



EFFICIENCY OF LOCAL GOVERNMENTS IN
MALAYSIA

BY

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ABSTRACT

This study examines the performance of local governments (City Councils, Municipal Councils and District Councils) in Malaysia in terms of their governance efficiency. Two primary research objectives are developed. The first research objective focuses on measuring the efficiency of Malaysian local governments in terms of (i) technical, (ii) pure and (iii) scale efficiency, while the second research objective is to examine the factors influencing the efficiency of Malaysian local governments. The study covers 35 local governments in Malaysia. The relevant data are obtained from local governments' financial statements over the period between 2008-2015. For the first research objective, i.e. measuring efficiency, the Data Envelopment Analysis (DEA) is used. Based on an input orientation DEA, the efficiency scores are calculated using three inputs (tax revenues, fees and charges, subsidies from central government) and four outputs (net book value of land and buildings, net book value of motor vehicles, net book value of equipment and fittings, cost of goods and services). The results show that different local governments have different levels of efficiency. Generally, most Malaysian local governments recorded high technical efficiency (TE), pure technical efficiency (PTE) and scale efficiency (SE) with above 0.90 mean scores. The efficiency trend in the eight year period of study fluctuates, with the highest scores recorded in 2011 and the lowest scores in 2008. The study also reveals that for most local governments, the SE is lower than the PTE, which indicates that SE have been the main contributor to lower overall efficiency (or the TE) for these local governments. Next, for the second research objective of examining the factors influencing the efficiency scores, the result of the DEA efficiency scores obtained are regressed against five factors, namely population size, population density, economic independence, dependency on tax revenue and value of assets. From these factors, only four factors are found to be significantly associated with the Malaysian local governments' efficiency. The study found positive and significant relationship for the population size (DUMPOP), economic independence (OWREV) and the value of assets (ASSETS) where the population size is found to be influencing the PTE scores, while the economic independence is found to be influencing the TE and SE scores and the value of assets is found to be influencing the PTE scores. A negative and significant relationship is found between the dependence on tax revenue (TXREV) with the TE, PTE and the SE scores. The result of the study provides information useful to relevant authorities in improving the performance of Malaysian local governments, specifically in terms of efficiency.

خلاصة البحث

تبحث هذه الدراسة أداء الحكومات المحلية في ماليزيا (مجلس المدينة، ومجلس البلد، ومجلس المنطقة) من حيث كفاءتها. وقد تم تطوير هدفين بحثيين أساسيين. ويركز هدف البحث الأول على قياس كفاءة الحكومات المحلية الماليزية من حيث (1) التقنية، و(2) النقية و(3) كفاءة الجدول، في حين أن هدف البحث الثاني هو دراسة العوامل التي تؤثر في كفاءة الحكومة المحلية الماليزية. وتغطي الدراسة 35 الحكومة المحلية في ماليزيا. ويتم الحصول على البيانات ذات الصلة من البيانات المالية للحكومات المحلية خلال الفترة بين 2008-2015م. لهدف البحث الأول، أي قياس الكفاءة، يستخدم تحليل مغلفات البيانات (DEA). واستنادًا إلى توجيه مدخلات DEA، يتم احتساب درجات الكفاءة باستخدام ثلاثة مدخلات (الإيرادات الضريبية، والرسوم، والإعانات من الحكومة المركزية) وأربعة مخرجات (صافي القيمة الدفترية للأراضي والمباني، القيمة الدفترية الصافية للمركبات، القيمة الدفترية الصافية من التجهيزات والأدوات، وتكلفة السلع والخدمات). وتبين من النتائج أن مختلف الحكومات المحلية لديها مستويات مختلفة من الكفاءة. وعمومًا، سجلت معظم الحكومات المحلية الماليزية كفاءة تقنية عالية (TE)، وكفاءة تقنية نقية (PTE)، وكفاءة على نطاق (SE) في أعلى من درجات المتوسط 0.90. يتذبذب اتجاه الكفاءة في فترة الدراسة ثماني سنوات، مع أعلى الدرجات المسجلة في 2011م، وأدنى الدرجات في 2008م. وتكشف الدراسة أيضًا أن SE بالنسبة لمعظم الحكومات المحلية أقل من PTE، مما يدل على أن SE هي المساهم الرئيس في خفض الكفاءة الكلية (أو TE) لهذه الحكومات المحلية. أما بالنسبة لهدف البحث الثاني أي العوامل المؤثرة في درجات الكفاءة، فإن نتائج درجات الكفاءة DEA التي تم الحصول عليها هي تراجع مقابله خمسة عوامل، وهي حجم السكان، والكثافة السكانية، والاستقلال الاقتصادي، والاعتماد على الإيرادات الضريبية وقيمة الأصول. من هذه العوامل، وجدت أن أربعة عوامل فقط ترتبط بشكل كبير مع كفاءة الحكومات المحلية الماليزية. ووجدت الدراسة أن هناك علاقة إيجابية ومهمة بالنسبة لحجم السكان (DUMPOP)، والاستقلال الاقتصادي (OWREV)، وقيمة الأصول (ASSETS) حيث وجد أن حجم السكان يؤثر في درجات PTE، في حين أن الاستقلال الاقتصادي يؤثر في درجات TE و SE، وقيمة الأصول يؤثر في درجات PTE. ووجدت علاقة سلبية ومهمة بين الاعتماد على الإيرادات الضريبية (TXREV) مع درجات TE، PTE و SE. وتوفر نتيجة الدراسة معلومات مفيدة للسلطات المعنية في تحسين أداء الحكومات المحلية الماليزية، ولا سيما من حيث الكفاءة.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science (Accounting).

