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Economic Effects of Political Institutions, With Special Reference to Constitutions[1]

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I Introduction

One of the major questions in economics is what causes the growth of wealth: what explains that some countries experience higher economic growth than others? The idea here is to explore the linkage between political institutions, on the one hand, where the constitution is at the center of our interest, and economic performance, on the other.[4] Is it the case that certain sets of institutions are more conducive to economic growth and sound fiscal affairs than others, through their influencing the way political decision-makers act? If so, which are these institutions? The present paper presents both a theoretical analysis of these issues, as well as the results from a number of real-world studies.

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[4] As clarified in Kasper and Streit (1998: 30-31), there are external (or formal) institutions, created and maintained by the government, and internal (or informal) institutions, such as conventions, ethical norms, customs, and professional practices. Focus here is on the former. It should also be noted from the outset that the institutional and constitutional focus does not preclude other determinants of economic variables, but it does hypothesize that all else equal, institutions and constitutions play an important role.

Below, some theoretical considerations will be presented, stemming from two perspectives – the new institutional economics and constitutional economics – which argue that political institutions matter for, among other things, how an economy functions (section 2). A survey of empirical studies that look into this is given next, the purpose of which is to clarify the degree to which the theoretical implications can be confirmed. Among the things covered: the effects of economic freedom, the rule of law, and secure property rights, the effects of different budget rules, the effects of electoral systems, the length of legislative terms, federalism, popular initiatives and referendums (section 3). Lastly, some concluding and summarizing remarks are offered, reflecting, among other things, on the potential for improving the working properties of an economy through reforming political institutions.

It should be noted at the outset that it is quite difficult to isolate the effects of particular constitutions on economic performance, since many factors, institutional and non-institutional, play a role for actual policies. But even though much more work needs to be done in this area, the studies discussed here, in conjunction, seem to indicate the clear relationship between certain institutions and economic outcomes, a result which must be included into any earnest and comprehensive constitutional discussion. The selection of institutions is an important matter.

II The Importance of Political Institutions: A Theoretical Perspective

Underlying many, or most, theories in the social sciences is some conception of man, at least with regard to what determines his actions. Not the least, this is the case in economics, with a view of man as a rational, largely self-interested actor who does his best, given his endowments and *given the rules, or institutions, under which he acts*. But whereas classical economists paid much attention to the role of rules for human behavior, this aspect has largely been ignored in the postwar literature, at least as an explicit factor to be studied. Rather, man has been seen as a utility-maximizer without a possibility to change the rules under which he goes about his business. Of course, the idea behind institutions is to direct human action in certain ways – and hopefully in ways productive of human well-being – which seems in effect to presume that institutions are completely exogenous and hence not objects with which social scientists need to concern themselves.[5]

[5] This is a rationalist-constructivist approach to institutional change that we largely adhere to, but there is also much merit in evolutionary theories of institutions, analyzing their unplanned, spontaneous emergence and persistence –

However, institutions can both be seen as exogenous and binding, on the one hand, and as possible (and, sometimes, desirable) to alter, on the other. The latter insight is important and, as mentioned, neglected in much economic analysis. As clarified by Buchanan and Tullock (1962: 77-80) and Brennan and Buchanan (1985), in many contexts there are two distinct levels of choice, e g, in choosing a constitution and in making everyday political decisions. If so, this implies that rules instituted by lower-level decisions in some practical sense are exogenous *for those for whom these rules apply* albeit possible to change for those given the authority, in line with some higher-level rules, to do so. But it bears noting that the higher-level rules are not totally exogenous: although they are more difficult to change, they can be changed. Hence, alterability is a continuous variable, not a dichotomous one.[6] This is in fact what underlies the research program of constitutional economics; as stated by Buchanan (1990: 1, 7),

> Constitutional political economy is a research program that directs inquiry to the working properties of rules, and institutions within which individuals interact, and the processes through which these rules and institutions are chosen or come into being. The emphasis on the choice of constraints distinguishes this research program from conventional economics. /…/ [E]mphasis is centered directly on the selection of rules, or institutions, that will, in turn, limit the behavior of the persons who operate within them. Institutions, defined broadly, are variables subject to deliberate evaluation and to explicit choice.

The logic behind institutions is hence at base one of ensuring that the incentives facing those making choices, to the highest degree possible, are such as to make it more probable that certain actions, considered desirable, are taken rather than others (Elster, 1985; Brennan and Kliemt, 1990). Just as a person may wish to exercise self-constraint by choosing to impose on himself a certain set of behavioral restrictions, ultimate democratic decision makers may likewise think it prudent not only to put constraints on themselves (admittedly, only binding in an imperfect manner) but on their fellow present and subsequent rulers as well.[7]

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cf. Hayek (1973). These two perspectives need not be viewed as substitutes; rather, they can, in our view, largely be seen as complementary.

