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The Economic Impact of Malaysia's 2018 Political Transition: A Synthetic Control Analysis

Impak ekonomi peralihan politik Malaysia 2018: Analisis kawalan sintetik

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ABSTRACT

Political transitions can cause significant economic consequences, but their causal effects are difficult to isolate. This study examines Malaysia's 2018 Regime Change from Barisan Nasional (BN) to Pakatan Harapan (PH), which is the first change of political party since its independence in 1957. The economic consequences are measured through the change in Malaysia's GDP per capita using Synthetic Control Method (SCM) as a quantitative analysis. SCM constructs a counterfactual measure of GDPpc as a weighted mixture of countries within the donor pool of countries with no major economic shocks around the 2018 treatment period ensuring pre-treatment comparability. Synthetic Malaysia's GDPpc represents what might have been if there was no regime change, allowing a direct comparison with the actual GDPpc. The results indicate that Malaysia's GDP per capita fell around $200 to $300 below the synthetic counterfactual by 2019 and fell further to $750 to $1000 by 2021. This aligns with the theoretical framework where a change in political transition leads to uncertainty, policy disruptions, and institutional adjustments. The gradual and increasing divergence suggests a time lag between the regime change and its economic consequences. Nonetheless, results should be interpreted cautiously, as the COVID-19 pandemic most likely increase the divergence from 2020 onwards.

KEYWORDS:
Political Transition, Regime Change, Economic Performance, Synthetic Control, Malaysia

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ABSTRAK

Peralihan politik boleh membawa kesan ekonomi yang ketara, namun kesan kausalnya sukar dikenal pasti secara berasingan. Kajian ini meneliti perubahan rejim politik Malaysia pada tahun 2018, daripada Barisan Nasional (BN) kepada Pakatan Harapan (PH), yang merupakan perubahan parti politik pertama sejak Malaysia mencapai kemerdekaan pada tahun 1957. Kesan ekonomi perubahan tersebut diukur melalui perubahan Keluaran Dalam Negara Kasar (KDNK) per kapita Malaysia dengan menggunakan Kaedah Kawalan Sintetik (Synthetic Control Method, SCM) sebagai pendekatan analisis kuantitatif. SCM membina ukuran kontrafaktual bagi KDNK per kapita melalui gabungan berwajaran negara-negara dalam kumpulan penderma (donor pool) yang tidak mengalami kejutan ekonomi besar sekitar tempoh intervensi pada tahun 2018, sekali gus memastikan kebolehbandingan keadaan sebelum intervensi. KDNK per kapita Malaysia Sintetik mewakili anggaran keadaan yang mungkin berlaku sekiranya perubahan rejim politik tidak berlaku, dan membolehkan perbandingan langsung dibuat dengan KDNK per kapita Malaysia yang sebenar. Hasil kajian menunjukkan bahawa KDNK per kapita Malaysia pada tahun 2019 berada sekitar AS$200 hingga AS$300 lebih rendah berbanding nilai kontrafaktual sintetik, dan jurang tersebut melebar kepada sekitar AS$750 hingga AS$1,000 pada tahun 2021. Dapatan ini selaras dengan kerangka teori yang mengandaikan bahawa perubahan politik boleh mencetuskan ketidakpastian, gangguan terhadap dasar serta penyesuaian institusi, yang seterusnya memberi kesan terhadap prestasi ekonomi. Jurang yang semakin melebar secara beransur-ansur juga menunjukkan bahawa terdapat kelewatan masa antara berlakunya perubahan rejim dengan kemunculan kesan ekonominya. Bagaimanapun, dapatan ini perlu ditafsirkan dengan berhati-hati kerana pandemik COVID-19 berkemungkinan besar menyumbang kepada peningkatan jurang tersebut mulai tahun 2020.

KATA KUNCI:
Peralihan Politik, Perubahan Rejim, Prestasi Ekonomi, Kawalan Sintetik, Malaysia

1.0 Introduction

Political transitions can represent major institutional shocks with potentially important economic consequences. Acemoglu et. al. (2019) estimate that democratisation, through reforms, improved fiscal capacity, public goods provision, and reduced social unrest raises long-run GDP per capita by approximately 20%. However, political or governmental instability may shorten policymakers' horizons, increase policy uncertainty, and lead to more frequent policy switches, thereby creating volatility and weakening economic performance (Aisen & Veiga, 2013). As a result, the overall economic impact of political change remains theoretically uncertain and empirically underexplored.

A growing body of literature examines the economic consequences of regime change and major political transitions. Matta, Appleton & Bleaney (2019) and Echevarría & García-Enríquez (2019) provide evidence that abrupt political upheaval can lead to sizable short-term economic losses. Together, these studies suggest that political transition is often associated with transitional economic costs, even when political reforms are normatively desirable.

Despite the extensive international literature, empirical evidence on the economic effects of political change in Malaysia remains limited. Existing studies on Malaysia's political economy have largely focused on qualitative assessments of the post-2018 transition (Izzuddin, 2019) or applied the Synthetic Control Method (SCM) to earlier periods of Malaysian political leadership, notably the Mahathir era of the 1980s (Adisa, Farmer, & Bologna Pavlik, 2023). The study evaluates the economic legacy of

Mahathir's initial premiership under the long-ruling Barisan Nasional coalition, a structurally different context from the 2018 transition, which involved a democratic transfer of power between rival coalitions for the first time in Malaysia's post-independence history. To our knowledge, no quantitative study has rigorously evaluated the economic impact of this unprecedented 2018 regime change.

