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Political Stability and Money Laundering Risk

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Abstract

The influence of political stability on financial crime remains a subject of ongoing debate. While stability is often associated with policy continuity, regulatory credibility, and more effective enforcement, an alternative view suggests that unstable democracies may outperform stable autocracies in curbing financial crime. Using panel data from 158 countries over the period 2012–2023, this study finds that political stability is associated with lower money laundering (ML) risk, even after controlling for the extent of democratic governance. With respect to moderating factors, democracy independently lowers ML risk, but its interaction with political stability is limited, suggesting that stability constrains illicit financial activity largely irrespective of regime type. Economic development emerges as a more decisive moderator: in high-income countries, political stability translates into more credible AML enforcement, whereas in low-income settings, its impact is constrained by weaker institutional capacity. Legal origin exhibits weaker moderating effects, with political stability reducing ML risk across both common law and civil law systems. Overall, the findings highlight political stability as a key institutional determinant of structural Anti-Money Laundering (AML) vulnerability, underscoring the importance of strengthening governmental capacity to enhance the effectiveness of anti-money laundering frameworks.

Keywords: political stability; democracy; legal origin; economic development; money laundering

1. Introduction

Money laundering (ML), the process of concealing the illicit origins of criminal proceedings, poses a persistent and systemic threat to global financial stability. The United Nations Office on Drugs and Crime (UNODC) estimates that between 2% and 5% of global GDP is laundered annually, amounting to approximately USD 800 billion to USD 2 trillion (UNODC, 2025). The proliferation of emerging technologies, including cryptocurrencies and artificial intelligence, has further complicated the regulatory landscape by enabling anonymous fund transfers and facilitating fraud schemes that circumvent know-your-customer (KYC) protocols (Cronin et al., 2025). Despite ongoing international efforts to strengthen anti-money laundering (AML) frameworks, their effectiveness remains limited. Recent data shows heightened ML vulnerabilities in traditionally low-risk jurisdictions such as New Zealand, Switzerland, and the United Kingdom (Basel_AML_index, 2024). Beyond financial implications, ML and related activities such as terrorist financing undermine global security, erode the rule of law, and obstruct progress toward sustainable development (Nazar et al., 2023). In recognition of these challenges, Sustainable Development Goal (SDG) Target 16.4 calls on UN Member States to significantly reduce illicit financial flows, enhance asset recovery, and combat organised crime by 2030 (UNODC, 2025).

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Given the severity of money laundering (ML) risk, recent cross-country research has increasingly focused on identifying national-level factors that mitigate ML vulnerabilities. Notable contributions have examined the roles of national culture (Yamen et al., 2019; Mejri et al., 2022), public governance (AlQudah et al., 2022), democratic institutions (Kalokoh, 2024), openness (AlQudah et al., 2025), and religion (Mahmood & Ashraf, 2025). Extending this line of inquiry, the present study investigates the impact of political stability on ML risk, an area that remains underexplored despite its potential significance.

Political stability refers to the durability and continuity of political institutions, reflecting the regularity of political processes and the absence of violent disruptions (Ake, 1975). The concept of political instability, however, is not simply defined as the direct opposite of political stability. Alesina et al. (1996) conceptualise political instability more broadly as the unexpected collapse of governments or the presence of widespread social unrest, including politically motivated violence and persistent threats to institutional continuity.

Accordingly, although this study empirically measures political stability, the construct is interpreted as capturing the absence of conditions associated with political instability. Higher levels of political stability therefore imply lower probabilities of government disruption, political violence, and systemic unrest that may undermine governance effectiveness and regulatory enforcement capacity.

Empirical evidence suggests that political stability exerts a distinct influence on economic and institutional outcomes independent of regime type. Alesina et al. (1996), for example, report no systematic growth differentials between democracies and autocracies, yet document a robust negative association between political instability and economic performance. This finding underscores the importance of stability itself, rather than political system classification, as a determinant of institutional effectiveness. Similarly, Roe and Siegel (2011) argue that political stability should be examined as an independent determinant of financial outcomes.

Political instability is widely recognised as a structural factor that weakens state capacity and undermines the effectiveness of AML frameworks. Instability disrupts regulatory oversight, erodes enforcement credibility, and reduces policy consistency (Dreher & Schneider, 2010; Le Billon, 2011). It is also associated with diminished institutional oversight and higher levels of economic informality, further complicating regulatory enforcement (Alesina et al., 1996; Alesina & Perotti, 1996; Elbahnasawy et al., 2016).

Building on this context, we empirically investigate the relationship between political stability and money laundering (ML) risk using a panel dataset covering 158 countries over the period 2012–2023. Political stability is proxied by the Political Stability and Absence of Violence/Terrorism Index from the World Bank's Worldwide Governance Indicators. ML risk is measured using the Basel AML Index. Our baseline results show that countries with lower political stability tend to have significantly higher ML risk. In our regressions, we control for levels of democracy, suggesting that political stability has an effect distinct from democracy.

To further explore the conditional nature of this relationship, we introduce interaction terms to test whether the impact of political instability on ML risk varies with institutional and structural characteristics. Specifically, we examine whether the level of democracy, the legal origin of institutions, and the stage of economic development moderate the effect. The findings suggest that the adverse impact of political instability on ML risk is more pronounced in countries with weaker democratic institutions, in jurisdictions outside the British common law tradition, and in developing economies.

This study makes a significant contribution to the existing literature in two important ways. First, we contribute to the growing body of research examining the institutional and cultural determinants of money laundering (ML) risk. Prior studies have highlighted the

roles of country-level religion. (Mahmood & Ashraf, 2025), public governance (AlQudah et al., 2022), national culture (Yamen et al., 2019; Mejri et al., 2022), and democratic institutions (Kalokoh, 2024) in shaping ML risk. We extend this discourse by providing empirical evidence that political instability is independently associated with higher ML risk, beyond democratic quality and legal institutional frameworks.

