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Economic freedom and effects on economic growth: A time series analysis for Turkey

By Aslı YENİPAZARLI †

Abstract. Economic freedom represents personally free economic activity level. Thus such as Fraser Institute or Heritage Foundation the level of economic freedom in Turkey for a compound period of before and after 1980 has been constituted originally. Freedom index referred to internationally measures of organization composed of different indicators. These indicators are derived from the point of view of market economy, liberal perspective. Level of economic freedom indicated by index values are to be analyzed econometrically with another economic indicators. Other variables are human capital, income per labor stemmed from MRW Model of economic growth, physical capital etc. Results of time series analysis with ARDL Model, Cointegration Methods found out significant relationship between economic freedom and growth. Findings are differently and specifically evaluated for Turkish economy and political economy.

Keywords. Economic freedom, Economic growth, Turkish economic freedom index, ARDL bound test approach, Johansen cointegration analysis.

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Highlights

- * This study highlighted a period for 36 years of Turkish economy as about economic freedoms evaluated both theoretically and empirically. The availability of data was problematic, for the period before and after 1980 the an economic freedom index for Turkey composed of seven different indicators has been constituted.
- * The soundness of economic organization in a country is one of factors determining the development of that economy. The factor endowment, trade openness, the market size, intellectual property rights and economic freedom level, content of Exchange determine the robustness of economic model used.
- * By means of market economy, economic development stems from private property, freedom to Exchange, competitive markets, efficient capital market, monetary stability, low tax rates and free trade.
- * Private property stimulate people to increase efficiency and to reach higher value of property. Government substitution of discretionary and discriminative political authority instead of dominance of law makes exchange process difficult.
- * In some countries governments have very high authority against some economic problems. But people working for government cannot be as much sensible against corruption.
- * Competition another factor influencing economic development could be a good motivator to reach new investment positions and productivity. Monetary stability as much as inflation, independent central banking, lower tax rates also influencing people to work and produce more and efficiently

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☎. +90 256 3477011- 201

✉. ayenipazarli@adu.edu.tr

Turkish Economic Review

* Free trade with lower tariff rates, lower quotas, lower level of intervention to the market increases the gains from trade for both parts of trade. Historically, by means of market economy western countries produced and increased welfare. In addition in the period of cold war these countries got ahead of central planning economies and globalization became a current issue.

Summary

In a market economy, main motivation for cooperation among individuals is personal benefit. People are seeking to follow through their goals, which indirectly lead others also benefit. Such a good performed system stated by economists like Adam Smith (1776), Hayek etc. may only be possible with an invisible hand mechanism. Personal benefit is a multi-effective indicator for all such market activities, political elections etc. In a market economy consumer demand and producer costs are equalizing functions. In this study, economic freedoms are related with economic growth. According to summarized studies in literature, market economies have a better performance than planned economies by governments. Economic freedoms are related with democracy, political and civil rights, economic crisis experienced in a country, foreign aids, average yearly growth etc. Turkish practice promotes different panel data studies in different countries. In the first chapter economic freedom is conceptually framed as international institutions such Fraser or Heritage Foundation dealt with economic freedom context. Economic Freedom and economic growth relationship according to the literature has been put forth, after theoretical statements of economic growth in economic theory. Turkey is selected as sample to analyse econometrically for the period of 1970- 2006. This period is important for Turkey because it includes years before and after 1980, which can be demonstrated as a start of market economy in Turkey. All indicators of economic freedom stated by Fraser Institute are put into analysis for Turkey to derive an original yearly index of Turkish economy. Economic freedom index is derived for different weighting methods. Econometrically selected technic was ARDL for time series series of Turkish economy. Necessary descriptive and econometric tests for time series analysis are applied. Cointegration and Causality relationship by Johansen and Granger Causality methods are used. The relationship between economic development and resource allocation mechanism is one of the mostly debated issues in economic theory. While the argument that free market economy promotes economic growth has been accepted in theory, but the empirical tests have produced various results.

For that reason, beginning with the hypothesis; "There is a positive relation between economic freedom and economic growth", in this study, the relationship between economic freedom and economic growth is analyzed by econometric methods using various indicators classified in six groups for the period 1970 – 2006. Economic freedom index from Fraser Institute used in six components with 25 sub-components. In third chapter trends of Turkish economic freedom are graphed as four different weighting methods. These are EF (Unweighted Economic freedom index), WEF (Weighted EF Index), COREF (Weighted with correlation coefficients) and HEDEF (hedonic weighted EF Index). Trend graphs of EF, WEF, COREF are similar, but HEDEF seems different than findings of regressed analysis, with decreased statistical level of variables which could be the reason of difference.

Solow Growth Model is augmented with Mankiw, Romer, Weil's Growth Model. In an extended Solow growth model, real GDP per capita is used as the dependent variable, while per labor net capital stock, human capital and economic freedom index are explanatory variables ($y = f(e, k, h)$). Per labor GDP is a function of economic freedom index, capital and human capital. Data obtained from TSI (Turkish Statistical Institute), CBRT, Financial Ministry, ceterisparibus.net.

ARDL Bound Tests and Johansen Cointegration methods are employed in empirical analyses. As the existing studies consist of mostly cross sectional or

Turkish Economic Review

panel data analyses, economic freedom index and the time series analyses in this thesis are expected to provide considerable contribution to the related literature.

The results of the analyses indicate that there is a cointegrating relationship between freedom and growth and that liberalization attempts recorded especially in the last ten years have contributed economic freedom and thus economic growth.

For a well performed market economy, government sector in market ought to be minimized, public investments and consumptions should be decreased as possible, tax rate decreased, open economic strategies and needed implementations ought to be promoted. Bureaucracy is a handicap for a well performed market economy. Therefore new entrepreneurs have to be promoted by governments policies. Especially openness, freedom in capital market, regulations in legal and institutional structure for free market, financial liberalization lead to higher levels of expected economic growth. As a conclusion, in years between 1970- 2006, mostly in Turkish economy economic freedom led to higher economic growth. Positive relationship between these two variables through different explanatory variables such as human capital, or physical capital are some results of special structural changes, and stability processes of Turkish economy.

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