

The Nexus between Governance Quality and Economic Growth of Malaysia: Short- And Long-Run Analyses

Saizal Pinjaman^{*1}, Mohamad Afifi Mat Thani², Syamsul Hadi³, Mohd. Allif Anwar Abu Bakar⁴

¹Centre for Economic Development and Policy, Universiti Malaysia Sabah, Malaysia

^{1,4}Faculty of Business, Economics and Accountancy, Universiti Malaysia Sabah, Malaysia

²National Audit Department Malaysia, Malaysia

³Universitas Sarjanawiyata Tamansiswa, Indonesia

*Correspondence Author

DOI: <https://dx.doi.org/10.47772/IJRISS.2025.915EC009>

Received: 14 January 2025; Accepted: 18 January 2025; Published: 19 February 2025

ABSTRACT

This study investigates the impact of governance quality on Malaysia's economic growth from 2000 to 2021, focusing on six World Governance Indicators (WGI): voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. Despite Malaysia's significant economic progress, the relationship between governance quality and growth remains underexplored, particularly in terms of long-run and short-run dynamics. Using the cointegration and error correction models, the study examines the short-run and long-run relationships between governance indicators and real GDP. The findings reveal that political stability and government effectiveness have significant positive long-run impacts on real GDP, emphasizing their critical role in fostering economic growth. However, regulatory quality and rule of law, while positively correlated, are statistically insignificant in the long run, suggesting that their benefits may take longer to materialize. Control of corruption shows a counterintuitive negative long-run relationship, likely due to transitional costs of anti-corruption measures. In the short run, most governance indicators significantly influence real GDP, with the error correction term confirming a robust adjustment toward long-run equilibrium. The study recommends prioritizing political stability and government effectiveness while implementing sustained reforms to enhance regulatory quality, rule of law, and anti-corruption measures. Policymakers should adopt a holistic approach to governance reforms, ensuring transparency, accountability, and institutional efficiency to support Malaysia's long-term economic growth and resilience. These insights are crucial for aligning governance strategies with Malaysia's development goals under initiatives like the Shared Prosperity Vision 2030.

Keywords: Economic Growth, Governance Quality, Short- and Long-Run Relationships

INTRODUCTION

Endowed with abundant natural resources such as petroleum, natural gas, palm oil, tin, and timber, Malaysia has emerged as one of the region's most dynamic economies. Since gaining independence in 1957, the country has undergone remarkable economic transformation, transitioning from a resource-dependent economy in the 1970s to a globally competitive exporter of manufactured goods, electronics, and agricultural products (Jomo, 2016). This economic progress is reflected in Malaysia's Gross Domestic Product (GDP), which reached USD 373 billion in 2021, positioning the country as one of Southeast Asia's largest economies. Additionally, Malaysia has achieved significant milestones in poverty reduction, with absolute poverty rates declining substantially over the decades. Over the years, Malaysia's economic trajectory has been shaped by distinct policy eras, from the New Economic Policy (NEP) in the 1970s to the current Shared Prosperity Vision 2030. Each era has seen varying levels of governance quality, influencing the country's economic outcomes. For instance, the NEP era focused on reducing economic disparities but faced challenges in institutional

transparency, while recent initiatives like the Economic Transformation Programme (ETP) have emphasized governance reforms to attract foreign investment and boost competitiveness.

However, Malaysia's economic journey has not been without challenges. Despite its impressive growth trajectory, the country continues to grapple with issues such as significant corruption cases involving political leaders, and ruling party transitions. These challenges underscore the critical role of governance quality in sustaining economic development. Governance quality, which encompasses the effectiveness of institutions, the rule of law, regulatory frameworks, and the control of corruption, is increasingly recognized as a key determinant of economic growth (Kaufmann et al., 2010). Effective governance fosters investor confidence, ensures efficient resource allocation, and creates an enabling environment for innovation and productivity—all of which are essential for long-term economic prosperity.

In recent years, Malaysia has taken steps to improve its governance quality. Initiatives such as the National Anti-Corruption Plan (NACP) and the introduction of institutional reforms reflect the government's commitment to strengthening transparency and accountability. Furthermore, Malaysia's Shared Prosperity Vision 2030, launched in 2020, highlights the importance of inclusive growth and equitable development (Nga & Kesumo, 2025), emphasizing the need to address income disparities and improve the well-being of all citizens. These efforts signal a recognition that governance quality is not only a moral imperative but also an economic necessity.