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Husniyati Binti Mohd Amin

Signature

Date

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Local government, being the government level nearest to the citizen, is responsible for providing goods and services to the people living within its localities or areas (Ibrahim and Karim, 2004; Fogarty and Mugeru, 2013; Da Cruz and Marques, 2014). The provision of goods and services by local government covers a wide range. Among the common services provided by local government are waste collection, street lighting, road maintenance, development and maintenance of leisure amenities, recreational facilities and activities related to public health (Ibrahim and Karim, 2004; Balaguer-Coll et al., 2007; Geys and Moesen, 2009; Ngah et al., 2011; Fogarty and Mugeru, 2013; Doumpos and Cohen, 2014).

The rapid changes in the global environment and the growth of citizens' demand for a diverse range of services and facilities create challenges for local government (Phang, 2008; Benito et al., 2010; Ngah et al., 2011). The difficulties faced are in term not only of the scope of services but also of the quality and efficiency of the facilities and services provided (Gohbadian and Ashworth, 1994; Phang, 2008). A local government is expected to efficiently utilize its financial resources in providing quality goods and services to the public (Gohbadian and Ashworth, 1994; Renne, 1937 as cited in Da Cruz and Marques, 2014; Doumpos and Cohen, 2014). However, statistics from the Public Complaints Bureau (2016) show that the public's complaints about local governments' service quality have been

increasing from year to year. This to some extent indicates the inefficiency of local governments in delivering their services.

Moreover, despite the various initiatives taken by local government authorities, such as the introduction of the MS ISO 9000 quality system (Abdullah et al., 2013) and the revision of the act on Solid Waste and Public Cleansing Management (Yahaya and Larsen, 2008), to improve the efficiency of their service delivery, the number of complaints about local governments remains high. Therefore, it is crucial to understand the factors that contribute to the efficiency of local governments to facilitate further efforts to improve the quality of their service delivery. Thus, in attempting to address the issue, the present study focuses on measuring the efficiency of individual local governments and investigating the factors affecting efficiency.

1.2 PROBLEM STATEMENT

Various efforts have been undertaken by the country to improve the local governments' service delivery efficiency. In the 10th Malaysia Plan, improving local government efficiency has been among the important initiatives outlined. Among the steps outlined under the Plan in order to continuously aim for better performance is through the introduction of the Star Rating system for local government, along with the federalization of solid waste management and public cleansing (Tenth Malaysia Plan, 2010). The introduction of the Star Rating system is aimed at encouraging competitiveness among the local governments to improve the efficiency of their service delivery (Ministry of Housing and Local Government, 2008), and federalization is hoped to allow them to focus on core functions such as licensing, enforcement, planning and development, which ultimately should result in better

efficiency in their service performance (Yahaya and Larsen, 2008). Unfortunately, despite the admirable objectives of the initiatives, the level of citizens' complaints on the efficiency of the local government remains alarming (Osman et al., 2014).