The 14th Malaysian General Election (GE14) in May 2018 marked a historic turning point, ending over 61 years of uninterrupted Barisan Nasional (BN) dominance and bringing the opposition coalition Pakatan Harapan (PH) to federal power for the first time. This realignment was made possible in part by the remarkable decision of former Prime Minister Mahathir Mohamad to lead the opposition alliance against his own political legacy, lending the PH coalition the credibility and momentum necessary to break BN's six-decade hold on power. Several factors contributed to BN's defeat. Most prominent was the 1Malaysia Development Berhad (1MDB) corruption scandal, in which billions of dollars of public funds were misappropriated, severely eroding public trust in Prime Minister Najib Razak's government. Compounding this was a sustained rise in the cost of living and widespread public resentment of the Goods and Services Tax (GST), introduced in 2015, which placed a disproportionate burden on low-income households (Funston, 2018).

Upon taking office, PH moved quickly to implement substantial policy changes. The GST was abolished within months, and several major infrastructure projects initiated under BN including the East Coast Rail Link, MRT extensions, Pan Borneo Highway components, and the 1Malaysia Clinics programme were cancelled or restructured. These rapid reversals represented a significant departure from the established policy baseline and introduced considerable uncertainty about the direction of economic governance. However, the PH government's tenure proved short-lived. In February 2020, Mahathir Mohamad resigned as Prime Minister, triggering the collapse of the PH coalition and a protracted political crisis known as the Sheraton Move over the formation of a successor government. This second political shock, occurring within the post-treatment window of our analysis, complicates the attribution of subsequent economic outcomes solely to the 2018 transition, and we address this identification challenge explicitly in our methodology and discussion.

This sequence of events provides a rare and valuable natural experiment for economic analysis. The 2018 election represents a clean, dateable institutional shock; the first democratic transfer of federal power in Malaysia's post-independence history, with a sufficiently long pre-treatment period available for counterfactual construction. It allows us to examine whether the change in political power itself, the policy decisions that followed, or the resulting institutional instability drove subsequent economic outcomes. The aim of this paper is to investigate the causal effect of Malaysia's 2018 political transition on economic performance through the application of synthetic control method (SCM).

This study hopes to contribute to the existing literature in two ways. First, to our knowledge, it is the first paper to rigorously evaluate the economic impact of Malaysia's 2018 regime change using the Synthetic Control Method. Second, it contributes to the broader literature on the economic costs of political transition, providing additional evidence from a Southeast Asian middle-income country context.

The remainder of this paper is structured as follows. Section 2 reviews the relevant literature on political transition and the synthetic control method. Section 3 outlines the data and methodology applied. Section 4 and 5 will present the main results and a series of robustness checks. Section 6 discusses the consequences of the findings for Malaysia's political economy, and Section 7 concludes and highlights the limitations of the study.

2.0 Literature Review

This study contributes to three strands of the literature: (1) economic consequences of political change, (2) consequences of PH policies and (3) application of synthetic control method.

2.1 Economic consequences of political change

The connection between political change and economic outcomes is well established, yet it is still highly debated within political economy. Most views in the topic agrees that political transitions tend to enhance long term economic performance mainly because of the strengthening of institutions. For instance, Acemoglu et. al. (2019) find evidence that a political shift raises GDP per capita by 20% over the long run (Acemoglu et. al., 2019). This growth is significantly contributed by better tax collection, increased public investment, and a reduction in elite rent seeking behaviours. Similarly, a study by Mauro (1995) on corruption and growth, demonstrates that lower corruption is often a byproduct of a political turnover. This has raised investment rates and GDP growth, establishing a clear link between governance quality and economic outcome.

However, some studies emphasize the disruptive short-term effect of political transitions. Political instability raises economic uncertainty which suppresses private investment even when transitions are democratically legitimate (Alesina & Perotti, 1996). It is further supported by Julio and Yook (2012), who observed that firms systematically reduce capital expenditure during election periods due to policy uncertainty. The effect still spillover into the post-election period and is highly concerning when new governments are appointed due to implementing unfamiliar policy agendas.

Connecting the two perspectives, economic impact of political change depends less on which party has the most power but more heavily focuses on whether the transition strengthens or degrades the underlying institutional framework (North, 1990). Overall, political transitions have played a huge influence in determining the economic state of countries. This has led to an empirical question of competing economic effects can either lead to long term benefits from improved governance or short-term cost driven by uncertainty. Therefore, this specific case has made the synthetic control approach both necessary and valuable in measuring and clearly illustrating the effects of political change to the economic state of a country.