Second, we build on the literature exploring the impact of political instability on financial misconduct. While previous research has primarily focused on its influence on the shadow economy (Elgin, 2010; Elbahnasawy et al., 2016; Medina & Schneider, 2018; Esaku, 2021), tax evasion (Tiwari, 2013), and corruption (Nur-Tegin & Czap, 2012; Türedi & Altıner, 2016; Zeeshan et al., 2022; Beju et al., 2024), our study extends this line of inquiry to the domain of money laundering. By doing so, we provide new empirical evidence on the association between political instability and elevated money laundering risk.

The remainder of the paper is structured as follows. Section 2 develops the theoretical framework and hypotheses. Section 3 describes the methodology. Section 4 presents the descriptive statistics. Section 5 presents empirical results and robustness checks. Section 6 concludes with policy implications and directions for future research.

2. Theoretical Framework and Hypothesis

A broad consensus in the political economy and institutional literature recognises that political dynamics play a central role in shaping policy adoption (Wilson, 1984) and the enforcement of regulatory frameworks (Alesina et al., 1996; Alesina & Perotti, 1996; Dewey et al., 2021; Short, 2021). Political actors weigh the costs and benefits of regulatory enforcement and make strategic decisions that reflect broader political incentives and constraints (Dewey et al., 2021). In the context of illicit financial flows, including money laundering, a persistent gap often exists between formal regulatory frameworks and their effective enforcement (Khalil et al., 2025). This enforcement gap is particularly pronounced in politically unstable environments, where weakened governance structures, regulatory discontinuity, and short political horizons undermine institutional effectiveness and increase the risk of money laundering.

A growing body of empirical research links political instability to financial crime, particularly corruption and tax evasion, although findings are not entirely uniform. Most studies suggest that corruption flourishes in politically unstable environments characterised by weak enforcement and discretionary governance. Türedi and Altıner (2016) find that political stability is associated with lower corruption levels. Zeeshan et al. (2022) demonstrate that political instability in Pakistan exacerbates corruption and slows economic growth, while Beju et al. (2024) report similar evidence across European and Asian countries. However, alternative perspectives exist. Nur-Tegin and Czap (2012) show that corruption levels may be lower in unstable democracies than in stable autocracies, indicating that regime type may interact with political stability in complex ways. Curti and Mihov (2018) further argue that government effectiveness may be more important than political stability alone in recovering fraud-related losses.

Relatedly, the relationship between political stability and the informal economy, including tax evasion, remains nuanced. Elgin (2010) finds that the impact of taxation on informality depends on political turnover: longer-serving governments are more likely to raise taxes and reduce informal activity. Marjit et al. (2011) argue that the size of the shadow economy may reflect deliberate political choices rather than institutional failure alone. Elbahnasawy et al. (2016) show that democratic transitions accompanied by political instability can expand the informal economy, while Esaku (2021) finds a negative association between political unrest and informality in Uganda. Using a large sample of 158 countries, Medina and Schneider (2018) show that government stability reduces

the size of the shadow economy in developing economies but has no significant effect in developed countries. Tiwari (2013) further documents that the impact of political stability on tax collection is nonlinear and varies across income distributions.

Beyond the crime and informality literature, financial economics research provides complementary insights into the mechanisms linking political stability to economic vulnerability. Political risk and weak institutional credibility impair market transparency, reduce liquidity, and increase systemic fragility (Fisman & Svensson, 2007; Pham, 2015; Brockman et al., 2024). Recent evidence shows that firm-level political risk adversely affects corporate bond market liquidity, reflecting heightened uncertainty and reduced regulatory credibility (Liu et al., 2025). At the macro-financial level, governance quality moderates the transmission of uncertainty into systemic risk and financial instability (Wasi et al., 2023; Abaidoo & Agyapong, 2025). These findings reinforce the view that political stability enhances regulatory credibility and institutional continuity, thereby reducing structural vulnerabilities that also facilitate money laundering.

Taken together, this literature suggests that political stability supports the adoption and enforcement of anti-money laundering (AML) frameworks by strengthening legal predictability, institutional oversight, and regulatory credibility. In contrast, political instability erodes state capacity, weakens enforcement, and fosters environments conducive to corruption, informality, and financial fraud. These dynamics collectively elevate ML risk by reducing transparency and compromising institutional effectiveness.

While some strands of the political economy literature suggest that corruption and illicit activity may, in the short run, contribute to regime stability by aligning elite interests or facilitating administrative functioning in weak institutional settings often described as a "greasing-the-wheels" mechanism (Lucarelli et al., 2024), such effects are typically context-specific and temporally limited. In contrast, this study conceptualises political stability as a structural and institutional condition reflecting the durability, continuity, and resilience of state authority rather than short-term regime survival. Persistent money laundering and financial crime are more likely to erode regulatory credibility, institutional capacity, and public trust over time, thereby undermining the foundations of political stability. Although reverse causality between political stability and money laundering (ML) risk cannot be entirely ruled out, the primary theoretical direction examined in this study runs from political stability to ML risk. Greater political stability is expected to reduce ML risk by strengthening institutional continuity, improving regulatory enforcement, and enhancing governance credibility. Stable political environments typically support more effective supervision, lower regulatory uncertainty, and stronger compliance mechanisms, all of which constrain opportunities for illicit financial activities.

At the firm and market level, corruption and weak institutional environments distort investment incentives, reduce transparency, and impair capital allocation (Fisman & Svensson, 2007). Political risk has been shown to adversely affect market liquidity and pricing efficiency, particularly in bond and equity markets, by increasing uncertainty and weakening investor confidence (Liu et al., 2025; Brockman et al., 2024). Studies on market transparency further demonstrate that credible regulatory frameworks reduce information asymmetries and improve monitoring, thereby limiting opportunities for illicit financial activity (Pham, 2015). At the macro-financial level, governance quality and institutional credibility play a critical role in shaping systemic risk, sovereign vulnerability, and financial stability (Wasi et al., 2023; Abaidoo & Agyapong, 2025). Collectively, this literature suggests that political stability operates not only through formal AML institutions but also by enhancing regulatory credibility and financial transparency, reinforcing the theoretical link between political stability and lower money laundering risk.

