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POLITICAL STABILITY AND ECONOMIC DEVELOPMENT IN TURKIC COUNCIL: A DYNAMIC PANEL DATA ANALYSIS

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ABSTRACT

Many studies have examined the relation between political stability and economic performance. Despite the long-lasting academic debate on this issue, there is no consensus on this relation. Political instability which is defined as the deviations from normal pattern or a change or challenge to the current political governance and economic growth are mainly interrelated. Many empirical studies show that weak economic performance is likely to deteriorate the political decision making process and may lead to emergence of macroeconomic imbalances. The aim of this paper is to examine the causal association between economic development and political stability by employing panel data analysis for members of Turkic council (Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey) for the period 2005-2014. Since there are not many econometric studies to analyze the relation between political stability and economic performance of Turkic nations, this study contributes to the limited literature.

Key Words: Turkic council, political stability, economic development, panel data analysis, governance.

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INTRODUCTION

Political stability is accepted to be one of the main factors affecting economic growth. Political instability, institutional weakness play major roles in formulating the public policies which may in turn stimulate economic performance.

Political stability is accepted to a quite complicated notion. It is widely argued that political stability consists of unexpected and regular political power shifts (Jaouadi et al. 2014: 20). It is argued that political stability and economic performance are reciprocally related. In this manner, political stability is sometimes the outcome, and sometimes the source of economic performance (Feng, 1997: 2). It is known that political instability may cause poor economic performance by preventing effective economic decisions and deteriorating the investment climate (Alesina et al. 2006: 191). It is argued that political instability may cause investors to avoid making investments and entrepreneurs to hesitate to going into new projects which in turn hamper the economic performance (Zablotsky, 1996). In this respect, political instability give harm to the economic performance. On the contrary, poor economic performance may generate political instability since lower economic performance of country may decrease the confidence to the policy makers (Alesina et al. 1996: 191). It is also shown that political instability may increase the use of seigniorage which in turn result in higher inflation and poor economic performance (Aisen and Veiga, 2008).

Two different hypothesis are developed for explaining the effects of economic performance on political stability. The first is "good growth hypothesis" which argues that increasing economic growth leads to recovering contents towards regimes and public policies through the channel of growing income per capita. The second is the "destabilizing growth hypothesis" which asserts that increasing economic growth causes complicated shifts in social structure which in turn results in political instability (Paldam, 1998: 171).

Besides these arguments it also seen that many countries achieve higher growth rates within unstable political environment. Many Central and Eastern European (CEE) transition countries experienced higher growth rates frequent government changes (Kouba and Grochová, 2011: 305). In this manner, it is seen that the relation between political stability and economic performance is ambiguous. The aim of the analyses is to examine the long-run relation between economic performance and political stability.

The applied model in this study is tested against data covering three countries for the period 1999-2013. The remainder of this study is organized as follows. Section I reviews the literature for the relation between political stability and economic performance. Section II gives information about the data used in this study and outlines its methodology. Section III presents the results of the dynamic panel data analysis. Section IV provides conclusions and policy implications.

LITERATURE REVIEW

Though there is a vast literature on the relation between political stability and economic performance, there is no common point of view. As one of the earliest studies, Barro (1991) examined the relation between economic growth and political stability for 98 countries for the period 1960-1985. He reports a negative association between economic growth and political in-

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stability.

Fosu (1992) examines this relation for 31 Sub-Saharan African countries for the 1956-85 period, and report that political instability reduce the GDP growth by 33% on average of the Sub-Saharan African countries. Examining the Sub-Saharan African countries with the simultaneous equations and dynamic panel estimation approaches, Gyimah and Traynor (1999) find that political instability lead to the lower growth rates via the transmission channel of lower capital formation.

Alesina et al. (1996) examine the relation for 113 countries for the time period 1950-1982, and find that political instability give harm to the economic performance. It is found in this study that economic performance of the countries where political environment is unstable is lower than that of in other countries.

Using the data of 100 countries for the time period between 1960 and 1999, Aisen and Veiga (2006) find that political stability is associated with poor economic performance. Examining the relation between political instability and the economic performance of United Kingdom for the time period between 1961 and 1997, Asteriou and Price (2001) report political instability has negative effects on economic performance. In particular, it is found that political instability reduces economic performance. They also find that political stability also cause an increase in the ambiguity of the expected growth rates.

Ozler and Tabellini (1991) examine the relation between political instability and external debt and conclude that political stability results in higher external financing for the developing countries analyzed for the time period 1972-1981. Examining the cross section of 79 countries, Cukierman et al. (1992) report that inflation is positively related to the economic instability. In particular, political instability induce poor economic performance. Investigating the relation between fiscal policy and budget deficits Roubini (1991) finds that higher levels of political instability generates higher budget deficits in developing countries.

Examining the data of 169 countries procedure for the time between 1960 and 2004 within system GGM estimation, Aisen and Veiga (2010) report negative association between GDP growth and political instability. In particular, they conclude that political instability reduces GDP growth via decreasing productivity growth and intellectual capital formation. The common point of the many of the above studies is that they find unidirectional causality running from economic performance to political stability. In other words, they report that good economic performance cause political stability. However, they could not find significant causality from political stability to economic performance. Contrary to the findings of the above studies Zablotsky (1996) reports bidirectional causality between political instability and economic performance. In this manner, not only political instability cause poor economic performance but also lower growth rates induce political instability.

