Governance and Society Review (GSR)
Volume 1 Issue 2, Fall 2022
ISSN (P): 2959-1619, **ISSN (E):**2959-1627
Homepage: https://journals.umt.edu.pk/index.php/gsr

Article QR

Title:	**Factors Involved in Economic Development and their Impact on State-Building in Malaysia**
Author (s):	Abdillahi Nedif Muse[1], Saidatulakmal Mohd[2]
Affiliation (s):	[1]School of Social Science, Universiti Sains Malaysia, Malaysia [2]Centre for Global Sustainability Studies and School of Social Sciences, Universiti Sains Malaysia
DOI:	https://doi.org/10.32350/gsr.12.04
History:	Received: October 25, 2022, Revised: December 06, 2022, Accepted: December 20, 2022, Published: December 30, 2022
Citation:	Muse, A. N., & Mohd, S. (2022). Factors involved in economic development and their impact on state-building in Malaysia. *Governance and Society Review*, *1*(2), 72–103. https://doi.org/10.32350/gsr.12.04
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Conflict of Interest:	Author(s) declared no conflict of interest

A publication of The School of Governance and Society
University of Management and Technology, Lahore, Pakistan

Factors Involved in Economic Development and their Impact on State-Building in Malaysia

Abdillahi Nedif Muse, and Saidatulakmal Mohd*

[1]Abdilahi Nedif. School of Social science, Universiti Sains Malaysia
[2]Centre for Global Sustainability Studies and School of Social Sciences, Universiti Sains Malaysia

Abstract

The current study takes its inspiration from the successful history of poverty elimination in Malaysia that's make it a model economy, and also investigates the role of state-building in achieving this success. Aim of the study is to examine the factors involved in economic development their impact on state-building. The autoregressive distributed lag (ARDL) model was employed to test the economic factors affecting state-building. The study covered thirty seven years period. The long run co-integration in the model has been confirmed, and econometric diagnostic tests are identified. This study findings showed that human capital, oil rent, and per capita income, positively and significantly affected the state-building in the long run. In the short-run, human capital and oil revenue effected positively and significantly. Population growth, democracy, inflation, and financial development have confirmed a negative and significant impact on the state-building. Policy implication has highlighted the importance of human capital development, macroeconomic stability, and population growth in Malaysia's state-building. Demographic transition exerted a considerable negative effect on the state-building in the long run, affecting economic health, and steady-state growth. The negative impact of financial development on state-building to promote economic is a worrisome. The study recommended that the economic policymakers and relevant bureaucracies should implement a prudent fiscal policy to the fiscal deficit and facilitate domestic financial institutions into the credits based on the findings. Currently, Malaysia is facing a demographic threat in the long run due to the aging/increased population and low fertility rate, therefore, it is essentially important to re-address the policy regarding population.

Keywords: Autoregressive distributed lag (ARDL), economic development, and economic factors, state-building

* Corresponding Author: eieydda@usm.my

JEL Classification: 010, O53, H70, C32

Introduction

State-building is a complex term to define and a multi-dimensional phenomenon. The concept of governance and its linkage on economic development to shape the socioeconomic structure in their relationship within the state-society framework have not been explored well. State institutions are designed to make the process of consensual regulation permanent for the good of society and economic development (Richmond, 2014). Neo-liberal economics have delimited the role of the state to promote the economic growth and welfare. Delimitation of the state has affected post-colonial under-developed states to absorb public investment, infrastructure, and financial development into local economies (Barbara, 2008). As a result, developing countries have experienced a vicious cycle of low capacity, poverty, and low saving, which could permit the private sector and mass population to stimulate economic growth. It has led to fragility to State and stumbled the state-building and socio-economic transformation in many developing countries in Asia and Sub-Saharan Africa.

State-building is a continuous process for strengthening economic resilience to close the national citizens' economic and political inequality gap, while keeping in mind the statehood's security and safety. Active state institutions require stringent conditions for state-building to be successful (Schneckener, 2011). The concept of statehood is put into the interpretive manner and stated as; an institutionalised design with the power to rule authoritatively and to legitimately monitor the means of violence (Max & Talcott, 1958). The complex task of state-building and its relationship with economics has not yet been discovered. Development economists have undermined the link between development and state-building until recently.

Neo-liberal economists were agnostic for the state's involvement and intervention in economic development (Friedman, 1976; Hayek, 1979; Hirschman, 1958). These economists were against the theory of Keynesian economics but are the proponents of monetarism economics theory. The state's role has shrunk since the Washington consensus and bipolar world order after the Cold War. The effectiveness of state capacity generally understands the influence of the government's ability to provide minimal state functions (for instance, public goods, education, health, and

infrastructure). The state's ineffectiveness to constrain violence, while delivering free products was the primary constraint for economic development in under-developed countries (Bates & Bates, 2001; Migdal, 1988). State-building is a tricky, evolving process of strengthening the two different economic analysis institutions, which are extractive and productive (Besley & Persson, 2011; Johnson & Koyama, 2017). This gradual process has a causal linkage with the economic development. The state's prosperity depends onto the inverse institution to gain economic welfare and development into the community.

A vital institution is a necessary condition to develop in terms of capacity, financial, economic, and legitimacy of the state-society relationship (Prichard, 2010). This endogenous process, creates a favourable state to transform the economic growth and prosperity of the nation. As confirmed by the European success history and recently in East and South-East Asia, economic transformation in any nation-state is primarily responsible for the good governance (Wade, 1991). Generally, in the last two decades, economists have recognised the importance of institutions for the economic development to deliver public service efficiently (La Porta et al., 1999; North, 1981).

