin of Statistics, 2000*. Calculated from data in Department of Statistics, Malaysia, *State/District Data Bank, 1999*.

Table 10
Malaysia: federal and consolidated state government revenues and expenditures, 1985-1999 (RM '000 million)

	1985	1990	1995	1999
Federal Government Revenue	21.114	29.521	50.954	58.675
Consolidated State Government Revenue	4.245	6.718	8.261	8.228
Federal Government Expenditure	26.82	34.19	49.03	68.162
Consolidated State Government Expenditure	5.61	8.54	10.534	8.91

Sources: Ministry of Finance, *Economic Report*, various issues.

Table 11
Malaysia: grants to State governments, 1975-1999

	1975	1980	1985	1990	1995	1999
Grants to State Governments (% Federal Government Operating Expenditure)	9.0	11.0	4.5		3.8	3.5*
Deficit grants (RM million)				27.50	13.56	17.11
Development grants (RM million)				99.60	166.39	165.93
Contingency grants (RM million)			262.50	797.80	1216.60	1021.80
Outstanding Loans Due to Federal Govt from State Govts (RM million)	1107	2461	6118	7317	7330	9335*

* 2000 estimate

Sources: *Economic Report*, various issues; *Federal Public Accounts*, various issues.

7 Federal and state government finances

Under the Malaysian Constitution, taxes may only be levied with authorization by federal law. The Federal Government collects direct taxes such as income taxes on individuals, companies and cooperatives, as well as capital gains taxes, import and export duties. The State Governments are assigned residual revenues such as those related to land, real property, agriculture and forestry. Within constitutionally set limits, the Federal Government can influence such State government revenue sources.

For instance, the federal-owned Petroleum Nasional Berhad (Petronas) is empowered to contract out exploration and production of petroleum under the Petroleum Act, 1974. If the Federal Government directs – through Petronas – such activities away from a particular State during a certain period, the State Government concerned will have less royalty revenue in that period. The 1991 federal ban on log exports from Sabah – then held by the opposition PBS (Parti Bersatu Sabah) government – undermined State government revenue (Wee, 1995: 24).

In essence, the State's financial powers are limited. State Governments receive grants from the Federal Government, given in consultation with the National Finance Council, which comprises the Prime Minister and ministers appointed by the Prime Minister and one representative from each State (Constitution of Malaysia, Article 108). Since the Prime Minister can appoint various ministers to the Council, he has much more power than any State representative. Current Prime Minister Mahathir Mohamad has been the most powerful and assertive among the four Malaysian prime ministers to date.

Grants to the States take the form of tax-sharing grants,³ general grants⁴ and specific grants.⁵ Federal Government expenditure has been far larger than for all the State Governments taken together (Table 10). Federal government revenue has contributed from between 77 to 91 per cent of total government revenue since 1963. Federal

³ Tax-sharing grants include 10 per cent of export duties on tin, iron and other minerals based on the 'derivation' principle. Under Article 110 (3A), the Federal Constitution allows the Federal Government to increase this grant for the peninsular States to more than the minimum 10 per cent 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. If export duties are abolished in line with World Trade Organization (WTO) proposals, State Government revenue from such tax-sharing grants will be reduced.

⁴ General grants include capitation grants, State Reserve Fund grants, Contingencies Fund grants, State Advance grants and special grants. The capitation grants are based on a State's population size. State Reserve Fund grants are for supplementing State Government revenues (deficit grants) and for development (development grants) as deemed necessary for the year. The Contingencies Fund grants are given for unforeseen needs. The State Advance Fund grants provide cash advances to State Governments facing cash flow problems.

⁵ Special grants have been given to the Governments of Kedah, Selangor, Sabah and Sarawak. These grants may be seen as compensation for land surrendered by the respective State Governments to the Federal Government. 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. Specific grants to the State Governments include State road grants, service charge grants and cost reimbursement grants. Thus, the State Government may be regarded as the implementing agency, whose services are subject to federal decisions.

government operating expenditure made up more than 70 per cent of total government operating expenditure for the period 1963-80, more than 50 per cent in the 1980s, and about 40 per cent in the 1990s. The period also saw higher federal current account surpluses as well as higher overall federal deficits.

Meanwhile, federal development expenditure constituted 68 to 90 per cent of total development expenditure during the period under review. For the period 1985-99, federal government expenditure was at least four and a half times the consolidated State government expenditure. It increased to more than five times in 1995, and to about seven and a half times in 1999⁶. Similarly, federal government revenue has exceeded consolidated State government revenues. Federal government revenue grew from four times the consolidated State government revenues to seven times in the period under review.⁷

Federal Government financial allocations to State Governments have shifted from grants to loans over time. Federal Government grants to the States decreased from 9.0 per cent of its operating budget in 1975 to 3.5 per cent in 1999 (Table 11). At the same time, outstanding loans from the Federal Government to the State Governments increased from RM1,107 million to over RM9,000 million. In general, deficit grants allocated from the State Reserve Fund to the State Governments declined from the late 1980s to the early 1990s, but have risen again recently, especially since the Asian financial crisis of 1997.

Besides special grants, federal grants contribute proportionately more to State government revenue in Selangor, Kedah, Johor, Pulau Pinang, Negeri Sembilan and Kelantan.⁸ Because of their limited financial resources, State Governments have

⁶ In 1999, federal government expenditure was estimated at RM68,187 million, compared to RM8,912 million for consolidated State government expenditure.

⁷ In 1999, federal government revenue was estimated at RM58,675 million, compared to the consolidated State government revenues of RM8,228 million.

⁸ With the exception of Pulau Pinang, these States as well as Sarawak and Pahang had the most federal loans for 1996-99 (see table below). Except for Kelantan, most of the loans were for housing and water supply. Forty-five per cent of outstanding loans to Kelantan in 1999 were for its State Economic Development Corporation. These consisted of two rescheduled loans given in 1997. The loans were probably rescheduled because the Kelantan State Government was unable to pay as originally scheduled. The Federal Government is also guarantor for two statutory bodies each in Sabah and Sarawak, as well as a statutory body in Pahang – RM169.2 million for the Sabah Electricity Board, RM8 million for the Sabah Ports Authority, RM424.1 million for the Sarawak Electricity Supply Corporation, RM2 million for the Sibiu Water Board and RM32.4 million for the Pahang State Development Authority in 1996.