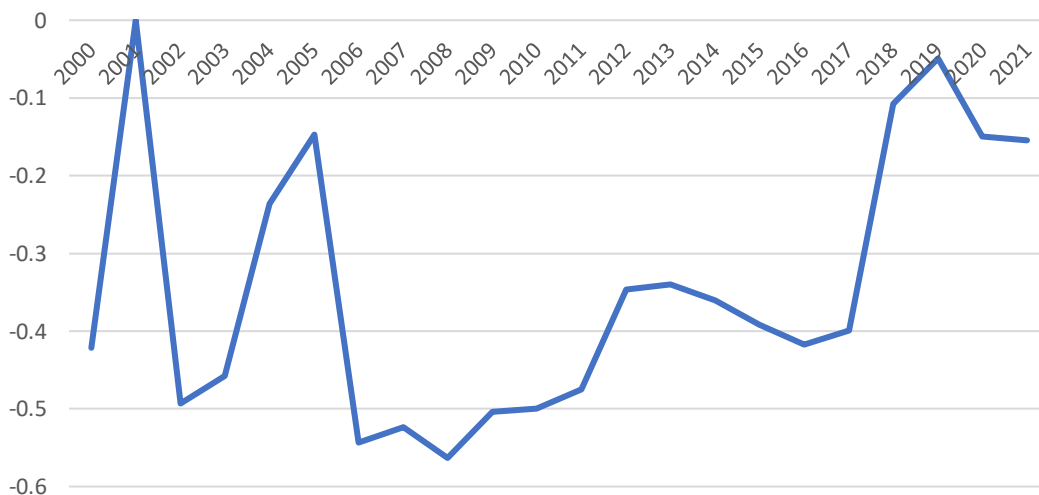


Figure 1: Voice and Accountability

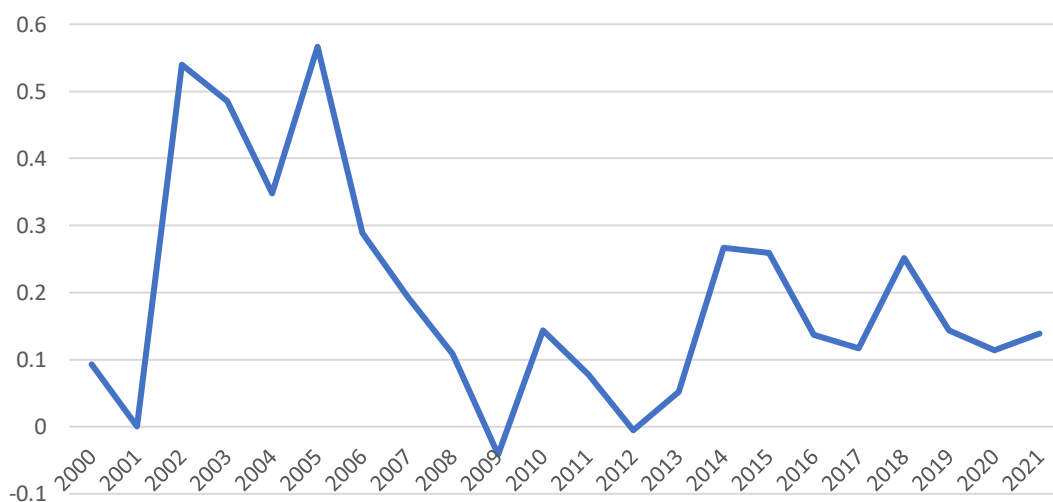


Figure 2: Political Stability and Absence of Violence/Terrorism

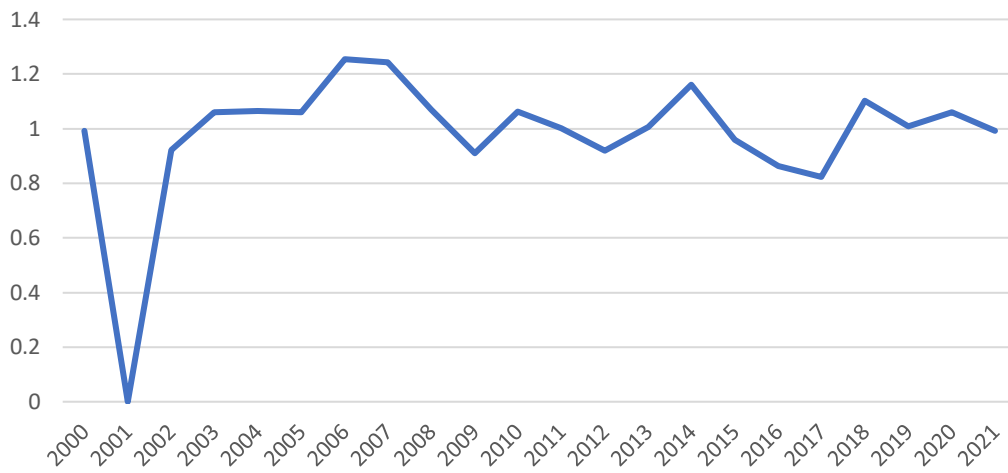


Figure 3: Government Effectiveness

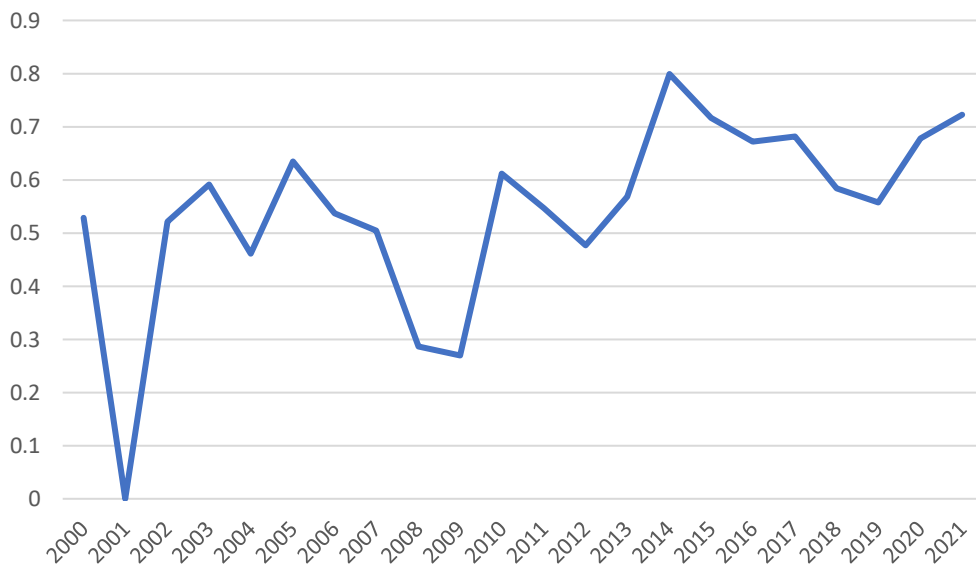


Figure 4: Regulatory Quality

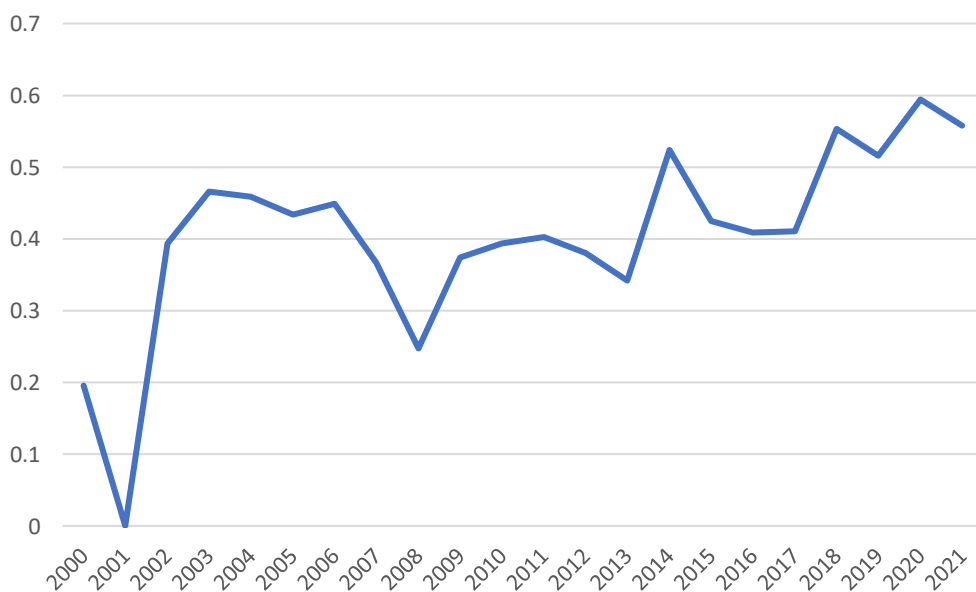


Figure 5: Rule of Law

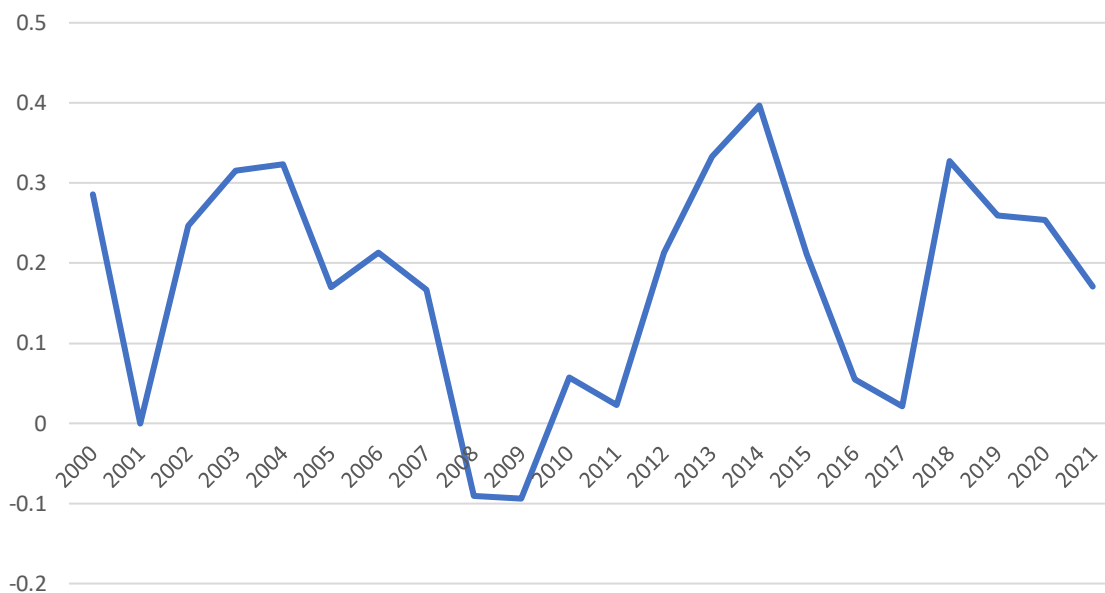


Figure 6: Control of Corruption

Malaysia's governance quality, as measured by the World Governance Indicators (WGI), has shown both progress and setbacks over time. As shown in Figure 1, voice and accountability in Malaysia is often in the moderate range, reflecting a certain level of citizen participation and government accountability. However, concerns about restrictions on freedom of expression and assembly persist, highlighting the need for greater inclusivity in governance. Figure 2 illustrates that political stability has been a hallmark of Malaysia's governance (Nathan, 2009), with peaceful transitions of power through elections and robust institutions contributing to a relatively stable environment (Wong, 2023). Despite this, isolated episodes of ethnic and religious tensions have occasionally disrupted this stability, underscoring the importance of continuous efforts to maintain social cohesion.

Government effectiveness, another critical indicator, highlights Malaysia's ability to deliver public services and implement policies efficiently. As depicted in Figure 3, Malaysia's government effectiveness scores have generally ranged from moderate to high, reflecting its capacity to drive development agendas. The successful execution of initiatives such as the New Economic Model (NEM) and the Economic Transformation Programme (ETP) has bolstered economic stability, attracted foreign investment, and diversified the economy. However, periodic inefficiencies and bureaucratic hurdles suggest room for improvement. Regulatory quality, a key factor in attracting foreign investment, has seen significant reforms in Malaysia. Figure 4 shows that the country's ranking as the 12th most business-friendly economy (World Bank, 2019) attests to its efforts to streamline regulations. Nevertheless, persistent issues such as corruption and bureaucratic red tape indicate that regulatory quality remains uneven.

The rule of law in Malaysia, grounded in the Federal Constitution, ensures equality before the law and prohibits discrimination based on ethnicity, religion, or gender. However, as illustrated in Figure 5, concerns about judicial independence and selective enforcement of laws have tempered its performance on this indicator. Malaysia's moderate scores for the rule of law reflect a generally effective legal framework but also point to the need for greater transparency and consistency in its application. Control of corruption, a persistent challenge for Malaysia, has seen mixed progress. Figure 6 highlights that while legislative measures such as the Malaysian Anti-Corruption Commission Act 2009 have been implemented, corruption remains a significant issue. Transparency International's Corruption Perceptions Index (CPI) shows fluctuating scores for Malaysia, indicating ongoing struggles to combat corruption effectively.

The interplay of these governance indicators has significant implications for Malaysia's economic growth. Strong political stability and government effectiveness create a favorable environment for investment and innovation, while regulatory quality and the rule of law provide the framework for efficient market operations. However, persistent issues such as corruption and uneven enforcement of laws pose risks to economic