An empirical test of viable state on economic development has hardly existed due to the measurement and endogeneity problems (van Noort, 2018). Although, state capacity's decisive role is widely recognised in economics and another social science discipline, it is not yet tested empirically (Johnson & Koyama, 2017; Tabellini, 2005). A renewed interest in intellectual and policy cycles was recently burgeoning to investigate the state's role in the economic development. The relative absence of attention devoted to economists' state-building is due to the concept's vagueness and practical difficulties.

Malaysia is regarded as one of the most prosperous countries in every aspect and standard for a post-colonial state of Asia and Africa (Turner et al., 2013). It is regarded that the state is a key and crucial factor for structural and economic transformation in any country. Malaysia's economic miracle has achieved during the premiership of Dr. Mahathir Mohamed (1981-2003) through a state-led development model imitated from East Asian countries, especially Japan and South Korea (Gomez, 2009). Favourable institutions and creating a conglomerate corporation with a secure link to the financial industry and government has hugely

transformed the traditional economy into a modern and industrialised economy. However, the ever-increasing interconnectedness for the global economy and international organisation (for instance, WTO, IMF, World Bank, and WTO) has increased the economic shocks and effects of fiscal policy in developing countries. Therefore, this study attempted to address; how effective the state promotes economic development and copes with economic crises and shocks. To drive this interaction, this study investigated the economic determinants of state-building in Malaysia. To our knowledge, there are no published works on state-building and economic development and its' determinants in Malaysia.

This research fills the gap by empirically examining the previous literature and by identifying determinants of state-building for Malaysia's case at the country level. Moreover, this study sheds light on various aspects of state-building literature and estimates state-building's newly developed variables from the economic freedom database. The rest of the paper is sub-categorized as follows: section II addresses Malaysia's economic development experience. Part III presents the concept of state-building and measurement. Section IV is the empirical review of literature.

Section V is a Methodology. Section VI presents the empirical analysis and results followed by conclusion and future research recommendations.

The Experience of Malaysian Economic Development and Role of State Building

The second-largest oil and gas producer in South East Asia is Malaysia and has a comparative advantage for the export of liquefied gas globally (Badeeb et al., 2016). Furthermore, the country located strategically important routes for seaborne energy trade. The state has been proven as a significant reserve of oil, which makes it the fifth-largest oil producer in Asia-pacific after China, India, Indonesia, and Vietnam.

Since independence, Malaysia has experienced robust economic growth, within an average of 4% from 1960-2005 (Lange, 2009). Economic growth in Malaysia was fluctuated mostly due to the full integration of the global market and its openness. The economy has shown a slow recovery process that remained inconsistent, with an annual growth rate of 5% from 2000 – 2008 and declined to -1.5 in 2009, during the financial (Badeeb et al., 2016; Cassey, 2019). Overall, the country's annual average growth rate has been in the range of 5-10% (Badeeb et al., 2016). Furthermore, there

has been a significant structural change during the past six decades. The dependency of agriculture in the economy has declined, while manufacturing has increased. The per capita of the country has risen six-fold during this period. The causes of this fundamental transformation were the mixed economic setting in which both the market and the state played an important role. The state's crucial purpose towards the Malaysia's economic development was the developmental planning and effective implementation of policies. The country has taken a bold measurement to eliminate poverty and inequality, which resulted in a structural transformation in Malaysia's economy and society as a whole.

The country's economic activities mainly involves domestic and international communities, indicating local and international trade interactions such as export, import, and foreign direct investment. The positive contribution of the trade openness on growth transmit through liberalisation that leaks the domestic producers to international practices in terms of knowledge, technology, and skills (Abdullah et al., 2009). The main arguments observed in this case are that trade openness and suitable macroeconomic policies can conserve the overall revenue generation. Some states can take advantage of improving economic stability with their firm policy on trade openness and tax revenues (Gaalya, 2015; Hisali, 2012; Mahdavi, 2008). According to Chandran (2009), the success of Malaysia's economy's trade openness depends on the tax policy formulation, which further spurs the investment.

Malaysia made a significant improvement to eliminate poverty since the 1970s, in which approximately 50% of the country's population had lived below the poverty line (Cassey, 2019). By 1997, the incidence of poverty has declined to about 11% due to the absorption of rural educated workers into higher income occupations in the industrial and service sector (Ragayah, 2011). Income inequality of the country declined over time since the 1960s. A significant reduction was achieved after implementing the New Economic Policy (NEP) in the 1970s and further deteriorated after the 2000s. Rising employment and high salaries were the main factors were the main reasoning reducing the income inequality (Ragayah, 2011).

Effective and efficient administrative system is an stepping stones for the state to play an active role in economic development both in developing and developed countries (Trezzini, 2001). Malaysia has experienced a strong bureaucratic and meritocratic in public organisations that have

guided the booming economic growth history for six decades. The relationship between technological innovation and governance institutions has significantly affected Malaysia's economic development in the longer-run (Bekhet & Latif, 2018). Abdullah et al. (2009) has investigated the impact of trade openness and fiscal policy on economic growth. They found that trade openness and fiscal policy have a strong positive effect on the economic growth of Malaysia. Studies on tax revenue and per capita GDP, in the longer run, existed in Malaysia and found that tax revenue has positively affected the economic growth of Malaysia (Loganathan et al., 2020).

