

## MALAYSIA

FEDERAL COUNTRY

## BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: UPPER MIDDLE INCOME

LOCAL CURRENCY: MALAYSIAN RINGGIT (MYR)

## POPULATION AND GEOGRAPHY

**Area:** 330 245 km<sup>2</sup>  
**Population:** 31.624 million inhabitants (2017), an increase of 1.4% per year (2010-2015)  
**Density:** 96 inhabitants / km<sup>2</sup>  
**Urban population:** 75.4% of national population (2017)  
**Urban population growth:** 2.2% (2017 vs 2016)  
**Capital city:** Kuala Lumpur (24% of national population)

## ECONOMIC DATA

**GDP:** 931.3 billion (current PPP international dollars), i.e. 29 449 dollars per inhabitant (2017)  
**Real GDP growth:** 5.9% (2017 vs 2016)  
**Unemployment rate:** 3.4% (2017)  
**Foreign direct investment, net inflows (FDI):** 9 512 (BoP, current USD millions, 2017)  
**Gross Fixed Capital Formation (GFCF):** 25% of GDP (2017)  
**HDI:** 0.802 (very high) rank 57 (2017)  
**Poverty rate:** 0.3% (2009)

## MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

Malaysia is a federal country with a parliamentary democracy with division of powers and a constitutional monarchy. The country has a three-tiered system of government – federal, state and local governments. The States of Sabah and Sarawak on East Malaysia became part of the Federation in 1963, and retain since then a higher degree of local autonomy. The head of the Federal State is the *Yang Di-Pertuan*, elected in rotation every five years by and from the hereditary royal families of the members' states gathered in the Conference of Rulers (out of thirteen states of the federation, four do not have hereditary royal rulers and do not participate in the process). The state monarchs are the heads of their respective 9 monarchical states (Johor, Negeri Sembilan, Pahang, Selangor, Perak, Kedah, Terengganu, Kelantan and Perlis), while the remaining states (Penang, Malacca, Sabah and Sarawak) are governed by a State governor appointed by the federal parliament.

The legislative power is divided between the federal and the state legislatures. The federal parliament is bicameral and is made up by the lower chamber (*Dewan Rakyat*) and the upper chamber (*Dewan Negara*). All members of the *Dewan Rakyat* are directly elected to parliament every 5 years, while members of the *Dewan Negara* are partly appointed by the states' governors and partly appointed by the King. Elections are regularly held at the national and state levels, although there have been no elections at the local government level since they were suspended in 1965. Elections to State legislative assemblies take place every 5 years, and with the exception of one State (Sarawak), they are celebrated simultaneously with the national elections.

The Local government system is enshrined in the 1957 Constitution and comprises cities, municipalities and districts (Ninth Schedule of the Constitution). The Constitution also provides regulations for the relations across levels of government. Local governance regulations differ between the Malaysian peninsula and the territory known as East Malaysia, located on the island of Borneo (i.e. the states of Sabah and Sarawak). In the Malaysian peninsula, the 1976 Local Government Act, amended in 2006, sets out the responsibilities and financial provisions for local governments, while in East Malaysia, the main legislation regulating local governments is the 1996 Local Authorities Ordinance. The relationship between the federal and local levels is articulated through the National Council for Local Government. The Ministry of Urban Wellbeing, Housing and Local Government (MHLG), in charge of exercising ministerial oversight of local governments and providing for coordination on policy and legal issues, while since 2004, local authorities in the three federal territories are under the oversight of the Ministry of Federal Territories.

The trend in institutional reforms in Malaysia has been towards the recentralization of tasks traditionally devolved to local governments. In this respect, the federal government is promoting the privatization of certain services with the aim of enhancing efficiency in service provision. In 2017, reforms were also undertaken regarding development planning with the approval of the 2nd National Urbanization Policy 2016 – 2025, which includes the preparation of development plans at the state and local levels to coordinate and implement sustainable urban development actions at the municipality level.

## TERRITORIAL ORGANISATION

| 2018 | MUNICIPAL LEVEL   | INTERMEDIATE LEVEL | REGIONAL OR STATE LEVEL | TOTAL NUMBER OF SNGS |
|------|---|--------------------|-------------------------|----------------------|
|      | 12 city councils<br>38 municipal councils<br>98 district councils |                    | States                  |                      |
|      | Average municipal size: 205 350 inhabitants                       |                    |                         |                      |
|      | 154   |                    | 13                      | 167                  |

**OVERALL DESCRIPTION.** Subnational government in Malaysia comprises 13 states, 3 federal territories and 154 local governments. Out of the 13 states, 11 are located in the Malaysian peninsula and two in East Malaysia, (i.e. the states of Sabah and Sarawak). Local governments include 12 city councils and 38 municipal councils in the urban territories and 98 district councils in the rural territories. In addition, other agencies operate as local development authorities or corporations.