performance by eroding trust, increasing transaction costs, and deterring foreign investors. Addressing these challenges through targeted reforms and stronger institutional frameworks will be critical for Malaysia to sustain its economic growth trajectory and achieve its development goals under initiatives like the Shared Prosperity Vision 2030.

A growing body of research has explored the relationship between governance quality and economic growth, with most studies, such as those by Kaufmann et al. (1999) and Huang and Ho (2017), establishing a positive relationship. These findings suggest that improved governance quality can significantly enhance economic performance. However, despite the wide recognition of governance as a critical driver of economic growth, there remains a limited study conducted in Malaysia's specific context. While studies in regions such as Sub-Saharan Africa, the Balkans, the Middle East and North Africa (MENA), and East Asia have provided valuable insights, the unique institutional, cultural, and economic dynamics of Malaysia warrant a more focused examination. In Malaysia, governance quality has been a cornerstone of its development strategy, yet the country continues to face governance quality challenges which may hinder its economic potential. While some studies, including those by Huang and Ho (2017) and Jamaiudin (2019), have identified a positive relationship between governance and economic growth in Malaysia, their analyses often lack a comprehensive assessment of other governance indicators. This limited scope has resulted in an incomplete understanding of how different dimensions of governance—such as political stability, regulatory quality, and control of corruption—individually and collectively influence economic growth. Moreover, the existing literature presents conflicting findings on the governance-growth relationship (Kaufmann et al., 1999; Mira & Hammadache, 2017; Emara & Chiu, 2016). These contradictions underscore the complexity of the governance-growth nexus and highlight the need for context-specific research, particularly in emerging economies like Malaysia. Given Malaysia's aspirations to achieve high-income status and sustainable development, understanding the precise mechanisms through which governance quality spectrum impacts economic growth is crucial for designing effective policies.

This study seeks to address these issues by examining the long-run and short-run relationships between governance quality and economic growth in Malaysia. By incorporating a comprehensive set of governance indicators—including voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption—the research aims to provide a nuanced understanding of how governance shapes economic outcomes. The findings will not only contribute to the academic discourse on governance and growth but also offer practical insights for policymakers striving to enhance Malaysia's governance framework and accelerate its economic development.

This paper is organized as follows: The Introduction outlines the research objectives and significance of studying governance quality and economic growth in Malaysia. The Literature Review discusses relevant theoretical frameworks and empirical studies on governance and economic growth, highlighting gaps in the context of Malaysia. The Data and Methodology section describes the data sources, variables, and analytical methods. The Results section presents the findings, including long-run and short-run relationships between governance indicators and GDP. Finally, the Conclusion summarizes the key findings, discusses their implications, and provides specific policy recommendations.