The role of the Malaysian state in economic development has been confirmed both directly and indirectly for extensive existing literature review. This study intended to investigate the economic determinants of the state-building factors in Malaysia.

The Concept of State Building

In economic development, state-building was not just analysing rigorously to understand its relationship in economic performance until in recent times. Therefore, the concept of state-building is a complex term to define and know into a generic aspect (Ghani et al., 2005). The multidimensionality of state-building is complicated to give better insights into the role of economic growth and development (Risse, 2011). Multi theories of state-building in different study fields exacerbate to investigate and establish the robust measurement parameters empirically. The complexity of state-building is a continuous process of strengthening the existing institutions and creating new ones to co-opt the state's expanded role in economic production and fiscal policy(Thies, 2007). In the economic mainstream, state-building in the vintage point is a catalyst for economic development, which is regarded as an endogenous variable in the growth theory model. Since state building is a process for strengthening institutions, it implies increasing economic institutions in two main state-building dimensions: extractive and product sides (Acemoglu et al., 2004; Acemoglu et al., 2015). The institutional building is a fundamental principle to lay the foundation for better economic growth and governance in any nation-state (Acemoglu, 2005; Acemoglu & Robinson, 2001; North, 2002; Olson, 1993).

According to the predatory theory of the state, the trajectory of economic development is rooted from the state, which implies that making a stable state is a conditionality of sound economic growth and development and state embedded society (Campbell, 2006; Centeno, 2002; Tilly, 1993a, 1993b). Capacity building of the state's institutions has considered a vital part of the socio-economic transformation in developing and developed countries as a path for the economic development. In most of the developing countries, democracy in general and competitive elections have facilitated state-building. Empirical studies have in development economics, political science, and political economy undermined the role and magnificence of state, state strength and capacity, and state-building for the economic growth and performance. Few studies have recently addressed the impact of the state on economic growth and welfare of the people (Bardhan, 2016; Besley & Persson, 2009, 2013; Borcan et al., 2018; Dincecco, 2017; Dincecco & Prado, 2012; Johnson & Koyama, 2017; Tabellini, 2005).

The critical concept of state-building is to strengthen state structure and institutions and the state apparatus's capacities to govern (Schneckener, 2011). In line with this concept of the governance system in a state is a procedural of building efficient economic institutions to enhance the economic transformation. Determinants of state-building are tapping in economic and political science, but empirical studies have hardly tested. The empirical analysis of state-building in both economic development and political science is hard to find, and few studies conducted in the last decades have mainly focused on the state capacity (Acemoglu et al., 2015; Dincecco, 2017; Thies, 2005; van Noort, 2018). Many variables affected the state-building either positively or negatively; the empirical studies on democracy have produced mixed results in different countries according to their economic development and capacity (Cheibub, 1998). Higher inequality is associated with weak state institutions and low state-building processes; therefore, income inequality negatively affects the state-building process (Engerman & Sokoloff, 2002; Savoia et al., 2010).

Oil rent plays a vital role in either strengthening or weakening the state capacity depending on the state's level of democracy. Whenever the state's democracy is unstable, natural resources, for instance, oil rents, negatively contribute in the state-capacity process due to the exemption to establish an efficient tax collection system (Karl & Gary, 2004). On the other hand, studies on governance, which regarded as a sub-component of the state and

state-building process, showed that improved management leads to better developmental outcomes such as, among other variables, economic growth, public investment, human capital, and social infrastructure (Boswell & Richardson, 2003; Gupta et al.,1998; Mauro, 1998; McKinney & Moore, 2008). Studies on Latin America's state-building showed that states spent money on constructing the economy, buying local lords and army officers' loyalty, establishing taxation systems and bureaucracies, and securing economic elites' support (Lopez- Alves, 2001). State-building is a tumultuous process to improve the state's extractive capacity and productive capacity to catalyse economic development and resource utilisation. On the other hand, a closed issue or subset of state-building is a governance issue.

Economic development and wealth are nonlinear factor for the state-building. However, when it reached a threshold level, more wealth GDP per capita implies functional and useful state-building since it would spend more on their state's public goods (Ruggie et al., 2005). Inequality in income is a significant setback of economic development in developing states, high inequality threats political stability, increases corruption and crimes, and eventually erodes good institutions in the governing system (Jha, 1997). When a state is a built successfully, it escapes fragility caused by a low level of public investment, attracts private investment, creates jobs and stimulates economic growth (Bandiera et al., 2019).

Empirical literature

An empirical investigation of state-building has barely explored the developmental economics as a determinant factor in state building, however, a few studies have attempted to examine the state capacity. It plays a role in economic development. Contemporary economists focused on governance and institutions as a primary determinant of economic development (Bardhan, 2020a, 2020b). Therefore, the core variables, which affects the economic growth have mesmerised and sliced into subcategories instead of addressing the holistic approach to identify the problems of the state capacity or state building (Acemoglu et al., 2015; Acemoglu & Robinson, 2001; Besley & Persson, 2014). This study addresses state-building economic determinants for Malaysia's case study as a prosperous independent developing country for the post-colonisation and decolonisation. As the review literature on the economic and state-building dearth and few studies concentrates on the state-building and development

of the country mainly from a political science and political economic point of view, it does not cover state-building measurement. It limits state capacity or extractive parts of state-building. In this study, we are combining the two-component of state-building, such as, legal size and property component and size of government or extractive component-driven from five elements of economic freedom world in two of them.