Malaysia: Outstanding Federal Loans to State Governments, 1996, 1998, 1999 (RM million)

State	1996	1998	1999
Johor	821	961	944
Kedah	1168	1257	1315
Kelantan	678	636	639
Melaka	372	503	574
Negeri Sembilan	678	859	992
Pahang	642	751	829
Perak	193	190	183
Perlis	120	122	175
Pulau Pinang	197	309	312
Sabah	140	231	456
Sarawak	790	862	1124
Selangor	1147	1084	1039
Trengganu	553	746	751

Sources: *Federal Public Accounts*, various issues.

attempted to reduce their fiscal gaps by cutting spending in line with their revenues (Umikalsum, 1992: 327) and handing over some functions to the Federal Government, leading to further centralization since the formation of Malaysia (Wee, 1996: 285).

Spending has been uneven among the states, reflecting federal government preferences as well as state government financial resources. The public sector was smallest in the Borneo states of Sabah and Sarawak, contributing the lowest shares of state GDPs during the NEP era. Public sector shares of state GDPs in the northern states of Perlis, Kedah, Pulau Pinang and Perak were relatively small in the early 1970s, but grew in the 1980s. The reverse was observed for Selangor, while Melaka's relatively large public sector share was maintained during this period (Table 12).

As noted earlier, the federal government has been fiscally much more important than the 13 state governments put together. With its greater financial resources, there has been greater attention to federal government efforts in reducing inter-regional welfare differences and ensuring more equitable development. Malaysia has had eight five-year development plans since 1966. More development funds have been channelled to Selangor and Johore, both absolutely and relatively (Figures 5 and 6). The smaller States of Melaka, Pulau Pinang and Perlis have been allocated the most development funds in relation to area. Conversely, the larger States of Pahang, Sabah and Sarawak have received the lowest allocations in relation to area.

The Seventh Malaysia Plan (1996-2000) saw relatively higher allocations for the poor States of Sabah and Sarawak. Besides Pahang, the poor State of Terengganu also got the most allocations per capita (Figure 7). However, Terengganu's allocations have been reduced relatively after electing a PAS government in late 1999. The poorest State in the peninsula, Kelantan, has long experienced such discrimination since electing PAS State governments from 1959 until 1978, and then again from 1990. Since the Federal Government is in a better position to finance development, discrimination against these two States has aggravated tensions between them and the Federal Government.

More government development allocations have been allocated for economic, rather than social development (Figure 8). Economic development programmes here include agricultural development, mineral resources development, commercial and industrial development, development of transport, communications, energy and water resources, and related feasibility studies as well as research and development to increase incomes. Social development programmes include provision of piped water supply, electricity, housing, sewerage and rubbish disposal, health services, roads or transport systems. The poor generally have less access to piped water supply and electricity than higher income groups. Among the urban poor, housing as well as sewerage and rubbish disposal services are relatively inaccessible.

Table 12
Malaysia: Government services as proportion of gross domestic product in purchasers' prices by State, 1970-90

	1970	1971	1975	1980	1983	1985	1986	1988	1990
Johor	7.49 (5)	10.98 (6)	7.05 (6)	9.57 (6)	11.94 (4)	11.72 (5)	11.65 (6)	12.52 (6)	10.36 (6)
Kedah	6.20 (4a)	10.14 (5a)	6.72 (5a)	11.85 (10)	19.26 (11)	15.34 (10)	16.11 (11)	16.48 (10)	15.02 (10)
Kelantan	8.62 (7)	12.59 (7)	9.16 (9)	16.45 (13)	22.64 (13)	20.38 (13)	24.82 (13)	24.65 (13)	22.26 (13)
Melaka	11.03 (11)	17.96 (12)	10.65 (11)	14.37 (11)	16.79 (10)	17.55 (11)	15.47 (9)	16.51 (11)	13.67 (8)
N. Sembilan	8.86 (8)	13.55 (10)	8.31 (7)	9.79 (8)	13.54 (6)	12.60 (8)	14.81 (8)	15.52 (8)	13.90 (9)
Pahang	8.98 (9)	12.83 (8)	9.17 (10)	10.73 (9)	13.09 (5)	13.09 (9)	16.09 (10)	16.25 (9)	15.41 (11)
Perak	4.28 (1)	7.85 (2)	4.36 (1)	9.75 (7)	13.83 (8)	12.25 (7)	13.95 (7)	14.30 (7)	12.71 (7)
Perlis	6.20 (4b)	10.14 (5b)	6.72 (5b)	14.54 (12)	21.67 (12)	17.67 (12)	20.03 (12)	21.13 (12)	17.46 (12)
P. Pinang	5.19 (2a)	7.29 (1)	6.27 (4)	9.21 (4)	10.68 (3)	12.00 (6)	11.24 (5)	12.22 (5)	9.84 (5)
Sabah	5.19 (2b)	9.83 (4)	5.80 (3)	9.56 (5)	10.15 (2)	8.73 (2)	7.44 (1)	7.94 (1)	8.07 (4)
Sarawak	5.23 (3)	9.78 (3)	5.22 (2)	6.77 (1)	13.71 (7)	10.08 (4)	8.62 (4)	8.68 (4)	6.41 (1)
Selangor	10.26 (10)	13.30 (9)	11.10 (12)	7.85 (2)	7.71(1)	8.38 (1)	7.47 (2)	8.28 (3)	6.86 (3)
Terengganu	8.51 (6)	14.18 (11)	8.63 (8)	7.95 (3)	14.55 (9)	9.45 (3)	8.42 (3)	8.16 (2)	6.75 (2)
Kuala Lumpur	n.a.	n.a.	n.a.	14.78	18.27	16.43	16.26	17.58	15.42

n.a. - Not available

Figures in brackets indicate ranks from highest to lowest proportions.

Sources: Calculated with data from *Third Malaysia Plan, 1971-1975*, Table 10-1 and 10-3; *Fourth Malaysia Plan*, Table 5-1; *Mid-Term Review of the Fourth Malaysia Plan*, Tables 5-1 and 5-3; *Fifth Malaysia Plan, 1986-1990*, Tables 5-2, 5-3; *Second Outline Perspective Plan, 1991-2000*, Tables 4-6, 13.