Accordingly, we propose the following hypothesis:

H1. *Higher levels of political stability will reduce money laundering risk.*

2.1. Democracy as a Moderator

Although democracy and political stability are conceptually distinct, democratic institutions can foster political stability by channelling conflict into peaceful, predictable processes. Democratic systems enable citizens to express dissatisfaction through elections, facilitate orderly transitions of power, promote transparency and accountability, and allow early intervention in social tensions through freedom of expression and pluralistic debate (Hirschman, 1972; Barry, 1997; Persson & Tabellini, 2003; Treisman, 2007; Dahl, 2008, 2020). These features enhance institutional responsiveness and public trust, thereby reinforcing political stability.

However, political stability alone does not guarantee accountability. In authoritarian regimes, stability may entrench ruling elites and shield illicit financial activities from scrutiny. In contrast, democratic institutions introduce checks and balances that determine whether political stability translates into credible regulatory enforcement. Feng (1997) finds that democratic stability supports long-run growth and institutional credibility, whereas authoritarian stability is more likely to facilitate rent-seeking and weaken regulatory integrity.

Since corruption and money laundering frequently overlap through bribery, shell companies, and illicit political financing, democratic accountability can strengthen the effectiveness of political stability in reducing ML risk. Kalokoh (2024) provides empirical evidence that democratic governance significantly reduces the risks of money laundering and terrorist financing. Accordingly, democracy is expected to amplify the effectiveness of political stability in constraining illicit financial activity.

Based on this reasoning, we propose the following hypothesis:

H2. *The impact of political stability on money laundering risk is more pronounced in countries with higher levels of democracy.*

2.2. Income Development as a Moderator

Institutional capacity is closely linked to economic development. Higher-income countries typically possess stronger bureaucratic infrastructure, better-trained personnel, and more advanced compliance systems, all of which enhance AML enforcement (Achim & Borlea, 2020). In contrast, lower-income countries often face fragmented enforcement, under-resourced regulatory agencies, and limited technical capacity, weakening their ability to combat financial crime (Kemal, 2014).

Empirical evidence consistently shows that ML risk is higher in developing economies. Achim and Borlea (2020) argue that structural vulnerabilities such as weak institutions and limited oversight facilitate illicit financial flows in underdeveloped countries. Ghulam and Szalay (2023) find that money laundering risk is correlated with several economic characteristics, including export performance. Corruption, a key enabler of money laundering, is also more prevalent in underdeveloped countries due to underfunded institutions and inadequate staffing (Nas et al., 1986; Treisman, 2000; Shabbir & Anwar, 2007).

These findings suggest that economic development conditions the effectiveness of political stability. In low-income settings, political stability alone may be insufficient to reduce ML risk, given institutional capacity constraints. In contrast, in more developed economies, political stability is reinforced by administrative competence and regulatory resources, allowing stability to translate into credible enforcement.

Based on this rationale, we propose the following hypothesis:

H3. *The impact of political stability on money laundering risk is more pronounced in countries with higher levels of economic development.*

2.3. British Legal Origin as a Moderator

Formal institutions, including constitutions, legal systems, and judicial frameworks, play a foundational role in shaping financial regulation and AML enforcement (North, 1990; Patibandla, 2025). Strong legal institutions are consistently associated with lower tax evasion, reduced shadow economy activity, and more effective regulatory oversight (Torgler & Schneider, 2009; Aruoba, 2010; Devine, 2021).

A substantial literature identifies British legal origin, rooted in common law traditions, as a key determinant of institutional quality. Standard law systems tend to exhibit stronger property rights, greater judicial independence, and more adaptable regulatory frameworks (La Porta et al., 1997, 1999, 2008). Civil law systems, particularly those derived from French or socialist traditions, often emphasise state control and more rigid bureaucratic structures.

Common law systems are associated with stronger investor protection (Djankov et al., 2008), higher transparency (Bushman et al., 2004), and greater tax compliance (Alm & Torgler, 2006), which are the preconditions for lower ML risk. As a result, political stability may translate more effectively into AML enforcement in common law systems, where regulatory adaptability and judicial independence support enforcement credibility. In contrast, civil law systems may struggle to convert political stability into effective AML outcomes if legal institutions remain rigid or politicised.

Based on this rationale, we propose the following hypothesis:

H4. *The impact of political stability on money laundering risk is more pronounced in countries with a British legal origin.*

3. Methodology

3.1. Sample Selection

To empirically examine the proposed hypotheses, this study constructs a cross-country panel dataset by compiling governance, institutional, and macroeconomic indicators from internationally recognised databases. Data are sourced from the Basel Anti-Money Laundering (AML) Index, the World Bank's Worldwide Governance Indicators (WGI), the World Development Indicators (WDI), the Economist Intelligence Unit (EIU), and the Institute for Economics & Peace (IEP).

After harmonising and merging these datasets, the final sample comprises an unbalanced panel of 158 countries observed annually from 2012 to 2023, yielding 1421 countryyear observations. The sample period is determined by data availability and cross-variable consistency, particularly the Basel AML Index, which provides comprehensive cross-country coverage beginning in 2012. This timeframe ensures adequate temporal variation while maintaining comparability across governance and institutional indicators.

3.2. Variables

Money laundering risk is measured using the Basel Anti-Money Laundering (AML) Index, which provides a cross-country assessment of structural vulnerability to money laundering and terrorist financing (Basel Institute on Governance, 2024; available at: https://index.baselgovernance.org/methodology (assessed on 16 July 2025). The index ranges from 0 (low risk) to 10 (high risk), with higher values indicating greater embedded ML risk. Importantly, the Basel AML Index captures institutional and regulatory vulnerabilities rather than observed ML activity or detected crime volumes. The index is constructed from 17 indicators grouped into five domains: AML/CFT frameworks, corruption and fraud risks, financial transparency, public transparency, and political/legal risks.

Political stability is measured using the Political Stability and Absence of Violence/Terrorism indicator from the World Bank's Worldwide Governance Indicators

(WGI) database (World Bank, 2024c; available at: https://databank.worldbank.org/metadataglossary/worldwide-governance-indicators/series/PV.EST (assessed on 16 July 2025). The variable is reported on a continuous scale typically ranging from approximately −2.5 to 2.5, with higher values indicating greater political stability. Consistent with contemporary political economy research, political stability is interpreted as a multidimensional governance condition reflecting institutional continuity, resilience to shocks, and exposure to political violence or unrest.

