

UNBUNDLING THE ROLES OF INSTITUTIONS AND HUMAN CAPITAL IN DEVELOPMENT: A GLOBAL EVIDENCE

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DOI: <https://doi.org/10.31410/eraz.2018.883>

Abstract: *There are two considerable broad approaches in controversy in the comparative development literature. First, one asserts that institutions have a primacy in development process. The other one emphasizes that human capital is a more basic source of development. In this paper we revisit the debate over unbundling the roles of institutions and human capital in development by using mediated structural equation modelling with latent construct. We used 14 publicly available indicators to measure institutional quality, human capital and economic development and our dataset covers 143 countries. Measures for the institutional quality are political rights and civil liberties estimated by Freedom House, polity scores taken from the report of Polity IV Project of Center for Systemic Peace, the rule of law score of The Worldwide Governance Indicators, and Political constraint index dataset by Witold Henisz. The set of proxies to constitute the aggregate human capital latent function includes Legatum Institute's education, health and business environment sub-indexes, capital per worker as current US\$ and research and development expenditure as percentage of GDP. The economic development latent variable includes gross domestic savings as percentage of GDP, high-technology exports as percentage of manufactured exports, GDP per capita and economic quality sub-index of Legatum Institute.*

At the first step we constructed a non-mediated structural equation model where institutional quality and economic development are respectively exogenous and endogenous. The finding verified the direct causal relationship between institutions and economic development which is a prerequisite for constructing the mediation model where human capital is a mediator while institutional quality and economic development are respectively exogenous and endogenous. The results of mediation model indicate that (a) human capital mediates the effects of institutional quality on economic development, (b) full mediator role of human capital makes the direct relationship between institutional quality and economic development insignificant and thus, (c) the effect of institutional quality on economic development occurs indirectly through human capital even institutional quality has a primacy in development process.

Key words: *institutions, human capital, development,*

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