In 1990, government spending on health came to three per cent of the gross domestic product (Economic Planning Unit, 1995, cited in Low *et al.*, 1996), well below the five per cent recommended by the World Health Organization (WHO). In 1998, government operating expenditure through the Ministry of Health represented about 1.2 per cent of the gross domestic product (calculated from information in *Federal Public Accounts, 1999* and from Ministry of Finance statistics). It is generally acknowledged that the Malaysian Government has provided reasonably good health services and that the cost of coverage has been kept reasonably low through the efficient use of resources. However, the distribution of health service delivery has been regionally inequitable. Of particular concern has been the relative lack of health personnel in Sabah, Sarawak, Terengganu, Kedah and Kelantan (Table 13). Skilled personnel, including doctors, would rather stay in the more developed States, where modern facilities as well as recreational and entertainment services are closer to their expectations. However, improved community health may not be seen as developmental or improving incomes.⁹

The development of road transport can be very important for improving the quality of life and incomes. Better road networks have lowered transport costs and increased marketing opportunities nationwide. In Sarawak, roads linking rural communities to health centres also increase access to health services. With the exceptions of Selangor and Johor, which have higher road densities relative to size, large States tend to have lower road densities. In fact, the Kelang Valley in Selangor is currently burdened by traffic congestion. In contrast, Sarawak, Sabah and Kelantan have lower road density relative to size.

Educational opportunities and scholarships have been politicized. Education has been and is perceived as a means to increase chances of participation in high-income employment. Most government educational opportunities and scholarships are reserved for Bumiputeras under the NEP. However, the ethnic quota system has failed to privilege the poor among the Bumiputeras. The siting of universities in various States has been similarly politicized. Universiti Malaysia Sarawak (Unimas) was set up when a Sarawakian was the federal Minister of Education. Some Sarawakians welcomed siting the university in the State, but many more still bemoan the low proportion of Sarawakian students in the university and the teachers' training colleges in the State.

Besides politicising development allocations and depriving States controlled by the opposition, the location of economic development projects and programmes have also been politicized to marginalize those States led by opposition governments. The consequence of such bias is to further increase the disparities as opposition parties have been strongest in States characterized by poverty, fiscal discrimination and slower economic growth if not for natural resources – especially petroleum and timber – extraction activities.

⁹ The opportunity cost of poor health in terms of increased medical care requirements is not obvious. Politicians find it easier to win over voters through projects with more apparent direct benefits.

Table 13
Malaysia: health facilities and road density by State, 1995-1999

State	Population Per Personnel/Facility				Road Density, 1995 (km/km ²)
	Doctor, 1999	Nurse, 1998	Government Hospital Bed, 1999	Dentist, 1999	
Johor	1,808 (7)	1,228 (4)	1,001 (3)	12,538 (9)	0.341514 (7)
Kedah	1,915 (6)	1,173 (7)	771 (7)	17,360 (3)	0.427010 (6)
Kelantan	1,962 (5)	1,357 (5)	943 (4)	16,727 (5)	0.189745 (11)
Melaka	1,111 (12)	939 (10)	710 (8)	10,785 (10)	0.837674 (3)
Negri Sembilan	1,455 (10)	932 (11)	630 (10)	9,958 (11)	0.577299 (5)
Pahang	2,110 (4)	1,087 (8)	787 (6)	14,676 (7)	0.190718 (10)
Perak	1,483 (9)	996 (9)	615 (12)	14,409 (8)	0.290978 (9)
Perlis	1,701 (8)	873 (13)	560 (13)	16,175 (6)	0.777358 (4)
Pulau Pinang	1,063 (13)	923 (12)	620 (11)	8,906 (13)	1.979611 (1)
Sabah	4,015 (1)	1,788 (2)	1,073 (2)	40,207 (1)	0.147244 (12)
Sarawak	2,629 (2)	1,544 (3)	676 (9)	25,659 (2)	0.041125 (13)
Selangor	1,431 (11)	2,609 (1)	1,261 (1)	9,085 (12)	1.087115 (2)
Trengganu	2,194 (3)	1,195 (6)	874 (5)	17,225 (4)	0.308529 (8)
Malaysia	1,465	1,223	806	11,897	0.195076

Note: Figures in parentheses show ranking.

Sources: Department of Statistics, Malaysia, *Social Bulletin of Statistics, 2000*.

Calculated from data in Department of Statistics, Malaysia, *State/District Data Bank, 1999*.

Handbook of Statistics, Malaysia, 1999.

Table 14
Malaysia: Government revenue, 1975-2001 (RM million)

	1975	1978	1980	1982	1983	1984	1985	1990	1996	2001
Federal government:										
Petroleum income tax	322	771	1,736	2,075	1,998	2,570	3,130	2,644	2,203	9,858
Petroleum royalty	78	116	345	425	491	581	619	627	848	2,000
Total	400	887	2,081	2,500	2,489	3,151	3,749	3,271	3,051	11,858
<i>% Total federal government revenue</i>	<i>7.82</i>	<i>10.03</i>	<i>14.94</i>	<i>14.98</i>	<i>13.38</i>	<i>15.15</i>	<i>17.76</i>	<i>11.08</i>	<i>5.24</i>	<i>14.90</i>
Sabah	0.85	50.74	74.98	87.71	118.84	104.55	104.32	115.37	80.47	N.A.
<i>% State government revenue</i>	<i>0.32</i>	<i>6.53</i>	<i>4.87</i>	<i>5.92</i>	<i>9.03</i>	<i>7.82</i>	<i>9.02</i>	<i>7.12</i>	<i>5.28</i>	
Sarawak	112.35*	64.50*	116.00*	159.93*	171.71*	216.70*	210.66*	204.90	320.00	N.A.
<i>% State government revenue</i>	<i>54.44*</i>	<i>27.01*</i>	<i>29.00</i>	<i>23.18*</i>	<i>17.36*</i>	<i>24.63*</i>	<i>22.41*</i>	<i>22.00</i>	<i>14.00</i>	
Terengganu	-	13.20	0	181.94	0	0	280.92	0	0	N.A.
<i>% State government revenue</i>		<i>22.37</i>		<i>0.70</i>			<i>83.07</i>			

* Refers to revenue from land and mines, the majority of which is from crude oil and natural gas.

2001: forecast only.

Sources: Calculated with data from *State Financial Statements*, various issues.

Economic Report, various issues.

<http://www.bnm.gov.my> (Bank Negara Malaysia).

The (usually federal) government-financed development of industrial infrastructure is generally expected to bring in employment-generating foreign investments. However, even without bias or neglect, it is often the case that poorer States and regions are more likely to be bypassed for cost, feasibility or viability considerations, leading to lower allocations to poorer States. Certain States may also lack the skilled human resources or other capabilities required for implementing some development projects. Limited capacities and capabilities are still common, and some development allocations have not been spent for such reasons.