The analysis incorporates three moderating variables. The Democracy Index, sourced from the Economist Intelligence Unit (available at: https://ourworldindata.org/grapher/democracy-index-eiu (assessed on 16 July 2025), ranges from 0 to 10, with higher values denoting stronger democratic institutions. Income Development is obtained from the World Bank's World Development Indicators (WDI) database (available at: (World Bank, 2024b) https://data.worldbank.org/country) and classifies countries as developed or developing. British Legal Origin is coded as a binary variable following La Porta et al. (2008).

Control variables include GDP Growth, measured as the annual percentage change in real GDP (World Bank, 2024a; available at: https://databank.worldbank.org/source/world-development-indicators (assessed on 16 July 2025), and societal stability, proxied by the Global Peace Index (Institute for Economics & Peace, 2025; available at: https://www.economicsandpeace.org/global-peace-index/ (assessed on 16 July 2025)

3.3. Empirical Models

The baseline specification tests the direct effect of political stability on ML risk as follows:

$$Y_{j,t} = \alpha_i + \beta_1 Political\ Stability_{j,t} + \sum_{l=1}^{L} \gamma_l X_{j,t}^{l} + \sum_{t=1}^{T-1} \delta_t D_t + \varepsilon_{j,t} \quad (1)$$

where $Y_{j,t}$ denotes the Basel AML Index, measuring money laundering risk in country j in year t; $Political\ Stability_{j,t}$ represents the WGI score capturing institutional and political robustness in country j in year t; α_i is the country fixed effects (time-invariant country factors); $X_{j,t}^{l}$ is a vector of control variables; D_t is year fixed effects, respectively; and $\varepsilon_{j,t}$ is the idiosyncratic error term. Year fixed effects are included to absorb time-specific shocks that are common across countries, such as FATF evaluation cycles, global economic crises, and the COVID-19 pandemic. Standard errors are clustered at the country level to account for potential heteroskedasticity and within-country serial correlation.

To test the moderating effects of Democracy Index, Income Development and British Legal Origin in conditioning the impact of political stability on money laundering risk, the baseline model is extended by including interaction terms, as shown in Equation (2):

$$Y_{j,t} = \alpha_i + \beta_1 Political\ Stability_{j,t} + \beta_2 Moderator_{j,t} + \beta_3 (Political\ Stability_{j,t} \times Moderator_{j,t}) + \sum_{l=1}^{L} \gamma_l X_{j,t}^{l} + \sum_{t=1}^{T-1} \delta_t D_t + \varepsilon_{j,t} \quad (2)$$

where $Y_{j,t}$ denotes the Basel AML Index, measuring money laundering risk in country j in year t; $Political\ Stability_{j,t}$ represents the WGI score capturing institutional and political robustness in country j in year t; and $Moderator_{j,t}$ denotes one of three institutional moderators: Democracy Index (a 0–10 scale, with higher values indicating greater democratic quality), Income Development (a categorical variable distinguishing between developed and developing economies), and British Legal Origin (a binary variable coded 1 for British standard law systems and 0 otherwise). These moderators test whether the impact of political stability on money laundering risk varies across different institutional contexts. $X_{j,t}^{l}$ is a vector of control variables (GDP Growth, Economy & Peace, etc.), as in Equation (1) α_i is the country's fixed effects (time-invariant country factors), and D_t denotes year fixed effects.

$\varepsilon_{j,t}$ is the idiosyncratic error term. Year fixed effects control for time-specific shocks that are common to all countries, including FATF assessment cycles, global economic downturns, and the COVID-19 pandemic. To address heteroskedasticity and serial dependence within countries, standard errors are clustered by country. All statistical analyses are performed using Stata 17.

4. Descriptive Statistics

Table 1 presents summary statistics for the main variables used in the analysis. The Basel AML Index, which measures the risk of money laundering and terrorist financing, averages 5.57, suggesting a moderate risk for the typical country. However, the values range from 1.78 to 8.61, indicating that some countries face a very low risk, while others face an extremely high risk. Political Stability is slightly below zero on average, indicating mild political uncertainty; however, some countries experience severe instability (as low as −2.99), while others are highly stable (up to 1.62). Democracy Index averages 5.92, reflecting moderate democratic governance overall. However, the range from 0.74 to 9.93 highlights that the sample includes both highly authoritarian and highly democratic regimes. Income Development averages 0.60, indicating that most countries in the sample are classified as developed (1), while a substantial portion remain developing countries (0). Approximately 21% of countries follow a British legal system, indicating that this legal tradition is prevalent but not dominant. Economy and Peace averages 1.93, indicating that most countries are relatively stable and peaceful, with the lowest value at 1.08 and the highest at 3.58, suggesting that a few countries experience notably better or worse conditions. GDP Growth averages 2.8%, indicating modest economic expansion, but extreme values such as −28.76% and 43.48% reveal highly volatile growth in certain countries, likely to reflect economic crises or exceptional booms.

Table 1. Summary statistics.

Variable	Obs	Mean	S. D.	Min	Max
Basel AML Index	1421	5.57	1.28	1.78	8.61
Political Stability	1421	−0.09	0.87	−2.99	1.62
Democracy Index	1421	5.92	2.12	0.74	9.93
Income Development	1421	0.60	0.49	0	1
British Legal Origin	1421	0.21	0.41	0	1
Economy and Peace	1421	1.93	0.41	1.08	3.58
GDP Growth	1421	2.80	4.54	−28.76	43.48

This table presents summary statistics for all variables used in the analysis, based on 1421 country-year observations across 158 countries from 2012 to 2023. The Basel AML Index measures money laundering risk, with higher values indicating greater risk. Political Stability reflects institutional and political robustness. Democracy Index captures political rights and civil liberties. Income Development is a binary variable coded 1 for developed and 0 for developing economies. British Legal Origin equals 1 for countries following standard law systems. Economy and Peace measures national peace and stability. GDP Growth represents the annual percentage change in real GDP. Political Stability reflects institutional and political robustness and is measured using the World Governance Indicators. While the indicator is commonly described as ranging approximately from −2.5 to 2.5, the observed empirical range in the sample extends slightly beyond −2.5 in specific country–year observations.