2.2 Malaysia's Political Economy

Before 2018, Malaysia's economy was deeply shaped by decades of rule under the Barisan Nasional coalition. BN built a political system in which economic resources were deliberately directed toward politically connected businesses and elites, using privatisation, government contracts, and state-owned companies to reward political allies and maintain power (Gomez & Jomo, 1997). However, scholars do not fully agree on what this meant for the economy. While some argue the system was fundamentally distortionary and unfair (Gomez & Jomo, 1997), others suggest it was more complicated, finding that politically connected firms in Malaysia did produce real economic output alongside their preferential treatment (Johnson & Mitton, 2003). This disagreement is important because it shapes expectations about what a change in government could realistically achieve if the old sys-

tem had some productive elements, removing it would not automatically produce better outcomes.
There is stronger agreement among scholars about the later years of BN rule. Despite Najib Razak's promises to modernise and open the economy through his Economic Transformation Programme, the basic structure of politically driven capitalism stayed largely unchanged, with state linked companies continuing to dominate key sectors and discourage private investment (Hutchinson, 2019). The situation worsened significantly with the emergence of the 1MDB scandal around 2015, which caused a

measurable fall in investor confidence, a weakening of the ringgit, and a rise in the cost of government borrowing (Lean, 2016). Annual corruption rankings consistently placed Malaysia in a weak position throughout this period, suggesting that by 2018, governance had deteriorated to a point where it posed a genuine risk to economic stability (Transparency International, 2019).

Scholars interpret the 2018 election result in notably different ways. Some view the Pakatan Harapan victory as a genuine turning point, an opportunity to break with patronage politics, restore institutional integrity, and create a more open and competitive economy (Welsh, 2018). This reading is supported by wider research showing that when entrenched governments are replaced through democratic processes, economies tend to perform better over the long run due to improvements in governance and public spending (Acemoglu et. al., 2019). Yet others offer an important warning, arguing that the deep structural features of Malaysia's political economy, including state linked corporations, ethnically based economic policies, and powerful bureaucratic interests, were too firmly embedded to be quickly dismantled by a new government (Gomez et. al., 2018). In this view, changing who holds power does not automatically change how power operates. This unresolved debate between those who see 2018 as a transformative moment and those who emphasise structural continuity sits at the heart of this study. Whether the transition produced a real and measurable shift in Malaysia's economic performance, or whether deeper institutional legacies limited its impact, is precisely the empirical question this study uses synthetic control analysis to address.

2.3 Application of synthetic control method

The synthetic control model (SCM) is an innovative methodological approach that integrates both quantitative and qualitative dimensions, enabling researchers to address complex questions in comparative politics with greater rigor and depth. Recent studies in comparative politics have increasingly advocated for such mixed-method frameworks, recognizing that quantitative techniques reveal broad patterns, correlations, and causal relationships, while qualitative approaches provide nuanced, conceptual insights into the underlying mechanisms answering the critical "why" behind observed phenomena.

The SCM was first introduced by Abadie & Gardeazabal (2003) to estimate the economic impact of political instability due to terrorism in the Basque Country. They constructed a "synthetic" version of the region from other Spanish regions to approximate what its economy would have looked like without conflict. Comparing actual outcomes to this counterfactual, they found that sustained terrorism led to a significant economic decline, with GDP per capita falling by roughly 10% relative to the synthetic control, highlighting the substantial long-term economic costs of political instability.

However, integrating these methods poses challenges: qualitative research often relies on detailed, context-rich analysis of small samples, which contrasts with the coarse, large-sample focus typical of quantitative studies. Recent methodological debates highlight a growing consensus on the necessity of bridging quantitative and qualitative approaches especially the need to refine quantitative methods to complement qualitative inquiry. Moreover, quantitative studies must carefully select comparison units to avoid bias (Abadie, Diamond & Hainmueller, 2015).

SCM directly addresses these concerns by offering a systematic, formalized mechanism for selecting comparison units. This systemization enhances the rigor of comparative case studies and strengthens causal inference, advocated by King, Keohane, and Verba (1994) among others. The primary obstacle to quantitative inference in comparative research is not necessarily small sample sizes, but the lack of an explicit, transparent process for choosing comparison units. SCM overcomes this by enabling precise quantitative inference without sacrificing qualitative depth.

A key advantage of SCM is its use of a synthetic control, in which it is a weighted combination of multiple comparison units rather than relying on a single comparator. This approach often better approximates the characteristics of the unit of interest, improving the validity of counterfactual analysis.

In this study, SCM is applied to estimate the economic impacts of political regime changes in Malaysia after 2018. The method systematizes the selection of comparison units that collectively mirror Malaysia's pre-intervention economic and political traits, allowing for an in-depth analysis of post-2018 outcomes while maintaining quantitative precision. To minimize extrapolation bias, a set of comparator countries is carefully selected based on relevant economic and institutional indicators.

Traditional statistical inference often faces limitations in comparative case studies due to small samples, absence of randomization, and non-probabilistic sampling. SCM addresses these issues by facilitating a range of falsification exercises, including placebo studies, which introduce elements of randomization and robustness testing into the inferential process. This expands the capacity for rigorous hypothesis testing even in contexts where conventional experimental designs are not feasible.

While Randomized Controlled Trials (RCTs) are often seen as the best way to prove cause and effect, they are not practical or ethical for studying a major national event like Malaysia's 2018 regime change (Deaton & Cartwright, 2018). A RCT requires a researcher to have control over "treatments," but it is impossible to randomly force a country to experience a political collapse for the sake of an experiment (Abadie, Diamond & Hainmueller, 2015). Furthermore, RCTs usually focus on small groups like individuals or firms over short periods, which does not fit a study looking at national GDP over several decades (Kantorowicz & Spruk, 2023). Because this research focuses on a single country, which is Malaysia, the standard statistical logic used for large-scale RCTs simply does not apply.