8 Tensions between the centre and the Borneo States

Since the mid-1970s, petroleum resources have been managed by the federal government-owned Petronas.¹⁰ The issue of increasing petroleum royalties for producing States has often been raised.¹¹ Based on the principle of ownership of the continental shelf by adjoining regions, Sabah and Sarawak could claim ownership before incorporation into Malaysia in 1963. The *status quo* could have been maintained insofar as the Malaysian Constitution is silent on the matter. Thus, the federal government claim to ownership has been construed as annexation.¹²

The Federal Government gets far more petroleum revenue than the governments of the petroleum producing States (Table 14). Besides getting the same five per cent royalties from petroleum output as the State government concerned, the Federal Government gets dividends from Petronas. Furthermore, it also taxes the profits of the oil producing-companies and Petronas itself. Since 1985, Federal Government revenue from petroleum tax and royalties have totalled more than RM3,000 million per annum,

¹⁰ Distribution of the gross value of petroleum output has been prescribed by the 1974 Petroleum Development Act as follows (Wee, 1995: 24-25):

Government of producing-State	5% royalty on the gross value of petroleum output
Federal Government	5% royalty on the gross value of petroleum output
Producer-company	<u>20%</u> for cost recovery
Total	30%
Producer-company	21% (30% of remaining 70%)
Petronas	<u>49%</u> (70% of remaining 70%)
Total	<u>100%</u>

¹¹ For instance, in 1969, the Sarawak Chief Minister claimed that the federal government had orally assured Sarawak that it could have all the revenue from offshore petroleum in return for a lower grant (Leigh, 1988: 133). During the election campaign of October 1990, Joseph Pairin Kitingan, the incumbent Chief Minister of Sabah, argued that the petroleum royalty rate for the State should be increased from 5 to 50 per cent.

The issue of Sarawak ownership of offshore petroleum was especially mentioned in the 1960s. Although petroleum royalties in general have long been an issue of contention, there has been little publicity on the matter in the Malaysian media. Members of Parliament from Sarawak have inquired about the value of petroleum royalties due to the State at various points in time. However, disputes on the formula for sharing petroleum revenues have never been well reported, reflecting the federal government's sensitivity to the matter and tight control of the mass media. The mention of benefits from petroleum resources – in the form of profits to government-owned shipping facilities now privatized and owned by Sarawakians – hint of public opinion in the Borneo States being critical of the matter (Abang Karim, 1999).

¹² See Bob Reece in *Far Eastern Economic Review*, 30 October 1969 and 12 March 1970, quoted in Leigh, 1971: 233.

representing at least five per cent of total revenue. It is estimated that at least half this revenue is from petroleum resources in the Borneo States.¹³

Both Sabah and Sarawak seemingly enjoy favoured financial positions among the Malaysian States (Table 15). They receive more grants compared to other States, partly rationalized by being among the three founding members of the federation. However, over time, the grants negotiated at the time of formation of the Malaysian federation have been abolished and/or reduced.¹⁴

Table 15
Malaysia: Federal Government grants by State, 1964-1996 (RM million)

State	1964-1970	1971-1980	1981-1990	1991-1996
Johor	80.77	182.37	350.04	423.46
Kedah	75.79	157.74	439.38	353.56
Kelantan	50.48	110.86	256.60	227.07 (8)
Melaka	34.36	72.31	128.45 (4)	85.23 (9)
N. Sembilan	42.38	99.21	199.87	101.13 (10)
Pahang	52.54	136.50	539.69 (5)	189.83 (11)
Perak	137.24	282.72 (1)	221.38 (6)	n.a.
Perlis	8.31	20.12 (2)	n.a.	59.55 (12)
P. Pinang	42.86	44.84 (3)	n.a.	n.a.
Sabah	267.20	421.11	885.78	585.23
Sarawak	312.00	525	1,098.31	746.719
Selangor	11,753,216.00	840.42	3005.25 (5)	n.a.
Terengganu	11,643,013.00	106.82	245.65 (7)	214.01

- (1) For 1971-79
(2) For 1971, 1973, 1974, 1976-78
(3) For 1973, 1975-77
(4) For 1981-89
(5) For 1981-85, 1987-89
(6) For 1981, 1983-86
(7) For 1981-87, 1989, 1990
(8) For 1991-95
(9) For 1991-94
(10) For 1991-93
(11) For 1992-96
(12) For 1993-96

Sources: Various *State Financial Statements*.

The export ban on logs from Sabah has been another point of contention between the Sabah State Government and the Federal Government. The federal Minister of Primary Industries, with whom some powers over timber policy have been vested, banned log

¹³ Crude petroleum exports constituted at least half of petroleum production in the mid-1990s, and exports from Sabah represented a fifth of exports, while those from Sarawak represented some 30 to 40 per cent (calculated with data from the Department of Statistics, Malaysia). However, Sabah's highest ever petroleum royalty was RM161 million, or 9.9 per cent of total government revenue in 1990. Sarawak's petroleum royalty was about RM200 million for the period, 1985-1998. The contribution of petroleum royalties to Sarawak State Government coffers decreased from 21.8 per cent in 1985 to 8.7 per cent in 1998.

¹⁴ There should have been reviews of the grants in 1973 and in subsequent decades, but no such review has been completed. It is anticipated that Sarawak and Sabah will lose their favoured financial positions within the Malaysian Federation over time. In a Sarawak State Government Assembly sitting in 2000, the need to review the escalating grant from the Federal Government to the State – per Article 112D of the Federal Constitution – was raised.

exports from the State in 1992. The ostensible reason for the ban was to encourage the growth of wood-based industries in Sabah, though it is widely attributed to the Sabah ruling party's post-nomination, pre-election defection to the opposition in late 1990. The Sabah Chief Minister unsuccessfully argued that the ban was only acceptable with compensation from the federal government for the State's anticipated revenue loss. The federal Minister had initially stated that the State would be compensated. He later claimed that the federal government was not in a position to do so, after the ruling party in Sabah had defected to the opposition (Wee, 1995: 22, 24).

