

FEDERAL STATE RELATIONS: SOME THOUGHTS FOR THE FUTURE



EMERITUS PROF. DATUK DR SHAD SALEEM FARUQI

TUN HUSSEIN ONN CHAIR, ISIS MALAYSIA

JULY 2020

A. CONCEPT OF FEDERALISM

There is no prototype federation and the 25 or so federal systems operating in countries like the USA, India, Brazil, Germany and Mexico exist in diverse forms. But some generalisations about the essential attributes of federal governments may be made.

1. A federation is an association of States

2. There is duality of government

Note the distinction between de-centralisation (which can exist in unitary states) and non-centralisation (which is a feature of federal states).

3. The states/provinces/cantons exist as semi-autonomous units

4. There is division of legislative, executive, judicial and financial powers between the Centre and the States. This division is constitutionally demarcated and guaranteed.

- 5. There is a supreme Constitution with federal guarantees of state/provincial/regional rights.**
- 6. “Cooperative federalism” is permitted: Articles 76-76A.**
- 7. There must be provision for judicial review if the federal or state governments trespass on each other’s powers (Appendix A).**

8. The States must have some control over constitutional amendments.

9. There must be equality among the constituent States of the Federation.

With many significant exceptions, some of the above features find a place in our Federal Constitution. However, a wide gap exists between theory and reality.

B. MALAYSIAN MODEL: A FEDERATION WITH A HEAVY CENTRAL BIAS

Except in relation to Sabah and Sarawak, the Constitution creates a very powerful central government that can lead, dominate and control the States in many ways.

B1. UNEQUAL DIVISION OF LEGISLATIVE POWER

The Legislative powers of the federal Parliament and the State Assemblies are prescribed in five Legislative Lists in the Ninth Schedule.

(i) The **Federal List** contains 122 entries and covers matters like external affairs, defence, education, internal security, citizenship, finance, trade, commerce, shipping, navigation, fisheries on the high seas and most of the lucrative taxes.

(ii) The **State List** contains 37 entries and covers such matters as Muslim law, land tenure, Malay reserves, agriculture, forestry, local government, turtle and riverine fishing.

(iii) The **Concurrent List** has 10 items, among them welfare, scholarships and drainage. In case there are both federal and state laws on topics in this List, federal law will prevail: Article 75.

(iv) The **Supplementary State List for Sabah and Sarawak** confers additional powers on these States on seven matters including native law and custom, ports and harbours in Sabah and the Sabah Railway.

(v) The **Supplementary Concurrent List for Sabah and Sarawak** extends the power of these States to 9 matters including shipping under 15 tons, charities and theatres.

The overall score is:

Federal jurisdiction: $122+10=132$ items.

State jurisdiction: $37+10=47$ topics.

Sabah and Sarawak have additional $7+9=16$ topics making a total of $47+16=63$ topics.

Residual matters: Any topic not covered in the Ninth Schedule is deemed to reside in the hands of the States (Article 77). Perhaps underground water may be one such topic.

B2. NO FISCAL FEDERALISM

Money is at the heart of government. In the financial field, the central government's preponderance of power is very evident. The Constitution has been so devised that almost all the important direct and indirect taxes belong to the Centre.

FEDERAL REVENUES

Most of the lucrative sources of income are assigned to the federal exchequer: Schedule 9 List I and List III indicate a massive amount of fiscal centralization.

Among the sources assigned to the federal government are:

- income tax, sales tax, corporate tax, stamp duty
- customs and excise duties from import and export
- licenses for motor vehicles
- banking, cheques, bills of exchange, money lending, pawnbrokers, control of credit, foreign exchange
- capital issues, stock and commodity exchanges

- trade, commerce and industry, production, supply and distribution of goods
- subject to state power over licensing, development of mineral resources, mines, mining, minerals, mineral ores; oils and oilfields; purchase, sale, import and export of minerals and mineral ores; petroleum products
- factories, industries
- shipping, navigation, ports and harbours
- maritime and estuarine fishing and fisheries
- railways, airways

- post and telecommunication
- water supplies, rivers and canals (except those wholly within a state), production and supply of water power
- electricity, gas, power and energy
- private enterprises, unincorporated societies
- insurance
- patents, designs, trademarks etc.
- betting and lotteries
- passports, visas and other immigration charges
- pilgrimages to places outside Malaysia
- imports into and export from the Federation

- Education
- Medicine and health including hospitals
- Charities
- professional occupations
- newspapers
- Tourism (incorporated into the Federal List by constitutional amendment in 1994).