LITERATURE REVIEW

One of the most widely accepted theories that relates governance quality with the economic growth is the Institutional Quality Hypothesis which suggests that an improvement in the quality of governance is positively associated with an increase in economic growth. This hypothesis argues that good governance, incorporating rule of law, property rights protection, effective regulation, and corruption-free, fosters an environment conducive to investment and innovation, leading to higher productivity and economic growth (North, 1990). This concept has been widely discussed in the literature on economic growth and development. For example, Acemoglu and Robinson (2012) defend the idea that inclusive institutions, which generate a level playing field for all members of society, are essential for sustained economic growth and development. Similarly, Rodrik (2000) argues that high-quality institutions are critical for promoting economic growth and stability.

Another theoretical framework is the Rent-Seeking Hypothesis which posits that poor governance quality, such as high levels of corruption and rent-seeking activities, creates barriers to economic growth (Krueger, 1974). Tullock (1967) initially proposed the Rent-Seeking Hypothesis it is Krueger (1974) that contributed to the further development of the concept. Rent-seeking activities involve individuals or firms seeking wealth by manipulating government policies rather than through productive economic activities. This hypothesis suggests that such activities can lead to market distortions, increased transaction costs, and a misallocation of resources, hindering economic growth. The analysis also explores the potential adverse effects of rent-seeking behaviour on the macroeconomic performance of a nation. People or organizations are said to be engaging in rent-seeking conduct when they try to increase their share of current wealth or income without generating any additional wealth or revenue themselves.

The relationship between governance quality and economic growth has been extensively studied across various regions and contexts, with most research underscoring the critical role of governance in shaping economic outcomes. Studies examining the impact of voice and accountability on economic growth consistently highlight its positive influence. Agoba (2020), focusing on 46 African countries, found that voice and accountability significantly enhance economic growth, particularly in nations with higher levels of human capital. Similarly, Azam (2022) analyzed Latin American and Caribbean countries, revealing a strong positive correlation between voice and accountability and economic advancement, with the effect being more pronounced in more innovative economies. Rana (2020) corroborated these findings, emphasizing that the positive impact of voice and accountability is especially significant in countries with higher educational attainment. These studies collectively suggest that inclusive governance and participatory decision-making are vital for fostering economic growth.

Political stability is another critical governance indicator that has been widely linked to economic growth. Rosli and Kamaluddin (2023) found that political stability positively and significantly affects economic growth in Asian countries, particularly those with higher financial development. Similarly, Elbargathi and Al-Assaf (2019) observed a positive relationship between political stability and economic growth in the Arab countries, with the effect being stronger in financially developed nations. Ofori and Asongu (2021) echoed these findings in their studies of sub-Saharan Africa, noting that political stability's impact on growth is amplified in countries with higher levels of human capital and financial development. These findings underscore the importance of a stable political environment for sustained economic progress.

Kaufmann et al. (2010) validated the reliability of the WGI indicators as measures of governance quality, while Udochukwu (2024) and Kunawotor et al. (2024) demonstrated that government effectiveness positively influences growth, particularly in the presence of strong institutional frameworks. Silberberger and Königer (2016) further highlighted the positive relationship between regulatory quality and economic growth, especially the role of regulatory reforms. Omotosho (2021) reinforced these findings in the context of African countries, suggesting that efficient regulatory environments are crucial for attracting investment and stimulating economic activity.

The rule of law and control of corruption are widely recognized as essential components of good governance that drive economic growth. Shevchuk et al., (2020) found that the rule of law significantly enhances growth in developing nations. Similarly, studies on corruption control, such as those by Ncube et al., (2014) in the Middle East and North Africa, Trpeski et al., (2023) in Central and Eastern Europe, and Lustrilanang et al., (2023) in Southeast Asia, consistently demonstrate that reducing corruption positively impacts economic growth, particularly in financially developed and human capital-rich nations.

Despite the vast research on governance and economic growth, the Malaysian context remains underexplored. Furthermore, the unique political, social, and economic conditions in Malaysia, including its multi-ethnic society and rapid industrialization, may influence the governance-growth relationship in ways that are not yet fully understood (World Bank, 2019). The existing literature also presents conflicting findings on the governance-growth relationship. While studies such as those by Kaufmann et al. (1999) have demonstrated a positive correlation, others like Mira and Hammadache (2017) and Emara and Chiu (2016) have found either negative or insignificant relationships.

DATA AND METHODOLOGY

The dependent variable in this study is Malaysia's economic growth, measured using real GDP annual data from 2000 to 2021. Real GDP is a widely accepted indicator of economic performance, as it reflects the value of goods and services produced in an economy, adjusted for inflation. This variable captures the overall trajectory of Malaysia's economic development over the study period. Meanwhile, the independent variables are derived from the WGI dataset, which serve as a proxy for good governance that measures six dimensions of governance, including voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. These six dimensions of governance provide a holistic view of governance quality and allow for an in-depth exploration of how variations in governance may impact Malaysia's economic growth. By incorporating all six indicators, this study aims to offer a comprehensive analysis of the relationship between governance quality and economic performance in Malaysia.

To better understand the relationship between governance quality and economic growth, the analysis is divided into two models. Model 1 focuses on democratic quality, represented by Voice and Accountability and Political Stability. These indicators capture the extent of citizen participation, political freedoms, and the stability of the political environment. Meanwhile, Model 2 examines technical quality, represented by Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. These indicators reflect the efficiency of public institutions, the quality of regulations, the enforcement of laws, and the level of corruption. This division allows for a more nuanced analysis, distinguishing between the democratic aspects of governance and the technical or institutional aspects, and their respective impacts on economic growth.

Unit Root Test

To ensure the reliability of the time series analysis, a unit root test was conducted to assess the stationarity of the variables. Stationarity means that a variable's statistical properties, such as its mean and variance, do not change over time. Non-stationary variables can lead to spurious regression results, where relationships appear significant even when they are not. In this study, the unit root test was performed by allowing for a one-time structural break, which accounts for sudden shifts in the data caused by significant economic, political, or institutional changes, such as the 2008 global financial crisis or the COVID-19 pandemic. The breakpoint was determined by identifying the minimum Dickey-Fuller t-statistic, which corresponds to the point in time where the structural break is most likely to have occurred (Pinjaman & Kogid, 2020). By incorporating a structural break, the unit root test provides a more robust assessment of stationarity and ensures the accuracy of subsequent econometric analyses.

Cointegration Analysis for Long-Run Relationship

This study uses the Autoregressive Distributed Lag (ARDL) model to examine the long-run relationship. The ARDL model is chosen because it works well with variables that have different integration orders—whether stationary at level $I(0)$ or first difference $I(1)$ —making it flexible for time series analysis (Pesaran & Shin, 1999). Order of integration refers to the number of times a variable must be differenced to become stationary. The ARDL model also handles autocorrelation, where error terms in a regression model are correlated over time, and structural breaks effectively (Hill et al., 2008).