In negotiations before the formation of Malaysia, Sabah and Sarawak politicians had insisted on Borneo-ization, i.e. staffing state civil services with Sabahans and Sarawakians respectively, as a condition for joining the federation. Many in Sabah and Sarawak still do not welcome the federal employees from the peninsular States, who are said to resent being sent there, to patronize the 'locals' or to take time to adjust to life in the two States. Relations between Malaysians from the peninsula and 'locals' in the Borneo States have, however, improved over the years. Nevertheless, social and economic difficulties, e.g. perceived higher rates of graduate unemployment, can threaten such relations, as in the past.

Although Sarawak was far more important historically in developing a sense of nationalism, these movements were largely co-opted in the 1970s, when the Sarawak United People's Party (SUPP) and then the Sarawak National Action Party (SNAP) joined the ruling coalition. In contrast, Sabah's status was rendered ambiguous by Filipino claims to territory once associated with the Sulu Sultanate. However, in recent decades, tensions between the centre and the Sabah State Government have been greater than those between the centre and the Sarawak State Government. Suggestions of secession have surfaced during periods of tension.

The mid-1970s saw the federal government oust the Mustapha government in favour of Berjaya. Tensions between the centre and Sabah rose again in the mid-1980s after Parti Bersatu Sabah (PBS) defeated the incumbent Berjaya with strong support from the Kadazandusun and ethnic Chinese communities. However, the PBS joined the ruling coalition, in which it felt discriminated against. After the PBS defected to the opposition during the 1990 general elections, federal government discrimination against the PBS state government – and the state – became more pronounced. However, this was reversed when the national ruling coalition recaptured the state in 1994 by engineering defections from the PBS after it narrowly won the state election. Support for the PBS has since declined, and the leadership rejoined the ruling coalition in early 2002.

Before the 1990s, peninsula-based political parties did not operate in the Borneo States. After the heightened tensions between Sabah and the Federal Government in the 1980s culminated in Sabah's ruling party, PBS, defecting to the opposition just before the 1990 federal parliamentary elections, peninsular-based political parties began operating in the State to undermine the PBS. The United Malays National Organization (UMNO), the most powerful party in the ruling national coalition, spread its wings to Sabah, even accepting non-Muslim Bumiputera members. After UMNO's entry into and take-over of the State in 1994, a two-year rotating chief ministership replaced the previously renewable full term chief ministership, still practiced in the other States. Sabah has

Table 16
Sabah and Sarawak: net transfers of revenue from federal Government, 1966-1989 (RM million)

	Sabah					Sarawak					
	1966-70	1971-75	1976-80	1981-85	1986-88	1964-65	1966-70	1971-75	1976-80	1981-85	1986-89
Federal allocations	299	350	363	1,732	382	72	240	225	300	543	491
Federal expenditure	1,140	2,284	3,741	9,283	4,159	209	614	1,190	1,815	6,139	4,741
Total	1,439	2,634	4,104	11,015	4,541	281	854	1,415	2,115	6,682	5,232
Federal revenue	655	1,152	4,922	9,415	2,195	130	441	692	1,906	5,346	3,741
Petroleum royalty	-	1	168	496	219	-	-	109	355	940	547
Petroleum dividend*	-	-	-	932*	751	-	-	-	-	2,048*	2,474
Petroleum tax*	-	-	845	1,894	1,023	-	-	-	584	646	1,942
Total	655	1,153	5,935	12,737	4,188	130	441	801	2,845	8,980	8,704
% total federal revenue	7%	6%	13%	14%	6%	5%	4%	4%	6%	10%	10%
Net transfer	784	1,481	-1,831	-1,722	353	151	413	614	-730	-2,298	-3,472

* Petroleum dividend for the period 1983-85.

Source: Wee, 1995: Table 2.17.

since had two Muslim Chief Ministers, two Chinese Chief Ministers¹⁵ and one Kadazan Chief Minister who did not even finish his two-year term after losing in the 1999 State elections.

This happened in spite of lower net transfers out of Sabah – compared to Sarawak – to the peninsula (Table 16). This may be due to poorer economic conditions in Sabah relative to Sarawak. Federal domination has been consolidated since the mid-1990s with federal patronage of a Muslim-Chinese elite alliance, not unlike the one that emerged in Sarawak in the 1970s – and was consolidated in the 1980s – that has also marginalized non-Muslim Bumiputeras.

Sarawak's relatively large area, lower population density, huge rural constituency areas,¹⁶ and State-level rivalries among its politicians have limited effective challenges from the State to the Federal Government. Citizens' protests have mainly been in the rural areas, where politically affiliated logging companies are active, and timber concessionaires threaten 'native' communities' claims to the forests for their livelihoods. Forests are a State matter, and hence, the protests have been directed at the State government. However, State politicians have been able to contain challenges from rural protestors, who are often spread over vast areas and largely cut off from one another, to the politicians' advantage. In fact, citizens' protests against the State Government of Sarawak have sometimes served to strengthen the State government's autonomy. Symbiotic relations between federal and State politicians have also helped diffuse federal-State conflicts.¹⁷

9 Tensions between the centre and North East Peninsular Malaysia

At the time of Malayan independence in 1957, the ruling Alliance coalition gave lip service to State autonomy in finances, as this had been the *status quo*, especially for the five Unfederated Malay States of Johore, Kedah, Perlis, Kelantan and Terengganu¹⁸. However, according to the Malaysian Constitution, tax may be levied only by the federal government or with the authority of federal law.¹⁹ State Governments can only

¹⁵ Although Sabah briefly had a Chinese Chief Minister right after joining Malaysia, other Malaysian States, except for the predominantly Chinese State of Pulau Pinang, have never had a Chinese chief minister.

¹⁶ Sarawak, the largest State in Malaysia, has an area of 124,499 square kilometres, while Sabah has an area of 73,619 square kilometres, less than sixty per cent of Sarawak's size. Sarawak has a smaller population than Sabah. In 2000, the Sarawak population was 2.01 million, compared to 2.45 million in Sabah.

¹⁷ State elections in Sarawak have also been held at different times than federal parliamentary elections, when federal politicians – to whom State politicians are allied – can help in political campaigns. This has been an incentive for politicians in the State ruling coalition to consolidate their alliance with the Federal Government ruling coalition. Sarawak has the most parliamentary seats, i.e. 27 of the 192 for the whole nation. Symbiotic alliances with Sarawak politicians have given the federal ruling coalition more members of parliament, ensuring continued incumbency for both.

¹⁸ The chief minister of Kedah, for example, noted, on 25 July 1956, that Kedah had enjoyed greater administrative autonomy before the Japanese Occupation during the Second World War.