What is also noteworthy is that the federal government makes indirect earnings from many items in the State List. For example, even though land is a state matter, Property Gains Tax and Stamp Duty on land transfers go to the Lembaga Hasil Dalam Negeri. If a person rents out his land or property, the rent received is “income” chargeable to the federal income tax!

STATE REVENUES

The Constitution in Schedule 9 Lists II and the Concurrent List grants law-making power to Peninsular States on 27 topics and to Sabah and Sarawak on 17 additional topics. Revenues from these topics will belong to the States. Some of these topics are also outlined in the Tenth Schedule, Part III as “Sources of Revenue Assigned to the States”. The most important sources are:

- Revenues from lands, mines and forests; toddy shops; licences other than those connected with water supplies and services; registration of businesses; entertainment duty.
- Fees in courts other than federal courts; fees in respect of services rendered by State Governments
- Revenue of town boards and local councils

- Raw water
- Rents on state property and receipt from sale of state property
- Fines, forfeiture
- Zakat, fitrah and baitulmal and similar Islamic revenue

- 10% export duty on tin produced in the state:
Article 110(3)
- Export duty on mineral ores, metal and mineral oils
as determined by Parliament (Article 110(3A)).

Sabah and Sarawak have additional sources of revenue: Schedule 10, Part V.

However, it is estimated that all in all, the yearly total state revenue of the 13 States comes to about 10% of federal revenues!

Federal grants: Even though there is a heavy preponderance of financial power in the hands of the federal government, the Constitution guarantees certain federal grants to the States. Among them are the following:

- **Capitation grants:** Articles 109, 112C and 10th Schedule. This grant is based on the state's population: RM72 per person for the first 100,000; RM10.20 for the next 500,000; RM 10.80 for the next 500,000; RM11.40 for the remainder.
- **State road grant** paid per mile of a state road.

In addition, there are other possible discretionary grants to the States from the federal government:

- State Reserve Fund (Article 109(6)).
- Contingency grants: Article 109(5)
- Loans (Art 111).

In the 2020 Budget these Grants and Transfers amounted to 2.6% of the Federal Budget.

In the 2019 Budget, federal allocation to the States amounted to 2.4% of the Federal Budget (Source: Budget 2019, Ministry of Finance Malaysia. Budget 2020, Ministry of Finance Malaysia).

It is obvious, therefore, that the Constitution does not provide for genuine “fiscal federalism”. The federal government has a preponderance of fiscal power.

B3. FEDERAL POWER OVER CONSTITUTIONAL AMENDMENTS

The power of amending the Constitution belongs largely to the federal parliament subject to procedures in Articles 2(b), 159 and 161E. Except in relation to two matters – (i) territorial changes to the boundaries of the States under Article 2(b) and (ii) the rights of Sabah and Sarawak under Article 161E - the States have absolutely no power to prevent a constitutional amendment from going through.

- In the Upper House of the federal parliament (the Dewan Negara) there are two Senators from each State: Article 45(1)(a). Theoretically speaking, they can block any constitutional amendment that affects adversely the rights or interests of the States. Regrettably this power has become extinguished due to constitutional amendments.

- The proportion of elected Senators to appointed Senators was 22:16 in 1959; 26:16 in 1963 but now stands at 26:44. Appointed Senators easily outnumber elected Senators. If three State Senators join hands with the 44 appointed Senators, the two-thirds majority to amend the Constitution is reached.
- Tourism, for example, a rich source of revenue, has been unfairly transferred from the State List to the Federal List.

OTHER MODES FOR FEDERAL DOMINANCE

- B4. Emergency provisions can be utilised by the federal government to suspend state rights : Article 150(2B), (5) & (6). Emergency proclamations in Sarawak (1966), Kelantan (1976)**
- B5. Federal power to sign international treaties can undermine state rights: Article 76(1). States must be “consulted” but State consent is not needed: Art 76(2).**
- B6. Federal power to enact uniform laws even on such crucial state matters as land law and local government : Article 76(1)(b) & 76(4).**

B7. Federal power to intervene if there is non-compliance with the Federal Constitution by a State: Article 71(3).