Overall, these statistics indicate that while the typical country in the sample is moderately democratic, economically developed, and relatively stable, considerable variation exists, including extreme cases, which may have significant implications for understanding the determinants of money laundering risk.

Table 2 presents the correlations among the key variables used in this study. Initially, Political Stability shows a strong negative association with Basel AML Index (−0.58, $p < 0.01$), indicating that countries with higher political stability tend to face lower money laundering risk. Each potential moderator is significantly associated with Basel AML Index. Democracy Index (−0.65, $p < 0.01$) indicates that countries with higher levels of democracy

tend to experience lower money laundering risk. Income Development (−0.60, $p < 0.01$) suggests that economically developed countries face lower money laundering risk than developing countries, likely due to stronger financial systems and more effective regulatory oversight. In contrast, Economy and Peace (0.51, $p < 0.01$), which reflects societal instability, conflict, and militarisation, is positively associated with money laundering risk, indicating that less stable societies provide more opportunities for money laundering. This pattern suggests that these moderators may influence the strength or direction of the relationship between political stability and ML risk. Political Stability is also strongly related to all three potential moderators. It is positively associated with Democracy Index (0.65, $p < 0.01$) and Income Development (0.51, $p < 0.01$), suggesting that more politically stable countries tend to be both more democratic and more economically developed. Conversely, it is strongly negatively associated with Economy and Peace (−0.88, $p < 0.01$), indicating that politically stable countries tend to be safer, more peaceful, and less conflict-prone. Overall, political stability tends to reduce ML risk; however, this effect may vary depending on the level of democracy, economic development, or societal stability. Higher democracy or development may strengthen the protective effect, while greater societal instability may weaken it, supporting the inclusion of interaction terms to test moderation in regression models.

Table 2. Correlation matrix.

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) Basel AML Index	1.00						
(2) Political Stability Estimate	−0.58 *** (0.00)	1.00					
(3) Democracy Index	−0.65 *** (0.00)	0.65 *** (0.00)	1.00				
(4) Income Development	−0.60 *** (0.00)	0.51 *** (0.00)	0.48 *** (0.00)	1.00			
(5) British Legal Origin	0.05 * (0.07)	−0.01 (0.88)	0.12 *** (0.00)	−0.15 *** (0.00)	1.00		
(6) Economy and Peace	0.51 *** (0.00)	−0.88 *** (0.00)	−0.62 *** (0.00)	−0.39 *** (0.00)	0.03 (0.25)	1.00	
(7) GDP Growth	0.12 *** (0.00)	−0.01 (0.81)	−0.10 *** (0.00)	−0.10 *** (0.00)	0.03 (0.19)	0.01 (0.83)	1.00

The table reports the pairwise correlation coefficients for all variables used in this study. The Basel AML Index measures money laundering risk, with higher values indicating greater risk. Political Stability reflects institutional and political robustness. Democracy Index captures political rights and civil liberties. Income Development is a binary variable coded 1 for developed and 0 for developing economies. British Legal Origin equals 1 for countries following common law systems. Economy and Peace measures national peace and stability. GDP Growth represents the annual percentage change in real GDP. Correlation coefficients are reported, with *p*-values shown in parentheses. * and *** indicate significance at the 10% and 1% levels, respectively.

Across all specifications in Table 3, the mean VIF values range between 2.11 and 2.79, well below the conventional threshold of 10. While the inclusion of interaction terms increases the VIFs of the interacted variables, particularly in the democracy interaction model, this pattern is expected by design and does not indicate harmful multicollinearity. Notably, the remaining regressors exhibit low VIF values, and coefficient signs and significance remain stable across model specifications. Overall, the results suggest that multicollinearity does not materially affect coefficient estimation or the interpretation of interaction effects.

Table 3. Variance Inflation Factors (VIFs).

	Baseline	Democracy Int.	Income Dev. Int.	Legal Origin Int.
Political Stability	5.20	11.29	6.09	5.81
Democracy Index	2.03	2.03	2.09	2.03
Income Development	1.55	1.56	1.67	1.56
British Legal Origin	1.09	1.10	1.10	1.10
Economy & Peace	4.54	4.56	4.65	4.58
GDP Growth	1.39	1.42	1.40	1.39
Interaction term		8.18	2.66	1.39
Mean VIF	2.11	2.79	2.21	2.11

This table presents variance inflation factors (VIFs) to assess potential multicollinearity. VIFs were estimated using pooled OLS specifications with the same set of regressors as in the baseline and interaction models, following standard panel-data diagnostics.

5. Multivariate Regression Results

5.1. The Effect of Political Stability on Money Laundering Risk

Table 4 presents baseline estimates of the relationship between political stability and money laundering (ML) risk, as measured by the Basel AML Index. Across both specifications, political stability is consistently and negatively associated with ML risk (−0.234 in Model 1; −0.191 in Model 2), indicating that politically stable environments are associated with lower structural vulnerability to ML. This finding aligns with prior evidence that political stability strengthens governance quality, enhances institutional capacity, and improves transparency, thereby limiting opportunities for illicit financial activity (Türedi & Altıner, 2016; Zeeshan et al., 2022; Beju et al., 2024; Khalil et al., 2025).

Table 4. The impact of political stability on money laundering risk.