**MUNICIPALITIES.** There are three types of local governments in Malaysia: city councils, municipal councils and district councils. Local government elections have been discontinued since 1965 and local councillors are appointed by the state government according to the criteria stipulated by the state-level ju-

risdiction each local government falls under. City councils govern large urban centres, typically state administrative centres or capitals, with populations above 500,000 and annual revenue greater than RM 100 million. George Town of Penang (2.41 million inhabitants), Ipoh (675 892 inhabitants) are city councils. Municipal councils are in urban areas, possibly state capitals, with populations greater than 100,000 and annual revenues above RM 20 million. Johor Bahru (497 067 inhabitants), Malacca City (484 855 inhabitants), Kota Kinabalu (452 058 inhabitants), and Kuantan (427 515 inhabitants) are the most populous municipal councils. Municipal councils can be upgraded to cities once they satisfy the required criteria. District councils are found in the country's rural areas.

**INTER-MUNICIPAL CO OPERATION.** There is no mention to inter-municipal co-operation at the territorial level, nevertheless, the Malaysian Association of Local Governments is established to foster greater cooperation among its members.

**REGIONAL LEVEL.** There are 13 states in Malaysia based off the historical Malay Kingdoms and three federal territories acknowledged in the 1957 Constitution: Kuala Lumpur, Putrajaya and Labuan. The state of Selangor is the most populated state and with 6.38 million inhabitants, it is home to 19.9% of the country's population. It is followed by Sabah and Johor, with 3.9 and 3.7 million inhabitants respectively. Together, the three states make up 43.5% of Malaysia's population. Moreover, since 2004, federal territories are under direct authority of the Federal Territories ministry of Malaysia, who appoints the head and members of their local authority's bodies (the mayor in the case of Kuala Lumpur and the Labuan and Putrajaya corporations for the other two territories).

## SUBNATIONAL GOVERNMENT RESPONSIBILITIES

The Constitution provides a framework for the allocation of responsibilities across levels of government in Malaysia (Ninth Schedule). Under the Local Government Act 2006 and the Town and Country Planning Act 1976, local governments are responsible for urban planning, sanitation and public health, among others. Local governments are also prescribed some sector specific powers and duties via the Road Transport Act 1987, the Building and Common Property (Maintenance and Management) Act 2007 and the Environmental Quality Act 1974, among others. State governments' exclusive responsibilities include the delivery of services related to slaughterhouses and electricity provision, while councils are exclusively responsible for cemeteries. Other services are jointly managed by the state and local governments, including housing and town planning, environmental and public sanitation, culture, leisure and sports and gas services. Several economic services such as agriculture, forests and fisheries, local economic development, trade and industry, and tourism are shared by the federal and the state governments.

### MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

|                                    | STATE LEVEL   | MUNICIPAL LEVEL  |
|------------------------------------|---|--|
| 1. General public services         |   | Business licencing; Cemeteries   |
| 2. Public order and safety         |   | Maintenance of peace and order   |
| 3. Economic affairs /transports    | Transport; Gas services (shared); Management of slaughterhouses, agriculture and fisheries activities; Local economic development; Tourism; Trade and industry; Electricity provision | Enhancement of local economic activity; Infrastructure development; Gas services |
| 4. Environmental protection        | Forestry; Water supply; Rehabilitation of mining and eroded land  | Waste collection and disposal; Sanitation  |
| 5. Housing and community amenities | Housing, accommodation and improvement trusts; Town and regional planning (except in the state's capital); Land use laws  | Housing and town planning  |
| 6. Health                          | Public health and sanitation (except in the state's capital); Disease prevention  | Public health  |
| 7. Recreation, culture & religion  | Culture and sports; Heritage preservation   | Cultural, sports and religious facilities  |
| 8. Education                       |   |  |
| 9. Social protection               |   |  |