B8. There are several federal supervisory or policy-making bodies whose advice is binding on the States: Among them are:

- THE NATIONAL LAND COUNCIL: ART 91
- NATIONAL COUNCIL FOR LOCAL GOVERNMENT: ART . 95A

- The National Finance Council: Art. 108
- The Auditor General: Art 105
- The Election Commission: Art 114

B9. The federal government has control over development plans (Article 92(1)) and over inquiries, surveys and statistics (Art 93).

B10. Public servants: Though the States are free to choose their own civil servants, many important posts in the States - the "designated posts" - are filled by federal officers on secondment to the States. Cf: Dispute over appointment of State Secretary in Selangor

B11. Article 75: "If any State law is inconsistent with a federal law, the federal law shall prevail and the State law shall, to the extent of the inconsistency, be void." But note the intricacies created by Art. 121(1A)

B12. Informal, defacto federalisation of some services like public complaints.

B13. Federal laws like Local Government Act, Official Secrets Act and the Printing Presses and Publications Act undermine state power. For example, local government elections, desired by some states, have been abolished.

B14. The federal government has power to acquire state land for federal purposes: Articles 83(1), 85.

C. SPECIAL POSITION OF SABAH & SARAWAK

Some of what was said above, does not apply to Sabah and Sarawak. Due to their geographical size, ethnic and religious uniqueness and the problems of under-development, Sabah and Sarawak entered the federation on many special terms not available to the 11 peninsula states.

This special position was justified for many reasons:

- Sabah and Sarawak's cultural and religious distinctiveness from Peninsular Malaysia.
- The huge territories and massive resources they contribute to the federation. Their combined area is 198,069 sq km, exceeding Peninsular Malaysia's 131,681 sq km. The coastline of the two States is 2,607 km compared to the peninsula's 2,068 km.
- Problems of poverty and underdevelopment in these states.
- The 1963 pact between the Federation of Malaya, United Kingdom, North Borneo, Sarawak and Singapore gives an international law basis to the guarantees for Sabah and Sarawak.

- The 1963 pact between the Federation of Malaya, the UK, North Borneo, Sarawak and Singapore was drawn up after a lengthy process of bargaining and negotiations. The delegates of these states made very clear to the Inter-Governmental Committee (IGC) headed by Lord Lansdowne, with then deputy prime minister Tun Abdul Razak as the deputy chairman, that special treatment was a pre-condition for constituting Malaysia.

- The sanctity of the IGC Report and Malaysia Agreement has been reiterated by our courts in several cases: *Sabah v Sugumar Balakrishnan* (2002), *Datuk Tufail v Dato Ting* (2009), and *Robert Linggi v Government* (2011).

C1. The Legislative Lists:

The Supplementary State List confers additional powers on these States in seven matters including native law and custom, ports and harbours and, in Sabah, the Sabah Railway.

The Supplementary Concurrent List for Sabah and Sarawak extends the legislative competence of these states to cover nine matters including shipping under fifteen tons, charities and theatres.

Federal power to have uniformity of laws:

Parliament may legislate on state matters for the purpose of promoting uniformity of laws of two or more states: Article 76(1)(b). This power of the federal Parliament is not applicable to Sabah and Sarawak: Article 95D.

Land, agriculture, forestry and local government are exclusive to S & S.

C2. AMENDING THE CONSTITUTION

The power of amending the Constitution which belongs to the federal parliament is not as extensive in relation to Sabah and Sarawak as it is in relation to the West Malaysian States: Article 161E(2).

(i) The consent of the Governors of Sabah and Sarawak is required to a constitutional amendment under Article 161E affecting the special position of these states: *Robert Linggi v Govt of Malaysia (2011)*.

(ii) Note also Article 2(b) – alteration of the boundaries of the States as in the federalization of Labuan. The consent of the State Assembly plus the Conference of Rulers is needed.

C3. JUDICIAL POWERS

Native Courts and shariah courts: In Sabah and Sarawak, besides Shariah Courts there is a system of native law and native courts.