Many Scholars contend that high state capacity plays a vital role in economic development (Evans, 1992; Leftwich, 2000), despite few have tested empirically. According to Evans & Rauch (1999), few have tested statistically, finding a positive effect of Weberian bureaucracy on economic growth. Among a few other empirical studies have found that state capacity enhances income levels by employing state institutions' historical penetration within a territory (Bockstette et al., 2002). In Africa's extant literature discussed whether political competition in low state capacity causes economic tragedy in the continent (Englebert, 2000; Sandbrook, 1986). The inadequate state capacity for effective implementing economic policies have led to spending resources on short –term projects through a clientelist network. It could lead to a selection of inadequate systems inducing poor macroeconomic performance. Theoretically, state power is a necessary condition for economic activities to produce long-term economic growth (Hanson, 2014). Weak states cannot provide the essential requirement for modern economies such as policy stability, property right, contract enforcement, infrastructure, and public services. Developmental states that implement well-designed, selective, and thoroughly implemented interventions in the economy are among the most successful. Stable states can act cohesively, and in particular, to extract performance from private firms (Amsden, 1990; Chibber, 2003).

In addition, the state's ability affects the manager's motivations. When state capacity is weak and the power structure is barely legitimate, incentives for personal or neo-patriarchal rule are decisive, especially in heterogeneous societies that emerge from fragile states that cannot afford to implement the necessary economic changes. The power-holders resort to clientelist activity to grip power and offer the state's resources. On the other hand, a healthy state provides the tools to implement developmental policies and induce rulers to chase them (Olson, 1993).

Methodology

This study has employed an annual time series data covering 1970-2017 for economic stability development indicators in Malaysia and state-building. For this purpose, the data was obtained from the world development indicator (WDI) from World Bank (2019) and Fraser institute for the state modernity index to measure state-building. All series are valued on $US dollar except population growth, democracy, and human capital. State building as a dependent variable is available in five-year intervals from 1970-2000 and yearly afterward; therefore, we interpolated the interval periods. Inflation, per capita GDP, financial development (FD), population growth, trade openness (OP), official development assistance (ODA), democracy (Polity VI), Oil rent, and human capital are all available annually.

In this study, the Autoregressive Distributed Lag (ARDL) approach to co-integration, which is proposed by Pesaran (1997), Pesaran et al. (1999), and (Pesaran et al. (2001) is used to test the long-run co-integration relationship between variables. Therefore, we specified the following ARDL model.

$$\Delta SEM = \beta + \lambda 1\text{lgdp} + \lambda 2\text{lpop} + \lambda 3\text{ODA} + \lambda 4\text{hci} + \lambda 5\text{lop} + \lambda 6\text{loilrentt} - 1 + \lambda 7\text{lpolity2} + \lambda 8\text{linfl} + \beta_1 + \sum_i^n \Delta SEM + \beta_2 + \sum_{i=1}^n \Delta lgdp + \beta_3 + \sum_{i=1}^n \Delta lpop + \beta_4 + \sum_{i=1}^n \Delta ODA + \beta_5 + \sum_{i=1}^n \Delta lhci + \beta_6 + \sum_{i=1}^n \Delta lop + \beta_7 + \sum_{i=1}^n \Delta loilrent + \beta_8 + \sum_{i=1}^n \Delta lpolity2 + \beta_9 + \sum_{i=1}^n \Delta\, linfl + \varepsilon_t \quad (1)$$

Where:

λ_1, λ_2, λ_3, λ_4, λ_5, λ_6, λ_7, and λ_8 are coefficients that measure the long run

β_1, β_2, β_3, β_4, β_5, β_6, β_7, and β_8 are the coefficients that represent the short-run dynamics of the model.

The null hypothesis is

H_o: $\lambda_{1,} = \lambda_{2,} = \lambda_{3,} = \lambda_{4,} = \lambda_{5,} = \lambda_{6,} = \lambda_{7,} = \lambda_8 = 0$ (there is no long-run relationship)

H_1: $\lambda_{1,} \neq \lambda_{2,} \neq \lambda_{3,} \neq \lambda_{4,} \neq \lambda_{5,} \neq \lambda_{6,} \neq \lambda_{7,} \neq \lambda_8 \neq 0$

To determine the existence of the long-run relationship between variables, a Bound test was used for the null hypothesis of no co-integration

and the calculated F-statistics was compared with the critical value formulated by Pesaran (1997) and Pesaran et al. (2001). If f-statistics exceeds the upper critical value, the null hypothesis of no long-run relationships can reject without considering whether the underlying order of integration is I(0) or I(1). Likewise, if statistics below the critical value, the null hypothesis is not rejected. Thirdly, if the test falls between these two bounds, the result is inconclusive.

Next step, if there is a long-run relationship among the variables, the following long-run equation (2) is estimated as follows:

$$SEM = \beta_0 + \beta_1 + \sum_i^n \Delta SEM + \beta_2 + \sum_{i=1}^n \Delta lgdp + \beta_3 + \sum_{i=1}^n \Delta lpop + \beta_4 + \sum_{i=1}^n \Delta ODA + \beta_5 + \sum_{i=1}^n \Delta lhci + \beta_6 + \sum_{i=1}^n \Delta lop + \beta_7 + \sum_{i=1}^n \Delta loilrent + \beta_8 + \sum_{i=1}^n \Delta lpolity2 + \beta_9 + \sum_{i=1}^n \Delta\, linfl + \varepsilon_t \quad (2)$$

