Reconsidering the fiscal effects of constitutions

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A R T I C L E I N F O

A B S T R A C T

This paper reconsiders Persson and Tabellini's (2003, 2004) analysis of the causal effect of constitution type on government size. It addresses the concerns of Acemoglu (2005) and makes some measurement and methodological refinements to the identification strategy to argue there is a qualitatively large and statistically significant relationship between constitution type and government size. The age of a democracy is of increased importance in the new identification strategy, but existing measures of when countries became democracies are shown to be flawed. Two new measures of the age of a democracy are introduced. The first details when a country first had a genuinely democratic election, the second when its current constitution was promulgated.

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1. Introduction

Constitutions vary: the US constitution is a classic of political philosophy, whilst the UK has no formal constitution. Yet, constitutions tend to vary little over time. In many cases the decisions made when drawing up a constitution as to the separation of powers or the rights of individuals echo down the centuries. This paper revisits the question of whether these echoes include macroeconomic outcomes, specifically the size of government, and argues they indeed do.

The work of (Persson et al., 1997, 2000) and (Persson and Tabellini, 2003, 2004) (henceforth, PT) was a key step forward. They provided theory and evidence that presidential democracies and those with majoritarian elections are associated with smaller governments. The importance of their work is summarized by (Acemoglu, 2005):

> "[…] I believe that overall PT have largely achieved their ambitious aim of revolutionizing comparative political economy, and this book is the most significant contribution to this field since Lipset's work almost 50 years ago".

Notwithstanding this conclusion, he also argues that a key part of their estimation strategy has serious shortcomings. In particular, he argues the instrumental-variables strategy used to obtain the causal estimates is flawed. A different critique is offered by (Blume et al., 2009) who focus on the data rather than the methodology and argue the results are sensitive to the dataset used. Yet, despite these critiques of both methodology and data, PT has been central to an expanding body of work that documents how differences in political systems affect policy outcomes.

This paper argues that addressing the methodological issues suggests PT's results understate the impact of presidential government, and are robust to using the expanded dataset of (Blume et al., 2009). In particular, it responds to Acemoglu's critique

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by proposing an alternative set of instruments, and advocating the use of weak-instrument robust estimators with good finite-sample properties. Moreover, as the age of a democracy is crucial to both this paper's and PT's identification strategy, two improved alternatives are proposed.

Scholars have demonstrated the importance of constitutional variation for a wide variety of outcomes, and provided evidence of other ways in which our lives are affected by constitutions. These include the form of Corporate Governance (see (Pagano and Volpin, 2005)), the consequences of resource wealth (Andersen and Aslaksen, 2008), corruption (e.g. (Kunicová and Rose-Ackerman, 2005)), and wages (Makris and Rockey, 2011). Yet, the effects of constitutions on spending remain a primary concern. Recent work has emphasized dynamic concerns such as the importance of term limits such as (Aidt and Shvets, forthcoming), and (Nogare and Ricciuti, 2011). Others, have investigated the greater sensitivity of expenditure to revenue shocks in presidential regimes (Andersen, 2011), and the relationship between government size and growth (see (Afonso and Furceri, 2010)). Given that PT is central to the study of constitutional political economy, it is vital the evidence for their hypotheses is evaluated as carefully as possible. This paper proceeds in three parts. First it considers PT's approach and Acemoglu's critique. Then, it introduces the new measures of the age of democracies and discusses improved IV estimators and the results obtained.

2. PT's estimation strategy and its problems

2.1. PT's instruments

This section briefly outlines PT's econometric strategy and its limitations. They claim presidentialism and majoritarian electoral rule reduce government spending. In the regressions of interest, the dependent variable is central government expenditure as a percentage of GDP, *cgexp*. Using data on around 80 democracies, PT consider whether constitution type partly determines the size of government. However, a country's choice of constitution is endogenous, driven by national preferences and specific historical events, which also partially determine the level of government expenditure. Evaluating the effects of constitutions on government spending under the assumption of random constitutional assignment may result in biased estimates and prohibits causal inference. PT take these concerns seriously and as (Persson and Tabellini, 2004) note, they

> "exploit systematic co-variation between the relative frequency of alternative constitutional rules and their broad time period of introduction".

This paper's focus is PT's 2SLS analysis since this approach has garnered the most attention, and also because it allows both of the PT constitutional variables to be treated as endogenous simultaneously. They instrument for whether a country's electoral system is majoritarian or not, and whether it has a presidential system. By instrumenting using a set of variables measuring the age of a democracy, as well as variables from (Hall and Jones, 1999) describing distance from the equator and the proportion of the population speaking English or another European language, PT claim the residual variation in constitutional choice is random.[1] Acemoglu (2005) questions whether their approach is successful. He argues that this instrument set is unsatisfactory. The (Hall and Jones, 1999) instruments are not able to predict variation in the form of democracy, and the constitutional timing variables lack predictive power.

2.2. Alternative instruments

This section introduces the new instruments designed to remedy Acemoglu's concerns. An obvious approach is to include age^2 as well as age as a parsimonious way to capture any non-linearities in the history of 'constitutional fashion'.[2] The 'fashion' argument is most applicable to those countries, typically western, that were not colonized. For countries that were colonized their colonial experience was often an important determinant of the form of constitution adopted.

The logic for the other instruments is that colonized countries were likely to inherit similar institutions to those of their colonial rulers. The widespread presence of UK-style Parliamentary democracies in ex-British colonies is anecdotal evidence of direct influence. More generally, there are several different but related indirect reasons why certain colonial powers might have induced particular constitutional rules. European colonization can be broadly conceived as having taken place in two phases. The first roughly coincides with the discovery of the Americas and the subsequent colonization. What is clear for this early process of colonization is that the different colonial nations had different objectives. The focus of Spanish and Portuguese colonialists was the extraction of mineral wealth and the conversion of indigenous peoples to Catholicism (see for example Olsson, 2004).

This necessarily engendered different institutions to those in the British, Dutch, and French colonies, which were focused on more permanent settlement and trade. Of course there was also substantial rent extraction in the British, Dutch, or French colonies as well as attempts to spread Christianity amongst indigenous peoples. Indeed, much of the economic logic of British

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[1] PT consider a range of other econometric techniques to circumvent the problems of endogeneity, specifically Heckman selection-correction models and matching estimators.

[2] This also has the advantage compared to PT's use of *con2150*, etc. of not needing to assume when the key changes in constitutional fashion took place. A cubic term was considered but added little additional explanatory power. Using the first-stage F-statistics designed to identify potential weak identification suggested by (Angrist and Pischke, 2009) suggests using *age2* rather than *con2150*, etc., and the remainder of PT's original excluded instrument set, improves the identification of both equations.