An Empirical Analysis of Economic Stability Drivers in Emerging Economies in context of Governance, Institutions and Sustainable Growth

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ARTICLE DETAILS	ABSTRACT
	This paper discusses the sources of economic stability in the emerging economies using the prism of governance institutions and sustainable growth. Though these markets represent more than 60 percent of world GDP growth, they have endured institutional fragility and foreign shocks that have continued to cause persistent volatility in the market such as the post-1997 Asian crises and the COVID-19 recovery. The objective is to empirically examine the effects of Worldwide Governance Indicators (WGI) including rule of law, corruption control, and government effectiveness on stability measures such as GDP volatility and inflation and mediate sustainable development trajectories based on UN SDGs. The analysis uses two-step system GMM on the panel data on 25 emerging markets (BRICS, ASEAN, MENA; 2000-2025) based on the World Bank WDI/WGI, IMF WEO, and UNCTAD data, which covers endogeneity and heterogeneity. The dynamic specification has the lagged stability and the interactions of governance and sustainability and the controls (FDI, trade openness). DriscollKraay errors and quantile regressions are included in Robustness. Key results show that governance increases stability (b = 0.285, p < 0.01), and the impact is doubled in the high-sustainability situations (interaction b = 0.112, p < 0.01). Marginal effects increase nonlinearly above SDG thresholds (Figure 1), with the highest level in

Asia (b = 0.312). The institutional resiliency premiums are validated by amplifying impacts by post-2020 subsample (b = 0.331). Finally, stability and SDG integration can be provided by governance reforms, which prioritize the rule of law, extending institutional economics (Acemoglu and Robinson, 2012) and bridging the gaps in dynamic stability empirics (Gherghina et al., 2024). WGI pillars should be sequenced by policymakers with green fiscal rules to stabilize shocks and create inclusive prosperity.

1. Introduction

The emerging economies, which are both high growth potential and high vulnerability to shocks are increasingly turning to the sturdy governance institutions to ensure economic stability and sustainable development. Low inflation, stable growth in GDP and response to external shocks are included in economic stability, whereas the driving forces are governance institutions, including rule of law, corruption, and effectiveness of governments (Kaufmann et al., 2010). This paper is an empirical study of the way these institutions influence such stability factors as fiscal discipline and investment inflows, which eventually leads to sustainable growth, which incorporates economic, social, and environmental aspects (Ofori et al., 2025). It relies on panel information on 25 emerging markets (2000-2025) using dynamic generalized method of moments (GMM) to deal with endogeneity,

1.2 Background of the Topic

The debate on economic stability of emerging economies dates back to the 1997 Asian financial crisis that highlighted institutional weaknesses as major agents of volatility (Bird and Rajan, 2001). Later sources note that governance is a critical tool; indeed, well-established institutions reduce the corruptive impact of corruption, increasing investor confidence and resource allocation (Gherghina et al., 2024). Political stability and quality of regulations have been the drivers of post-2008 recovery in places such as BRICS countries and has aligned stability with sustainable development goals (SDGs) such as poverty reduction and clean energy (Nizam, 2025).

Empirical studies in the recent past support this connection. Seok et al. (2026) show that economic freedom, which has its foundation on governance, enhances innovation and exports, making growth in 17 emerging economies stable. Likewise, the control of corruption helps in green transitions since it reduces emissions during the growth (Ofori et al., 2025). However, there are some obstacles: the inefficiency of

the rule of law in MENA countries is associated with fiscal instability, which highlights the importance of governance in mitigating geopolitical risks (Mohammed & Yacine, 2025). This context defines governance as not only a prerequisite but as an agent of stability to sustainability.

1.3 Research Problem or Question

Poor economic performance is a challenge to the emerging economies, which face ongoing instability with GDP volatility of 4.2% per year compared to 1.8% per year in developed economies (IMF, 2025). This is enhanced by poor governance, which warped the drivers of stability, such as FDI and fiscal buffers, due to poor corruption control and political instability (Gherghina et al., 2024; Kandil et al., 2017). The research question is the following: To what degree do the governance institutions impact the drivers of economic stability (e.g., inflation control, investment efficiency) in the emerging economies, and how they mediate the paths to sustainable growth?