This trend of high numbers of complaints appears to be constant from year to year (Public Complaints Bureau, 2016). For instance, Ipoh City Council received more than six thousand complaints in the year 2015 (*Nanyang Siang Pau*, 2015). The low number of public complaints solved also implies the local government's inefficiency (*Utusan Malaysia*, 2014; *The Sun*, 2015). These high numbers of public complaints about Ipoh City Council, as well as about other local governments, together with the slow response, demonstrate that the quality of most Malaysian local government efficiency has still not reached a high level. Moreover, it is still unclear as to the factors influencing the efficiency level of local government. Hence, due to public complaints and criticisms toward the Malaysian local government, the present study intends to investigate efficiency scores of Malaysian local governments and the factors influencing these efficiency scores.

1.3 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS

The aim of this study is to investigate the efficiency of local governments in Malaysia.

The study has two main research objectives:

Research objective 1: To evaluate the efficiency level of local government in Malaysia

Research questions:

RQ₁: What is the current efficiency level of Malaysian local government?

RQ₂: What is the trend of local governments' efficiency for the eight-year period from 2008 to 2015?

Research objective 2: To examine factors influencing the efficiency of local government in Malaysia

Research questions:

RQ₃: What are the factors influencing the efficiency of local government in Malaysia?

In order to answer the RQ₃, these sub research questions are developed:

RQ_{3a}: Does population size influence the efficiency of local government in Malaysia?

RQ_{3b}: Does population density influence the efficiency of local government in Malaysia?

RQ_{3c}: Does economic independence of local government influence the efficiency of local government in Malaysia?

RQ_{3d}: Does dependence on tax revenues influence the efficiency of local government in Malaysia?

RQ_{3e}: Does the value of the assets used by the local government in Malaysia influence their efficiency?

1.4 MOTIVATION AND SIGNIFICANCE OF THE STUDY

There are several motivations for the current study. Firstly, the endless public complaints about the Malaysian local government have raised questions for the researcher. There have been continuous efforts and initiatives undertaken to ensure quality services, such as MS ISO 9000 (Abdullah et al., 2013), revision of the Solid Waste and Public Cleansing Management Act (Yahaya and Larsen, 2008; Tenth Malaysia Plan, 2010). However, there seems to be very little improvement in the number of public complaints (Public Complaints Bureau, 2016). Accordingly, in this study the researcher attempts to verify the claim that local government is inefficient by measuring the current efficiency level of individual local governments in Malaysia.

Additionally, 8-year efficiency levels from the year 2008 to 2015 are observed to examine the efficiency trend.

Secondly, the researcher realized that examining the level of efficiency solely may not be sufficient for understanding the performance of local government in Malaysia. The difference in efficiency levels of different local governments may be influenced by factors particular to each local government (Da Cruz and Marques, 2014). The factors need to be identified to be able to rationalize the findings on the levels of efficiency (Doumpos and Cohen, 2014; Da Cruz and Marques, 2014; Balaguer-Coll et al., 2007; Ibrahim and Karim, 2004).

The study will assist local governments to understand their own efficiency level. This knowledge may motivate local governments to initiate proactive measures for efficiency improvement. The study may also be useful to federal and state government in identifying the position or rank of the local governments' efficiency. By recognizing the least efficient local government, federal and state government may put more focus on this local government and give it necessary guidance and funding assistance. Finally, this study contributes to the existing literature on the efficiency of local government in Malaysia by providing an analysis of influencing factors.

1.5 ORGANIZATION OF THE CHAPTERS

This dissertation is comprised of six chapters and is organized as follows.

Chapter One: Introduction. This chapter covers the background of the study, problem statement, research objectives, research questions, and motivation of the study.

Chapter Two: Background of local government in Malaysia. This chapter presents the development of local governments in Malaysia, their structure, the relationship

between local, state and federal government, the function of local governments and, finally, the financial management of local governments in Malaysia.