[6] There is no infinite series of levels: in all cases, there is some highest level of rule making, which is never, in itself, exogenous. From the point of view of those who are able to change these rules, *all* rules stemming from the political sector are, indeed, at base changeable. However, political transaction costs are generally higher when it comes to changing higher-level rules, due to more stringent decision mechanisms. Clearly, these costs are never infinitely high, which is why overarching rules, as well as other rules, *are* suitable study objects. They can be changed, and they affect human behavior. Cf. Kasper and Streit (1998, ch. 12), who analyze how constitutions evolve through choices induced by economic and political competition between jurisdictions.

[7] The precise form of such constraints may vary and be either procedural or substantial, see Wagner and Gwartney, 1988 and Aranson (1988). The former concern the rules for the political process – e g, those regulating how

The realization that institutions matter has been stressed by several economists, not the least Adam Smith, as remarked by Coase (1977: 320):

> [T]hroughout the *Wealth of Nations* one finds Adam Smith discussing the appropriate institutional framework for the working of a price system. Whether one agrees or disagrees with his views on apprenticeship laws, land tenure, joint-stock companies, the administration of justice, or the educational system, what distinguishes Adam Smith's approach from much of what has come since is that he obviously thinks this is a proper and important part of the work of an economist. It is, I believe, only recently that economists in any number have come to realize that the choice of an institutional framework is a subject which deserves to be studied systematically.[8]

And in that tradition we follow.

However, there is a theoretical critique of this view, as formulated by, e g, Boudreaux (1998) and Voigt (1998). In a somewhat nihilistic tone, these critics seem to assert that the specific contents of a written constitution are more or less unimportant for the way politics is actually carried out. The reason: those deciding on the written constitution are the ones who must obey it, and if they wish to act in ways which the constitution do not allow, they either change it to suit their desires or simply agree not to follow it.[9] Above, some theoretical counter-arguments have been presented to this dichotomous way of analyzing the issue, and Buchanan (1999) sums it up well,

> Constitutional rules have the effect of increasing the costs of taking certain actions. It is more costly to take action in violation of a rule than it is to take the same action in the absence of the rule. If this much be acknowledged, then rules must matter if the basic law of economics is accepted. An increase in the cost of any choice alternative will reduce the resort to that alternative.[10]

We largely agree with this statement.[11] But ultimately, this is an empirical matter, hopefully to be settled in section 3 below. Before delving into the real-world effects of political institutions, this section will present some theoretical insights from new institutional economics and constitutional economics.

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decisions are made in the legislature – while the latter refer to specific requirements on political outcomes – e g, that the national debt may not exceed a certain share of the GDP.

[8] For more on the institutional insights of Adam Smith, see Rosenberg (1960), Buchanan (1990: 11), and Berggren (1993).

[9] This is akin to the old question, who guards the guardians?

[10] Cf. Brennan and Buchanan (1985).

II.I Institutions, Politics, and the Economy

One of the major questions in economics and economic history has been the basis for growth of wealth. What explains that some countries have experienced higher economic growth than others? In older, more traditional neo-classical economic models economic growth was largely, if not completely, a question of natural endowments: Economic output simply flowed from combinations of such inputs as land, labor and capital, and faster – or slower – growth would then just be a question of the amount or efficient use of input. In contrast, newer economic theories have emphasized the role played by institutions, and hence by institutional design. Specifically, one approach is represented by the so-called *new institutional economics*,[12] which stresses that man acts under uncertainty because of a lack of perfect information about the world and because of a limited capacity for processing information. This implies that there are transaction costs in connection with human action, which among other things have an inhibiting effect on economic activities. Among these costs can be mentioned search costs, contractual costs, and controlling costs.[13] In such a reality, institutions, in the sense of formal and informal rules the violation of which entails some sort of penalty, tend to arise to reduce uncertainty and transaction costs.[14] Typical institutions of this kind are judicial systems, accounting systems, insurance, and the existence and protection of private property rights, which entail a set of rules within which ownership of property is delineated and which stipulate how conflicts on such issues are to be resolved. If property rights are clearly defined and enforced, we should expect this to facilitate welfare-enhancing interactions between individuals, as well as the internalization of externalities, and hence to stimulate economic growth.[15]

An *efficient* institution can thus be defined as one that guides human action such that productive activities are favored instead of unproductive, or even destructive, activities and which therefore leads to economic growth. To achieve economic progress, efficient institutions are required. It is hence of central importance to realize that economic development is highly affected by the institutional structure, as it affects how humans choose to behave both in economic and political contexts. As Coase (1998: 73) puts it,

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[11] Cf. Mueller (1989: ch. 17).

[12] See, e g, North (1981, 1990), Eggertsson (1990), Myhrman (1994: chs. 2, 8), and Kasper and Streit (1998).

[13] See, e g, North (1990: ch. 5).