After probing the co-integration, the next step is to estimate the error correction model (ECT), which showed the speed of adjustment back to long-run equilibrium after a short-run disturbance. The standard Ect was estimated as follows:

$$SEM = \beta_0 + \beta_1 + \sum_i^n \Delta SEM + \beta_2 + \sum_{i=1}^n \Delta lgdp + \beta_3 + \sum_{i=1}^n \Delta lpop + \beta_4 + \sum_{i=1}^n \Delta ODA + \beta_5 + \sum_{i=1}^n \Delta lhci + \beta_6 + \sum_{i=1}^n \Delta lop + \beta_7 + \sum_{i=1}^n \Delta loilrent + \beta_8 + \sum_{i=1}^n \Delta lpolity2 + \beta_9 + \sum_{i=1}^n \Delta\, linfl + \psi ect_{t-1} + \varepsilon_t \quad (3)$$

The coefficients represented the short-run dynamics of the model. ect_{t-1} is error correction term lagged one period. ε_t is a white noise disturbance error term. Finally, the robustness of the model was tested through serial correlation, Normality test, and heteroscedasticity test in the model. In this methodological analysis, the economic determinants of state-building in Malaysia were examined as a prosperous nation.

Results

Table 1 presents the unit root test results for checking the stochastic properties of the data assessed based on the series of each variable through the augmented dickey fuller test. Results indicated that human capital, population density are stationary at level I (0). Gross domestic product, openness, and state economic modernity (SEM) or state-building are not stationary at level. All the time series variables were checked again in the first differencing. The results showed that oil rent, democracy, official development assistance, inflation, openness, and state economic modernity

index are stationary. The variables' order of integration revealed a mixed of I (0) and I (1) integrations, which were used to employ the autoregressive distributive lag (ARDL).

Table 1
Unit Root Test Results ADF

Variables	At level		At first difference		
	intercept	Intercept & trend	intercept	Intercept & trend	
LGDP	-1.732623	-2.527453	-5.86479***	-5.951354	I(1)
LNIHC2	-7.42208***	2.430603	-0.950247	-2.183833	I(0)
LNPOPD	-4.58208***	-3.160493	-0.591648	-1.932986	I(0)
LOILRENT	-8.50310***	-7.73227***	-7.04218***	-7.23842***	I(1)
LPOLITY2	-6.10990***	-5.84056***	-13.5318***	-13.1086***	I(0)
ODA	-2.339279	-4.533256**	-9377978***	-9.48013***	I(1)
LNOP	-1.455028	-0.071142	-5.07395***	-5.56310***	I(1)
LNINF	-3.986437**	-4.207049**	-8.98038***	-8.87894***	I(0)
SEM1	-2.515330	-2.388620	-4.19250***	-4.318956*	I(1)
Ldcp	-2.780964*	-1.389165	-2.459087	-6.53389***	I(1)

Note. *Shows stationary at 10% ;** shows stationary at 5%; and *** shows stationary at 1%

Following the check of the unit root test and order of integration, it's essential to determine the optimal lag selection before proceeding towards the application of the ARDL model in the study variables. In this selection procedure, Akaike information criteria (AIC) and Schwarz Bayesian Criteria (SBC) are the two most used methods to select the best lags for variables. Therefore, this study used SBC for lag selection criteria. The maximum order of lags included in this study are two.

The current study further followed to examine the long-run relationships among the variables. According to Pesaran et al., (1999), since the observations are annual, therefore, the researcher choose two as maximum optimal lag and estimate for 1970-2017. The co-integration relationship in Table 2 based on the F-critical value suggested by using a small sample size between 30-80 (Narayan & Narayan, 2004). The calculated f-Statistics (7.291925) are higher than all critical bound values in the study. This

confirmed the existence of the long-run co-integration between the selected variables in the study. After the test and establishment for the co-integration, the dynamic relationships both in the long-run and short-run effect was investigated for the independent variable to the independent variables for the direction and degree of correlation.

Table 2

F-statistic of Co-integration Relationship

Test statistics	Lag	Critical Bounds		
		Significance level	I(0)	I(1)
7.291925	2	10%	1.88	2.99
		5%	2.14	3.3
		2.5%	2.37	3.6
		1%	2.65	3.97

The long-run relationship between state-building and other economic variables are presented in Table 3. The economic determinants of state-building in both short-run and long-run periods are presented here.

Coefficient of Interpretation

Table 3

Estimated Long-run Co-integration

Variable	Coefficient	Std. Errors	t-statistics	Prob.
C	563.230419**	171.265023	3.288648	0.0028
LGDP	6.548958**	2.723080	1.953702	0.0112
LNIHC2	37.597331**	14.807804	2.539021	0.0172
LDCP	-1.476784**	0.702772	-2.101369	0.0451
LPOP	-37.60101***	11.20981	-3.354513	0.0024
LOILRENT	1.010071***	0.130152	7.760686	0.0000
LPOLITY2	-2.194563***	0.664147	-3.304331	0.0027
ODA	-0.208731**	0.100187	-2.083425	0.0468
LOP	-1.578598	1.036553	-1.525929	0.1394
LINFL	-1.120068***	0.228603	-5.252228	0.0000

Note. ARDL (1,2,0,0,2,1,1,1,0,2) selected based on SBC. The dependent variable is SEM/state-building

A 1% increase of gross domestic per capita income is associated with increased state-building by 0.0654%. The positive relationship between state-building and economic development showed a mutual interdependence of these variables.