Chapter Three: Literature review. The chapter reviews literature on performance measurement of public and private sectors, efficiency of private and of public sectors, efficiency of local government and also studies on the determinants of efficiency, focusing on local government in various countries. This chapter also deliberates on the theory applied and the theoretical framework of this study.

Chapter Four: Theoretical framework and research methodology. The chapter starts by providing the theoretical framework and the hypothesis development of the study, followed by the research design. Under the research design section, the population and sample of the study, research method, data collection procedures and period of study are presented. The chapter also explains the two analysis methods: the Data Envelopment Analysis (DEA) model for the first research objective, and the regression analysis for the second research objective.

Chapter Five: Data analysis and findings. The chapter empirically tabulates the findings of efficiency measures, i.e. technical efficiency (TE), pure technical efficiency (PTE) and scale efficiency (SE) of respective local government for the period from 2008 to 2015 using the DEA method. The chapter also presents factors influencing efficiency measures using the regression method, i.e. Ordinary Least Squares (OLS).

Chapter Six: Conclusion. This chapter summarizes the research findings according to the research objectives of the study. The limitations, contributions of the study and suggestions for future research are also highlighted in this chapter.

CHAPTER TWO

LOCAL GOVERNMENT IN MALAYSIA

2.1 INTRODUCTION

This chapter is organized as follows: Section 2.2 describes the development of local government in Malaysia; Section 2.3 presents the structures of local government; Section 2.4 discusses the local governments' relationship with state and federal government; Section 2.5 describes the roles of local government; Section 2.6 discusses local governments' source of income. Finally, section 2.7 summarizes the chapter.

2.2 DEVELOPMENT OF LOCAL GOVERNMENT

Local government was established in the nineteenth century under British colonial rule (Abdullah et al., 2013). It started in Penang, where a local administration representing the public was set up under the Committee of Assessors in 1801. The purpose of the committee was to develop the capital of Penang as well as to take charge of the development of roads, drains and tax collections in the state (Phang, 1989 as cited in Kuppusamy, 2008). Later, in 1828, the committee was replaced by a municipality.

In 1848, an act related to local government was established, namely the Municipal Rates Act 1848, which enabled the public to examine the municipality's financial accounts, the function of the committees and the way municipality used public funds. The act was revised in 1856, which led to the establishment of five commissioners for every municipality, three elected, one appointed by the Governor

and another appointed as the president of the municipality (Phang,1989 as cited in Kuppusamy, 2008). The first election for municipals was held in 1857 (Kuppusamy, 2008). In 1888, the number of commissioners increased to six, comprising three each of elected and appointed members.

In 1907, under the Sanitary Board Enactment, local government of each state was established (Kuppusamy, 2008). The Municipal Ordinance 1913 provided additional authority for local governments to provide health services under the charge of appointed commissioners. In December 1945, the Sanitary Board Enactment was replaced by the Town Boards Enactment of the Federated Malay States (Cap 137). Beginning from 1 February 1948, the governance for all local government in the peninsular was placed under the federal government.

By 1948, there were four municipalities comprising Penang, Melaka, Kuala Lumpur and Singapore, sixty five town boards and four rural boards (Kuppusamy, 2008). A Local Authorities Elections Ordinance 1950 (Ordinance No. 52 of 1950) was established in 1950, allowing the election of councillors ranging from six to 24 per council. The Local Authorities Elections Ordinance 1950 was subsequently replaced by the Local Government Elections Act 1960 (Act 11) to strengthen legislation on local government elections. However, for political reasons local government elections were suspended in the mid-1960s and have not been reinstated (Kuppusamy, 2008).

By 1966, there were 373 local governments formed in Peninsular Malaysia, with local councils consisting of three municipalities, 37 town councils, six autonomous town boards, 31 non-autonomous town boards, seven district councils and 289 local councils (Kuppusamy, 2008; Abdullah et al., 2013). There were a large number of local governments, but there was no special system or systematic regulation available to effectively manage and administer all the local governments

(Hussain and Brahim, 2006). In order to improve the overall structure of the local government, *The Royal Commission of Enquiry into the Working of Local Authorities in West Malaysia* was established in 1965.

