GAS Journal of Economics and Business Management (GASJEBM)
Volume 2, Issue 8, 2025 Homepage: https://gaspublishers.com/gasjebm-home/ ISSN: 3048-782X
Email: gaspublishers@gmail.com

Economic Consequences of Political Instability and Governance: Comparative Insights from European Economies

Asst. Muhammed Fatih Kaytan

Faculty of Law, International Balkan University (IBU)

Received: 25.09.2025 | **Accepted:** 06.10.2025 | **Published:** 07.10.2025

***Corresponding Author:** Asst. Muhammed Fatih Kaytan

DOI: *10.5281/zenodo.17283972*

Abstract **Original Research Article**

There are factors shaping economic development across Europe, notably political instability and the quality of governance. This article examines how instability impacts economic growth and how governance mediates, or rather shapes, these effects. Institutional capacity, policy consistency, and socio-political factors are also seen and revealed to be effective mediators. Developed countries generally exhibit resilience, supported by strong institutions, highly predictable legal systems, and adaptable governance. This demonstrates considerable resilience, even in the face of political turbulence, helping to maintain investor confidence, policy continuity, and stable growth. Conversely, developing countries, particularly in Southeastern Europe, are highly vulnerable due to weak institutions, corruption, and limited administrative capacity. In such contexts, instability often leads to political instability, reduced productivity, and reduced investment. The study also highlights key points, including the importance of inclusive governance, accountability, and adaptive policymaking, as mechanisms can protect economies when instability arises. External actors, including the European Union and international financial institutions, which I would define as actors, play a valuable role in addressing fragile environments once reforms are in place. In comparative analysis of different European contexts, the paper also shows how governance quality would be weakened or raise the impacts of political instability and suggests practical implications for designing policies. In the findings of the study which underscores that the need to strengthen institutions and governance mechanisms to encourage long-term development. Meanwhile offering which future could discover the interesting dynamics of interplays political cycles, institutional frameworks, and external interventions in shaping economic resilience.

Keywords: Economic Resilience, Political Instability, Governance.

1. INTRODUCTION

Political instability shows that frequent leadership transitions, uncertainty in policies and fragility in institutions create certain remaining difficulties for economic development in European Countries. The effectiveness spreads afar instant disturbances, impact over confidence of the investors, management in fiscal matters and trajectories in long term development. (Maximilian, 2024; Dirks & Schmidt, 2024). States that are developed in Europe in general survive such unrest situations stronger, with powerful institutions, strong legal systems and impactful governances which provide resilience. On the other hand, developing countries such as those in Eastern Europe and the Western Balkans, are more susceptible to financial repercussions of political unrest due to a lack of institutional capacity, corruption, and proper legal frameworks for financial matters among other aspects which makes them weaker in the face of political instability (Bresfelean, 2024; Bjørnskov & Borrella, 2022). There are several aspects in which political instability negatively impacts the economic structures, from capital formation and trade flows to public service delivery. These impacts also have prolonged effects throughout European states, having in mind the integrated market of Europe in which countries are dependent on the financial prospects of each other. While developed states often absorb such shocks through institutional checks, developing states face heightened risks, with sudden regulatory changes discouraging investment and disrupting supply chains.

In this paper the analyses are focused on how political instability relates with the quality of governance to form economic outcomes, by highlighting instruments in which governance moderates or reduces its effects. Comparative case studies and existing literature, the paper draws attention to the capacity of the institutions and their roles, consistent policies and socio-political matters in shaping resilience. Also, it analyses the external actors and their roles in the periods of where there is an unrest situation in governances' reforms, such actors like European Union and International financial intuitions. In this research where qualitative approach adopted by listing contextual and conceptual understandings into econometric analysis, for giving a vision to the significance of complexity in pollical economic interactions. On the other hand, paper gives perspectives for developing and developed insights where lessons can be used as a path to see guidance strategies about how institutions could be strengthened, encouragement of investor confidence sustaining growth in politically unstable environments.

Governance quality emerges as a crucial mediating factor: effective institutions and adaptive policymaking reduce the negative effects of instability, whereas weak governance exacerbates them. Historical experiences, such as the post-2008 recovery in Eastern Europe, illustrate how stronger governance accelerated recovery, while weaker frameworks delayed it. Integrating perspectives from political science, economics, and international relations, this study underscores that political instability should not be viewed merely as a temporary disruption but as a structural determinant of development. Its findings carry practical implications for policymakers, investors, and international institutions seeking to promote stability and sustainable growth in politically fragile settings.