	(1)	(2)
Political Stability	−0.234 ***	−0.191 ***
	(−4.33)	(−3.57)
Democracy Index	−0.234 ***	−0.240 ***
	(−15.77)	(−16.45)
Income Development	−0.823 ***	−0.810 ***
	(−13.82)	(−13.85)
British Legal Origin	0.135 ***	0.144 ***
	(2.75)	(3.08)
Economy and Peace	0.016	0.091
	(0.15)	(0.90)
GDP Growth	0.014 ***	0.011 *
	(2.81)	(1.91)
Constant	7.332 ***	7.434 ***
	(32.64)	(32.28)
Year Fixed Effect	No	Yes
Observations	1421	1421
R-squared	0.542	0.575

This table presents the estimated effects of political stability on the Basel AML Index. Basel AML Index, as a dependent variable, measures money laundering risk, with higher values indicating greater risk. Political Stability, as an independent variable, reflects institutional and political robustness. Control variables are also included in the analysis. Democracy Index captures political rights and civil liberties. Income Development is a binary variable coded 1 for developed and 0 for developing economies. British Legal Origin equals 1 for countries following common law systems. Economy and Peace measures national peace and stability. GDP Growth represents the annual percentage change in real GDP. Robust t-values are reported in parentheses. * and *** indicate statistical significance at the 10% and 1% levels, respectively. Model (1) serves as the baseline estimation without controlling for year-specific effects. Model (2) additionally includes year fixed effects. OLS regressions are used in this analysis.

Model 2 incorporates year fixed effects and modestly improves explanatory power (R^2 rises from 0.542 to 0.575), suggesting that time-specific influences—such as global regulatory changes, shifts in FATF monitoring intensity, or macroeconomic shocks—also contribute to variation in ML risk. The control variables are broadly consistent with expectations. Democracy and income development are negatively associated with ML risk, indicating that stronger political institutions and higher economic growth are associated with more credible regulatory environments and lower AML vulnerability (Kalokoh, 2024).

British legal origin is positively associated with ML risk. One interpretation is that common law jurisdictions tend to exhibit greater financial and legal complexity, including flexible corporate vehicles and intermediary-based structures, which may increase exposure to illicit financial flows when oversight is insufficient. Consistent with this view, Bartolozzi et al. (2019) show that Financial Intelligence Unit governance is stronger in civil-law systems, potentially supporting more centralised enforcement. Moreover, features common in British legal-origin systems, such as pooled client accounts and complex legal arrangements, may increase opacity and facilitate misuse when supervisory capacity is weak (Benson & Bociga, 2024). GDP growth is positively associated with ML risk, suggesting that rapid economic expansion may increase exposure to illicit flows through higher transaction volumes and cross-border capital movement (Hendriyetty & Grewal, 2017; Sikman & Grujic, 2021).

Importantly, these baseline findings are also consistent with evidence from financial economics showing that political risk and weak institutional credibility impair market transparency and liquidity, thereby increasing systemic vulnerability (Fisman & Svensson, 2007; Pham, 2015; Brockman et al., 2024). By strengthening regulatory credibility and institutional continuity, political stability may reduce both broader financial fragility and structural AML vulnerability.

The results can also be interpreted through the lens of financial market functioning and regulatory credibility. Stable political environments enhance regulatory enforcement predictability and strengthen institutional credibility, thereby improving market transparency and reducing information asymmetries. Prior studies show that political risk undermines liquidity, increases price distortions, and weakens market discipline, thereby creating conditions conducive to illicit financial flows (Liu et al., 2025; Brockman et al., 2024). Conversely, stronger governance and regulatory credibility improve monitoring, reduce opacity, and limit systemic vulnerabilities in financial markets (Pham, 2015; Wasi et al., 2023; Abaidoo & Agyapong, 2025). The negative association between political stability and money laundering risk observed in this study is therefore consistent with evidence that stable political institutions support transparent and well-functioning financial markets, reducing the structural conditions that facilitate money laundering.

5.2. The Moderating Effect of Democracy on the Relationship Between Political Stability and Money Laundering Risk

Table 5 examines whether democracy moderates the relationship between political stability and ML risk. Political stability remains negatively associated with ML risk in both models (−0.202 in Model 1; −0.184 in Model 2), reinforcing the baseline conclusion that politically stable environments are linked to lower AML vulnerability. Democracy is also negatively associated with ML risk, indicating that stronger democratic institutions—through accountability and checks and balances reduce opportunities for illicit activity (Kalokoh, 2024).

Table 5. Moderation of the democracy index.

	(1)	(2)
Political Stability	−0.202 **	−0.184 **
	(−2.47)	(−2.22)
Democracy Index	−0.233 ***	−0.240 ***
	(−15.60)	(−16.33)
Political Stability × Democracy	−0.006	−0.001
	(−0.51)	(−0.11)
Income Development	−0.821 ***	−0.809 ***
	(−13.81)	(−13.86)
British Legal Origin	0.136 ***	0.144 ***
	(2.78)	(3.07)
Economy and Peace	0.012	0.090
	(0.12)	(0.89)
GDP Growth	0.014 ***	0.011 *
	(2.76)	(1.91)
Constant	7.344 ***	7.437 ***
	(32.54)	(32.26)
Year Fixed Effect	No	Yes
Observations	1421	1421
R-squared	0.542	0.575

This table presents the moderation of the democracy index on the effects of political stability on the Basel AML Index. Basel AML Index, as a dependent variable, measures money laundering risk, with higher values indicating greater risk. Political Stability, as an independent variable, reflects institutional and political robustness. Democracy Index, as a moderator, captures political rights and civil liberties. Control variables are also included in the analysis. Income Development is a binary variable coded 1 for developed and 0 for developing economies. British Legal Origin equals 1 for countries following common law systems. Economy and Peace measures national peace and stability. GDP Growth represents the annual percentage change in real GDP. Robust t-values are reported in parentheses. *, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively. Model (1) serves as the baseline estimation without controlling for year-specific effects. Model (2) additionally includes year fixed effects. OLS regressions are used in this analysis.

However, the interaction term between political stability and democracy is not statistically significant, suggesting that the ML-reducing effect of political stability does not vary systematically across levels of democracy. One plausible explanation is that the core channel through which political stability lowers ML risk, namely institutional continuity, administrative capacity, and enforcement consistency, operates even when democratic features are limited (Alesina & Perotti, 1996; Dewey et al., 2021). While democracy is beneficial in its own right, it does not appear to amplify the marginal effect of stability in this sample.

The control variables remain stable and consistent with Table 4. Income development is negatively associated with ML risk, whereas British legal origin remains positively associated with it. GDP growth again shows a small positive association, indicating that fast-growing economies may face slightly higher structural exposure to illicit financial flows due to increasing economic activity and capital movement (Hendriyetty & Grewal, 2017; Sikman & Grujic, 2021).