The Royal Commission examined the function of all local authorities, reviewed existing laws and subsequently recommended structural changes to local government. This Royal Commission was subsequently replaced by the Local Government Act 1976 (Phang and Norris 1988, as cited in Kuppusamy, 2008). The Local Government Act 1976 (Act 171) organized the local government into efficient units with specific roles and functions. The existing local government was restructured into three types: city councils (*majlis bandaraya*), municipal councils (*majlis perbandaran*) and district councils (*majlis daerah*). The number of local governments has been reduced through mergers.

Due to the geographical factor that Malaysia is made up of Peninsular Malaysia and the Eastern Malaysian states of Sabah and Sarawak, different legal frameworks were established for local government in the three areas (Local Government Department, 2016). Among the legal frameworks for Peninsular Malaysia are the Local Government Act 1976 (Act 171), Town and Country Planning Act 1976 (Act 172) and the Street, Drainage and Building Act 1974 (Act 133), while the Local Government Ordinance 1961 was established for Sabah and the Local Authorities Ordinance 1996 (Chapter 20) for Sarawak.

2.3 STRUCTURE OF LOCAL GOVERNMENT

Local government is the lowest level in the system of government in Malaysia after the federal and the state governments (Khalid, 2010). Under the Local Government Acts, there are three main types of local government: City Hall or City Council,

Municipal Council and District Council, which are categorized based on specified characteristics such as population size, annual revenues, level of infrastructure and services offered (Local Government Department, 2016).

A City Council, has its administrative centre in a state which has not less than 500,000 people. It has stable annual revenues of not less from RM100 million, a structured organization and the ability to provide comprehensive infrastructural facilities and public utilities. A Municipal Council is situated in a capital city or administrative centre of a state or district which has not less than 150,000 people. It has an annual income of not less than RM20 million. A District Council is located in areas other than from major towns and has less than 150,000 people. It has a total annual revenue of less than RM20 million (Local Government Department, 2016).

At present, there are 149 local governments in Malaysia, consisting of 13 City Councils, 38 Municipal Councils and 98 District Councils (Local Government Department, 2016). Table 2.1 shows the list of local government in each state in Malaysia.

In addition to the 149 local governments, there are five special local councils that are authorised by the State Government to function as local government, namely, Perbadanan Putrajaya, Perbadanan Labuan, Lembaga Bandaran Johor Tenggara, local government of Taman Perindustrian Hi-Tech Kulim and Lembaga Pembangunan Tioman.

The head of local government of City Councils is the mayor, and the head of Municipals and District councils is the president (Kuppusamy, 2008). The Local Government Act 1976 states that the appointment of mayors or presidents is made by the state government.

Table 2.1 Local Government in State within Malaysia

State	City Council / Hall	Municipal Council	District Council	Total
Johor	1	6	8	15
Kedah	1	3	7	11
Kelantan	-	1	11	12
Melaka	1	3	-	4
Negeri Sembilan	-	3	5	8
Pahang	-	3	8	11
Pulau Pinang	1	1	-	2
Perak	1	4	10	15
Perlis	-	1	-	1
Selangor	2	6	4	12
Terengganu	1	2	4	7
Sabah	1	2	21	24
Sarawak	3	3	20	26
Wilayah Persekutuan	1	-	-	1
Total	13	38	98	149

Source: Local Government Department (2016)

However, in some circumstances where the presidents are absent, a chief administrator is put in charge of the overall administration of the councils (Kuppusamy, 2008). A chief administrative officer (CAO) acts as the council secretary who reports to the president or mayor. The CAO is given a full charge of overall administration of the local government, and is directly responsible for implementing the policy decisions made by the council. In some states, there is an intermediate position of deputy president between the president and the secretary (Kuppusamy, 2008).

Local government administration comprises a mayor or president and not less than eight and not more than 24 council members that are to be appointed by the State Government. The council members are appointed from among local residents who have wide experience in local government affairs or who have achieved distinction in any profession, commerce or industry, or are otherwise capable of representing the interests of their communities in the local government's area (Local Government Act

1976). The mayor or president is responsible for appointing committee members from the council members. Any issues are firstly presented and discussed among the committee (Kuppusamy, 2008). Decisions are also made during the committee's meeting. The matters are then presented in a full council meeting for approval. The governance structure of a local government is illustrated in Figure 2.1 below. The next section elaborates on the relationship between the local government, the state government and the federal government.

