

Does Solow Residual Reflect Deep Political Economy Dynamics in Developing Countries?

Mustafa Ismihan

Department of Economics, Atılım University, Incek-Golbasi, 06836, Ankara, Turkey

E-mail: ismihan@atilim.edu.tr

Abstract

Developing countries have shown distinct patterns of growth and productivity rates that usually lack persistence. In Turkey, for example, endemic instability and recurrent crises and associated low and volatile productivity and growth rates have been the dominant macroeconomic themes since its transition to the multi-party democracy in 1950. This paper, inspired by the Turkish experience, aims to develop a simple model of total factor productivity for explaining the substantial volatility in long-run productivity and growth.

This study, in turn, attempts to explore the new political economy literature as the theoretical bridge to link short and medium-term macroeconomic outcomes to long-term economic growth in a simple production function framework. More specifically, we attempt to link short-run policy outcomes to long-run productivity measure by considering political economy factors such as socio-political and institutional dynamics. It is shown that this framework is capable of explaining the substantial volatility in productivity and hence output trend in Turkey as well as in many other developing countries, notably Latin American countries. In fact, empirical results, based on time series econometric techniques, confirm that Turkey has experienced productivity accelerations and collapses as a consequence of the endemic instability, populist cycles, and resultant crises and regime changes since the 1950s. However, social conflicts (e.g. arising from distributional problems) and weaker institutions were the deep causes of the persistence of unsound policies in Turkey with undesirable outcomes, in terms of macroeconomic instability and productivity, prior to 2001. In contrast, productivity and growth rebounded quickly during the 2002-2006 period, mainly due to the *committed* stabilization program –of which fiscal adjustment was the central part. This, in turn, fuelled by the institutional and related reforms that improved both the regulatory capacity (e.g. in banking sector) and fiscal stability of the state in Turkey.

Keywords: *Total factor Productivity, Instability, Economic growth, Political economy, Institutions.*