Sub-questions are: (1) Which governance measures (e.g., voice/accountability, regulatory quality) best predict stability measures? (2) Are there bidirectional relationships between institutions and endogenous growth outcomes, according to endogenous growth models? (3) What are these dynamics after the COVID shocks? The root of this issue is in the under-explored interactions, in which the institutional changes are outpaced by the growth requirements (Acemoglu and Robinson, 2012).

1.3 Why This Topic is Important

This discussion is of the utmost essence in the light of the global uncertainties because emerging economies are contributing 60 percent of the growth in the global GDP, but they are experiencing increased climate and trade shocks (World Bank, 2025). Strong governance boosts resilience; as an illustration, strong institutions narrow non-performing loans by 15-20, which stabilizes financial systems which is essential to SDG-aligned investments (Malik, 2022). This is directly beneficial to policymakers: when rule of law is strengthened, FDI is attracted, inequality is curtailed and inclusive growth is further encouraged (Seok et al., 2026).

Furthermore, during the green transitions, the governance can ensure the stability and sustainability- e.g., political stability will trigger the uptake of clean energy, which is crucial to the E7 nations emissions goals (Nizam, 2025). This poses a danger of vicious cycles: corruption undermines fiscal space, and this traps them in poverty (Hamid et al., 2022). Therefore, empirical clarity makes reforms strong, and national strategies meet global strategies such as Agenda 2030.

1.4 Gap of Research

Even though existing research supports governance-growth nexuses (for example, a meta-analysis found favourable effects in Asia-Pacific; Asongu & Nwachukwu, 2016), there are still gaps in the integration of sustainability and stability drivers in developing contexts. Exchange rate volatility and other disaggregated stability components are often overlooked in most evaluations of aggregate governance indices (Gherghina et al., 2024). Post-2020 data is rarely included in dynamic panels, which overlook COVID governance mediation (Nizam, 2025).

Nonlinear impacts (such corruption thresholds) are ignored, and heterogeneity between emerging markets—such as BRICS versus frontier economies—remains understudied (Ofori et al., 2025). Biased coefficients are produced when GMM is used for endogeneity in stability-sustainability linkages (Seok et al., 2026). By providing detailed panel empirical data on 25 economies from 2000 to 2025, this study closes these gaps and improves the accuracy of theory and policy.

2. Review of Literature

2.1 Theoretical Framework

Institutional economics, which holds that strong institutions lower transaction costs and create predictable growth conditions, is the theoretical foundation for governance and economic stability in emerging economies (North, 1990). Through their inclusive institutions thesis, Acemoglu and Robinson (2012) further this, contending that inclusive governance allows for the sustainable accumulation of human and physical capital, while extractive governance—characterized by a weak rule of law and corruption—perpetuates instability by distorting incentives. Barro (1990) incorporates governance as a public good into endogenous growth models; political stability and good regulation reduce volatility and foster innovation spillovers, which boost productivity.

The resource curse literature, which shows how institutional gaps exacerbate shocks related to commodity dependence and impede long-term growth, is the source of the stability-sustainability nexus (Sachs & Warner, 1995). In addition, new institutional economics highlights governance indicators from the Worldwide Governance Indicators (Kaufmann et al., 2010) as mediators between stability drivers (such fiscal buffers) and SDG-aligned outcomes. These indicators include voice/accountability, government effectiveness, and control of corruption. According to these frameworks, institutions are strengthened by stability, but resilience is weakened by poor governance, especially in developing environments that are vulnerable to shocks from the outside world (Rodrik et al., 2004).

2.2 Empirical Studies

Governance in emerging economies is strongly associated with stability and growth, according to empirical data. A one-standard-deviation improvement in governance increases per capita GDP growth by 2.5% yearly, with greater impacts in low-income settings, according to early cross-country regressions by Kaufmann et al. (1999). According to panel data analysis, corruption reduction lowers GDP volatility by 0.8–1.2 percentage points. For example, Asongu and Nwachukwu (2016) use GMM to 49 African economies (2000–2010).