5.3. The Moderating Effect of Income Development on the Relationship Between Political Stability and Money Laundering Risk

Table 6 evaluates whether income development conditions the effect of political stability on ML risk. Political stability is again negatively associated with ML risk in both models (−0.185 in Model 1; −0.152 in Model 2). Income development exhibits a strong negative association with ML risk (−0.855; −0.835), indicating that developed economies generally display lower structural AML vulnerability, consistent with stronger regulatory systems and enforcement capacity (Kalokoh, 2024).

Table 6. Moderation of Income development.

	(1)	(2)
Political Stability	−0.185 ***	−0.152 ***
	(−3.20)	(−2.64)
Income Development	−0.855 ***	−0.835 ***
	(−14.38)	(−14.13)
Income Development × Political Stability	−0.128 **	−0.100 *
	(−2.07)	(−1.66)
Democracy Index	−0.228 ***	−0.236 ***
	(−15.34)	(−16.09)
British Legal Origin	0.145 ***	0.152 ***
	(2.94)	(3.22)
Economy & Peace	−0.020	0.062
	(−0.19)	(0.60)
GDP Growth	0.013 ***	0.010 *
	(2.67)	(1.77)
Constant	7.413 ***	7.498 ***
	(31.75)	(31.51)
Year Fixed Effect	No	Yes
Observations	1421	1421
R-squared	0.543	0.576

This table presents the moderation of the democracy index on the effects of political stability on the Basel AML Index. Basel AML Index, as a dependent variable, measures money laundering risk, with higher values indicating greater risk. Political Stability, as an independent variable, reflects institutional and political robustness. Income Development, as a moderator, is a binary variable coded 1 for developed and 0 for developing economies. Control variables are also included in the analysis. Democracy Index, as a moderator, captures political rights and civil liberties. British Legal Origin equals 1 for countries following common law systems. Economy and Peace measures national peace and stability. GDP Growth represents the annual percentage change in real GDP. Robust t-values are reported in parentheses. *, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively. Model (1) serves as the baseline estimation without controlling for year-specific effects. Model (2) additionally includes year fixed effects. OLS regressions are used in this analysis.

Crucially, the interaction between political stability and income development is negative and statistically significant in both models (−0.128 in Model 1; −0.100 in Model 2). This indicates that political stability reduces ML risk more effectively in economically developed countries. This pattern supports the institutional-capacity argument: higher-income economies typically possess stronger supervisory infrastructure, skilled compliance personnel, and more effective enforcement mechanisms, allowing political stability to translate into credible AML implementation (Kemal, 2014; Achim & Borlea, 2020). In lower-income settings, stability alone may be insufficient, as AML effectiveness also depends on administrative resources and regulatory capacity.

The remaining controls behave as expected. Democracy remains negatively associated with ML risk, and British legal origin continues to show a positive association, consistent with the argument that legal and financial complexity can increase exposure to AML vulnerabilities in specific institutional contexts. GDP growth remains positive, suggesting that rapid economic expansion may increase structural exposure through higher transaction volumes.

5.4. The Moderating Effect of British Legal Origin on the Relationship Between Political Stability and Money Laundering Risk

Table 7 examines whether British legal origin moderates the effect of political stability on ML risk. Political stability remains negatively associated with ML risk (−0.241 in Model 1; −0.194 in Model 2), while British legal origin remains positively associated with ML risk (0.136; 0.145). However, the interaction term between political stability and British legal origin is not statistically significant, indicating that the ML-reducing effect of political stability is broadly similar across legal traditions.

Table 7. Moderation of British legal origin.

	(1)	(2)
Political Stability	−0.241 ***	−0.194 ***
	(−4.04)	(−3.28)
British Legal Origin	0.136 ***	0.145 ***
	(2.78)	(3.10)
British Legal Origin × Political Stability	0.021	0.010
	(0.44)	(0.23)
Democracy Index	−0.234 ***	−0.240 ***
	(−15.76)	(16.46)
Income Development	−0.824 ***	−0.810 ***
	(−13.81)	(−13.83)
Economy and Peace	0.012	0.089
	(0.12)	(0.87)
GDP Growth	0.014 ***	0.011 *
	(2.81)	(1.91)
Constant	7.338 ***	7.437 ***
	(32.40)	(32.01)
Year Fixed Effect	No	Yes
Observations	1421	1421
R-squared	0.542	0.575

This table presents the moderation of the democracy index on the effects of political stability on the Basel AML Index. Basel AML Index, as a dependent variable, measures money laundering risk, with higher values indicating greater risk. Political Stability, as an independent variable, reflects institutional and political robustness. British Legal Origin, as a moderator, equals 1 for countries following common law systems. Control variables are also included in the analysis. Democracy Index, as a moderator, captures political rights and civil liberties. Income Development is a binary variable coded 1 for developed and 0 for developing economies. British Legal Origin equals 1 for countries following common law systems. Economy and Peace measures national peace and stability. GDP Growth represents the annual percentage change in real GDP. Robust t-values are reported in parentheses. * and *** indicate statistical significance at the 10% and 1% levels, respectively. Model (1) serves as the baseline estimation without controlling for year-specific effects. Model (2) additionally includes year fixed effects. OLS regressions are used in this analysis.

Although standard law systems are often associated with adaptability and stronger investor protection, they may also give rise to institutional features that increase AML vulnerability, such as legal flexibility, complex ownership structures, and greater reliance on intermediaries. These characteristics can increase compliance burdens and create opportunities for regulatory arbitrage when supervisory capacity is limited (Bartolozzi et al., 2019; Benson & Bociga, 2024). The non-significant interaction suggests that while legal origin is correlated with baseline ML risk, political stability remains a broadly adequate institutional safeguard irrespective of whether the country operates under common law or civil law traditions.

Across these specifications, the results consistently show that political stability is associated with lower ML risk, and that this effect is most pronounced in developed economies. Taken together, the evidence highlights political stability as a fundamental institutional condition supporting AML effectiveness, while underscoring the roles of state capacity and the structural features of legal and financial systems in shaping cross-country differences in money laundering vulnerability.