The Synthetic Control Method (SCM) is better suited for this "small-N" setting because it was explicitly developed for large-scale, non-experimental interventions affecting a single aggregate unit (Bouttell et. al., 2018). By matching Malaysia's economic path closely during the long 1998–2017 pre-treatment period, the SCM accounts for hidden factors (unobserved confounders) that might otherwise bias the results. This approach assumes that if a "Synthetic Malaysia" can replicate the actual country's GDP for twenty years before the transition, it likely shares the same underlying economic structure (World Bank Blogs, 2013)

Finally, the SCM offers a level of openness that other methods lack, as it explicitly reports the weights assigned to donor countries like Belarus and Cambodia. This transparency allows for "placebo tests" and other diagnostic checks to prove that the economic dip after 2018 was likely caused by the political change and not just a random fluke (Klößner et. al., 2018). By bridging the gap between qualitative case studies and rigorous quantitative inference, the SCM provides a more credible basis for evaluating the 2018 transition than traditional experimental designs could offer in this context (Klößner et. al., 2018).

3.0 Methodology and data

3.1 Data

This study uses annual country level panel data covering the period 1998 to 2021. The pre-treatment period spans 1998–2017, while the post-treatment period covers 2018–2021, with 2018 designated as the treatment year, corresponding to Malaysia's political regime change following the fall of Barisan Nasional. A sufficiently long pre-treatment period is essential to ensure a close match between the treated unit and synthetic counterpart prior to the intervention (Abadie, Diamond & Hainmueller, 2010,

2015). The selected time frame allows for an assessment of Malaysia's long-run economic trajectory before the political transition as well as its medium-term performance afterward. The outcome variable which is GDP per capita was obtained from the World Bank World Development Indicators (WDI). In addition, for an easy interpretation and numerical precision in estimation, GDP per capita is rescaled by dividing by 1,000.

In addition to the outcome variable, the Synthetic Control Method requires a set of predictor variables that are informative of post-treatment GDP per capita and enhance pre-treatment fit. Following the existing literature on political shocks and economic performance (Echevarría & García-Enríquez, 2019; Matta, Appleton & Bleaney, 2019), predictors are selected based on economic relevance and data availability. The predictor variables include household consumption, lagged GDP per capita, domestic investment as a percentage of GDP, foreign direct investment inflows (% of GDP), and net export activity. These predictors are averaged over the pre-treatment period to capture Malaysia's underlying economic structure prior to 2018.

3.2 Donor Pool

The construction of an appropriate donor pool is a critical step in the Synthetic Control Method. Following the guidelines proposed by Abadie, Diamond & Hainmueller (2015), we restrict the donor pool to countries with economic and political characteristics comparable to Malaysia in order to avoid interpolation bias and overfitting. The donor pool is constructed through a series of filtering steps, where countries are excluded based on three main criteria.

First criterion, we exclude all countries that experienced major political regime changes, revolutions, or coups during the sample period in particular between 1998 and 2025. For example, Algeria is excluded as it was indirectly affected by the Arab Spring since 2011, which may have influenced its political and economic stability.

The second criterion is countries that experienced major macroeconomic shocks around the treatment period, particularly from 2018 onwards. These include severe financial crises, natural disasters, or other large external disruptions that could distort GDP per capita trends. For example, Argentina is excluded due to its 2018 currency crisis, where the peso lost more than 50% of its value against the US dollar. Third, countries with insufficient data availability for the outcome or predictor variables over the sample period are excluded from the analysis. In total, 64 countries are excluded due to missing data.

After applying these criteria, the remaining countries form a donor pool of stable economies that were not directly affected by Malaysia's political transition. The initial sample consists of 197 countries, including all UN member states and four additional entities (Vatican City, Palestine, Taiwan, and Kosovo). From this, 65 countries are excluded based on the first two criteria, while a further 64 countries are removed due to insufficient data availability. The remaining countries serve as potential contributors to the construction of Synthetic Malaysia.

3.3 Methodology

By creating a counterfactual as a weighted mixture of many control units selected from a donor pool, the Synthetic Control Method (SCM) solves the issue of assessing the effects of political regime changes at the national level in the absence of a reliable counterfactual. Formally, let Malaysia be the treated unit indexed by j = 1, and let j = 2 , ..., J + 1 denote the set of countries in the donor pool that were not affected by the 2018 political transition. Given a vector of non-negative weights W = (w2, ...,

wj+1) that sum to one, the synthetic control estimator of the counterfactual outcome for Malaysia in period t is given by:

$$\hat{Y}_{1t}^{N} = \sum_{j=2}^{J+1} w_j Y_{jt}$$

where Yjt denotes GDP per capita of country j at time t. The weights are chosen such that the weighted average of predictor variables for the donor countries closely matches Malaysia's predictor values during the pre-treatment period.

For the treated unit j = 1, Yˆ N represents the level of GDP per capita that would have been observed in the absence of the treatment, namely, if Malaysia had not experienced the 2018 regime change (Abadie, 2021). The estimated treatment effect for Malaysia at time t is therefore defined as:

$$\hat{t}_{1t} = Y_{1t} - \hat{Y}_{1t}^{N}$$

This expression shows the difference between Malaysia's actual GDP per capita and that of its synthetic counterpart. In this study, SCM is applied to construct a "Synthetic Malaysia" using a weighted combination of countries from the donor pool that best reproduces Malaysia's economic characteristics and GDP per capita trajectory over the pre-treatment period 1998–2017. By comparing the post-2018 evolution of GDP per capita in Malaysia with that of Synthetic Malaysia, we identify the causal impact of the 2018 political transition and the fall of Barisan Nasional on Malaysia's economic performance over the period 2018–2021.