If human capital increases by 1%, state building would be expected to increase by 0.375%. The vital role that human capital development plays in state-building in Malaysia is paramount for sustainable economic development. The study findings stated that a 1% increase in population growth caused a decrease in -0.376% by state-building in Malaysia in the longer run. A 1% increase in the financial development has decreased by -0.0147% in state-building, holding all other variables constant. Financial development's negative contribution in the state-building in Malaysia is related to the country's fiscal deficit and debt, mainly a domestic debt that crowded out the access of credit to the private sector. This finding revealed that 1% increase in the natural resource (oil rent) linked with the rise of state-building by 0.0101%. Revenue from oil has strengthened the effectiveness of state-building and economic development.

If democracy increases by 1%, state-building is expected to decrease by approximately -0.022%, holding other independent variables constant. The inverse relationship between democracy and state-building has a threshold level; therefore, there is a nonlinear relationship between these variables. Macroeconomic stability has contributed in the effectiveness of state-building in Malaysia during the study period. A 1% decrease in inflation increased by 0.012% in the state-building, holding other independent variables constant. Inflation is a symptom of macroeconomic stability and low inflation has increased consumer and investors' certainty, which in turn boosts the total productivity factors.

Table 4

Short-run Error Correction Model

ARDL Model (1,2,0,0,2,1,1,1,0,2)				
Variable	Coefficient	Std. Errors	*t*-statistics	Prob.
D(LGDP)	-1.296174	1.119000	-1.158332	0.2569
D(LGDP(-1))	-2.506815	0.934781	-2.681715	0.0123
D(LNIHC2)	17.068710	6.214908	2.746414	0.0106
D(LDCP)	-0.669732	0.274003	-2.444253	0.0213
D(LNPOPD)	-395.30943	68.405457	-5.778917	0.0000

Variable	Coefficient	Std. Errors	*t*-statistics	Prob.
D(LNPOPD(-1))	275.551509	54.393949	5.065849	0.0000
D(LOILRENT)	0.303234	0.091760	3.304645	0.0027
D(LPOLITY2)	-0.537482	0.252708	-2.126892	0.0427
D(ODA)	-0.094706	0.038874	-2.436207	0.0217
D(LNOP)	-0.714277	0.453309	-1.575695	0.1267
D(LINFL)	-0.115733	0.043949	-2.633369	0.0138
D(LINFL(-1))	0.184179	0.050761	3.628382	0.0012
CointEq(-1)	-0.453524	0.070623	-6.421716	0.0000

Note. *$p < 0.05$. **$p < 0.01$. ***$p < 0.001$.

The short-run coefficient estimates showed the dynamic of all variables. The short-run coefficients for dlgdp, dlnhc2, dldcp, dlnpopd, dloilrent, dlpolity2, dlinfl, and dloda were significant at 1 and 5% level of significance.

Error correction term cointEq(-1) estimated at -0.453524 was highly significant, indicating that human capital, economic development (per capita income), population growth, natural resource, official development assistance, democracy, and inflation are co-integrated. The estimated value of the coefficient showed that 45.3% of the disequilibrium offset by a short-term in state-building adjustment in the same year.

Discussion

After establishing long-run co-integration among the variables, the result from Table 3 shows a long-run relationship. The constant term is positive and statistically significant, and all other variables are significant, except openness in the long-run. A 1% increase in the real gross domestic product increased the state-building by 6.55% at 5% significance level. Economic growth has contributed in the state-building of Malaysia, significantly. The result supported the empirical findings of (Dincecco & Katz, 2016; Loganathan et al., 2020). Economic growth allowed the government to provide public goods, strengthen judiciary and law and order to the citizens, create employment opportunities, and political stability. These results were effective for the state-building and robust economic policies with capable fiscal and implementation capacity. Human capital is a strong determinant of state-building; it has exerted significant and positive impact on the state-building. A level 1% increase in human capital increase the state-building of Malaysia by 37.6%. The positive relationship between human capital and

state-building has confirmed the extant literature across disciplines. The result confirmed by the study of (2019), human capital development raises workers' productivity and creates a decent living standard. The necessity of human capital in the state-building is often captured by political-economy and development economics. Furthermore, it was stated that effective tax systems in developing countries require capacity building through training and strengthening supportive institutions (Besley & Persson, 2014). It has been established that human capital is a key factor in how Malaysia's government is structured.

Domestic credit to the private sector is negatively and significantly affected by the process of state-building in Malaysia. A level 1% increases in domestic credit to private sector decreases the state-building by 1.5%. The negative relationship between financial development and state-building has a theoretical contrast. The causes of the negativity are due to the multiple factors of the economic structure in Malaysia. High domestic debt has crowded out the availability of private credit to private firms. It might encourage the underground economy, which would eventually affect the state-building effectiveness through legal and fiscal capacity (Kumhof & Tanner, 2005). Another similar study was found in (Chung-Yee et al., 2020), which showed the negative relationship between domestic credit to the private sector/financial development and public debt. Population density per square km has exerted a strong and significant negative relationship with state-building in the long-run. A level 1% increase in the population density reduce 37.6% by state-building in Malaysia. The negative relationship between state-building and population growth contributes in the disproportionate share of wealth, aging population pressure to provide health and fertility reduction rate in the long-run. The demographic change, which Malaysia experienced so far may have an adverse consequence in the long-run. Democracy, official development assistance, and inflation have a significant and negative long-run relationship in state-building. Findings of the study is consistency with theoretical assumptions of economic development and political economy.