¹⁹ In December 1999, the PAS State government in Terengganu was reported to have been considering the collection of an agricultural land tax known as *kharaj*. Since land is a State matter, *kharaj* would fall under the State government's jurisdiction. Disputes between the State Government and the Federal Government over the issue eventually fizzled out as the Terengganu State government shelved its plans.

borrow from the Federal Government or from sources approved by the Federal Government for up to five years.²⁰

As noted earlier, Kelantan has been led by the Pan-Malaysian Islamic Party (PAS) for many years, and has long had conflicts with the Federal Government.²¹ PAS ruled Kelantan from 1959, joined the expanded ruling coalition in 1973, and then was forced out just before the 1978 state election, in which it lost Kelantan. During its years in political opposition to the ruling coalition, Kelantan has been discriminated against in terms of federal grant allocations. In the mid-1970s, PAS joined the ruling coalition for a few years and was rewarded with higher federal allocations for Kelantan. After PAS recaptured the state in 1990, Kelantan's allocations have again been adversely affected.

In the federal and peninsular State elections of 1999, PAS made significant inroads, capturing Terengganu and many seats in Kedah and Pahang as well. Since then, the ruling UMNO has sought to isolate and weaken the seemingly ascendant PAS, even withholding petroleum royalties previously paid directly to the Terengganu State government.

The government of the East Coast State of Terengganu filed a suit against Petronas and the Federal Government on 8 March 2001 over this non-payment of petroleum royalties to the State.²² The Federal Government had told Petronas to stop paying petroleum royalties to the Terengganu State Government. The Federal Government has diverted the oil royalties to a discretionary fund for expenditure in the State under Federal Government and federal ruling coalition control.²³ The Federal Government took RM521,863,062 as special payment from Petronas for the people of Terengganu, which

²⁰ 'Borrowing' is interpreted to include raising money by entering into an agreement whereby the Government has to repay or refund any benefits it enjoys under the agreement (Constitution of Malaysia, Article 111(2)). This constitutional amendment sought to overcome the Court's decision against the Federal Government argument that the agreement between the Kelantan State Government and a corporation for advance royalty payments amounted to borrowing (Shafruddin, 1987: 66-67).

²¹ Kelantan's problems of insufficient financial resources date back to colonial times. A Memorandum of the Ex-Officio Members of the Kelantan State Executive Council in 1956 stated that there were insufficient development grants then for roads, land development and water supply (Records of the Colonial Office).

²² Terengganu Economic Development, Petroleum and Human Resources Committee chairman Mustafa Ali said, 'The action is taken since there is no clear signs (sic) that the rights to the royalty will be given back to the government and people of Terengganu after they were taken away six months ago. The grounds given for the action against Petronas were breach of agreement signed with the State government, discrimination against the Terengganu Government, deprivation of property right (sic) without adequate compensation in breach of Article 13 of the Federal Constitution. That equitable estoppel does not enable the royalty payment to Terengganu, which had been going on for more than 20 years, to be stopped and that Petronas ought not to have complied with illegal direction of the federal government' (*Sarawak Tribune*, 9 March 2001, 'Terengganu govt files suit on oil royalty').

²³ It was reported that the Terengganu State Government will receive RM90 million from the Federal Government if the State runs a budget deficit. The Parliamentary Secretary to the Finance Ministry told Parliament (*Dewan Rakyat*, or Lower House) that the allocation would be made after the Auditor-General's Department verified that the State was experiencing a deficit. The RM90 million was part of an initial allocation of RM400 million approved for 2000/2001 for the special fund established for Terengganu.

was credited into the trustee account of the special fund under Section 9 of the Financial Procedures Act 1957.²⁴

These conflicts between the Federal Government on the one hand and the opposition PAS-held States of Terengganu and Kelantan on the other reflect party rivalries. Greater electoral support for PAS not only reflects resurgent Islamism's growing political influence, but also greater marginalization, socio-economic deprivation, frustration and dissent in the two East Coast States. Both States have had the two highest incidences of poverty in the Peninsula from pre-independence days (according to Colonial Office records) despite Terengganu's thriving economy two centuries ago and more recent oil wealth.

Apparently, development allocations to the states do not seek to reduce inter-state or inter-regional inequalities. The improved allocations for Kedah from the tenth highest during the Third Malaysia Plan period (1976-80) to the sixth highest in the current Eighth Malaysia Plan period (2001-2005) is widely attributed to the Kedah-born Prime Minister's political concerns and provincialism. Conversely, Kelantan's share deteriorated from seventh to tenth over the same period. Meanwhile, the allocation for Selangor rose from sixth highest to third highest. Similarly, the poor state of Terengganu has also been allocated relatively less development funds, while the reverse has been true for the more developed state of Johor (Table 17 and Figure 5).

As stated earlier, the relatively greater funds allocated to the poor states of Sabah and Sarawak – compared to their counterparts in the peninsula – have not been enough to compensate for the states' much large sizes (Table 18 and Figure 6). Sarawak was favoured from the 1980s, after the state ruling coalition was challenged from within, with the contending factions remaining within the national ruling coalition. However, no similar privileges have been accorded to the other poor states of Kelantan, Sabah and Terengganu, where opposition to the national ruling coalition has been stronger and led to opposition control of the state governments. In fact, the relative per capita allocation to Sabah declined over the period reviewed (Table 19 and Figure 7) despite the growing incidence of poverty in the state.

10 Conclusion

The Federation of Malaya had a centralized administration developed towards the end of the British colonial period. The circumstances of the formation of the Federation of Malaysia initially reversed this trend temporarily, with guarantees of greater autonomy for Sabah and Sarawak to induce them to join the new Malaysian federation. However, centralization has advanced over the years since within the context of a federal system.

²⁴ Up to mid-March, such spending included the Program Mesra Rakyat (Befriend the People) (RM7,609,305), the Natural Disaster Fund (RM298,648), management of institutions of higher learning in the State (RM40 million), the Terengganu Education Fund (RM35,595,450), welfare programme (RM500,000), the Special Entrepreneur Development Programme (RM1,908,392) and the Special Rural Development Programme (RM3,106,420) (*Sarawak Tribune*, 30 March 2001, 'Terengganu to receive RM90 million if in deficit').