On the other hand, there are also studies reporting no significant relation between these factors. As one of these studies, using the data of 25 developed and developing countries for the time period 1985-2002, Zureiqat (2005) finds no supportive finding for the bidirectional causality association between economic performance and political stability. Okafor (2015) examined the impact of political stability in Economic Community of West African States (ECOWAS) using the fixed effects and generalized method of mo-

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ments panel data approaches for the period 2005–2012, and find that poor governance is negatively related to the economic growth in these countries.

Using different measures of political stability Qureshi et al. (2010) report negative association between political instability and economic performance. They argue that political instability causes reductions in investment and export which in turn result in poor economic performance. Though majority of the studies aforementioned above induce negative relation between political instability and economic growth, there are also some studies reporting positive association between political instability and economic growth. As one of these studies, Younis et al. (2008) find that political instability boot the economic growth. Similarly, Ahmed and Pulok (2013) conclude that political instability give harm to the economics growth in the long term whereas, contribute to the economic performance in the short run.

DATA AND METHODOLOGY

In this study, we use three different measures of political stability for the time period between 2005-2014. We use government effectiveness (GE) and rule of law (RL) for the measures of political stability. In addition, we also calculate the political instability measure (PI) using the data of absence of violence/terrorism. All the data are gathered from World Development Indicators (WDI) database. We use GDP per capita as the measure of economic performance. GDP data is also obtained from WDI database. Natural logarithms of the all data are used in the analysis. We use a relatively new approach of dynamic panel estimation technique to examine the relationship between political instability and economic performance. It is well known that fixed effect and random effect estimators might be biased due to the endogeneity problem which in turn result in inconsistent estimates. In order to deal with this problem instrumental variables approach or the Generalized Method of Moments (GMM) estimation procedure is developed (Arellano and Bond, 1991; Arellano and Bover, 1995; Blundell and Bond, 1998). It is possible to start with the error components model with the equation below:

$$u_{it} = v_i + \varepsilon_{it}$$

(1)

$$GDP_{it} = \alpha_1 GDP_{it-1} + \sum_{k=1}^{n} \beta_{1k} iP_{it-k} + u_{it}$$

It is possible to eliminate the country specific effect by taking the first difference as below;

$$\Delta GDP_{it} = \Delta GDP_{it-1}\alpha_1 + \sum_{k=1}^{n-1} \beta_{1k} \Delta iP_{it-k} + \Delta\varepsilon_{it}$$

Where Δ, P and GDP represents first difference, P political instability and GDP growth, respectively. This approach helps to overcome the problem of unobserved effects.

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EMPIRICAL RESULTS

We estimate the above generalized method of moments (GMM) equation using the Eviews 9 software though the instructions of Arellano and Bond (1991). The results of our estimation are presented in Table 1 below.

Table 1. *Panel Dynamic GMM Estimation of the Dependent Variable (GDP).*

	1		2		3	
	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value
GDP_{t-1}	0.536	0.00	0.607	0.00	0.475	0.00
PI	-0.227	0.02				
GE			0.005	0.93		
RL					0.32	0.00
AR(1)		0.022		0.036		0.035
AR(2)		0.799		0.675		0.792

Source: Authors' estimates.

In the first column of the Table 1, political instability (PI) is the measure used in analysis. In column 2, the measure for political stability is government effectiveness (GE). Finally, in column 3 rule of law (RL) is used to measure the political stability. Columns 1 displays the results when political instability is used as the measure. It is seen that political instability negatively affect economic growth of the Turkic council. This result is consistent for the majority of the relevant studies in literature (Fosu, 1992; Gyimah and Traynor, 1999; Alesina et al., 1996; Aisen and Veiga, 2006; Asteriou and Price, 2001; Aisen and Veiga, 2010). This finding indicates that political instability gives harm to the economic growth in Turkic council.

When government effectiveness is used as the measure of political stability, it is seen that it has a positive significant coefficient indicating a long run positive association between economic growth and political stability. This empirical finding indicates that effectiveness of the governance in Turkic council boosts the economic performance in these countries.

The empirical results presented in column 3 are similar to those in previous columns. The results show that there is a long run positive association between rule of law and economic growth in Turkic council. This implies that that rule of law has positive effects on economic performance. Among the measures of political stability, rule of law is the one that has the highest effect on economic performance. We think that this finding is quite important especially for policy makers.

CONCLUSION

This study re-examines the association between political stability and economic growth in Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey namely the Turkic council for the period 2005-2014. We use three different measures of political stability. In particular, we use the governance effectiveness and rule of law as the measures of political stability. In addition, we calculate the political instability measure using the using the data of absence of violence/terrorism. We use the system GMM approach in order to analyze the

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dynamic relation between political stability and economic growth. The advantages of this approach are the improved efficiency of the estimates, ability to account for dynamic relationships, and reduced possibility of omitted variables and measurement errors problem (Hsiao, 2007). Using the panel data approach of Arenallo and Bond (1991) we find that political instability hampers economic growth in Turkic council. In addition, it is also shown that effectiveness of governance policies also positively affect the economic performance in these countries. Furthermore, it is seen that there is long run association between rule of law and economic growth in Turkic council. We think that these results are crucial especially for policy makers in Turkic council. Policy makers should take precautions to prevent the rise of political instability to account for the negative effect of political instability on economic performance.

Since it is also shown that rule of law has significantly positive effect on economic performance, policy makers should develop regulations which are clear, publicized and stable. It is shown in this study that well developed rule of law may boost the economies of Turkic council. Finally, the results indicate that effectiveness of the governance has little but significant effect on the economic performance of the council.

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