## SUBNATIONAL, STATE AND LOCAL GOVERNMENT FINANCE

|   |          |   |   |
|---|----------|---|---|
| Scope of fiscal data : state governments and local governments. | SNA 2008 | Availability of fiscal data:<br><b>Medium</b> | Quality/reliability of fiscal data :<br><b>Medium</b> |
|---|----------|---|---|

**GENERAL INTRODUCTION.** The general Financial Provisions of local government in the Peninsula of Malaysia are enacted by Part V Section 39 of Local Government Act 1976. The Sabah local financing is under Local Governance Ordinance 1961. The Sarawak local government finance is regulated under Local Authority Ordinance 1948, amended in 1996. Section 54 gives authority to state governments to determine the form and content of local government annual financial accounting. Local governments consolidated financial accounting is available to the public, but not included in the annual Economic Report of the Treasury. Local governments are autonomous in terms of planning and managing local budgets, and their accounts are subject to annual audits conducted by the auditor general. They have the authority to collect taxes and grant permits and licenses.

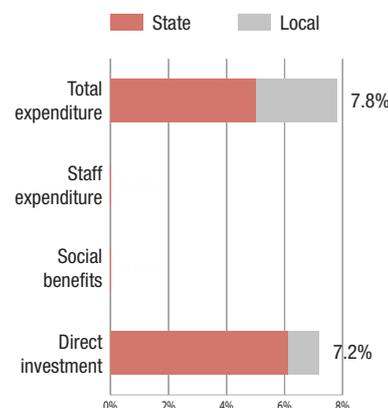
A reform of the Intergovernmental Agreement on Federal Financial Relations (IGAFFR) took place in 2008, which led to the simplification and greater flexibility of the system of intergovernmental grants. In 2015, a public consultation was held in the country on tax reform, considering the revenue raising capacity of each level of government in the federal system, yet the expected tax reform was abandoned.

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## SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

| 2016                             | DOLLARS PPP / INH. |       |       | % GDP       |       |       | % SUBNATIONAL, STATE AND LOCAL GOVERNMENT EXPENDITURE |       |       | % GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY) |
|----------------------------------|--------------------|-------|-------|-------------|-------|-------|---|-------|-------|--|
|                                  | SNG                | State | Local | SNG         | State | Local | SNG   | State | Local |  |
| <b>Total expenditure</b>         | <b>670</b>         | 429   | 241   | <b>2.4%</b> | 1.5%  | 0.9%  | <b>100%</b>   | 100%  | 100%  | 7.8%   |
| <b>Inc. current expenditure</b>  | <b>438</b>         | 233   | 205   | <b>1.6%</b> | 0.8%  | 0.7%  | <b>65.4%</b>  | 54.4% | 85.1% |  |
| Staff expenditure                |                    |       |       |             |       |       |   |       |       |  |
| Intermediate consumption         |                    |       |       |             |       |       |   |       |       |  |
| Social expenditure               |                    |       |       |             |       |       |   |       |       |  |
| Subsidies and current transfers  |                    |       |       |             |       |       |   |       |       |  |
| Financial charges                |                    |       |       |             |       |       |   |       |       |  |
| Others                           |                    |       |       |             |       |       |   |       |       |  |
| <b>Incl. capital expenditure</b> | <b>231</b>         | 195   | 36    | <b>0.8%</b> | 0.7%  | 0.1%  | <b>34.6%</b>  | 45.6% | 14.9% | 7.2%   |
| Capital transfers                |                    |       |       |             |       |       |   |       |       |  |
| Direct investment (or GFCF)      | <b>231</b>         | 195   | 36    | <b>0.8%</b> | 0.7%  | 0.1%  | <b>34.6%</b>  | 45.6% | 14.9% |  |

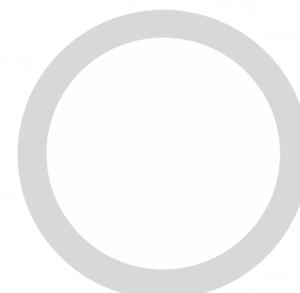
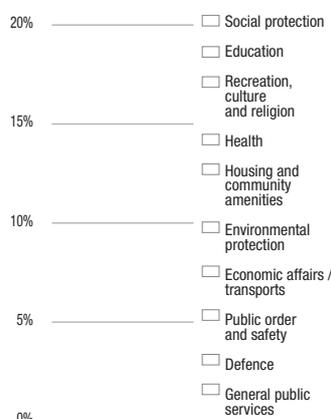