Table 17
Malaysia: development allocations by state, 1976-2005 (RM million)

	3MP 1976-80	4MP 1981-85	5MP 1986-90	6MP 1991-95	7MP 1996-2000	8MP 2001-05
Johor	1,832 (2)	2,929 (4)	4,529 (1)	3,794 (2)	3,613 (4)	5,937 (4)
Kedah	854 (10)	2,389 (8)	2,659 (9)	2,826 (5)	3,341 (5)	5,180 (6)
Kelantan	1,019 (7)	2,848 (5)	3,621 (7)	2,064 (9)	1,850 (10)	2,905 (10)
Melaka	328 (12)	940 (12)	520 (13)	924 (11)	1,191 (12)	2,465 (11)
N. Sembilan	617 (11)	1,131 (11)	1,302 (10)	1,548 (10a)	1,801 (11)	5,221 (5)
Pahang	2,054 (1)	2,944 (3)	4,118 (3)	2,837 (4)	3,090 (7)	3,821 (9)
Perak	1,792 (3)	2,834 (6)	3,738 (6)	2,563 (7)	3,216 (6)	4,849 (7)
Perlis	156 (13)	304 (13)	560 (12)	505 (12)	953 (13)	1,581 (13)
P.Pinang	894 (9)	1,236 (10)	1,257 (11)	1,548 (10b)	1,968 (9)	4,040 (8)
Sabah	1,452 (5)	3,172 (2)	3,913 (4)	2,307 (8)	4,495 (2)	7,990 (2)
Sarawak	1,657 (4)	2,608 (7)	3,464 (8)	3,209 (3)	4,548 (1)	8,676 (1)
Selangor*	1,413 (6)	3,677 (1)	4,365 (2)	4,295 (1)	4,296 (3)	7,848 (3)
Terengganu	911 (8)	2,023 (9)	3,790 (5)	2,729 (6)	2,553 (8)	2,443 (12)

Note: Development allocation rather than development expenditure is used because information on the later covers a shorter time period.

* Excludes Federal Territory of Kuala Lumpur.

Figures in brackets indicate ranks from highest to lowest.

Sources: Various Malaysia Plan documents.

Table 18
Malaysia: development allocation by area (RM/Sq Km) by State, 1976-2005

	3MP 1976-80	4MP 1981-85	5MP 1986-90	6MP 1991-95	7MP 1996-2000	8MP 2001-05
Johor	96 (5)	154 (9)	239 (8)	200 (8)	190 (8)	313 (7)
Kedah	91 (7)	253 (5)	282 (6)	300 (5)	354 (5)	549 (6)
Kelantan	68 (10)	191 (6)	242 (7)	138 (9)	124 (10)	195 (9)
Melaka	199 (2)	570 (2)	315 (4)	560 (3)	722 (3)	1,493 (3)
N. Sembilan	93 (6)	170 (7)	196 (9)	233 (6)	271 (6)	786 (5)
Pahang	57 (11)	82 (11)	115 (11)	79 (11)	86 (11)	106 (12)
Perak	85 (8)	135 (10)	178 (10)	122 (10)	153 (9)	231 (8)
Perlis	196 (3)	383 (4)	705 (2)	635 (2)	1,199 (2)	1,989 (2)
P. Pinang	867 (1)	1,199 (1)	1,219 (1)	1,501 (1)	1,909 (1)	3,923 (1)
Sabah	20 (12)	43 (12)	53 (12)	31 (12)	61 (12)	109 (11)
Sarawak	13 (13)	21 (13)	28 (13)	26 (13)	37 (13)	70 (13)
Selangor*	178 (4)	462 (3)	549 (3)	550 (4)	540 (4)	987 (4)
Terengganu	70 (9)	156 (8)	293 (5)	211 (7)	197 (7)	189 (10)

* Excludes Federal Territory of Kuala Lumpur.

Figures in brackets indicate ranks from highest to lowest.

Sources: Various Malaysia Plan documents.

Table 19
Malaysia: development allocation per capita by State, 1996-2000 (RM)

	3MP 1976-80	4MP 1981-85	5MP 1986-90	6MP 1991-95	7MP 1996-2000
Johor	1,114 (6)	1,651 (11)	2,276 (6)	1,800 (6)	1,353 (11)
Kedah	761 (10b)	1,983 (6)	2,092 (8)	2,000 (5a)	2,115 (6)
Kelantan	1,207 (5)	2,892 (3)	3,231 (3)	1,700 (7)	1,215 (13)
Melaka	644 (11)	1,889 (8)	1,015 (13)	1,600 (8a)	2,008 (7)
N. Sembilan	1,003 (7)	1,833 (9)	1,979 (10)	2,100 (4)	2,153 (5)
Pahang	2,885 (1)	3,378 (2)	3,574 (2)	2,700 (2a)	2,393 (3)
Perak	930 (9)	1,464 (12)	1,861 (11)	1,200 (10)	1,518 (9)
Perlis	761(10a)	1,911 (7)	3,162 (4)	2,700 (2b)	4,213 (1)
P. Pinang	935 (8)	1,222 (13)	1,137 (12)	1,499 (9)	1,578 (8)
Sabah	1,762 (2)	2,797 (4)	2,712 (5)	1,600 (8b)	1,513 (10)
Sarawak	1,372 (4)	1,851 (10)	2,059 (9)	2,000 (5b)	2,244 (4)
Selangor*	643 (12)	2,444 (5)	2,145 (7)	2,200 (3)	1,347 (12)
Terengganu	1,732 (3)	3,391 (1)	5,346 (1)	3,700 (1)	2,470 (2)

* Excludes Federal Territory of Kuala Lumpur.

Figures in brackets indicate ranks from highest to lowest.

Source: Calculated with data from various Malaysia Plans and Yearbook of Statistics, Malaysia.

Consequently, State Governments have surrendered various functions to the Federal Government for various reasons, including lack of fiscal resources. In response, State Governments – including those led by members of the ruling Barisan Nasional coalition – have requested reassigning certain revenues from the Federal Government to State coffers.²⁵ Such views have been most strongly expressed by representatives of the Borneo States of Sabah and Sarawak as well as Terengganu asking for higher petroleum royalties for their States. As founding members of the Malaysian Federation, the Borneo States have emphasized that they had expected net transfers of public funds in their favour – rather than the converse – from joining the federation. Instead, there is considerable evidence of a significant drain of economic resources away from the two States to national (Kuala Lumpur) and regional centres (Singapore, Hong Kong, Australia, New Zealand). Consequently, many in the Borneo states are of the view that their expectations from joining the Malaysian federation have been betrayed.