High Court for Sabah & Sarawak: The federal High Court has two wings – one in Malaya and the other in the States of Sabah and Sarawak.

Courts of Judicature Act 1964: Appointment of the Chief Judge of the Sabah and Sarawak High Court requires consultation with the Chief Minister of these States: Art. 122B(3).

Appointment of JCs: These should be appointed by the YDPN on the advice of the CJ of S & S. Accordingly, Act 122AB (as amended) was declared null and void: *Robert Linggi v Govt.* (2011). However, the *Robert Linggi* decision was overturned on appeal.

Lawyers for cases originating in S&S: If a case originates in Sabah or Sarawak, only S&S lawyers or lawyers specially admitted, may appear in court.

C4. REPRESENTATION IN PARLIAMENT

Dewan Rakyat: Ideally, a State's representation in the elected House should be proportionate to the State's population. Sabah has 25 MPs; Sarawak 31. Together, Sabah and Sarawak have 56/222 or 25.2% of the MPs in the Dewan Rakyat. This is disproportionately large based on their population. However it must be noted that it is lesser than the 33% envisaged for Sabah, Sarawak and Singapore in 1963 in order to give these States protection against amendments requiring 2/3 majority.

C5. EMERGENCY POWERS

Emergency under Article 150 can allow the Federal Government to usurp the powers of the States. See the case of *Stephen Kalong Ningkan v Govt of Malaysia (1966)*. However, even during an emergency under Article 150, the native law or customs of Sabah and Sarawak cannot be extinguished by emergency law: Article 150(6A).

C6. DEVELOPMENT PLANS

In relation to national development plans, Article 92(1) empowers the Yang di-Pertuan Agong to proclaim an area of a State as a "development area". Thereupon Parliament has power to give effect to the development plan notwithstanding State powers on the matter.

Under Article 95E(3) Sabah and Sarawak are excluded from national plans for land utilization, local government and development unless the consent of the Yang di-Pertua Negeri is obtained.

Policies of National Land Council & National Council for Local Government are not binding on S&S: Article 95 E(2).

C7. FISCAL FEDERALISM

“Money represents power”. The Federal Government's stranglehold over most of the lucrative sources of revenue is not as strong in relation to Sabah and Sarawak as it is in relation to other states. In several areas Sabah and Sarawak enjoy fiscal privileges that are not available to the Peninsular States:

Loans: In *Government of Malaysia v Government of the State of Kelantan* (1968) IMLJ 129 it was held that a State cannot raise a loan except from the federal government or a federally approved institution. However, under article 112B, Sabah and Sarawak are allowed to raise loans for their purposes with the consent of Bank Negara.

Special sources of revenue: These States are allocated special revenues to meet their needs above and beyond what other States receive: Article 112 C(1)(b). Sabah and Sarawak are assigned eight special sources of revenue.

Sabah and Sarawak are also entitled to earnings (taxes, fees and dues) from ports and harbours and state sales tax: Article 112C & Schedule 10, Pt. V. There is pending litigation between Petronas and Sarawak over Sales Tax on petroleum products.

Special grants: These States enjoy some special grants: Articles 112C(a) and 112D.

Audits: There are special rules about state audits (Article 112A).

C8. ARTICLE 153 PROTECTION

Under Article 153, the natives of Sabah and Sarawak enjoy a special position similar to that of the Malays of Peninsular Malaysia. Article 153 is, however silent about whether the special protection has full or limited territorial reach.

C9. IMMIGRATION

The mobility of non-residents to Sabah and Sarawak is restricted: Art. 161E(4) and Part VII Immigration Act, Act 155.

There is restriction on non-residents practicing before the courts of Sabah and Sarawak: Article 161B

C10. ENGLISH & NATIVE LANGUAGES

Sabah and Sarawak enjoy special protection in relation to the use of English and native languages (Article 161).