**EXPENDITURE.** Expenditure remains highly centralized in Malaysia. In FY 2016/17, subnational governments spent 670 dollars PPP per capita, which corresponds to 7.8% of the total public expenditure. Local governments' expenditure corresponded to 2.8% of general public expenditure, while states' expenditure corresponds to 5%. According to CLGF, local governments' expenditure has been gradually increasing since 2014. Local governments' expenditures are mainly directed to covering for operating expenses, which represent 85% of expenditures incurred at the local level versus 15% which is devoted to development expenditure. At the State level, the allocation of expenditure between current (54.4%) and capital expenditure (45.6) is more balanced. At both levels, it is not possible to further break down the categorization of development expenses and thus the exact share devoted to capital transfers and capital expenditures cannot be specified.

**DIRECT INVESTMENT.** In FY 2016, state-level gross development expenditure increased by 25.6% with respect to 2015. In particular, expenditures from the Development Fund and the Water Supply fund respectively increased by 25.4% and 38.3% with respect to the previous year. According to the Malaysia Treasury, for FY 2017, development expenditures are expected to rise at the state level by 46.5% with respect to 2016, going from approximately 8.7 to 12.7 billion ringgit (which approximately represents an increase from 6.1 to 8.9 billion dollars PPP). The main projects to be developed regard public housing, agricultural and rural development, energy and public amenities. There is no available information concerning local governments' projects.

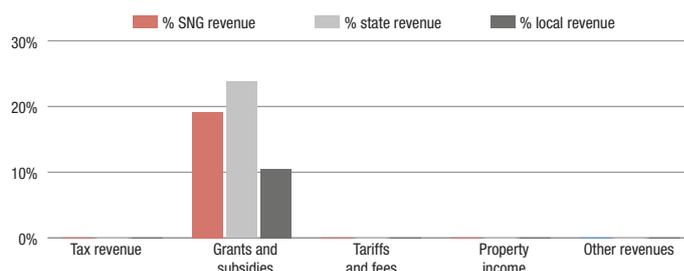
## SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG (OR OTHER CLASSIFICATION OR ESTIMATION)

|                                     | % GDP |       |       | % SUBNATIONAL, STATE AND LOCAL GOVERNMENT |       |       | SNG EXPENDITURE AS A % GDP | % OF TOTAL SNG EXPENDITURE |
|-------------------------------------|-------|-------|-------|---|-------|-------|----------------------------|----------------------------|
|                                     | SNG   | State | Local | SNG                                       | State | Local |                            |                            |
| <b>Total expenditure</b>            |       |       |       |   |       |       |                            |                            |
| 1. General public services          |       |       |       |   |       |       |                            |                            |
| 2. Defence                          |       |       |       |   |       |       |                            |                            |
| 3. Security and public order        |       |       |       |   |       |       |                            |                            |
| 4. Economic affairs / transports    |       |       |       |   |       |       |                            |                            |
| 5. Environmental protection         |       |       |       |   |       |       |                            |                            |
| 6. Housing and community amenities  |       |       |       |   |       |       |                            |                            |
| 7. Health                           |       |       |       |   |       |       |                            |                            |
| 8. Recreation, culture and religion |       |       |       |   |       |       |                            |                            |
| 9. Education                        |       |       |       |   |       |       |                            |                            |
| 10. Social protection               |       |       |       |   |       |       |                            |                            |



## SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

| 2016                 | % GDP       |       |       | % GENERAL GOVERNMENT REVENUE (SAME REVENUE CATEGORY) |       |       | % SUBNATIONAL, STATE AND LOCAL GOVERNMENT REVENUE |  |  |  |  |
|----------------------|-------------|-------|-------|--|-------|-------|---|--|--|--|--|
|                      | SNG         | State | Local | SNG  | State | Local |   |  |  |  |  |
| <b>Total revenue</b> | <b>2.4%</b> | 1.6%  | 0.9%  | <b>13.4%</b>   | 8.8%  | 4.6%  |   |  |  |  |  |
| Tax revenue          |             |       |       |  |       |       |   |  |  |  |  |
| Grants and subsidies | <b>0.5%</b> | 0.5%  | 0.1%  |  |       |       |   |  |  |  |  |
| Tariffs and fees     |             |       |       |  |       |       |   |  |  |  |  |
| Property income      |             |       |       |  |       |       |   |  |  |  |  |
| Other revenues       |             |       |       |  |       |       |   |  |  |  |  |



**OVERALL DESCRIPTION.** In FY 2016/17, subnational governments raised approximately 676 dollars PPP per capita, of which state and local governments respectively accounted for 65% and 35%. This amount corresponds to 2.5% of the country's GDP, which is relatively low compared to both federal and unitary countries in the region (only Cambodia reports lower figures).