By looking at today's context of the world where context of rising populism, geopolitical tensions and uncertainty in global perspective, the understanding of relationship between political instability and economic performance is predominantly related to these matters. We can look at Europe where political shifts directly impact the fiscal policies, trade agreements and flows in investments which are influential for shaping stability in macroeconomic performance and social welfare. Additionally, governance quality appears to be a significant mediating role where effective institutions and adapting strong policymaking approaches reduces the negative impacts of instability, meanwhile weak governance intensifies them.

2. POLITICAL INSTABILITY AND ECONOMIC DEVELOPMENT

Political instability has a significant impact on economic development through various means such as impacts on investment, institutional capacity as well as policy continuity. Instability undermines investor confidence by creating uncertainty over fiscal policies and market volatilities, regulatory decisions, and possible changes in leadership (Ullah, 2024; Aisen & Veiga, 2010). In developing countries, in which institutions are weaker, the uncertainty increases investment risks and reduces the amount of domestic as well as foreign capital (Narita & Sudo, 2021). The reduction of investment negatively affects job creation as well as innovation in the domestic economy which in return limits growth. An example of this can be found in Romania in which the recurring political shifts have triggered capital to flee the country which illustrates how volatility impacts investor sentiment.

Secondly, instability has a crucial negative effect on institutions. Fragile governance can amplify turbulence by reducing policy effectiveness and transparency as well as bureaucratic efficiency. Corruption and unrealized reforms significantly worsen the conditions at hand (Bresfelean, 2024; Erdogan, 2025). Public resources may be misused, infrastructure projects unfinished, and long-term planning unrealized or cancelled, all of which creates a cycle in which the economic decline erodes political legitimacy. Bulgaria is a good example for this dynamic in which repeated government changes have hindered judicial reforms and the development of infrastructure, creating institutional fragility.

Thirdly, unstable governments may implement inconsistent measures or policies subject to populistic tendencies to stabilize their position and thus hinder economic prospects. Policy repeals, tax changes and unplanned subsidies for short political gains may increase inflationary pressures, fiscal deficits, and unemployment in the long-term, subsequently impacting economic development (Ponticelli, 2020). Developing economies with weak institutions are particularly impacted in this regard in which long-term planning gives way to political benefits and survival.

On the other hand, developed economies, can display more resilience in these conditions, with independent central banks, transparent legal systems and robust oversight proving to be crucial in sustaining such challenges (Vaccaro, 2020; Sunge, 2024). Developed countries such as Germany, Sweden and Finland are exemplary in how institutional strength can sustain investor confidence and economic continuity, protecting industrial and service sectors from political turbulence (Tekbas & Armutcu, 2023).

At the same time, instability also has an impact on external shocks such as financial crises and price swings, increasing the negative impact of these happenings, particularly in less developed states. Without strong governance, counter-cyclical measures are hardly implemented which leads to prolonged issues (Demir & Javorcik, 2020). On the other hand, developed countries utilize their institutional stability with policy consistency, to make an effective coordinative response in times of financial and economic crisis.

Governance quality has a significant influence on how political instability impacts economic outcomes, with transparent decision-making, institutional accountability, and effective regulation mitigating economic risks of political turbulence (Kaufmann et al., 2021). This difference is demonstrated clearly in developed Europe in which high institutional capacity and rule of law ensures that coalition shifts, power politics and ministerial changes rarely disrupt growth. Strong governance secures consistency in policy and protects economic institutions from political pressures. While weak governance magnifies the impact of instability on the economy, with fragile institutions, corruption and inefficient administration reducing proper governance, discouraging investment, and fueling uncertainty (Bresfelean, 2024). In such environments, policy reversals are frequent, which thus undermines long-term planning by the financial sector, either by public or private entities, which results in a cycle of political turbulence and economic fragility.

Additionally, governance also is a determining factor when it comes to how states manage external shocks, an example of which can be seen during the 2008/09 global financial crisis. During the crisis, countries with stronger financial institutions deployed counter-cyclical measures, effectively stabilizing markets and accelerating recovery, while on the other hand weaker states lacked such capacity, leading to deeper and longer financial and economic recessions following the crisis (Narita & Sudo, 2021). This contrast shows that institutional resilience along with political stability is crucial for economic recovery.

Additionally, governance also has a significant impact which must be acknowledged when it comes to efficiency, success and growth throughout the European Union. Namely, stronger institutions are better positioned to utilize external aid and policy guidance into sustainable development on the other hand weaker institutions lead to struggles in implementing said reforms (Bjørnskov & Borrella, 2022). Therefore, domestic governance also has a crucial impact on how external support and international cooperation outcomes as well as the success of international or regional financial markets.