Over the decades, Federal Government financing for State Governments has shifted from grants to loans, further reinforcing federal control of the States. While disbursing loans – instead of grants – may require greater accountability on the part of the State Governments, expecting repayment is unrealistic because of the State Governments' limited revenue sources. However, the loans enable the Federal Government to assert

²⁵ During the colonial era, State Governments also requested reassigning certain revenues from the Federal Government to the State Governments, in one case reflecting conflicts between Kedah and some southern States of the peninsula. The conflicts included the imposition of export duties for certain exports to Singapore and the ban on exports of certain tree species.

greater control over the State governments, particularly when they are run by opposition parties or coalitions, or even by more independently minded members of the ruling coalition. Among the Malaysian States not under opposition control, the Sarawak State government probably enjoys most autonomy after the successful entry of UMNO into Sabah (Lim, 1997). Although the Borneo States have more constitutionally guaranteed autonomy than the Peninsular Malaysian States, they probably suffer greater abuse and poverty, partly because their greater autonomy has been abused by self-serving political business elites.

In short, economic resource (especially petroleum, gas and timber) extraction and political competition have reshaped federalism in Malaysia. This has led to the 'politicization' and manipulation of the original terms of Malaysian federalism – especially federal-state relations with regard to finances – to force opposition-held States to capitulate and, in the event of failure to do so, to 'buy votes' for recapture of those States. Such tactics have exacerbated federal-State conflicts and previously encouraged occasional threats to secede in the absence of any federal government indication of willingness to reform more equitably, e.g. through devolution or fiscal reform.

While federal arrangements may well be superior to unions or unitary states in dealing with regional diversity, this paper has suggested that the overwhelming power of the centre (federal government) at the expense of the States has increased over time since Malayan independence in 1957 and the creation of the Malaysian federation in 1963. Undoubtedly, the federal government has successfully used – and abused – its authority and powers to overcome regional political opposition expressed in the capture of State governments. This has enabled the federal government to secure the bulk of petroleum rents extracted from the States, especially Sabah, Sarawak and Terengganu.

The apparently generous fiscal transfers from the centre to these petroleum rich States actually obscure the considerable oil rent transfers to the centre from these States. Some of this seeming generosity has been due to the terms of the Borneo States' entry into the Malaysian federation as well as the earlier hints of secession or demands for greater regional autonomy as options, especially before the 1990s. However, resource transfers from the States to the federal centre are not obvious to most in Sabah and Sarawak, and have probably been obscured by the regional elites' rapacious and ostentatious accumulation and abuse of timber wealth.

Continued access to this dwindling source of natural resource wealth has probably also deterred the States' elites from challenging the centre's claim to most petroleum resource rents. As timber resources are exhausted, these elites will inevitably turn their sights to the oil and gas offshore, but since they have never really claimed these mineral resource rents strongly before, their belated efforts may not enjoy much popular legitimacy and potential for political mobilization, let alone succeed.

Not surprisingly, there continues to be considerable resentment in the two Borneo States of the federal government, expressed in various changing ways over time.²⁶ However, for the time being, the challenges from the Borneo States – which peaked in the 1980s – seem to have receded with the consolidated hegemony of Muslim-Chinese-led

²⁶ Including bloody fights between troops recruited from Sarawak and those deployed from the peninsula, or in the especially strong support for Borneo football teams playing against teams from the peninsula.

consociational elite alliances. While non-Muslim Bumiputeras have become increasingly alienated, most do not see any alternative in the short term, but to make the most of patronage by these alliances. Things seem to have changed in recent years, however, with the ultimate central control over the Sabah government since 1994, and the dependence of the Taib government for central support since the failed 'palace coup' in 1987 known as the Ming Court Hotel affair, and the more recent Muslim-Malay challenge to his supposed 'Melanau clique' control.

With the declining legitimacy of the ruling Barisan Nasional (National Front) coalition among Muslim Malays in the peninsula, especially after the sacking of then Deputy Prime Minister Anwar Ibrahim in September 1998, and the federal government's increased demonization and persecution of the Islamist Parti Islam SeMalaysia (Pan-Malaysian Islamic Party, or PAS) after its electoral gains in the November 1999 federal elections, it has used the federal financial system to put the two PAS-held States under greater fiscal pressure, especially by depriving the State of Terengganu of its petroleum royalty payments. With increased support for the opposition in Kedah and Pahang, it is quite possible that the ruling coalition's drive against the opposition will be reflected in new abuses of Malaysian federalism, especially federal-state finances.

It therefore seems quite likely that the federal system may be further de-legitimized and even undermined in Malaysia, not only by persistent frustrations in the Borneo States, but also by greater opposition from those States in the peninsula disaffected with the current regime. For the time being though, the successful reconfiguration of ethnic politics in the Borneo States – with hegemonic Muslim-Chinese elite alliances and hapless large non-Muslim Bumiputera minorities – has contained the challenge from Sabah and Sarawak.

However, the increasingly ham-fisted 'choking' of the Peninsular Malaysian Malay opposition, especially through discriminatory treatment of the two PAS-held States of Kelantan and Terengganu, could well further undermine the legitimacy of existing federal arrangements, with possibly unpredictable consequences. While this political rivalry is currently primarily understood in terms of the Malay supremacist UMNO versus the Islamicist PAS, its political expression – in terms of the unilateral reordering of previous federal financial arrangements to deprive the opposition State governments of fiscal means – could well unintentionally provoke regional responses which may undermine the very legitimacy and unity of the Malaysian federation.

Political developments since late 1998 continued to erode and undermine the legitimacy of Prime Minister Mahathir's leadership, especially among ethnic Malays in the northern and central States of Peninsular Malaysia, although his acceptability among non-Malays did not change much after his unprecedentedly large electoral victory of 1995 until events from 2000 – the al-Maunah arms heist and its aftermath, the 11 September 2001 terror attacks in the US and the Bush-led anti-terror campaign as well as the Terengganu state government's insistence on legislating onerous ostensibly Islamic hudud punishments in mid-2002. It also appears that the ruling Barisan Nasional coalition has managed to secure acceptance as the only viable option in the Borneo States despite festering non-Muslim Bumiputera frustrations as well as Malay opposition to the incumbent Chief Minister of Sarawak. Meanwhile, the continuing heavy-handed ruling coalition responses to the Islamic Party's electoral success in the November 1999 general elections, including PAS victories in Kelantan and Terengganu, may sustain growing regional tensions within Peninsular Malaysia, even if unintended.

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