States' revenues amounted to 19.63 billion ringgit (approximately 441 dollars PPP per capita), of which 76% correspond to "state-generated revenues" and 24% come from "federal grants" – as per the Treasury report. According to the Treasury, non-tax revenue coming from land premiums and royalties from petroleum and investment correspond to 53.5% of own generated revenue at the state level. Taxes (and mainly land-based direct taxes) make up the rest of states own revenues.

Local revenues may come from three sources: locally-raised revenue, transfers and loans. In FY 2016, local government revenues amounted to 10.42 billion ringgits (approximately 235 dollars PPP per capita), of which 10.5% corresponded to transfers made to local governments and the remaining 89.5% was locally-raised revenue. Locally-raised revenue includes direct taxes and non-tax revenue, such as licence payments, trade and investment profits, fines and user fees. Details of local revenues are available only at an aggregate level, under the category "own source revenues", which does not allow to discern between tax and tariffs and fees as the sources of the revenue. The total amount of locally-raised revenue corresponds to approximately 209 dollars PPP per capita. Transfers, which may be from the tax-sharing system, earmarked for specific purposes or general purpose, come from the State or Federal levels. However, in practice States do not have the capacity to financially support local governments, which rely on federal funding instead.

**TAX REVENUE.** Tax bases are set by central authorities, and sub-national governments have limited authority for setting rates. The larger share of taxes is levied under federal law; thereby, the federal government concentrates most of the tax receipts. The introduction of the Goods and Services Tax (GST) in 2015 at a rate of 6%, was an important step forward in developing consumption-based tax arrangement to enhance the efficiency of the tax system and widen the tax base. The GST was replaced in 2018 with the reintroduction of the Sales and Services Tax, which sets the tax rate for sales at 10% and 6% for services, and that was firstly introduced in the 1970s. State taxes include export duties on timber (in the State of Sabah), excise duties (in the State of Sarawak), a land tax, taxes on mines, an entertainment tax, an excise duty on liquor, among other smaller sources of revenue. According to the Treasury report, state-generated tax revenue, corresponds to 47.5% of the state own revenue.

There have been several policy changes to the structure and treatment to further enhance the efficiency of the tax system at the local level. According to CLGF, municipal tax revenue includes self-assessed income tax as the main source of revenue for local authorities. It contributes 60–70% of the total revenue of the 13 city councils. According to the Local Government Act 1976 the self-assess income tax is a property tax collected on the basis of the annual assessment of rental value or the value-added, and limited to 35% of annual value or 5% of value-added of a holding. Local government financial capacities are weakened by the high rate of uncollected revenue. Formally, there is a legal provision for local governments to collect drainage and sewerage rates. However, both these services are currently being provided for by private companies.

**GRANTS AND SUBSIDIES.** In Malaysia, the system of intergovernmental transfers is enshrined in the Constitution.

General and specific transfers to municipalities are made by state and federal governments to local authorities. For federal grants, the MHLG is responsible for the annual grants' administration. According to the MHLG, local governments may receive five types of financial grants (1) Annual Equalisation Grant; (2) Launching Grant (3) Development Project Grant (4) Road Maintenance Grant; (5) Balancing Grant. Of the five, the most important are the Annual Equalisation Grant and the Development Project Grant, which is given by the Federal government to local governments through the state government in accordance with the States Grants (maintenance of Local Authorities) Act of 1981. Sabah and Sarawak states do not receive this grant since they fall under their own ordinance, respectively Local Government Ordinance 1961 and Local Authorities Ordinance 1996.

State government account for 89% of the total grants to subnational governments. There are three main categories of state grants from federal government: tax-sharing grants, general purpose grants, and specific purpose grants. Tax sharing grants are defined under the Article 110 of the Federal Constitution which established that 10% of revenues collected nationally from exports duties on tin, on iron and mineral ores should be allocated to the states where the mineral exploitations are carried. General purpose grants provide general-purpose funds to state governments; they are six categories, all formula-based according to population size and GDP per capita. Some have Constitutional provisions i.e. Capitation grant (article 109), Special grants (article 112c), the State Reserve Fund grants, the Contingencies fund grant (article 103). The Special grants operate as an equalization fund to the states of Sabah and Sarawak on the one hand as well as the states of Selangor and Kedah. Specific purpose grants support specific capital expenditures, as provided by the Constitution. The Economic Development Grants are the main component, intended to compensate for state inequalities and promote the development of less developed states. On average, they represent 7.8% of federal grants.