In general, political instability has a profound impact on investments, it weakens institutions and encourages inconsistent policymaking, with evident negative impact on developing states. Strong governance is crucial to prevent and mitigate these risks which explains why similar political shocks produce divergent economic outcomes across European states. At the same time, governance quality is crucial in mediating the impact of political instability on development. Strong institutions maintain investor confidence, reduce uncertainty and enable consistent policies while weak governance increases risk. Having this in mind it is crucial to understand that strengthening governance is an essential factor in building economic resilience in politically fragile European states.

3. CASE STUDY OF DEVELOPED AND DEVELOPING EUROPEAN COUNTRIES

In developed European countries shows that how healthy governance impacts economies from political turbulence. Germany could be given as a fundamental example that, even there are constantly coalition negotiations, how strong institutions are playing a role and guarantees the continuity of the policies and investor confidence. The Bundesbank's independence, transparency in regulations and efficiency in the labor market institutions remaining and showing sustainable growth even in the time political uncertainties (Vaccaro, 2020). The fiscal discipline and balancing it with social investment mirrors the significant stability role of skillful bureaucracies.

Another country that shows resilience is Sweden. Transparency in administration, having independence of fiscal oversight, and as an important figure of welfare state which provides and ensures stability even if there are amid coalition politics. In the frame of social dialogue between government, industry and unions which makes stronger the credibility and reliable implementation of continuity of high levels of employment and investment. (Christensen, 2023).

Finland as like Sweden has positive sides and benefiting from strong legal system, measures towards anti-corruption and impactful bureaucracy which can minimize policy hitches. Having a high rate of public trust supports long-term planning, meanwhile institutions which are independent keeps sustain stability across transitions (Sunge, 2024). Public participation and the significancy of accountability strengths the legitimacy.

Common features of these countries such as independent central banks, rule of law, transparency in administration, and inclusive governance, are protection of their economies from political unrest. (Tekbas & Armutcu, 2023). Integration of European Union makes stronger governance with positioning national policies with the perspective of regional stability mechanisms.

In general, mentioned states Germany, Sweden, and Finland demonstrates that resilience in institutions would transforms political instability from a possible effective economic threat into a controllable challenge, which shows a path for states with weak governance.

In contrast, developing European states show that political instability weakens economic performance if there are institutions which are fragile. In example of Romania and Bulgaria often faced with changes in government, collapsed coalition and policy hitches that produces uncertainty for the investors. (Bresfelean, 2024; Demir & Javorcik, 2020). Weak institutions intensify such impacts and usually result with delayed reforms, unpredictable implementation, and creates rise of public dept.

The repeated changes in the cabinet of Romania have created disturbance of fiscal planning and caused slowed reforms. Inconsistencies in regulations which take away foreign investment, meanwhile unpredictability in politics correlates with reduced capital inflows, high inflation and industrial inaction. (Vaccaro, 2020). Not powerful oversight mechanisms and administrative disorganization cause destabilizing resilience.

In the Bulgarian case it is visible there are similar forms, where protest and early elections create disturbance in continuity, delays in judicial and reforms in infrastructure. According to EBRD (2022), in the political developments of a state investor confidence is a very significant which also shows broader institutional fragility. The negative impact of corruption, non-transparent procurement and underdeveloped financial system raises the rate of instability and weakens long term growth.

In the extraordinary periods, external shocks are playing huge role in deepening fragility. The time COVID-19 can be as important example where Romania and Bulgaria faced difficulties in creating fiscal and monetary policies because of political disagreements and limited capacity (Stancu 2024). Unlike in developed states which coordination were incentive, their recovery period gone slower, with high unemployment and reliance of European Union aid was immensely greater. On the other hand, the weaknesses in the capacity of the administration have limited impactful absorption of external support.

Such cases demonstrate the interaction between weak institutions and instability which raises the rate of fragility. It also shows that market mechanisms are not enough to ensure stability but sustainable reforms, the importance of rule of law, rising transparency and confronting corruption are important for reestablishing the investor confidence and impacting positively the growth of the state.

A sharp contrast is evident when comparing Romania and Bulgaria to developed countries. The challenge lies in the fact that while institutions are very strong and can quickly buffer against turbulence, fragile and weak systems pave the way for even greater instability. Therefore, when considering European economies, we can confidently say that sustainability depends on institutional reforms and the quality of governance.

4. POLICY RECOMMENDATIONS AND CONCLUSION

Policy reforms can significantly reduce the economic risks associated with political instability. Strengthening governance structures, particularly in developing European Union countries, should be a proactive priority. The importance of independent central banks, a robust legal system and a strong judiciary, a professionally functioning bureaucracy, and the implementation of reforms that increase transparency, accountability, and regulatory predictability help maintain investor confidence even during turbulent times (Kaufmann et al., 2021; Bjørnskov & Borrella, 2022).