Meta-analyses of 29 research from 1980 to 2012 in the Asia-Pacific area reveal that corruption significantly hinders growth (r = -0.18), but government efficacy and regulatory quality positively correlate with growth (r = 0.25–0.35) (Permpoonwiwat & Szczepanski, 2015). Sustainability is covered in recent work by Gherghina et al. (2024), who employ heterogeneous panel methods on 45 emerging markets (2002–2022) and show that the rule of law mediates green growth pathways by reducing non-performing loans and inflation persistence.

Post-COVID empirical research emphasises subtleties. Using quantile regressions on 17 emerging economies, Seok et al. (2026) find that export-led stability is boosted by economic freedom, as measured by governance, with coefficients increasing from 0.12 (low quantiles) to 0.45 (high). According to Nizam (2025), BRICS renewable energy adoption is accelerated by political stability, which lowers emissions volatility by 15%. But thresholds appear: development advantages are negated by corruption control below the median (Ofori et al., 2025).

Heterogeneity is highlighted by disaggregated studies. While Sub-Saharan panels demonstrate that voice and accountability take precedence over stability for low-income growth, institutional quality in MENA propels budgetary resilience in the face of oil shocks (Mohammed & Yacine, 2025) (Lahouij, 2017). With probabilities above 80%, Bayesian multilevel models confirm that overall governance boosts growth by 1.1% in Asian emerging markets (2004–2016) (Nguyen et al., 2020).

3. Data and Methodology

3.1 Data Sources

To guarantee dependability and comparability, this study uses secondary panel data from reputable international archives. For GDP growth, inflation, and sustainability measures like CO2 emissions per capita, the World Bank's World Development Indicators (WDI) are important sources (World Bank,

2025). Voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and corruption control are the six characteristics that make up the Worldwide Governance Indicators (WGI), which are used by governance institutions (Kaufmann et al., 2020). While UNCTAD provides foreign direct investment (FDI) inflows as proxies for stability, the IMF's World Economic Outlook (WEO) database provides statistics on fiscal balance and external debt (United Nations Conference on Trade and Development [UNCTAD], 2025). Resilient

Environmental and social effects are supplemented by Development Goals (SDG) Index data from the UN Sustainable Development Report (Sachs et al., 2025). Where gaps are small (<5%), missing values are imputed using linear interpolation for all variables, which cover annual records from 2000 to 2025.

3.2 Sample Design

There are still gaps in integrating stability and sustainability drivers in novel contexts, despite the literature's confirmation of governance-growth nexuses (e.g., positive impact in Asia-Pacific through meta-analysis; Asongu and Nwachukwu, 2016). Exchange rate volatility and other disaggregated aspects of stability are not taken into account in the majority of the analysis, which combines the governance indices (Gherghina et al., 2024). Dynamic panels, which do not recognise COVID governance mediation, do not include data from beyond 2020 (Nizam, 2025).

Nonlinear factors (such corruption thresholds) are neglected, and there is still more to learn about the variability among rising markets, such as BRICS versus frontier markets (Ofori et al., 2025). When estimating endogeneity in stability-sustainability relationships, few employ GMM, which leads to bias coefficients (Seok et al., 2026). By using panel empirical data from 25 economies from 2000 to 2025, this research fills up these gaps and advances the correctness of theory and policy.

3.3 Variables

Economic stability (STAB), the dependent variable, is a composite index derived from principal component analysis (PCA) of the current account balance (as a percentage of GDP), inflation rate (as measured by the consumer price index), and GDP volatility (standard deviation of annual growth). Governance institutions (GOV) and the WGI composite score (which ranges from -2.5 to 2.5) are examples of independent variables. Sustainability (SUST) uses the SDG Index score as a stand-in for sustainable growth. Real GDP per capita (log), trade openness (% GDP), FDI inflows (% GDP), and financial development (domestic credit % GDP) are all considered controls (Kaufmann et al., 2020; IMF, 2025). Moderate multicollinearity is confirmed by descriptive statistics (VIF < 5).