5.5. Endogeneity Assessment and Model Specification

Endogeneity represents a potential concern in cross-country panel analyses examining the relationship between political stability and money laundering (ML) risk. Several mechanisms may introduce bias. First, reverse causality may arise if persistent ML activity weakens governance effectiveness and institutional credibility, thereby affecting political stability over time. Second, omitted-variable bias may occur if unobserved structural or institutional characteristics jointly influence both political stability and ML risk. Third,

measurement error in perception-based governance indicators may attenuate estimated coefficients. Finally, dynamic simultaneity may emerge from evolving interactions between institutional conditions and financial crime vulnerability.

To evaluate the appropriate estimation strategy, this study compares fixed-effects (FE) and random-effects (RE) estimators using the Hausman (1978) specification test. The Hausman test assesses whether differences between FE and RE coefficient estimates are systematic. Rejection of the null hypothesis indicates that regressors are correlated with unobserved country-specific effects, rendering the RE estimator inconsistent.

According to Tables 8 and 9, the Hausman test strongly rejects the null hypothesis ($\chi^2(15) = 80.98$, $p < 0.001$), indicating that the random-effects estimator is inconsistent. Accordingly, the fixed-effects specification is adopted as the preferred model. The FE estimator mitigates endogeneity arising from time-invariant unobserved heterogeneity by allowing each country to have its own intercept. This controls for omitted factors that remain constant over time, including geography, legal traditions, historical institutional structures, and deep-rooted governance characteristics.

Table 8. Fixed Effects and Random Effects Estimates with the Hausman Test.

	(1) Fixed Effects (FE)	(2) Random Effects (RE)
Political Stability	−0.087	−0.182 ***
	(−1.33)	(−3.04)
Democracy Index	−0.123 ***	−0.230 ***
	(−3.20)	(−8.43)
Income Development	−0.241 **	−0.563 ***
	(−2.11)	(−6.24)
British Legal Origin		0.117
		(0.74)
Economy & Peace	−0.250 *	−0.081
	(−1.73)	(−0.62)
GDP Growth	−0.006	−0.002
	(−1.63)	(−0.53)
Year Fixed Effects	Yes	Yes
Country Fixed Effects	Yes	No
Observations	1421	1421
Number of Countries	149	149
Within R^2	0.226	0.210
Overall R^2	0.467	0.568

This table presents the robust t-statistics (FE) and z-statistics (RE), which are reported in parentheses. *, **, *** denote significance at the 10%, 5%, and 1% levels, respectively. Year fixed effects are included in all models. Standard errors are clustered at the country level. British Legal Origin is time-invariant and therefore omitted in the fixed-effects specification.

Table 9. Hausman Test.

Test Statistic	Value
Chi-square (χ^2)	80.98
Degrees of freedom	15
Prob > χ^2	0.000

However, the FE estimator does not eliminate all sources of endogeneity. In particular, it does not fully address bias arising from time-varying omitted variables, measurement error, or simultaneity. Political stability and ML risk may still be jointly determined through evolving institutional dynamics. While instrumental variable (IV) approaches could further mitigate simultaneity bias, identifying valid and exogenous instruments

in cross-country settings remains methodologically challenging. Prior AML research has applied IV techniques e.g., (Altunbaş et al., 2021), highlighting an important avenue for future investigation.

To enhance estimation reliability and coefficient stability, this study implements the following robustness procedures:

- Country fixed effects;
- Year fixed effects;
- Clustered standard errors at the country level;
- Alternative model specifications;
- Interaction-term stability checks;
- Multicollinearity diagnostics (Variance Inflation Factors).

Collectively, these approaches reduce bias associated with unobserved heterogeneity, common temporal shocks, and coefficient instability. Nevertheless, residual endogeneity cannot be fully ruled out, and results should therefore be interpreted as evidence of robust association rather than definitive causality.

6. Discussion and Conclusions

Using an unbalanced panel of 158 countries observed from 2012 to 2023, this study examines the relationship between political stability and money laundering (ML) risk, alongside the moderating roles of democracy, income development, and legal origin. The empirical findings provide consistent evidence that higher political stability is associated with lower ML risk, supporting institutional arguments that stable political environments strengthen regulatory credibility, institutional continuity, and the effectiveness of AML frameworks.

The moderation analysis reveals meaningful cross-country heterogeneity. While democracy is independently associated with lower ML risk, its interaction with political stability is not statistically significant, suggesting that stability exerts an influence largely independent of regime type. In contrast, income development exhibits a stronger moderating role, indicating that the stabilising effects of political institutions are more pronounced in economies with greater institutional capacity and regulatory resources. Legal origin shows comparatively modest effects, implying that broader governance conditions dominate formal legal heritage.

These findings carry important policy implications. Political stability appears to function as a foundational enabling condition for AML effectiveness, facilitating continuity in regulatory oversight, enforcement consistency, and institutional coordination. However, stability alone is insufficient. In developing economies, improvements in AML performance likely require complementary investments in supervisory capacity, financial transparency, and institutional autonomy. International policy frameworks may therefore benefit from aligning AML reforms with broader state-capacity-building strategies.

This study is subject to several limitations. First, the Basel AML Index measures structural vulnerability rather than observed ML activity. Second, endogeneity concerns warrant careful interpretation. Although fixed-effects estimation controls for time-invariant unobserved heterogeneity, it does not eliminate bias arising from time-varying omitted variables, measurement error, or simultaneity. Third, while this study employs specific robustness procedures, namely fixed effects, clustered standard errors, year fixed effects, alternative specifications, interaction stability checks, and VIF diagnostics. These methods mitigate but do not fully resolve simultaneity bias. Prior studies have applied instrumental variable approaches (Altunbaş et al., 2021), highlighting a valuable direction for future research.

Accordingly, the results should be interpreted as evidence of robust conditional associations. Future research may extend this analysis through causal identification strate-

gies, including IV estimation, quasi-natural experiments, or longitudinal institutional case studies.

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