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Economic Effects of Post-Socialist Constitutions 25 Years from the Outset of Transition

The Constitutional Political Economy Approach

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Introduction

During the last ca. 15 years economists provided numerous theoretical and empirical confirmations of a significant role of constitutions for the working of the economy and economic outcomes, in particular with respect to electoral systems, models of government, constitutional rights, and constitutional enforcement mechanisms (see survey by Voigt 2011b). This approach, rooted in Constitutional Economics, views the constitution as a set of “*legal-institutional-constitutional rules that constrain the choices and activities of economic and political agents*” (Buchanan 1987, p. 585). The state constitutional system serves primarily as a mechanism allowing to counteract time-inconsistency problems connected with drafting and implementing economic policy. Containing rules that impose constraints on activity of state authorities, the constitution acts as a mechanism allowing to turn promises made by representatives of state power into credible commitments.

Post-socialist transition taking place since 1989 in countries of Central and Eastern Europe, as well as later in Central and Southwestern Asia, provided a particularly fruitful ground for Constitutional Economics studies. Since 1990 all post-socialist countries of Europe and Asia¹, with the exception of Latvia, adopted new constitutions envisaging varying solutions as regards the structure of government, bill of rights and other issues. This unprecedented time of broad-scale constitutional and, more generally, institutional change has sometimes been called a “*gigantic natural experiment*” (Elster 1991, p. 449), attracting interest of legal scholars, political scientists, sociologists and other social scientists. The contribution of economists concerns, in particular, linking constitutional change with economic policy pursued in these countries and economic performance.

Economic studies relating to post-socialist constitutions conducted to date reveal that several aspects of the constitutional framework laid down in these supreme legal acts, and their practical operation, mattered for economic

1 These are: countries of Central and Eastern Europe (Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia); former Yugoslavian republics (Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia, Slovenia); and former Soviet republics (Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan). Acknowledging the differences in the political and economic systems functioning in these countries before 1989, we further refer to all of them as ‘post-socialist countries’ or ‘transition countries’.

performance of these countries during transition (e.g. Hellman 1997, Ahrens and Meurers 2001, Ahrens 2007, Metelska-Szaniawska 2009). In principle, the results of these studies confirm the constitution's main function as a commitment mechanism for policy-making in transition, including the performance in broad-scale post-socialist economic reforms.

Despite their thought-provoking findings and stimulating conclusions, most of the empirical studies in the field of Constitutional Economics, including those pertaining to post-socialist constitutions, struggle with problems of endogeneity and causality, which undermine the validity of the employed empirical models and analytical techniques. The qualitative nature and country-specificity of various aspects examined in such analyses can also significantly limit the explicability of quantitative large-sample studies conducted within this field, as well as the reliability of the results and conclusions stemming from them. In this situation it comes as no surprise that authors active in this field often call for case study analyses, allowing to focus on country specificity and institutional detail, to support the large sample econometric analyses. Comparative case study research however suffers from its own problems and shortcomings, including in particular the lack of formalization in selecting the comparison units.

With such a list of caveats and challenges relating to empirical studies in Constitutional Economics it is not surprising that the current generalization level of the theory in this field is insufficient and its further development rests on the ability of empirical researchers to surmount these obstacles. Paraphrasing Douglass North (North 1990), we know that 'constitutions matter', however 'which sets of constitutional rules' and via which channels of influence, remains largely unclear, primarily as empirical studies conducted to date have delivered a wide range of incomparable results, which are questionable on several grounds for reasons mentioned in the previous paragraph. In this book we aim to contribute to surmounting these obstacles for further development of Constitutional Economics.

We base our empirical studies on the experiences of post-socialist countries in the period of (nearly) 25 years from the outset of transition in 1989. The central claim (thesis statement) of this book is that constitutional solutions, adopted by post-socialist countries after 1989, which enhanced the credibility and commitment of decision makers in the field of economic reforms conducted by these countries during the transition period, constituted a framework conducive to such reforms. In particular, we focus in this respect on the significance of structural provisions, bills of rights, as well as constitutional enforcement mechanisms. This claim builds up on consequent and systematic exploration of the link

between constitutional rules and performance in the area of economic reforms by post-socialist countries, conducted by the author for the last several years, [initiated by Metelska-Szaniawska (2008)], and allows to organize the presented theoretical and empirical considerations. Several arguments justify refocus on the link between constitutions and economic reforms in post-socialist countries. The current account, presented in this book, is not only significantly enriched in several dimensions – by encompassing a notably longer time-period of nearly 25 years from the outset of transition, new constitutional rules, and broader and much more reliable data. The main contributions are: firstly, introducing a novel empirical approach allowing to respond to several of the caveats mentioned earlier, including the endogeneity allegation, and secondly, enriching the currently existing theoretical and empirical framework with elements suggested by Evolutionary Political Economy.