The estimation of the long-run relationship between variables using the fundamental ARDL (p,q) model is shown below:

$$y_t = \alpha + \sum_{i=1}^p \theta_i y_{t-i} + \sum_{i=0}^q \beta_i x'_{t-i} + \lambda_1 y_{t-1} + \lambda_2 x'_{t-1} + \varepsilon_t \quad (1)$$

In Eq. 1, ε_t denotes the error term, which indicated the difference between observed and predicted values, and α, θ, β and λ stand for the coefficients that need to be estimated. The GDP is referred to as y and x' is a set of governance indexes, including voice and accountability, political stability, government effectiveness,

regulatory quality, rule of law, and control of corruption. The optimal lag length for the ARDL model is determined using the Akaike Information Criterion (AIC), which selects the model with the lowest AIC value. To account for structural breaks, a dummy variable is included, representing breakpoints identified during unit root testing.

To test for a long-run relationship, the bounds testing approach by Pesaran, Shin, and Smith (2001) is applied. The computed F-statistic, measuring the overall significance in a regression model, is compared against two critical bounds. If the F-statistic exceeds the upper bound, a long-run relationship exists. If it falls below the lower bound, no relationship is found. If it lies between the bounds, the result is inconclusive. This approach ensures a robust analysis of the long-run relationship between governance quality and economic growth in Malaysia, addressing structural breaks and autocorrelation.

ARDL-Error Correction Modelling for Short Run Relationship

The short-run relationship between governance quality and economic growth is analyzed using an Error Correction Model (ECM) derived from the ARDL framework. The ECM captures how quickly the system returns to long-run equilibrium after a shock, with the Error Correction Term (ECT) representing the speed of adjustment. According to Engle and Granger (1987), the ECT measures the proportion of disequilibrium or deviation from long-run equilibrium corrected in each period, reflecting how the economic growth responds to changes in the governance indicators.

$$\Delta y_t = \alpha + \sum_{i=1}^p \theta_i \Delta y_{t-i} + \sum_{i=0}^q \beta_i \Delta x'_{t-i} + \lambda_1 ECT_{t-1} + \varepsilon_t \quad (2)$$

Where $ECT_{t-1} = \varepsilon_{t-1} = y_{t-1} - \alpha - \beta x'_{t-1}$.

A statistically significant coefficient ($\beta \neq 0$) in Eq. 2 indicates a short-run causal relationship between governance quality and economic growth. This suggests that changes in governance indicators have an immediate impact on GDP, even if the long-run equilibrium has not yet been achieved. The ECT coefficient (λ) provides critical insights into the adjustment process. A statistically significant value of $-1 < \lambda < 0$ indicates that the model is converging toward long-run equilibrium. The magnitude of λ reflects the speed of adjustment: a larger absolute value of λ means faster correction of disequilibrium. The time required for the system to fully return to equilibrium is calculated as $(1/\lambda)^1$.

RESULTS

The stationarity test results, as shown in Table 1, reveal a mixed order of integration among the variables. Specifically, Voice and Accountability, Government Effectiveness, Regulatory Quality, and Control of Corruption are stationary at level, or I(0). In contrast, real GDP, Political Stability, and Rule of Law become stationary only after first differencing, or I(1). This mixed integration of variables justifies the use of the ARDL model, which is well-suited for analyzing long-run relationships in datasets with variables integrated at different orders.

Table 1: Unit root test with breakpoint

Variable	Breakpoint Period	ADF Test Statistics	
		At level	At 1 st difference
Real GDP	2004	-2.6326	-5.3591***
Voice and accountability	2017	-4.5386***	-7.9034***

¹ The Breusch-Godfrey serial correlation LM test will be utilised in order to investigate whether or not the ARDL and ECM models contain a serial correlation. Concurrently, the CUSUM test will be utilised in order to investigate whether or not the models are stable. On the other hand, the Ramsey (1969) Regression Specification Error Test (RESET) is applied in order to determine whether or not the models are accurately stated. This study utilised the Breusch-Pagan test to investigate the possibility of heteroskedasticity while maintaining a null hypothesis that heteroskedasticity does not exist.

Political stability	2005	-4.0877	-7.5476***
Government effectiveness	2003	-9.9061***	-18.2248***
Regulatory quality	2012	-5.2637***	-9.3259***
Rule of law	2017	-3.3641	-10.2069***
Control of corruption	2018	-4.2132***	-5.4179***

Note: 1. The underlying assumption of the model is that the break transpires in a gradual manner and adheres to the identical dynamic trajectory as the innovations

2. The assumption is made that the data exhibits trends with interruptions in both the intercept and trend
3. The determination of the appropriate quantity of lags is predicated upon the Schwarz information criterion, whereas the identification of the breaking point date is predicated upon the minimum Dickey-Fuller t-statistics
4. The null hypothesis posits that the model being tested comprises a unit root.
5. Parentheses *** indicate which level the variable be stationary.

Long-Run Relationship using ARDL Bound Test

The results of the ARDL bounds test, presented in Table 2, provide strong evidence of cointegration between the variables in both models. For Model 1, where real GDP is the dependent variable and democratic quality indicators (Voice and Accountability and Political Stability) are the independent variables, the computed F-statistic (8.9083) exceeds the upper-bound critical values at all significance levels². This indicates a significant long-run relationship between real GDP and democratic quality, confirming that these variables jointly influence economic growth at the 1 percent significance level.

Table 2: Results of Bounds Test for Model 1

<i>Model 1 (DV: Real GDP; IV: Voice and accountability + Political Stability)</i>		
ARDL Model: (1,4,3)		
F-Statistic: 8.9083		
Critical Value	Lower Critical Bound	Upper Critical Bound
10% Significance	2.17	3.19
5% Significance	2.72	3.83
1% Significance	3.88	5.3

Note: 1. This study employs the Bounds test of cointegration to examine the correlation between GDP and governance quality over an extended period.

2. The regression model incorporates a constant parameter, whereas the breakpoint is regarded as an immovable independent variable.

Similarly, for Model 2, which examines the relationship between real GDP and technical quality indicators (Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption), the F-statistic (6.2158) also surpasses the upper-bound critical values at all significance levels as shown in Table 3³. This result rejects the null hypothesis of no cointegration, demonstrating that real GDP and technical quality are significantly correlated in the long run. At the 1 percent significance level, the variables collectively exert a meaningful impact on real GDP.

² The optimal ARDL lags in the analysis for Model 1 is (1,4,3) as the model produces the lowest value of Akaike Information Criteria (AIC).

³ Meanwhile, for Model 2, the optimal ARDL lags in the analysis for model 2 is (1,1,0,1,2) as the model produces the lowest value of AIC.