4.0 Results

We run the SCM by treating Malaysia in 2018, with GDP per capita as the outcome variable. We also used the components of GDP, life expectancy and education as the special predictors. The optimisation procedure provides non-negative weights that sum to 100%. The country weights produce through this procedure are shown on table 1.

Table 1: Countries weight in synthetic Malaysia

Country	Weight
Belarus	0.309
Cambodia	0.259
Serbia	0.206
Ireland	0.189
Guatemala	0.037

Before the treatment period, which is the regime change period, we can see that Malaysia and synthetic Malaysia is closely match in the trend as shown in Figure 1. The close correspondence between Malaysia and Synthetic Malaysia during the pre-treatment period indicates a relatively good pre-treatment fit, though this is just a first impression before doing robustness check. Even right after the

treatment period, there is only a slight divergence which might not cause by the regime change. This is because this is some kind of cyclical pattern that we can observed since before the pre-treatment period. Then in 2019, we can observe that the divergence starts to increase as Malaysia and synthetic Malaysia plot diverge from each other. This indicates that the regime change had a negative impact on the country's economy in the years that followed.

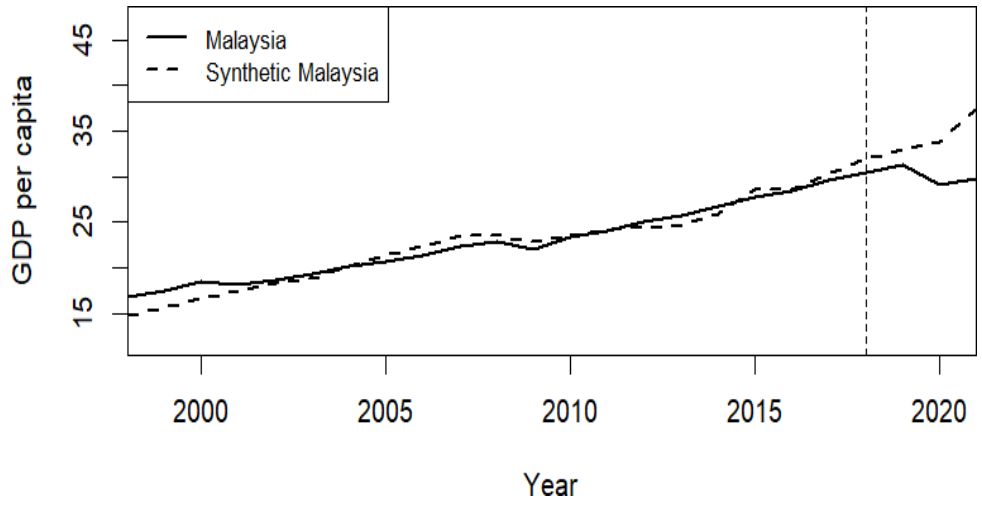


Figure 1: GDP per capita of Malaysia against Synthetic Malaysia

The gap between the divergence is measured and shown in Figure 2. This reveals a loss of about $750 to $1000 in GDP per capita by 2021. The gap keeps increasing till the end of our sample period which is in 2021. This provides evidence of a negative economic effect associated with the regime change.

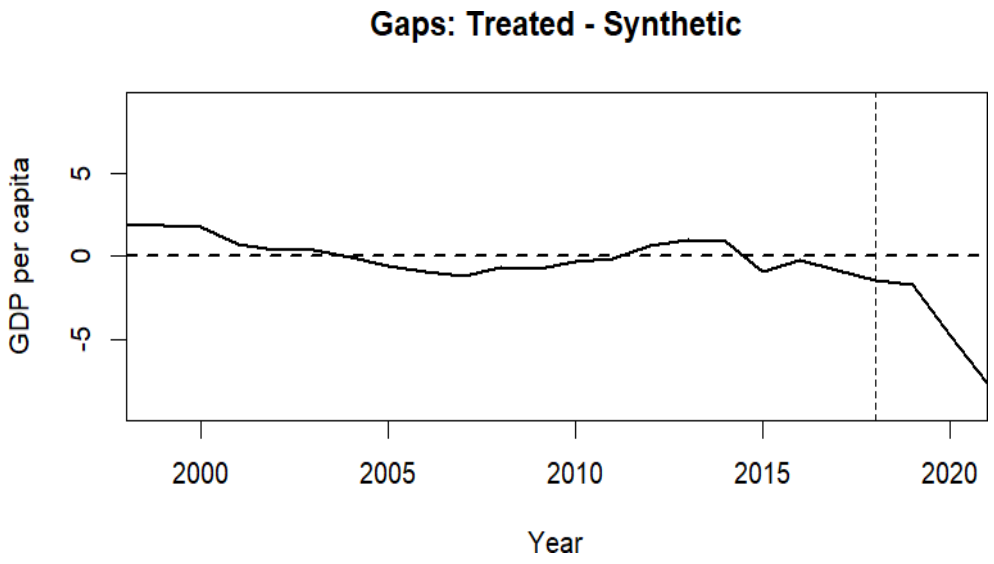


Figure 2: The GDP per capita gap between Malaysia and Synthetic Malaysia

Graphs in Figures 3, 4 and 5 compare Malaysia's actual economic performance in terms of GDP component breakdown with a synthetic version of Malaysia before and after the intervention. Figure 3 shows the consumption graph whereby both Malaysia and synthetic Malaysia move in a similar way before the intervention, which suggests the model fits reasonably well. After the intervention, Malaysia's consumption becomes slightly higher than the synthetic control. This may suggest that consumption increased more than it would have without the intervention, but the difference is quite small and seems to get smaller toward the end of the period.