A 1% decrease in inflation have increases 1.2% of state-building. Malaysia has maintained a stable macroeconomic and robust monetary policy since independence; therefore, low inflation and good monetary policies have indirectly contributed the effective state-building. Domestic borrowing kept less inflationary in the country (Khan et al., 2020). Another

critical determinant of state-building is democracy, which is found to be a negative and significant contributor to the state's economic development. A 1% decline in the democracy has increased the state-building by 2.2%. Malaysia is a youthful state, which attained its independence in 1957 from the British colony and multi-racial; thus, democracy has not supported the State's structure/ development due to the income inequality among ethnical groups, high poverty situations, and a dearth of human capital (Muller, 1995). Official development assistance is also finding negative and significantly associated with state-building. Malaysia has maintained a high tax–GDP ratio throughout the decades and relied on its revenue and domestic borrowings; Thies (2007) presented a similar finding.

Oil rent has contributed in the effectiveness of the state-building in Malaysia. It has exerted a positive and significant impact on the state-building. The study finds that a 1% increase in oil rent has increased the state-building by 1.01%. The positive contribution of natural resources in general and especially oil allowed the state-government to spend on the public provisions and reduce extreme poverty, which the country has inherited from the colony. Similar studies found the significant positive contribution of oil rents in Kazakhstan's fiscal policy (Azhgaliyeva, 2014). The effectiveness of state-building in Malaysia has successfully managed natural resource endowment and diversified her economic structure (Ali, 2016). These successes' main contribution is the effective state-building in the country, which can significantly be determined by prudent macroeconomic management.

In the Short-run Discussion

The short-run findings revealed a negative and insignificant association with gross domestic per-capita income and state-building in Malaysia. This implies that Malaysia's gross domestic per-capita income has not contributed in the state's economic strengthening in the short-run. However, one-year lag of gross domestic per-capita has a significant and negative impact on the state-building. This infers that the contribution of gross-domestic per-capita income in the previous year has influenced the current level of income per-capita.

The short-run findings showed that human capital has a positive and significant contrition in the state-building. It indicated the importance of human capital in state-building through skills and knowledge split over to the state's economic development and its effectiveness. Domestic credit to

the private sector exerts a negative and significant association on state-building. It entailed that the state borrowed local financial institutions to support fiscal deficit and stimulated the domestic expenditure; this created an inflationary pressure on the short-run of the state, which halts the strengthening of state effectiveness. This economic leakage affected the economic performance through underground economic activities and the state-building process in Malaysia.

Short-run dynamics revealed that the population growth has also exerted a negative and significant impact on state-building. The one-year lag of population density's coefficient depicted the positive and significant relationship with state-building at a 1% significant level. It can be interpreted to mean that the previous year population growth leads to the current state-building improvement. Decreasing the population's fertility and an aging population has exerted challenges in the long-run state-building to sustain the economic and human capital success for the last five decades. Also, former studies set up the rising concern about the growing population in Malaysia and unmatched employment provident fund(EPF) that might push back to poverty challenges while, impedes high- income line plan (Shakil et al., 2016).

Oil rent showed a positive and significant association with state-building in short-run dynamics, in Malaysia. Oil revenue has facilitated the role of the state-building process to catalyse the economic development of the Malaysian State. The natural resources have become a blessing in Malaysia, like other developing countries. Democracy has revealed a negative and significant impact on the short-run at a 5% significance level. The negative association between state-building and democracy has contributed in many factors, including the story of economic development and income inequality. These findings align with Muller's (1995) and Kamaruddin & Rogers, (2020) studies. Official development assistance and inflation are also depicted as unfavourable and significant nexus on state-building in the short-run. Official development assistance has eroded tax capacity and increased the corruption and shuttle economic development, which was eventually effective in state-building. A study undertaken in developing countries has concluded that official developmental assistance reduces the government effectiveness (Lee & Im, 2015). Similarly, in a likewise manner similar results were found in previous researches of (Bräutigam & Knack, 2004; Kekic, 2007; Rajan & Subramanian, 2011). Strong monetary policies and a sound financial system in Malaysia have

kept low inflation, which has enhanced the state-building of the country. Openness has exerted a negative sign but insignificant sign. This implies the slowdown of manufacturing competitiveness and the workers' lower productivity (Narayanan & Yew-Wah, 2016). The ECM coefficient signified the adjustment speed after the shock showed a negative sign at the 1% level of significance. This inferred that 45% of the disequilibrium errors are corrected annually.

Diagnostic tests

To check the impartiality of data analysis, this study has employed statistical diagnostic tests. For autocorrelation, heteroscedasticity, normality, stability, and specification for the ARDL model, which are presented in Table 5. The serial correlation test conducted using the Breusch-Godfrey LM test results revealed that the null hypothesis cannot be rejected as the F statistics of the model is 0.824507 with a probability of 0.4500, indicating the absence of serial correlation in the model.