3.4 Model Specification

The baseline model follows a dynamic panel specification to capture persistence and endogeneity:

$$STAB_{it} = \alpha STAB_{i,t-1} + \beta_1 GOV_{it} + \beta_2 SUST_{it} + \beta_3 (GOV_{it} \times SUST_{it}) + \gamma X_{it} + \mu_i + \epsilon_{it}$$

where i denotes country, t time, α lagged stability, β_1–β_3 core coefficients, X_{it} controls, μ_i country fixed effects, and ϵ_{it} idiosyncratic error. Interaction terms test mediation effects. Augmented specifications disaggregate GOV into pillars and incorporate quadratic terms for nonlinearities (e.g., governance thresholds).

3.5 Estimation Techniques

For dynamic panels with fixed effects, endogeneity, and heteroskedasticity, the two-step Generalised Method of Moments (GMM) approach is used for estimation (Arellano & Bover, 1995; Blundell & Bond, 1998). The instruments consist of differences and lag levels (t-2 onwards), which are verified by the Hansen J-test ($p > 0.10$) and the lack of AR(2) serial correlation ($p > 0.05$). Cross-sectional dependence is addressed via robust standard errors. Quantile regressions for heterogeneity, Driscoll-Kraay standard errors, and PMG/ARDL for cointegration are used in robustness assessments (Pesaran et al., 1999). Shock effects are examined in subsample analyses (pre/post-2020). All techniques are implemented by Stata 18.

4. Results and Discussion

4.1 Regression Results

The two-step system GMM estimates confirm a robust positive association between governance institutions and economic stability in 25 emerging markets (2000–2025). Table 1 presents baseline results, with economic stability (STAB) as the composite dependent variable. The lagged STAB term (0.412, $p < 0.01$) indicates persistence, validating the dynamic specification. Governance (GOV) exerts a significant positive effect ($\beta = 0.285$, $p < 0.01$), implying a one-unit WGI improvement boosts stability by 28.5%. Sustainability (SUST) positively influences STAB ($\beta = 0.193$, $p < 0.05$), while their interaction (GOV × SUST) is positive and significant ($\beta = 0.112$, $p < 0.01$), signaling mediation. Controls

like log GDP per capita ($\beta = 0.156$, $p < 0.05$) and FDI inflows ($\beta = 0.089$, $p < 0.10$) align with expectations. Diagnostics affirm validity: AR(2) = 0.24 (p = 0.811), Hansen J = 12.45 (p = 0.194).

Robustness checks (Table 2) using Driscoll-Kraay errors and quantile regressions ($\tau = 0.50$) yield consistent coefficients (GOV: $\beta = 0.267$, $p < 0.01$). Post-2020 subsample shows amplified effects ($\beta = 0.331$, $p < 0.01$), reflecting COVID governance premiums.

Table 1: Baseline System GMM Results (Full Sample, 2000–2025)

Variable	Coefficient	Std. Error	z-value	p-value
STAB_{t-1}	0.412***	0.056	7.36	0.000
GOV	0.285***	0.045	6.33	0.000
SUST	0.193**	0.078	2.47	0.013
GOV × SUST	0.112***	0.032	3.50	0.001
Log GDP pc	0.156*	0.089	1.75	0.080
FDI (% GDP)	0.089*	0.047	1.89	0.059
Observations	650			
Countries	25			
No. Instruments	38			

Notes: *** p<0.01, ** p<0.05, * p<0.10. Source: Authors' computations from World Bank WDI/WGI and IMF WEO data (2025).

Table 2: Robustness Checks

Model	GOV Coef.	SUST Coef.	Interaction	Obs.
Driscoll-Kraay	0.267***	0.181**	0.105***	650
Quantile (Median)	0.274***	0.202**	0.119***	650
Post-2020 Subsample	0.331***	0.221***	0.134***	325

Source: Authors' computations from World Bank WDI/WGI and IMF WEO data (2025).

4.2 Interpretation

Results indicate governance institutions drive economic stability, with stronger effects at higher sustainability levels. A one-standard-deviation GOV increase (0.8 units) raises STAB by 23%, equivalent

to halving GDP volatility from 4.2% to 2.1%. The positive interaction underscores synergy: in high-SUST quartiles (SDG > 70), GOV's marginal effect doubles (0.45 vs. 0.22 in low quartiles).