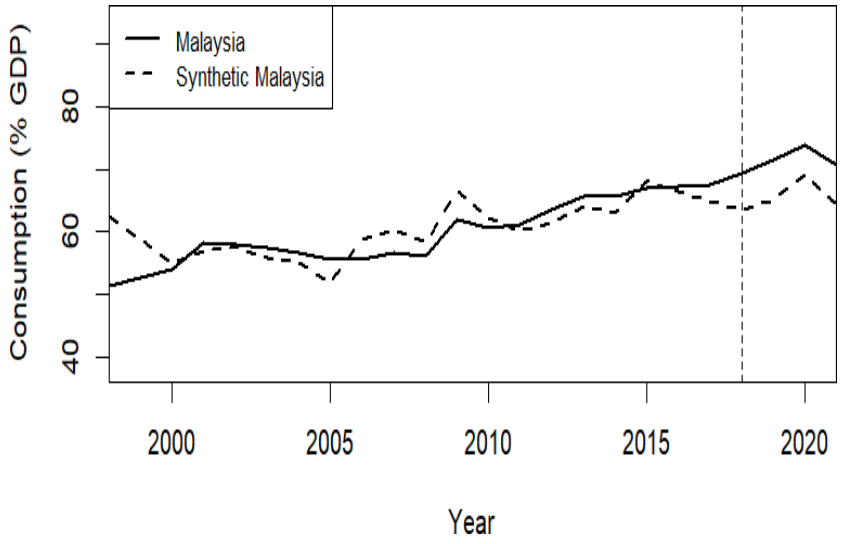


Figure 3: GDP component (household consumption) of Malaysia against synthetic Malaysia

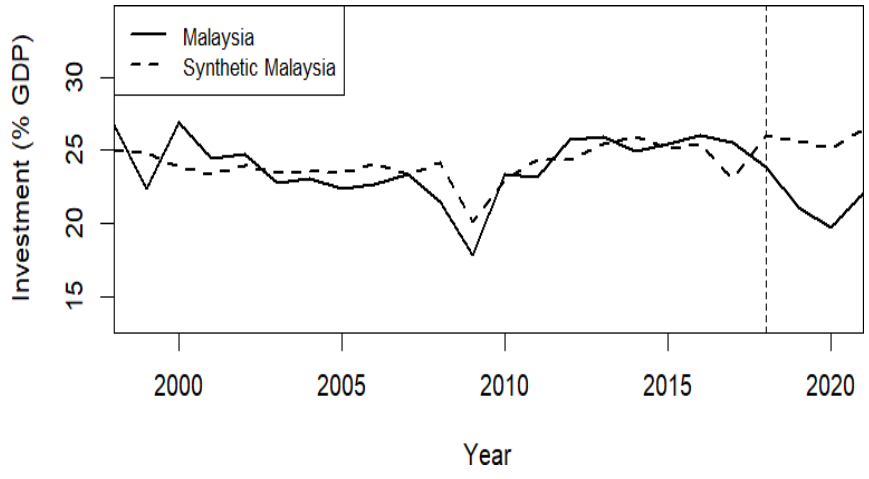


Figure 4: GDP component (investment) of Malaysia against synthetic Malaysia

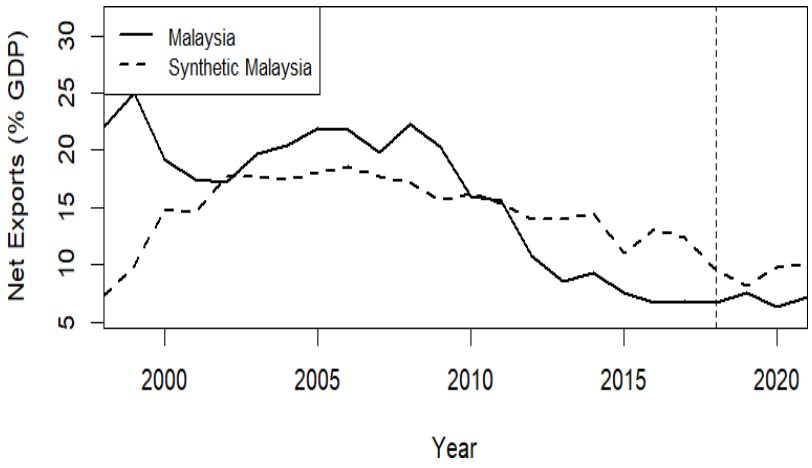


Figure 5: GDP component (net exports) of Malaysia against synthetic Malaysia

For investment and net exports, Malaysia's performance is generally lower than the synthetic counterfactual after the intervention. Figure 4 shows that investments fall more noticeably below synthetic Malaysia, especially in the years just after the intervention. Figure 5 shows that net exports also stayed below the synthetic control for most of the post-intervention period. Across all three graphs, the difference between Malaysia and the synthetic control is largest in the middle of the post-intervention period and then starts to decrease. However, because the pre-intervention fit is not very strong, particularly for investment and net exports, these results should be treated with caution.