Table 3: Results of Bounds Test for Model 2

<i>Model 2 (DV: Real GDP; IV: Government effectiveness+Regulatory quality+Rule of law+Control of corruption)</i>		
ARDL Model: (1,1,0,1,2)		
F-Statistic: 6.2158		
Critical Value	Lower Critical Bound	Upper Critical Bound
10% Significance	1.9	3.01
5% Significance	2.26	3.48
1% Significance	3.07	4.44

Note: 1. This study employs the Bounds test of cointegration to examine the correlation between GDP and governance quality over an extended period.

2. The regression model incorporates a constant parameter, whereas the breakpoint is regarded as an immovable independent variable.

Individual Long-Run Relationship

The findings presented in Table 4 reveal that most governance quality variables have a statistically significant and positive impact on real GDP, as evidenced by their long-run coefficients and associated p-values. However, two exceptions are noted: Regulatory Quality and Rule of Law exhibit negative long-run coefficients and lack statistical significance.

Specifically, a 1% increase in Voice and Accountability is associated with a long-run decrease of 54.65% in real GDP, holding all other variables constant. This counterintuitive result implies that improvements in participatory governance and freedom of expression may initially hinder economic growth, possibly due to transitional costs or short-term disruptions. In contrast, Political Stability shows a strong positive relationship, with a 1% increase linked to a 52.01% rise in real GDP. This underscores the critical role of a stable political environment in fostering economic growth.

Table 4: Long-run coefficient

Independent Variable	Coefficient	P-Value
Democratic quality:		
Voice and accountability	-54.6465	0.0000
Political stability	52.0145	0.0013
Technical quality:		
Government effectiveness	32.0355	0.0010
Regulatory quality	9.2248	0.3618
Rule of law	5.0310	0.7964
Control of corruption	-31.7546	0.0566

Note: Individual long-run coefficients of governance quality with respect to economic growth is analysed based on the ARDL model.

For Government Effectiveness, a 1% increase corresponds to a 32.03% rise in real GDP, highlighting the importance of efficient public institutions and policy implementation. Similarly, Regulatory Quality and Rule of Law show positive but statistically insignificant relationships, with 1% increases associated with 9.22% and 5.03% rises in real GDP, respectively. While these results suggest potential benefits from better regulations and legal frameworks, their lack of significance calls for further investigation.

Interestingly, Control of Corruption exhibits a negative long-run coefficient, with a 1% increase linked to a 31.75% decrease in GDP. This unexpected finding may reflect the short-term costs of anti-corruption measures, such as disruptions to established systems or increased bureaucratic inefficiencies during transitional

phases. While reducing corruption is fundamentally important, its immediate economic impact appears complex and context-dependent.

The diagnostic tests, specifically the Breusch-Godfrey Serial Correlation LM Test indicates no evidence of serial correlation, while the Breusch-Pagan-Godfrey Heteroskedasticity Test confirms the absence of heteroskedasticity. Additionally, the Ramsey RESET Test supports the correct specification of the cointegration model. Stability tests, including CUSUM and CUSUMSQ, further validate that both models remain stable in the long run, ensuring the reliability of the findings.

Short-Run Relationship

The results of the Wald test, presented in Table 5, reveal the significance of individual governance quality variables in explaining short-run variations in real GDP. Based on the F-statistics and probability values, all variables except Regulatory Quality exhibit statistically significant short-run impacts on GDP. This allows us to reject the null hypothesis of no short-run relationship between governance quality and real GDP, confirming that most governance indicators play a meaningful role in driving economic performance over shorter time horizons.

Table 5: Short-run relationship between economic growth and individual governance quality

Governance quality	Wald Test F-Statistics	P-Value
Voice and accountability	15621.45	0.0000
Political stability	6.0586	0.0187
Government effectiveness	12155.68	0.0000
Rule of law	18.9650	0.0011
Control of corruption	4.3460	0.0406
Regulatory Quality	N.A	N.A

Note: 1. Short-run relationship between governance quality and economic growth is analysed based on the F-Statistics obtained from the Wald test with hypothesis null assumes no causal relation between variables.

2. Probability value is shown in parenthesis with 0.10(10%), 0.05(5%) and 0.01(1%) significance level.

The error correction term (ECT) in Table 6 is statistically significant at the 1 percent level, with a negative coefficient, indicating an adjustment mechanism toward long-run equilibrium following short-run macroeconomic fluctuations. For Model 1, the ECT coefficient suggests that approximately 1.5 percent of the disequilibrium gap between actual and equilibrium GDP is corrected within a year. Similarly, for Model 2, the ECT coefficient implies a 1.9 percent annual adjustment. These findings highlight the dynamic nature of the relationship between governance quality and GDP, with short-run deviations being systematically corrected over time.

Table 6: Short-run adjustment

Variable	Coefficient	
	Model 1	Model 2
Error Correction Term	-0.014827***	-0.019280***

Note: 1. The coefficient for ECT is identified by inserting the lag value of the ECT as one of the independent variables in the Error Correction Model.

2. Standard errors are shown in parentheses. *, **, *** indicate statistical significance at 10%, 5% and 1% level, respectively.

The cointegration graphs in Figure 7 (Model 1) and Figure 8 (Model 2) visually illustrate how the models respond to macroeconomic fluctuations, gradually converging to their long-run equilibrium paths. The consistent adjustment patterns further validate the stability and reliability of the estimated relationships.