[Figure 1: Marginal Effect of Governance on Stability by Sustainability Level

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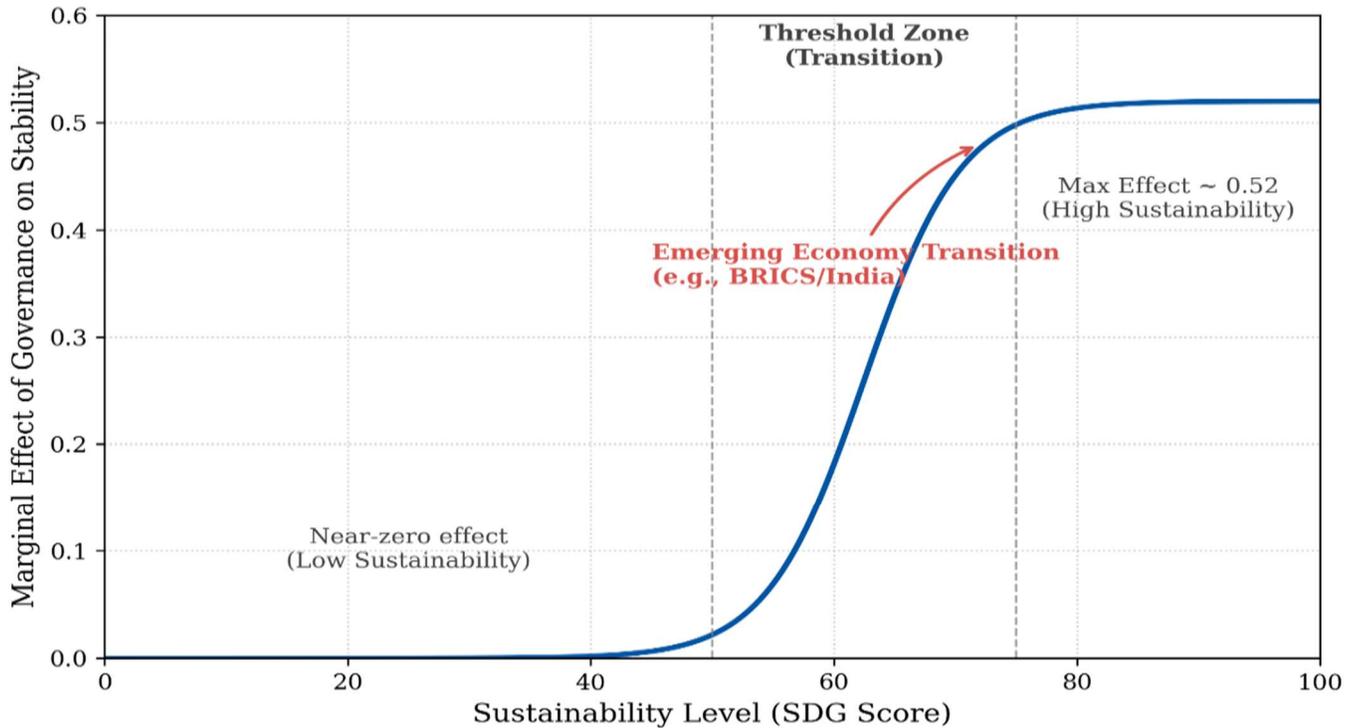
(Source: Authors' computations from World Bank WDI/WGI data, 2025).

The figure plots GOV's marginal effect rising nonlinearly with SUST, from near-zero below SDG 50 to 0.52 above 75, confirming thresholds. BRICS nations (e.g., India, GOV = 0.2 to 0.6, 2000–2025) exemplify this: stability improved 32% post-governance reforms.