5.0 Robustness Checks

Despite the significant impact shown by the previous estimation results, we seek to strengthen the reliability and robustness of our results. Then we run two robustness checks: (1) In-Time placebo test and (2) Leave-one-out.

To test the validity of our results, we run robustness tests. The first of these is an in-time placebo shown the top plot of Figure 3, where we apply the same SCM to a 'fake' Malaysia in 2008. This time, Synthetic Malaysia is a composite of donor pool countries based on pre-2008 predictor and outcome variables. If there is no divergence in trends following the fake treatment, then the divergence seen after the true 2018 treatment is more likely due to the reasons we hypothesise rather than some other factor.

As a further robustness check, we conduct a 'leave-one-out' test. Here we restrict our donor pool to the non-zero weighted countries comprising Synthetic Malaysia from Table 1. We then omit these countries from the pool one-by-one, running the SCM each time. This tests whether our results are sensitive to the dynamics of a particular country in the donor pool. The results from these tests can be seen in Figure 6 and 7.

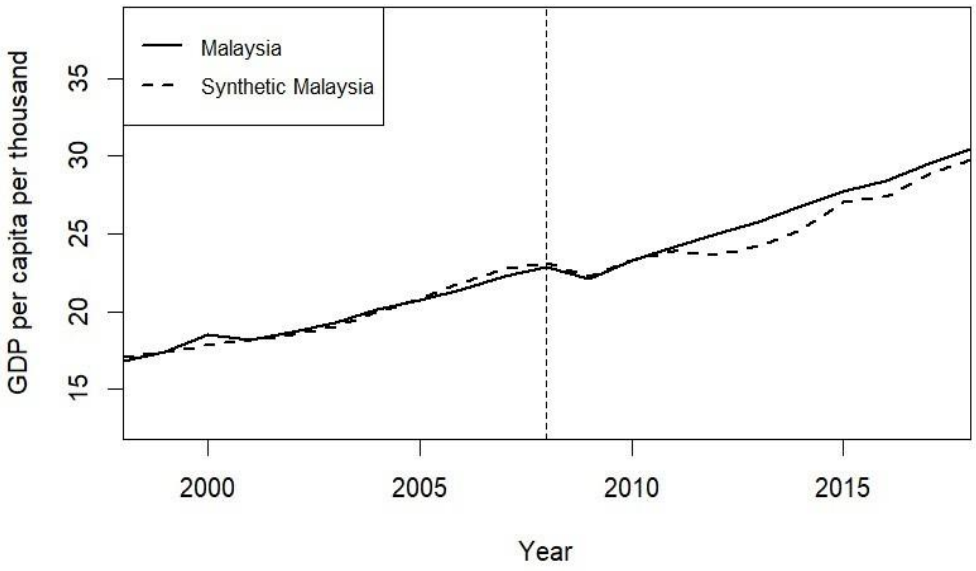


Figure 6: In-time placebo test

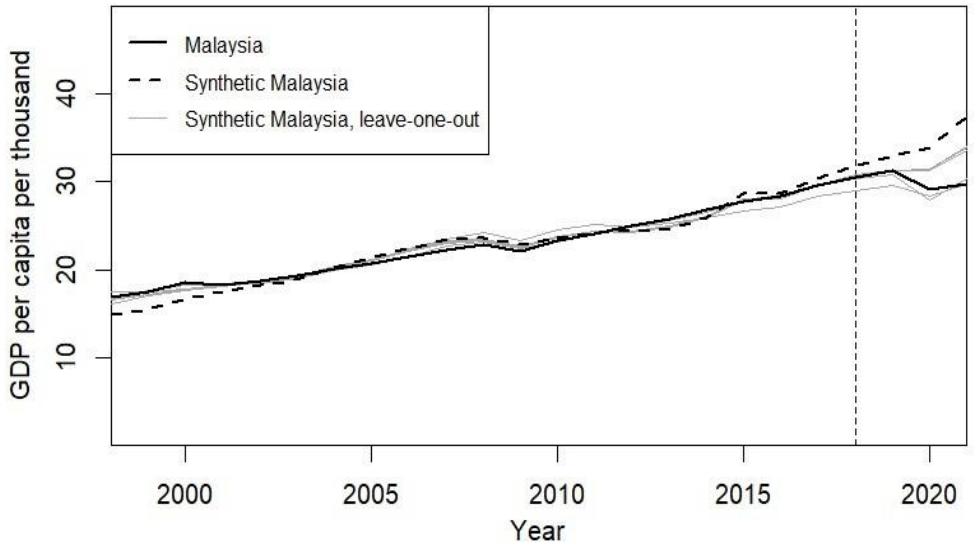


Figure 7: Leave-one-out robustness test

The in-time placebo test shown in Figure 6 does reveal a slight notable divergent in the year following 2011. However, it is a minor positive divergent which in the following years the gap is noticeable decreasing. This suggests the divergence found in our previous results is valid.

The 'leave-one-out' of Synthetic Malaysia test shown in Figure 7 follows a similar pattern, an approximation of Malaysia's GDP per capita in the pre-intervention period, and a marked deviation in the post-intervention period. This suggests the evolution of GDP per capita in the original Synthetic Malaysia is not driven by any one particular country in Table 1.