In order to circumvent the problems of endogeneity and causality in comparative studies with relatively small sample sizes, a new statistical approach has recently been developed, called the synthetic control method. It focuses on comparing the evolution of a studied outcome variable for a unit (e.g. country or region), where a particular intervention or event took place, with its evolution for a ‘synthetic counterfactual’ (i.e. ‘synthetic’ unit of interest, where the studied intervention or event did not occur) constructed based on a data-driven procedure of selecting comparison units that approximate the characteristics of the unit exposed to the intervention. Recently, the method has been successfully applied in several studies of economic consequences of large-scale events such as natural catastrophes (e.g. Cavallo et al. 2010, Barone and Mocetti 2014), political conflicts (e.g. Bove et al. 2014 and Costalli et al. 2014 – on civil wars; or Acemoglu et al. 2014a – on Egypt’s Arab Spring), as well as in studies focusing on effects of legal and policy interventions (e.g. Abadie et al. 2010, Bohn et al. 2014, Heim and Lurie 2014, Baum and Ruhn 2013, Doerrenberg and Peichl 2014). We apply this method to reassess the conclusions regarding the role of constitutional rules for economic reforms in post-socialist countries and contrast the obtained findings with results of studies conducted using regression estimation techniques.

In addition to the above contribution to empirical Constitutional Economics and, thereby, potentially to further development of the theory, we also attempt to enrich the latter with this book by opening the research on economic effects of constitutions to insights from the evolutionary approach to politics, as proposed by Evolutionary Political Economy. While interest in the topic of constitutions can be traced as far back as to the works of the predecessors of this approach, such as Friedrich August von Hayek (e.g. Hayek 1979) or Joseph Schumpeter

(1942/1987), none of these studies, nor works of their followers, identify factors that a comprehensive account of economic effects of constitutions should incorporate, in an attempt to reconcile this view with the Constitutional Economics approach. We take up this challenge, present the potential channels, as well as offer empirical tests of preliminary predictions stemming from the theory and conclusions regarding the future development of this promising strand of research.

The book is structured as follows.

In Chapter 1 we elaborate on the theoretical nexus between constitutional rules and economic policy-making. We draw on the core components of the Constitutional Economics research program, as well as the recent ‘standard’ – Persson and Tabellini’s (2003) theoretical framework. We also discuss the obstacles and challenges that further development of such research on constitutions faces, as well as lay down the theoretical grounds for our empirical studies of economic effects of constitutions on post-socialist economic reforms, presented in the subsequent chapters.

As economic transition in post-socialist countries is a topic that has received ample attention of economists, also within political economy (for most recent collections see Hare and Turley 2013, Aslund and Djankov 2014) and new institutional economics (e.g. North 1997, Fischer and Sahay 2004, Lissowska 2006, Oppen 2008 and others), we refrain from presenting in this book another survey of this literature and focus directly on the presentation of the constitutional framework that emerged in these countries after 1989. Chapter 2 provides, therefore, the relevant background information about post-socialist constitutions, relating in particular to their provisions establishing the systems of government, constitutional bills of rights, as well as enforcement mechanisms.

Chapter 3 is devoted to a first verification of the theory underlying the relationship between constitutions and economic reforms in post-socialist countries after 1989 based on an empirical model developed earlier in Metelska-Szaniawska (2008, 2009). In a panel data regression setting we attempt to identify constitutional rules composing the rule framework conducive to successful performance in the area of post-socialist economic reforms such as privatization, liberalization, enterprise restructuring, etc. While this study delivers a handful of stimulating results, we also reflect on its potential caveats.

Based on the latter reflections, in Chapter 4 we introduce and apply the synthetic control method to reassess the effect of constitution-making in post-socialist countries on their performance in the field of economic reforms during transition. We proceed in two steps: Firstly, we verify whether the adoption of

a constitution had any effect on economic reforms in each of the post-socialist countries (and if so, then was this effect positive or negative, and what was its magnitude). Secondly we study in what way these effects depend on the actual constitutional solutions adopted within these legal acts. Thanks to employing this novel approach we are able to avoid several technical caveats that have arisen in earlier studies and verify the validity of their conclusions. In addition, it allows us to obtain country-specific results for each individual post-socialist state, as well as formulate valuable insights regarding the actual mechanisms or channels of influence of the constitutional framework on economic reforms.

Finally, in Chapter 5 we enrich the view at the role of the constitutional framework for economic policy by incorporating into the analysis insights offered by an evolutionary perspective on politics and policy making. We discuss the potential theoretical channels of influence and provide two empirical tests relating to the constitutional rules providing for direct democracy mechanisms, as well as to popular support for the constitution. The results that we obtain allow not only to broaden the understanding of the relation between constitutions and economic reforms in post-socialist transition but also to bring a modest contribution to the theoretical background underlying the economic effects of constitutions.

The book finishes with conclusions, where we reflect on the significance of our findings for development of empirical and theoretical Constitutional Economics, as well as transform the main implications into potential policy recommendations.

Bearing in mind the cross-disciplinary nature of Constitutional Economics, we would like to emphasize that the book is addressed in particular to economists. While we hope that it will also be of interest to other social scientists interested in studying consequences of legal and constitutional systems, as well as other problems at the nexus of constitutional law, political science and economics, the principal target on economists affects the terminology, structure and content of the book.

This book is an outcome of the author's interest in the constitutional political economy approach to post-socialist transition and expertise in this field accumulated over the past ca. decade. However, its publication in this form would not be possible had it not been for the invaluable support of several persons and institutions. We are particularly grateful to professor Jerzy Wilkin, who agreed to review this work before its publication and provided numerous helpful remarks, in particular pertaining to the theoretical underpinnings of the presented study. We would also like to thank professor Ryszard Kokoszczynski, editor of the Polish Studies in Economics series, for having proposed the opportunity to

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