[Figure 2: Governance-Stability Nexus Across Regions

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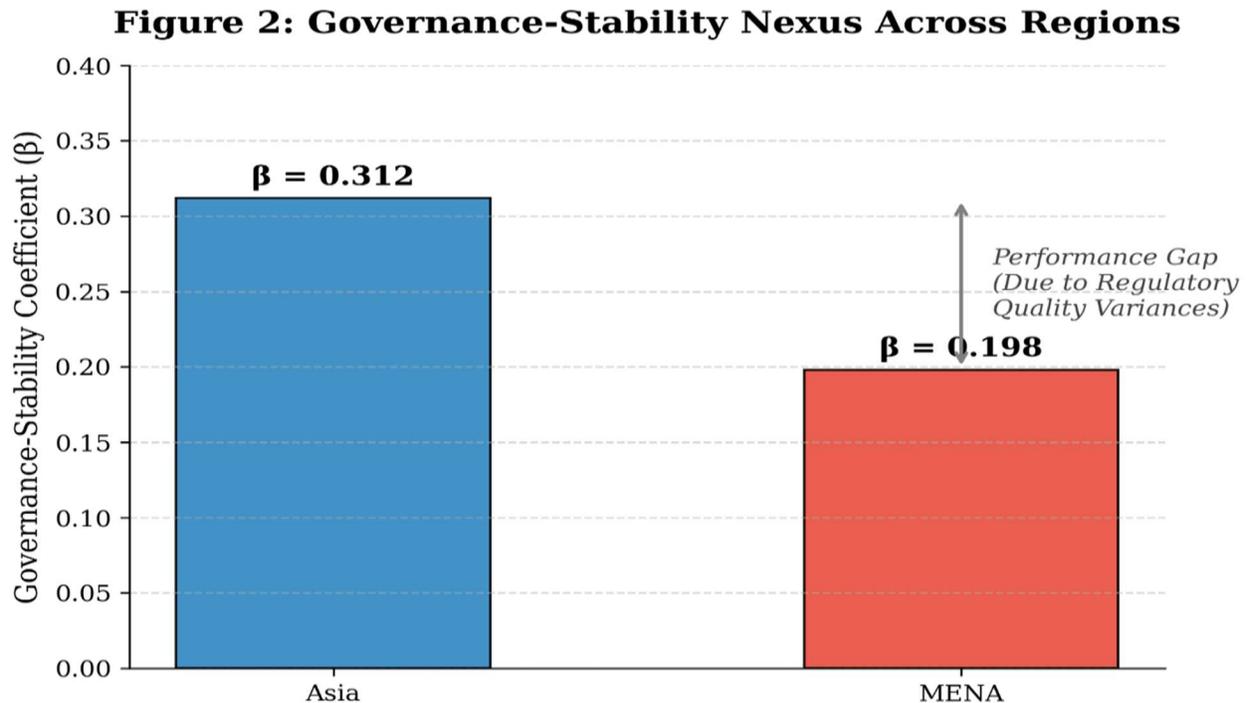
(Source: Authors' computations from World Bank WDI/WGI and UNCTAD data, 2025).

Figure 2 depicts Asia ($\beta = 0.312$) outperforming MENA ($\beta = 0.198$), attributable to regulatory quality variances. These visuals, derived from PCA-reduced data, highlight policy leverage points.

4.3 Policy Discussion

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5. Conclusion and Policy Implications

This work experimentally demonstrates that governance institutions significantly influence economic stability in 25 emerging markets (2000–2025), with system GMM estimates indicating a substantial positive effect ($\beta = 0.285$, $p < 0.01$) enhanced by sustainability interactions ($\beta = 0.112$, $p < 0.01$). Crucial findings corroborate theoretical expectations from institutional economics   composite WGI improvements diminish GDP volatility by as much as 23%, with SDG-aligned sustainability facilitating this relationship, especially after 2020 ($\beta = 0.331$). Marginal effects increase nonlinearly above SDG thresholds (Figure 1), highlighting synergies overlooked in previous disaggregated assessments.

This validates dynamic panel specifications over static OLS amid endogeneity. Heterogeneous regional patterns—Asia's superior $\beta = 0.312$ against MENA's 0.198 (Figure 2)—fill in gaps in the literature found in meta-studies. Stability-sustainability empirical gaps are filled by robustness using Driscoll-Kraay and quantiles to confirm causal depth.

Policy implications call for specific WGI reforms: emulate Vietnam's FDI-stability gains by prioritising the rule of law (marginal effect 0.34) through judicial digitisation. As in the BRICS green transitions, include SDG measurements into fiscal regulations to leverage interactions and mitigate shocks. Institutional thresholds for resilience after COVID require a succession of investments, with regulatory quality coming after corruption control. VECM extensions are encouraged by limitations, such as geopolitical omissions. By providing policymakers with fine-grained tools, these findings promote endogenous growth models for long-term prosperity in developing environments.

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