6.0 Discussion

This study investigates the causal impact of Malaysia's 2018 political transition on economic performance using the Synthetic Control Method. The results indicate that Malaysia experienced a decline in GDP per capita relative to its synthetic counterpart in the post-2018 period, suggesting that the regime change was associated with negative short to medium economic effects. Notably, the divergence between Malaysia and Synthetic Malaysia becomes more pronounced after 2019, indicating that the economic consequences of the political transition may not be immediate but rather emerge gradually over time.

These findings are broadly consistent with theoretical predictions and existing literature which suggest that political transitions often generate short-term economic costs due to uncertainty, policy disruptions and institutional adjustments. In the case of Malaysia, the collapse of a government that had remained in power for more than six decades represents a significant institutional shock. Even though political change can bring long-term improvements, the transition period can create uncertainty for investors and slow down new policy decisions. This can reduce confidence in the direction of the economy. This uncertainty may have been even stronger because the incoming Pakatan Harapan (PH) government was new and had less experience at the federal level, which could have made businesses and investors more cautious. This highlights the importance of distinguishing between the potential long-term benefits of reform and the short-term costs associated with political instability.

Further insights can be drawn from the analysis of GDP components. The results suggest that the negative impact is primarily driven by declines in investment and net exports, while consumption remains relatively stable. This pattern indicates that the downturn is likely linked to reduced business confidence and external competitiveness rather than a collapse in domestic demand. In particular, heightened political uncertainty following the regime change, as well as subsequent political instability, may have discouraged both domestic and foreign investment. This aligns with broader economic theory, which emphasises the sensitivity of investment decisions to uncertainty and expectations about future policy direction.

From a policy perspective, the findings highlight the importance of institutional frameworks that can ensure policy continuity during periods of political transition. In more institutionalised systems, such as the United States, major policy changes typically require approval across multiple branches of government. This process helps maintain stability and reduces sudden shifts in economic policy. Similarly, in the United Kingdom, cross-party select committees play an important role in shaping long-term economic policies that are less likely to change even when there is a change in government. These committees bring together members from different political parties to review policies, build agreement and provide recommendations that are more consistent over time. Since the policies are discussed and agreed across parties, they are less likely to be reversed after elections in which helps reduce uncertainty. This stability increases confidence among businesses and investors, as they can make long-term decisions without worrying about sudden policy changes. For Malaysia, these examples suggest that strengthening institutional safeguards and developing more consistent policy frameworks could help reduce uncertainty and minimise the economic costs associated with future political transitions.

From a political party's point of view, findings in this paper signal the importance of opportunity cost between campaign promises for radical changes and economic uncertainty. Actors in the market view radical changes as a take-off from the status quo or a move from an established baseline. This often creates indecision and difficulty for investors particularly in navigating and making informed decisions on their investment. Thus, creates a below optimal level of investment that results in divergence of the country's GDP from its expectation.

However, while this study provides evidence of a causal relationship between political regime change and economic performance, it is important to acknowledge its limitations in explaining the precise mechanisms underlying this relationship. The analysis is able to identify that a downturn occurred following the political transition, but it cannot fully disentangle the specific channels through which this effect operates. Although reduced investment is a plausible explanation, it remains difficult to determine the relative importance of factors such as policy changes, political instability, or external economic conditions. As such, the findings should be interpreted as evidence of an overall causal effect rather than a complete explanation of the underlying processes.

7.0 Limitation

Despite providing valuable insights, this study is subject to several limitations that should be considered when interpreting the results. First, the Synthetic Control Method relies on the selection of a donor pool of countries to construct the counterfactual and this process may introduce bias. The choice of donor countries is constrained by data availability and selection criteria, and it is possible that the resulting synthetic control does not perfectly represent Malaysia's true counterfactual trajectory. Although robustness checks like the leave-one-out test show that the results are not driven by any single country, there may still be some bias in how the donor countries were selected. Second, the post-treatment period examined in this study coincides with significant global events, most notably the COVID-19 pandemic. This presents a challenge in isolating the effect of Malaysia's political transition from broader global economic shocks. However, it is important to note that the divergence between Malaysia and Synthetic Malaysia began to appear in 2019, which is before the onset of COVID-19. This suggests that at least part of the observed post-treatment effect is not driven by the pandemic. While the Synthetic Control Method partially accounts for common trends across countries, it may not fully capture differences in how individual countries respond to such shocks. Consequently, some of the observed economic divergence may still be influenced by factors unrelated to the political transition.

In addition, the model includes a limited set of predictor variables, focusing primarily on investment, foreign direct investment and net exports. While these variables are economically relevant, other important factors such as institutional quality, political stability and human capital are not explicitly included. The absence of these variables may reduce the precision of the synthetic control and introduce potential bias in the estimation. Furthermore, although the pre-treatment fit for GDP per capita is relatively strong, the fit is weaker for certain components, particularly investment and net exports. This suggests that the synthetic control may not fully replicate all aspects of Malaysia's economic structure, and therefore, results related to these variables should be interpreted with caution. Even with these limitations, the findings are reliable since the results are consistent and supported by a strong pre-treatment fit. Overall, the study shows that Malaysia's 2018 political transition had a real impact on the economy. This impact is likely linked to changes in investment and economic confidence following the regime change.

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