The Institutional Fundamentals of Turkey's Economic Performance: A New Institutional Perspective

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Abstract. In this thesis, the effects of institutional structure of Turkey on economic performance are analyzed by using the notions of transaction cost and credible commitment which are contributed by the New Institutional Economics (NIE). According to this school, neoclassical economics ignores transaction costs, bounded rationality, incomplete contracts, and property rights. Hence, neoclassical models cannot represent the real world. But it is well-known that the transaction costs are seldom nil in our daily life. Starting from this point of view, we examine the issues of institutions and NIE and the relationship between institutions and economic performance. Then, defining, measuring, and effects of the transaction costs are discussed. Afterwards, we analyze the political transaction costs. Next, the policymaking process and credible commitment are explained. The role of institutions on formation of institutional policies, the 3 determiner power (legislative-executive-judiciary), and the separation of powers are discussed, so that credible commitment is clarified in this context. Having underlined the theoretical framework of these issues, Turkey's progress is reviewed. Some of the significant contributions of this thesis are defining the political transaction cost and credible commitment and after showing the effects of Turkey's institutional structure on economic performance by using time series analysis with structural breaks in accordance with the NIE perspective. Our findings indicate that the transaction cost and credible commitment are strictly important on investment decisions and national income.

Keywords. New Institutional Economics, Transaction Cost, Credible Commitment, Institutional Structure, Investment, Co-integration, Structural Breaks, Turkey.

JEL. B15, B25, B52, D23, D72.

Highlights
* Effects of corporate structure in Turkey to economic performance are analyzed.
* Institutions, transaction cost, political process and credible commitment literature is reviewed.
* Simultaneous co-integration with structural-breaks analysis is performed with the data obtained from ICRG.
* As a result, institutional structure in Turkey has an important effect on economic performance.

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Summary

In this thesis, the relationship between institutional structure and economic performance in Turkey is analyzed through transaction cost and credible commitment introduced by the NIE. There is a significant literature claiming that the institutional structure in a country specifies the transaction cost and the credibility of the economic activity and thus these two variables affect the investment decisions of economic agents (North, 1990; Levy and Spiller, 1996; Spiller, 2012). In this context, this thesis aims to define the transaction cost and credibility of Turkey’s institutional structure and to show the effects of them on investments and economic growth.

Transaction costs are defined as research and information costs, contract and decision costs, monitoring and enforcement costs. The level of the transaction cost is determined by the institutional structure. One of the most important factors affecting the institutional structure is political institutions. Political institutions may reduce political transaction costs through securing the property rights and enforcing contracts. Such an environment would have positive impact on the investment decisions and so that economic performance would improve.

Besides transaction costs, the second important factor affecting the relationship between institutions and economic performance is credible commitment. Credible commitment determined by political process is one of the main determinants of investment decisions. As long as the policymaking process of a country works efficiently, credible policies could be constituted. Principally, the institutions generating the political process are legislative, executive, and judiciary. If these political institutions are operated efficiently, transparently, and harmonized with each other, commitment could be credible since the institutional structure will have consistency and certainty as working in a perspective of legal based and nondiscretionary way.

When analyzing the changes of Turkey’s institutional structure to date, due to the absence of efficient institutions, economic performance follows a discontinuous path. The attitude of the state in legal structure and property rights blocks assurance of the credible commitment. Although an institutional evolution started in Turkish economy during 1980s, because of the problems such as continuous coalitions in 1990s, not fulfilling institutional reforms, stability and balance problems between the powers, transaction costs in political process were kept in a high level and the investments remained low. On the other hand, the economy gained a positive trend with the developments in the institutional structure after 2000s. These were stability and fiscal discipline, reform packages for EU target, independent regulatory agencies and efficient regulations caused by one-party government.

Due to the measurement restrictions, in our econometric analysis the indices obtained from ICRG database are utilized to represent these two variables. Political risk rating index represents the political transaction cost and investment profile index represents the credible commitment. The data is estimated by Johansen, Mosconi and Nielsen (2000) simultaneous cointegration with structural breaks approach. The findings of the models, in which three different breaks (internal and external) used, comply with our expectations. Accordingly, assurance of institutional structure, which makes progress in credible commitment, increases foreign direct investment (FDI). Otherwise, if the institutional structure is unable to provide credible commitment to agents, FDI decreases. Likewise, minimizing the political transaction costs decreases GDP and vice versa. According to the other findings, the effects of the interest rate and FDI in Turkey on economic performance are in accordance with the economic theory. However, the impact of the institutional structure to economic performance is superior to these variables.
Additionally, when we compare coalition and one-party periods, it’s deduced that one-party government creates positive effects on economic performance by reducing the transaction costs and increasing the credibility.

According to these results, the institutional structure of Turkey should attentively be designed for getting better economic results. The indicator for generating an efficient political process is to compose a mechanism which will reduce the transaction costs and increase the credible commitment.

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