C11. MALAY RESERVES

There is non-application of Malay Reserves to these States (Article 161A(5))

D. DEVELOPMENTS IN MALAYSIAN FEDERALISM

Sixty-three years after *Merdeka* and fifty-seven years after *Malaysia Day*, not all is well with the relationship of the States with the centre. This is especially so in relation to Sabah and Sarawak. In many areas their autonomy has suffered retreat due to constitutional developments. A case in which Sabah's grievances were unsuccessfully sought to be articulated is *Fung Fong Chen @Bernard v The Government of Malaysia and Anor* (2012)

Sabah and Sarawak's Main Grievances

- Sabah's 20 and Sarawak's 18 Points have not been fully honoured. For example, guarantees for “no State religion”, linguistic diversity and immigration have weakened. It must be noted however that on language, it is the Sabah and Sarawak Assemblies and on religion, the Sabah Assembly, and not the federal Parliament that amended the State Constitutions.
- The federally appointed Governors have not always protected the special interests of S & S.

- Repeal of Article 161C. This Article required that if aid is given for Islamic institutions, an equivalent amount shall be given for social welfare.
- Repeal of Article 161D. This Article provided an exception to Article 11(4) which prohibits preaching of any religion to Muslims.

- Removal of MBs – Kalong Ningkan and Pairin
- Labuan's federalisation.
- Allegation that Article 153 is not vigorously enforced for the natives of S & S.
- The 1965 amendment to Article 1(2) is criticised because it diminished the status of S & S from being a special category of States to being merely two of thirteen States.

- The constitutional definition of “natives” creates problems. For Sarawak Article 161A(7) requires that a native must belong to one of 28 races or be of mixed blood derived exclusively from these races. In Sabah, 161A(6) suffers from gender bias against women.

- Native law and Syariah law are often in conflict. In some cases Muslim litigants wish native law to apply. Under existing provisions, native law is displaced. Sabahans/Sarawakians point to the position in Negeri Sembilan where in some areas adat applies over the religious rule.
- It is submitted by some that the special immunity to Syariah Courts from civil court jurisdiction in Article 121(1A) should be extended to native courts as well.

- Petroleum . Oil and oilfields are in federal hands. Only import and excise duty on petroleum products are in state jurisdiction. Royalty rights of S & S are derived from Petroleum Development Act, Petroleum Mining Act and the Assignment Deed between the states and Petronas. There is a demand to increase royalty from 5% to 20%.
- Sabah and Sarawak's power to impose sales tax on petroleum sales has caused controversy. Recently, Petronas Chief Executive Wan Zulkiflee Wan Ariffin resigned over the federal government's plan to pay \$470 million in Sales Tax to Sarawak.

- Federalisation of critical state matters such as water and tourism.
- Declaration of emergency in 1966 to topple Kalong Ningkan.
- Strength in Parliament

1963: 35%

Now: 25%

- Borneonisation is proceeding too slowly
- Illegal immigrants have altered the demography of Sabah.
- Ketuanan Melayu concept arouses discomfort.
- The Kalimah Allah issue – Titular Roman Catholic Archbishop of KL v Menteri Dalam Negeri (2014).

- Empaneling of the Federal Court. There was a pre-1963 understanding that when the Federal Court sits to hear a case involving Sabah or Sarawak, at least one judge “with Borneo experience” must be empaneled. This convention was recently refused any legal basis by the Federal Court.

Grievances of the Peninsular States

- Lack of fiscal federalism. This manifests itself in two ways: vertically and horizontally.
- Unequal treatment of states on petroleum royalty for opposition-controlled states.
- Federalisation of water supply
- Local authority elections are prevented by federal law
- Conflict between federal law and state law over freedom of information

- . Many states are complaining that Islam – a state matter - is being federalised through such federal agencies as JAKIM.

Federal hindrances to international investment in state economies. This defeats the opportunities of a globalized economy.

E. THOUGHTS FOR THE FUTURE

All in all, except in relation to Sabah and Sarawak, the Constitution creates a very powerful central government that can limit and control the States in the legislative, executive and financial fields.

- There is a clear situation of fiscal centralization and lack of fiscal federalism.
- Policy-making and development plans are subject to federal control.
- International treaties and foreign investment are entirely under federal jurisdiction.

Such concentration of powers in federal hands has some advantages for development goals.

Because of the small size of most state economies and the lack of any “economies of scale”, fiscal decentralization is regarded by some economists as a poor option.