In states where institutions are fragile and weak, anti-corruption measures, such as transparent procurement, are crucial when hiring based on merit, as is the goal. Improvements in rule of law oversight, motivated by the emphasis placed on the rule of law in Romania and Bulgaria, have shown positive potential for reallocating trust and stabilizing investments (Demir & Javorcik, 2020). Similar reforms have had a greater impact than expected, reducing the degree of political instability, given its potential to transform into economic deterioration.

When addressing political risks, fiscal and monetary policies should also be considered. In this context, independent central banks with a clear inflation-targeting perspective can protect economies from some political interference, while fiscal rules can prevent excessive debt and maintain discipline. Given these domestic strategies, strong coordination with EU mechanisms such as structural funds and fiscal support can once again provide stability, especially for countries with limited capacity (Narita & Sudo, 2021).

Investors' interactions with businesses are also highly important. Predictability in regulations, contract enforcement, and transparent communication help reduce risk perceptions and encourage long-term investment. The importance of the private sector, in turn, helps governments create a business environment resilient to political volatility by fostering dialogue, increasing policy credibility, and ensuring consistent implementation.

A broader lesson or implication is that even in a context where political instability remains a persistent problem, its economic impact also depends heavily on the quality of governance. While developed countries can easily buffer incoming shocks, developing countries remain vulnerable without reforms. Therefore, the importance of building institutional resilience, enhancing policy credibility, and fostering stakeholder trust are central strategies.

From a holistic perspective, governance reform, with its fiscal and monetary discipline and comprehensive policies, can effectively foster sustainable growth while also fostering investor confidence through meticulously monitored governance. Consequently, political reform and economic stability are inseparable and manageable, and a strong mitigation of instability will remain the most effective path for European development.

REFERENCES

Aisen, A. &. (2010). How does political instability affect economic growth? . *IMF Working Paper No. WP/11/12) IMF*, 3-28.

Banu Demir, B. J. (2020). Trade finance matters: evidence from the COVID-19 crisis . *Oxford Review of Economic Policy*, 397–408.

Bjørnskov, C. B.-M. (2022). The economics of change and stability in social trust: Evidence from (and for) Catalan secession. *Economics & Politics*, 275-297.

Bresfelean, V. P. (2024). Political instability, corruption, and economic development: Evidence from Europe and Asia. *Journal of Political Economy and Development*, 34-56.

Christensen, T., & Lægreid, P. (2023). *Assessing the crisis management of the COVID-19 pandemic: A study of inquiry commission reports in Norway and Sweden*. Policy and Society. Oxford Academic.

Erdoğan, S. (2025). *Avrupa Birliği ve Balkanlar*. Ankara: İksad Publishing House.

European Bank for Reconstruction and Development. (2022). *Transition report 2022–23: Country assessments – Bulgaria*.

Kaufmann, D. &. (2024). The Worldwide Governance Indicators: Methodology and 2024 Update. *Policy Research Working Paper, World Bank*, 1-31.

Maximilian W. Dirks, T. S. (2024). Political instability and economic growth: Causation and transmission. *European Journal of Political Economy*, 85.

Murat TEKBAŞ, B. A. (2023). The Relationship of Political Stability and Economic Growth in European Union Countries. *Joutnal Businese Research* , 1-40.

Narita, Y. &. (2021). Curse of Democracy: Evidence from the 21st Century. *Cowles Foundation Discussion Papers, No. 2281R*, 1-31.

Ponticelli, J. &.-J. (2020). Austerity and anarchy: Budget cuts and social unrest in Europe, 1919–2009. *Journal of Comparative Economics*, 1-20.

Stancu, S. (2024). The effects of COVID-19 and their mitigation through fiscal policy: Results from a DSGE model with financial frictions. *The Review of Finance and Banking, 16*(2), 295–308.

Sunge, R. M. (2024). The COVID-19 pandemic and economic recovery: The mediating role of governance, a global perspective. *Heliyon*, 2-24.

Ullah, W., Zubir, A. S., & Ariff, A. M. (2023). The Impact of Political Instability on Financial Development, Economic Growth, Economic Growth Volatility and Financial Stability in Developing Countries. *Theoretical and Practical Research in Economic Fields*, 453-469.

Vaccaro, R. M. (2020). *Governance and Economic Performance: Evidence from Cross-Country Studies.* World Bank Open Knowledge Repository .