



# EU membership, institutions and growth: The case of Turkey



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## ARTICLE INFO

### Article history:

Accepted 19 December 2013

Available online 30 January 2014

### Keywords:

Economic development  
Economic growth  
Institutions  
European Union

## ABSTRACT

This paper investigates the institutions-growth relationship during the EU membership process in Turkey. The membership process is considered as a supranational anchor to further improving institutional quality. I examine effects of individual components of institutions on economic growth. I find significant evidence that institutions matter for growth. Specifically, law and order and bureaucratic quality and management of internal conflict and ethnic tensions affect growth in Turkey.

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## 1. Introduction

Economic and social cohesion have long been considered among the main objectives of the European Union (EU). However, since the benefits associated with the Turkish accession were significantly dwarfed, the commonly made association of the full membership with the prosperity may not work for Turkey. Is it possible to argue that reforms of the existing institutions will promote economic growth? This paper explores the relationship between institutions and growth during the EU membership process where the membership process is considered as a supranational anchor to further improving the institutional quality.

Turkey's membership history dates back to 1959, the year Turkey applied to EEC (European Economic Community) for membership. Turkey became an 'associate member' in 1963 in line with Ankara Association Agreement. The agreement conceives Turkey's gradual integration into the Customs Union and finally accession into the EEC as a full member. Turkey applied for full membership in the EU in 1987. The establishment of Customs Union between EU and Turkey in 1995 ignited hope for the full membership in Turkey, however Turkey's candidacy status was not accepted until 1999 Helsinki Summit. As the process is getting unprecedentedly and incomparably complicated, Turkey is about to lose both faith and interest in the EU. On the EU side, on the other hand, there is little enthusiasm for further enlargement in general, and even less enthusiasm for the accession of Turkey specifically.

Nonetheless, Turkey undertook a series of political and legal reforms including constitutional amendments. The constitution

was amended nine times between 1987 and 2004.<sup>1</sup> Ozbudun and Genckaya (2009) draw attention to the external stimulus in the amendments and note that constitutional revisions adopted since 1995 were strongly conditioned by Turkey's hope of accession to the EU.

The general purposes of these amendments were to improve the protection of fundamental rights and liberties, to enforce the rule of law, to prevent torture and to limit the military involvement in politics. Specifically, amendments related to press and broadcasting freedom were adopted in July 1993. The 1995 amendment to the Constitution was a comprehensive democratization package. It abolished the ban on political activities of associations and allowed them to engage activities with political parties and other civil society organizations. The 1999 amendment replaced military judges and public prosecutors in State Security Courts by civil judiciary. Another amendment in 1999 lifted legal and constitutional obstacles regarding privatization and foreign investments. The most comprehensive of all nine constitutional amendments was ratified in 2001. It improved the protection of fundamental rights and liberties, freedom of the press, freedom of association, freedom of assembly, the right to a fair trial, etc. The death penalty, which was limited to war and terror crimes, was restricted to war crimes with the amendment in 2002. The 2004 amendment totally eliminated the death penalty.<sup>2</sup>

In addition, some major legislative reforms were adapted. A number of laws were changed to harmonize with the *acquis communautaire*. Between 2002 and 2004 eight EU *harmonization packages* were entered

<sup>1</sup> The constitution was amended in May 1987, July 1993, July 1995, June 1999, August 1999, October 2001, November 2001, December 2002 and May 2004 Altintas (2008)).

<sup>2</sup> The discussion on constitutional amendments follows Ozbudun and Genckaya (2009), Altintas (2008), Ozbudun (2007) and Uskul (2002).

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into force.<sup>3</sup> Hence, the new Civil Code strengthening gender equality was adopted. Also, the Criminal Code and the Code of Criminal Procedure, and the Law of Association were changed. The legal changes implemented during the EU membership process include the expansion of the freedom of expression and freedom of association and assembly, improvements in the areas of human rights and fundamental freedoms, the reduction of pre-trial detention periods, the safeguard provisions of the rights of prisoners and the encouragement of foreign direct investments by protecting rights of foreign investors and by reducing bureaucracy. Onis (2003) notes that the momentum of political and economic reforms accelerated especially after the 1999 Helsinki summit. Bac (2005) and Noutcheva and Duzgit (2012) among others draw attention to the importance of EU conditionality and find evidence for the influence of the EU on political and legal reforms.

This paper aims to explore effects of institutions on economic growth in Turkey. Specifically, it intends to investigate which institutional component matters the most during the period under study. To accomplish that, the paper uses individual components of institutional quality variables proxied by *law and order*, *corruption*, *investment profile* and *bureaucratic quality*, and conflict governance variables proxied by *democratic accountability*, *internal conflict*, *ethnic tensions* and *socioeconomic conditions*. Also, the time span of the study encompasses an era of major institutional changes related with the EU membership process. The time period is important in that it can show effects of the institutional reform efforts on the causality relationship. Hence, this paper using individual components of institutions reassesses the relationship between institutions and economic performance.<sup>4</sup>

Most of previous literature uses a rough measure of 'best-practice institutions' index. This index is a crude average of institutional components indices and hides 'what matters the most'. Moreover, developing economies may need 'transitional institutions' to improve economic efficiency, and those 'transitional institutions' may differ from 'best-practice institutions' (Qian (2003)). In addition, these studies use cross-section analysis, hence ignore the fact that a given institutional component can affect growth in a given country more (or less) than other components. By contrast, this paper examines individual components of institutions and analyzes the direction of causality between institutions and growth. Therefore, different from cross-section studies that content themselves with an overall answer to that question, this study, using time series and adopting an Autoregressive Distributed Lag (ARDL) methodology to overcome difficulties associated with time series (i.e. endogeneity, serial correlation, etc.) focuses on the largest and most controversial candidate for membership in the EU and tries to investigate what (which component of institutions) really matters for economic growth.