- The Covid-19 pandemic illustrated the need for vigorous centralised action.
- Many states have handled the environmental crisis badly. If the approaching environmental catastrophe is to be prevented, then firm, centralised, federal action is needed.

On the other hand, proponents of decentralisation argue that despite federal dominance:

- There is persistence of poverty and under-development in many states due to poor federal planning and inequitable treatment of some states.
- There is a serious vertical disparity of wealth between the Centre and the States and a horizontal disparity among the States
- There is serious influence of partisan politics on budgetary allocations. Opposition controlled states feel seriously discriminated.

- The federal control over state economies has significant implications for a State's ability to implement its electoral promises. This has contributed to the long reign of one political party from 1957 to 2018.

- The current highly centralized fiscal system has discouraged a competitive environment among state governments resulting in low levels of efficiency in the states.
- The Constitutional Councils and Commissions like the National Financial Council (under Art 108) have not been able to operate in an independent and bipartisan manner.
- There are emerging voices of regionalism and separatism.

- Federal grants to the states (2.5% or so of the federal budget) must be enhanced.
- The federation must evolve rules to remit to the states a proportion of those federal taxes derived indirectly from “state topics” like land.
- The huge income from the halal-haram certification must be handed over to the states.

CONCLUSION

1. The overall picture is that neither in the letter of the law, nor in its working, is the Malaysian federation a true federation in the sense in which this term is understood in the U.S.A., Canada and Australia.
2. This, however, is not meant to be a criticism of the way things are working in Malaysia. Federalism is not an end in itself. It is not synonymous with good or effective government.

3. From an ordinary citizen's point view, labels or descriptions of Malaysia as a "federation with a central bias", or a "quasi-federation", or a "unitary state with some federal features" are not of much consequence. To the ordinary citizen, "all is well that works well".

4. Things did work fairly well except in Sarawak 1966, Kelantan 1976 and Sabah 1994. However, lately some intractable problems have emerged. We need to douse the embers of controversy.

5. Leaders of the federal government must recognise that the restiveness of the States, especially of Sabah and Sarawak, is real and must be addressed.

6. Balancing the concerns of equity and efficiency in intergovernmental financial relations is paramount. Petrol royalty issues have triggered separatist movements in many federations.

7. In the decades ahead, some fresh thinking is needed to repatriate to the States a portion of the earnings from the States on such matters as land, oil, gas, and hydro-electric power. Tourism should be returned to the States. Halal-haram certification is a matter of Islam and should be given to the States.

7. There is a need to strengthen institutional mechanisms for regular, non-partisan dialogue between the centre and the States especially Sabah and Sarawak so that the inevitable tensions that are inherent in a federal set-up can be resolved with least friction. The various Commissions and Councils have to be strengthened to play a professional and neutral role.

8. The survival and stability of this Federation, especially in relation to Sabah and Sarawak, rests on reviving the spirit of moderation, accommodation and compromise that animated the architects of Malaya in 1957 and Malaysia in 1963. To move forward we need to go back and recapture that spirit.

SCHEDULE 1

CASES ON JUDICIAL REVIEW

- *Government of Kelantan v Government of Malaya* [1963]
MLJ 355
- *Government of Malaysia v Government of the State of Kelantan* [1968] 1 MLJ 129
- *City Council of Georgetown v Government of Penang* [1967]
1 MLJ 169
- *Mamat Daud v Government of Malaysia* [1988] 1 MLJ 119

- *Abdul Karim v Legislative Assembly of Sabah* [1988] 1 MLJ 171
- *Dewan Undangan Negeri Kelantan v Nordin Salleh* [1993] 1 MLJ 343
- *Ketua Pengarah Jabatan Alam Sekitar v Kajing Tubek* [1997] 3 MLJ 23
- *Pusat Berkuasa Negeri Sabah v Sugumar Balakrishnan* [2002] 3 MLJ 72

- *Muhammad Tufail Mahmud v Dato Ting Chek Sii*
[2009] 4 MLJ 165
- *Mohamed Azahari Matiasin* [2011] 2 CLJ 630
- *Robert Linggi v Govt of Malaysia* [2011] 2 MLJ 741
- *Fung Fon Chen@Barnard v Govt* [2012] 6 MLJ 724

*WASSALAM
THANK YOU*