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**OTHER REVENUES.** State governments include royalties from petroleum, gas and forestry, sales of goods and services, dividends and interests, fees from licenses and services, property revenues. Moreover, Under the Town and Country Planning Act 1976, local governments are allowed to collect fees and charges for services rendered. Other local revenues include licence payments, trade and investment profits. Yet the treasury report from 2013 and 2016 make no mentions to those sources of revenues.

#### ■ SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

| 2016                          | DOLLARS PPP/INH. |       |       | % GDP       |       |       | % GENERAL GOVERNMENT DEBT |       |       | % SNG DEBT  |       |       |
|-------------------------------|------------------|-------|-------|-------------|-------|-------|---------------------------|-------|-------|-------------|-------|-------|
|                               | SNG              | State | Local | SNG         | State | Local | SNG                       | State | Local | SNG         | State | Local |
| <b>Total outstanding debt</b> | <b>124</b>       | 123   | 1     | <b>0.4%</b> | 0.4%  | 0     | <b>0.6%</b>               | 0.6%  | 0     | <b>100%</b> | 98.8% | 0.2%  |
| Financial debt*               | 124              | 123   | 1     | 0.4%        | 0.4%  | 0     | 0.6%                      | 0.6%  | 0     | 100%        | 98.8% | 0.2%  |

\* Currency and deposits, loans and bonds

**FISCAL RULES.** Fiscal guidance is provided by the Medium-Term Fiscal Framework 2018 – 2020, which outlines the three-year fiscal projection and the policy initiatives required to achieve the fiscal objectives in light of the medium-term macroeconomic forecasts. The framework sets an optimal spending level for the period, taking into account the government's revenue-generating capacity and commitments, with the objective of gradually reducing the deficit level towards a near-balanced budget by 2020. Borrowing is effectively regulated by the 1959 Loan Act, the 1983 Government Funding Act, the 1963 External Loans Act and the 1946 Treasury Bills Act. In particular, the 1959 Loan Act and the 1983 Government Funding Act set the debt ceiling at 55% of GDP, which is defined as including the outstanding Malaysian Government Securities, the Malaysian Government Investment Issues and the Malaysian Islamic Treasury Bills.

**DEBT.** All subnational government are allowed to borrow for a period not exceeding five years. FY 2016, subnational debt corresponded to 0.4% of the country's GDP and 0.6% of the general governments outstanding debt. According to Article 111 of the Constitution, state governments, except Sabah and Sarawak, are only allowed to borrow from the Federal Government, with its prior approval. Sabah and Sarawak may borrow, under similar conditions, with the approval of the Central bank. State government loans account for 99% of SNG debt. According to the 2006 Local Government Act, local governments may, with the approval and under the conditions of the State Authority, contract loans. Within the authorities of local governments, such loans may be used for the acquisition of land, the construction of public buildings, for carrying out permanent works, for providing or maintaining plant equipment and vehicles and to pay off existing loans. Nevertheless, local governments' debt remains low, corresponding to 0.2% of total subnational debt in FY 2016.



Lead responsible: UCLG  
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[www.sng-wofi.org](http://www.sng-wofi.org)

**Socio-economic indicators:** World Bank // UNDP // UN Desa // ILO.

**Fiscal data:** Ministry of Finance Malaysia (2017). 2016 Budget.

**Other sources of information:** CLGF (2018) Country profile Malaysia // UCLG ASPAC Cities Alliance (2018) City enabling rating: assessment of the countries in Asia and the Pacific // Faezah, N., Aini, Rahida., Adalabu, S. (2017), Transparency in Malaysia Local Government Administration. The overview of Internally Generated Revenue (IGR) // Mohamed, S., (2015), Sustainable Development Agenda: The Role of Local Government in Malaysia // Osman, M., Bachok, S., Bakri, N.M., Harun, N.Z. (2014), Government Delivery System: Effectiveness of Local Authorities in Perak, Malaysia // Nooi, P.S. (2008), Decentralisation or Recentralisation? Trends in Local Government in Malaysia.