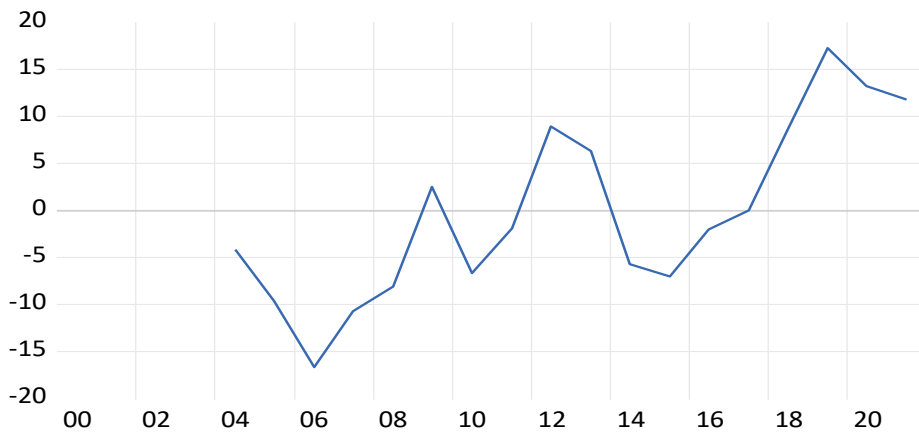


Figure 7: The cointegration graph for Model 1

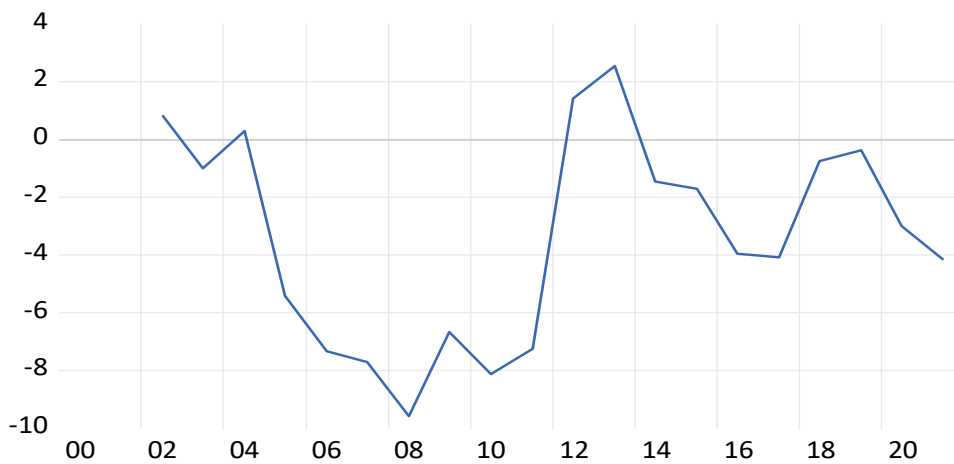


Figure 8: The cointegration graph for Model 2

CONCLUSIONS

The findings of this study underscore the significant role of governance quality in driving Malaysia's economic growth, particularly in the long run. Political Stability and Absence of Violence emerge as a critical determinant, with its positive coefficient highlighting that a stable political environment is essential for sustained economic development. Political stability fosters investor confidence, ensures the smooth implementation of economic policies, and creates a predictable business environment, all of which are conducive to growth (Aisen & Veiga, 2013). In Malaysia, where political and economic contexts are deeply intertwined, maintaining political stability is crucial for achieving long-term economic objectives.

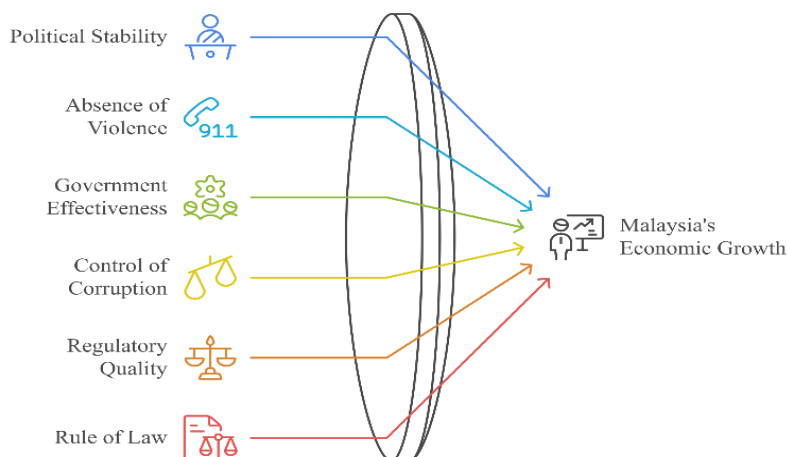


Figure 9: The relationship between governance quality and economic growth

Similarly, Government Effectiveness demonstrates a significant and positive relationship with real GDP, emphasizing the importance of efficient public services, independent policy formulation, and competent civil services. As Kaufmann et al. (2010) argue, effective governance reduces bureaucratic hurdles, enhances productivity, and creates an enabling environment for economic activities. In Malaysia, this translates to the need for transparent and efficient government operations that support business growth and innovation.

While Regulatory Quality and Rule of Law show positive correlations with real GDP, their long-run impacts are statistically insignificant. This could be attributed to the complex and gradual nature of regulatory and legal reforms, which may take longer to manifest tangible economic benefits. For instance, improvements in regulatory frameworks or legal systems often face implementation challenges, resistance from entrenched interests, or require complementary institutional changes to yield measurable impacts on growth (Knack & Keefer, 1995). Similarly, the Control of Corruption exhibits a counterintuitive negative relationship with real GDP in the long run, suggesting that while anti-corruption measures are fundamentally important, their immediate effects may involve transitional costs or disruptions to established systems. These findings align with studies from other emerging economies, such as those in Sub-Saharan Africa and MENA, where governance reforms often face implementation challenges and require sustained efforts to yield measurable impacts (Mauro, 1995).

The short-run analysis reveals that most governance quality variables, except Regulatory Quality, have a statistically significant impact on real GDP, highlighting their immediate influence on economic performance. The significant and negative error correction term (ECT) coefficients for both models indicate a robust adjustment mechanism, with 1.5% and 1.9% of disequilibrium corrected annually for Model 1 and Model 2, respectively. This demonstrates the dynamic nature of the relationship between governance quality and real GDP, where short-run deviations are systematically corrected over time. The findings underscore the importance of governance reforms not only for long-term growth but also for stabilizing the economy in the face of short-term fluctuations.

To sustain and enhance economic growth, Malaysian policymakers should prioritize governance reforms, particularly in areas with significant long-run impacts, such as political stability and government effectiveness. To sustain economic growth, Malaysia should prioritize governance reforms in key areas. First, strengthen political stability by reducing ethnic and religious tensions, ensuring peaceful power transitions, and building public trust in institutions. Second, enhance government effectiveness by streamlining bureaucracy, investing in civil service training, and adopting digital tools for better service delivery. Third, combat corruption through independent anti-corruption bodies, transparent procurement processes, and whistleblowing mechanisms. Finally, improve regulatory quality and the rule of law by simplifying business regulations, ensuring judicial independence, and protecting property rights. These reforms will create a stable, transparent, and investor-friendly environment, aligning with Malaysia's Shared Prosperity Vision 2030 goals.

The findings resonate with studies from other regions facing governance challenges, such as Southeast Asia, Sub-Saharan Africa, and MENA. For instance, countries like Indonesia and Thailand have shown that political stability and government effectiveness are critical for attracting foreign investment and sustaining growth (Morrissey & Udomkerdmongkol, 2012; Buracom, 2014). Similarly, post-pandemic recovery efforts globally emphasize the need for robust governance frameworks to rebuild economies and ensure resilience (World Bank, 2021). Malaysia's experience offers valuable lessons for other emerging economies striving to balance governance reforms with economic development.

This study has several limitations, including its reliance on national-level governance indicators, which may not capture subnational variations, and potential biases in self-reported governance data. Future research could explore subnational governance dynamics, incorporate qualitative insights from policymakers, and examine the role of digital governance in economic growth. Additionally, longitudinal studies could provide deeper insights into the long-term impacts of governance reforms.

REFERENCE

1. Acemoglu, D., & Robinson, J. A. (2012). *Why nations fail: The origins of power, prosperity, and poverty*. Crown Business.