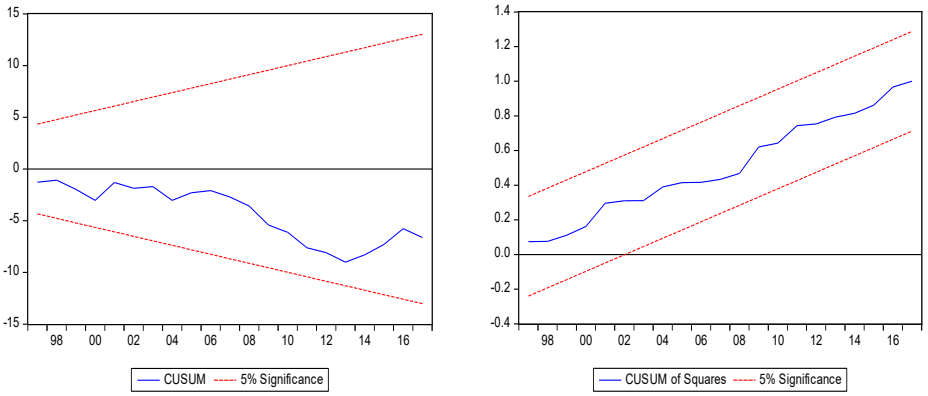
Table 5

Diagnostic Tests

Test	Statistics	*p*-value
Serial correlation (2)	0.824507	0.4500
Heteroscedasticity (2)	1.581942	0.1369
Normality	0.553302	0.758319
Functional form	0.087352	0.9166

The diagnostic test also indicated that the model normally distributed and there was no heteroscedasticity in the model. Finally, the model is tested against missed specifications using the Ramsey RESET test and the result indicated that the model was correctly specified.

Finally, the model's stability tested the employing CUSUM and CUSUM square techniques developed by Brown et al. (1975). The test showed that the model lies within the 5% of the significance level. The null hypothesis accepted that the model for the economic determinants of state-building in Malaysia is stable at a 5% level of significance.



Conclusion

In this study, we have investigated the factors involved economic development and their impact on economic development in Malaysia. The importance of the state in economic development and social transformation has recognised early period 19th century. The successful socio-economic transformation in Malaysia's state building has been significantly contributed by the prudent economic policies and development, Therefore, the State has played a vital role in economic development and transformation in post-colonial states, mainly in East & South East Asia (Robert, 1990).

Malaysians have experienced a tremendous economic and social transformation in the last six decades of her financial success. The role of state-building and economic factors have been examined in this study. To achieve the study's objective, this research applied autoregressive distributive lag (ARDL) to conduct the data analysis.

This study findings highlighted the economic factors of effective state-building to support the economic development of the country. Initially, the stationarity properties of time series data was checked to proceed for further analysis. At the initial level, only four variables were stationary; the remaining variables were stationary after the first differencing. These results allowed the ARDL co-integration analyses. Bounds test depicted the existence of long-run co-integration among the variables in the model. The long-run and short-run results revealed the decisive determinants of economy in the state-building and supported an economic theory. It implies that a strong correlation between economic development and state-building in Malaysia has determined its socio-economic transformation.

Furthermore, the result revealed that gross-domestic per capita income, human capital, and oil revenue have significantly and positively contributed to state-building in Malaysia for the longer-run. Therefore, these variables are significant factors, which have affected the state-building of Malaysia. Population growth has shown high significance and negative correlation in the longer-run. However, one year lag of the population returns to positive and remains significant. Democracy, inflation, domestic credit to the private sector, and official development assistance indicated the negative association between state-building in the short-run and long-run. The study revealed that all study variables are the vital determinants of state-building in Malaysia except the insignificance level of openness. The negative and insignificant level of trade openness has implied the unfavourable circumvent for the State's competitiveness.

Recommendations

The current study has confirmed the importance of economic development in state-building and successful economic transformation from poor communities to high middle income and industrialised country. However, the two best odds for the results were curios for the future success of state-building. Domestic credit to private investment has been find as negative and significance. This inferred domestic borrowing from financial institutions plays a vital role that state-building in Malaysia as a result of less opportunity from private and small scale enterprises due to the constraints of credit investments. This would constrain the state-building and eventually the economic development through two transmissions; firstly, through inflationary pressure since the government's fiscal deficit has supported the domestic borrowing from financial institutions. In the long-run, this debt created a liquidity problem for the credit market, and finally, inflation, which affected the state-building. The second transmission mechanism is through the shadow economies, which is transactional because of credit constraints in micro-scale and medium enterprises by the government spending through domestic borrowing. Therefore, the credit system regulation crowded out the private sector, which eventually compels to go underground/shadow economy and weakens the tax efficiency system. Population density and the robust checking for an alternative variable of population growth has exerted a negative and significant impact on the state-building in the longer-run. Therefore, the population has positively contributed currently as a result of

the previous negativity in the short-run. Malaysia's aging population is rapidly increasing and the demographic transition has already taken place in the country. Therefore, the state of welfare and employment provident fund are not appropriately responding to this demographic change. The population decrease due to the total fertility reduction and the aging population would ultimately affect the revenue and welfare system of the country. Eventually, the accumulation of this effect would decrease the effectiveness of the state-building and economic development.

Policy Implications

The implication of the policy reflected the strict monetary policies employed Asian financial crisis in 1997 onward, which allowed an effective state-building to contribute economic development in Malaysia. For this purpose, the improvement of the financial systems would be able to strengthen state-building in Malaysia. The government should further advance human capital into a global standard that participates, while allocating more research and developmental budgets. Malaysia promotes its industrialisation; therefore, the country should prepare world-class human capital that strengthens the state-building and economic development. The government should balance its fiscal deficit and strength to channel domestic credit to the private sector and cut the government's domestic borrowing.

Population policy should be addressed curiously and establish active institutions for the welfare system. Finally, the state-building policymakers in Malaysia should strengthen the legal capacity to transform higher income for developed countries and avoid the middle-income trap like many emerging/under developing countries.

The role of state power or building in economic growth is a new frontier in the field and is under-explored empirically; therefore, future research should address the causal relationship between state strength and economic development.

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