The rest of the paper is organized as follows. Section 2 is devoted to the literature review. Section 3 discusses the ARDL approach of Pesaran and Shin (1998) which I use to estimate the effects of institutions on

economic growth. Section 4 summarizes the dataset. Section 5, the main part of the study, contains empirical tests. It investigates the relationship between institutions and growth. Results suggest that 'institutions matter' for growth in Turkey. Specifically, the individual index of *internal conflict* and the composite indices of *the law and order and bureaucratic quality* and *internal conflict and ethnic tensions* are effective in promoting growth. Section 6 summarizes and concludes with some caveats to these results.

## 2. The literature review

There seems to be a general consensus among economists on the significant role of institutions in generating economic growth. However, they may have different approaches to understanding institutions. While some scholars conceive institutions as 'the humanly devised constraints that shape human interaction' following North (1990), others recognizing a two way causation between motivations and institutions, draw attention to the 'constitutive role of institutions' (Chang (2004)) or 'reconstitutive downward causation from institutions to individual dispositions' (Hodgson (2003)).

Why are some countries so much poorer than others? Hall and Jones (1999) in their comprehensive cross-country analysis suggest that what they call 'social infrastructure' (institutions and government policies providing incentives for individuals and firms) is the main reason underlying cross-country variations in output per worker. In order to overcome the endogeneity problem, Hall and Jones use distance from equator and the usage of a Western European language as instrumental variables.<sup>5</sup>

Acemoglu et al. (2001) henceforth AJR, in their well-known paper, study the historical framework that shapes the long lasting institutions, which in turn causes differences in the prosperity levels. The basis of AJR's argument is that European colonialists adopted a different type of colonization strategy based on the feasibility of the settlement areas and that the institutional pattern developed by colonialists persist even after the independence. They use settler mortality as an instrumental variable for the institutional quality. Easterly and Levine (2003) focusing on a large sample of former colonies, study the impact of endowments (i.e. tropical location, soil fertile for cash crops, etc.) on economic development and find that endowments affect economic development only through institutions. Easterly and Levine use latitude, settler mortality, being land locked, and crops as instrumental variables.

Another feature feeding the poverty in the less developed countries is that their growth rates are unstable and halted frequently with crises. Rodrik (1999), analyzing a large sample of less-developed countries, examines the role of conflict management institutions in determining economic performance. According to Rodrik's findings, when conflict management institutions are weak and social divisions are pronounced, economic cost of the shock is magnified by the distributional conflict. Similarly, Easterly et al. (2006) in their cross-country analysis study the role of 'social cohesion' (proxied by income inequality and ethnolinguistic fractionalization) in affecting economic growth through its influence on institutional quality and find evidence that 'more social cohesion leads to better institutions and that better institutions lead to higher growth'.

While the current literature provides remarkable contributions on whether 'institution matters' for growth, empirical works suffer from cross-country generalizations and inadequacy of instrumental variables. Most empirical studies consist of cross-section analysis and try to come up with a 'one size fits all' answer. Moreover, the use of an aggregate institutional index in growth regression is a highly rough measure that hides 'what matters the most?' Also, instruments for institutions are scarce. Main instruments used in the literature (i.e. latitude, usage

<sup>3</sup> The first harmonization package (February 2002) includes changes with regard to the freedom of expression, proceedings at State Security Courts, the detainee rights. The second harmonization package (April 2002) includes modifications with regard to the prevention of torture, the freedom of assembly and demonstration, the freedom of associations and the freedom of the press. The third harmonization package (August 2002) includes changes related to the freedom of expression and the freedom of associations. It also enables retrial and limits the death penalty to war crimes. The fourth harmonization package (January 2003) includes changes related to the freedom of the press, the freedom of associations and the prevention of torture and mistreatment. The fifth harmonization package (February 2003) includes provisions on retrial and on the freedom of association. The sixth harmonization package (July 2003) includes changes expanding the freedom of expression, safeguard provisions on the rights of prisoners, religious freedom and retrial. The seventh harmonization package (August 2003) includes modifications with regard to the prevention of torture, the freedom of assembly and demonstrations and the freedom of associations. The eighth harmonization package (July 2004) includes provisions on the total abolishment of the death penalty and on the freedom of the press (<http://www.abgs.gov.tr/files/pub/prt.pdf>).

<sup>4</sup> A word of caution is in order. It might take generations to detect the effects of a major change on institutions and accordingly it might require an analysis with much longer time span than this study covers. This study aims to crystallize the effects of institutions on growth using the data within the available time span.

<sup>5</sup> Since the institutions can be both the cause and the consequence of economic development, cross-country studies, analyzing the role of institutions on growth, use the IV method to overcome the endogeneity problem.

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