2. Agoba, A. (2020). The impact of voice and accountability on economic growth in Africa. *Journal of African Business*, 21(1), 1-17.
3. Aisen, A., & Veiga, F. J. (2013). How does political instability affect economic growth?. *European Journal of Political Economy*, 29, 151-167.
4. Azam, M. (2022). Governance and economic growth: evidence from 14 Latin America and Caribbean countries. *Journal of the Knowledge Economy*, 13(2), 1470-1495.
5. Buracom, P. (2014). ASEAN economic performance, institutional effectiveness, and foreign direct investment. *Asian Affairs: An American Review*, 41(3), 108-126.
6. Elbargathi, K., & Al-Assaf, G. (2019). The impact of political instability on the economic growth: an empirical analysis for the case of selected Arab countries. *International Journal of Business and Economics Research*, 8(1), 14-22.
7. Emara, N., & Chiu, I-M. (2016). The impact of governance environment on economic growth: The case of Middle Eastern and North African countries. *Journal of Economics Library*, 3(1), 24–37.
8. Engle, R.F. & Granger, C.W.J. 1987. Cointegration and error correction representation, estimation and testing. *Econometrica*, 55, 251-76
9. Hill, R.C., Griffiths, W.E. & Lim, G.C. 2008. *Principles of Econometrics*. (3rd edition). Hoboken, NJ: John Wiley & Sons, Inc.
10. Huang, C. J., & Ho, Y. H. (2017). Governance and economic growth in Asia. *The North American journal of economics and finance*, 39, 260-272.
11. Jamaudin, N. (2019). Good Governance in Malaysia: Assessing Public Perceptions on the Implementation of National Transformation Policy, 2011-2016. *Intellectual Discourse*, 27(SI# 1), 719-743.
12. Jomo. (2016). *Growth and Structural Change in the Malaysian Economy*. Springer.
13. Kaufmann, D., Kraay, A., & Mastruzzi, M. (2010). *The Worldwide Governance Indicators: Methodology and Analytical Issues*. World Bank Policy Research Working Paper No. 5430.
14. Kaufmann, D., Kraay, A., & Zoido-Lobaton, P. (1999). *Aggregating Governance Indicators* (World Bank Policy Research Working Paper No. 2195). Washington, DC: World Bank.
15. Knack, S., and Keefer, P. (1995). Institutions and economic performance: Cross-country tests using alternative institutional measures. *Economics and Politics*, 7(3), 207-227.
16. Krueger, A. O. (1974). The Political Economy of the Rent-Seeking Society. *The American Economic Review*, 64(3), 291-303.
17. Kunawotor, M., Ahiabor, G., & Yobo, E. (2024). Government size, institutional quality and economic welfare in Africa. *International Journal of Social Economics*.
18. Lustrilanang, P., Suwarno, Darusalam, Rizki, L. T., Omar, N., & Said, J. (2023). The role of control of corruption and quality of governance in ASEAN: Evidence from DOLS and FMOLS Test. *Cogent Business & Management*, 10(1), 2154060.
19. Mauro, P. (1995). Corruption and growth. *Quarterly Journal of Economics*, 110(3), 681-712
20. Mira, R., & Hammadache, A. (2017). Good governance and economic growth: A contribution to the institutional debate about state failure in the Middle East and North Africa. *Asian Journal of Middle Eastern and Islamic Studies*, 11(3), 107–120
21. Morrissey, O., & Udomkerdmongkol, M. (2012). Governance, private investment and foreign direct investment in developing countries. *World development*, 40(3), 437-445.
22. Nathan, K. S. (2009). Harmony in government–society governance: Problems, challenges and prospects in Malaysia. *Governance for Harmony in Asia and Beyond*, 103-123.
23. Ncube, M., Anyanwu, J. C., & Hausken, K. (2014). Inequality, economic growth and poverty in the Middle East and North Africa (MENA). *African Development Review*, 26(3), 435-453.
24. Nga, J. K. H., & Kesumo, A. (2025). Does shared prosperity affect perceived financial well-being among individual consumers?. *Asia-Pacific Journal of Business Administration*.
25. North, D. (1990). *Institutions, Institutional Change, and Economic Performance*. Cambridge University Press.
26. Ofori, I. K., & Asongu, S. (2021). Foreign direct investment, governance and inclusive growth in sub-Saharan Africa. *Governance and Inclusive Growth in Sub-Saharan Africa* (June 7, 2021).

27. Omotosho, M. O. (2021). Impact of regulatory frameworks on informal cross border trade in Nigeria: a case study of the rice import restriction and border closure of 2019 (Doctoral dissertation, University of British Columbia).
28. Pesaran, M. H. & Shin, Y. (1999). An autoregressive distributed-lag modelling approach to cointegration analysis. *Econometric Society Monographs*, 31(7), 371–413
29. Pesaran, M. H., Shin, Y., & Smith, R. J. (2001). Bounds testing approaches to the analysis of level relationships. *Journal of Applied Econometrics*, 16(3), 289 – 326
30. Pinjaman, S., & Kogid, M. (2020). Macroeconomic Determinants of House Prices in Malaysia. *Jurnal Ekonomi Malaysia*, 54(1), 153-165.
31. Ramsey, J. B. (1969). Tests for specification errors in classical linear least-squares regression analysis. *Journal of the Royal Statistical Society Series B: Statistical Methodology*, 31(2), 350-371.
32. Rana, P. B. (2020). Voice and accountability and economic growth: Evidence from Asia. *Journal of Asian Economics*, 69, 101223.
33. Rodrik, D. (2000). Institutions for high-quality growth: What they are and how to acquire them. *Studies in Comparative International Development*, 35(3), 3-31.
34. Rosli, S., & Kamaluddin, A. (2023). Control of Corruption, Political Stability, Foreign Investors, Government Expenditure and Economic Growth Trends in the Southeast Asian Region. *IPN Journal of Research and Practice in Public Sector Accounting and Management*, 11(1), 127-155.
35. Shevchuk, V. O., Blikhar, M. M., Komarnytska, I. I., & Tataryn, N. M. (2020). Rule of law and economic growth. *Financial and credit activity problems of theory and practice*, 1(32), 278-289.
36. Silberberger, M., & Königer, J. (2016). Regulation, trade and economic growth. *Economic Systems*, 40(2), 308-322.
37. Trpeski, P., Merdzan, G., Kozeski, K., & Cvetanoska, M. (2023). Corruption, Government Spending and Economic Growth: The Case of Central and Eastern Europe.
38. Tullock, G. (1967). The welfare costs of tariffs, monopolies and theft. *Western Economic Journal*, 5, 224–232.
39. Udochukwu, N. E. (2024). Impact of Institutional Framework on Economic Growth of Nigeria (1996 to 2022). *International Journal of Research and Innovation in Social Science*, 8(1), 1185-1198.
40. Wong, C. H. (2023). Transitioning from aggregated bipartism: state elections in Malaysia, May 2018–March 2022. *Regional & Federal Studies*, 1-23.
41. World Bank. (2019). *Malaysia economic monitor: Making ends meet*. Washington, DC: World Bank Group.