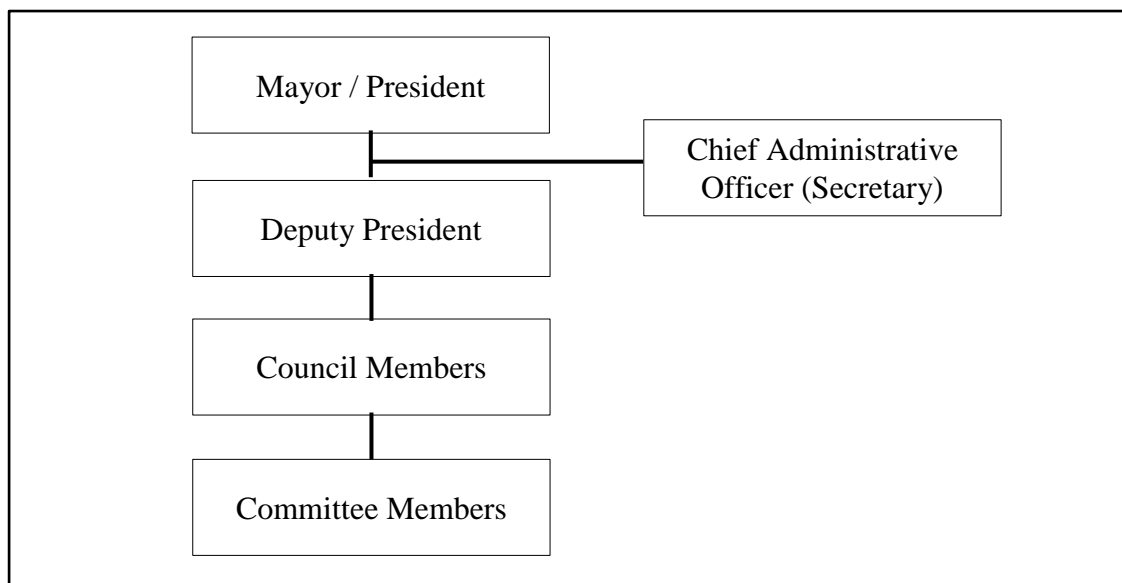


Figure 2.1 Governance Structure of a Local Government in Malaysia

2.4 LOCAL GOVERNMENT RELATIONSHIP WITH STATE AND FEDERAL GOVERNMENT

The Ministry of Housing and Local Government (federal government) coordinates and supervises the local government. Any directives from the ministry are adopted by the state government before implementing them in the local government (Kuppusamy, 2008). All financial grants from the Ministry of Housing and Local Government (federal government) are channeled through the state government. Apart from

financial grants provided, the federal government does not have any direct control over local government. The federal government is not allowed to interfere in the affairs of local government, as stipulated under the Act 171, which states that only the state government has direct financial authority over local government (UCLG, 2005).

For Peninsular Malaysia, through the Malaysian Federal Constitution, the power to administer local government was granted to the respective state governments (Abdullah et al., 2013). According to Act 171, the state government gives the local government directions on the policy to be followed in exercising local government powers and the duties indicated under this Act (Local Government Act 1976). Furthermore, local governments are instructed to furnish state government with the information associated with its returns, accounts and other information relating to their property and activities. Based on the local governments' various responsibilities to the state government, it may be concluded that state government has more authority over the local government than does the federal government (Kuppusamy, 2008; Khalid, 2010).

In addition, there is a National Council for Local Government (NCLG) chaired by the Minister of Housing and Local Government (Kuppusamy, 2008). The Council is comprised of representatives from every state and ten other members representing the federal government. Occasionally, the Deputy Prime Minister will be invited as a chairman by the Minister to influence the state representatives on acceptance of policies and delegation of action to its local government. The Council is responsible for formulating policy concerning the promotion, development and control of local government (Hussain and Brahim, 2006; Kuppusamy, 2008). However, a policy can be implemented only upon consultation with both the federal and state government.