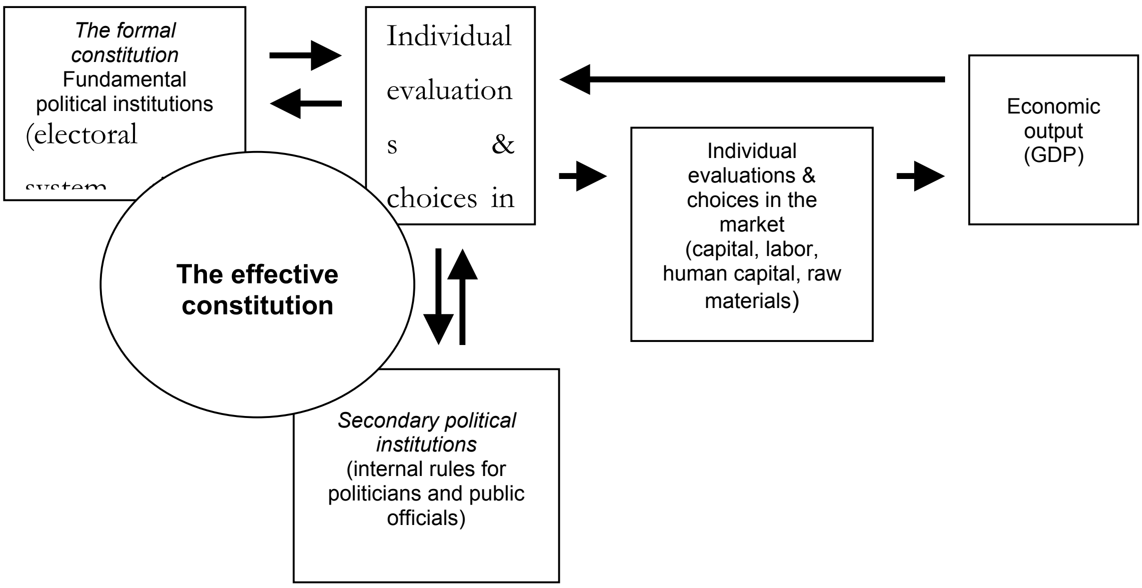
[14] See Heiner (1983) and Vanberg (1994).

[15] See, e g, Coase (1960), North and Thomas (1973), North (1981) and Eggertsson (1990). Cf. also North and Weingast (1989).

Adam Smith explained that the productivity of the economic system depends on specialization (he says the division of labor), but specialization is only possible if there is exchange – and the lower the costs of exchange (transaction costs if you will), the more specialization there will be and the greater the productivity of the system. But the costs of exchange depend on the institutions of a country: its legal system, its political system, its social system, its educational system, its culture, and so on. In effect it is the institutions that govern the performance of an economy.

This insight – especially the connection between political institutions, decisions in the political process, decisions in the market, and economic performance - is partly captured in the following figure.[16]

Figure 1. **How political institutions interacts with the economy**



Note: An arrow should be interpreted as "influence(s)".

The political institutions define the rules of the political game and thus heavily influence the working properties of the political process. Among these institutions, the foremost is the *formal constitution*, which lays down such basic things as voting rules, the electoral system, a catalog of rights, the central political units (not the least the relationship between the legislature, the executive, and the judiciary).[17] But there are also other political institutions, and they may also be

[16] Cf. Figure 2.4 in Myhrman (1994).

[17] It bears noting that the effects of a constitution on politics can be direct (in defining the formal properties of the political system) or indirect (in that the formal properties may have secondary effects on the political system). The latter may not be easily understood. Both types of effects in turn affect how the judicial system and the economy

quite important. Examples are the internal organization of the legislature, the budgetary process, and the structure of the bureaucracy, which together with the formal constitution may be seen as constituting what could be called the *'extended'* or *'effective' constitution*. This concept allows for unwritten rules as well: it may be that political decisions do not follow the formal rules, perhaps in a setting where "all" actors think this prudent. In such cases, the formal and the efficient constitutions are not identical but probably overlap considerably.[18]

Furthermore, the central actors when it comes to deciding on political institutions in a democracy are, ultimately, the politicians themselves: it is their goals and the constraints put upon them (by themselves or other politicians on previous occasions) as they strive towards reaching those goals that determine the institutional set-up. Politicians, in turn, of course often decide on the basis of taking voter and interest-group concerns into consideration, also on institutional and constitutional issues. As clarified in the figure, in this some, probably considerable, constraint is exercised by the existing political institutions.

The laws and policies imposed in the political process in turn have an effect on, among other things, the evaluations and choices made in the economic markets. This affects such central factors as the capital-formation process and the functioning of the labor market – not the least through the incentive effects on economic actors and through affecting transaction costs – and hence the development of economic output, e g, in the form of Gross Domestic Product (GDP).[19] Economic growth, lastly, enters as a factor in the political process: a poor growth record may induce decision makers to introduce some institutional changes – both constitutional and non-constitutional – or, more frequently, some policy changes to make the economy work better.[20]

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function. On the importance of analyzing the indirect effects, see Moberg (2000a), which explores how the constitution influences the party system without dealing with it explicitly and how this, in turn, influences the type of decisions that are made in politics.

[18] We may thus distinguish between the *formal constitution*, understood as, e g, the formal document so named, and the *effective constitution*, where this is the constitution broadly conceived and the set of rules, which are enforced *de facto*, i e, including, e g, the level of regulation, taxation, etc. Cf. Vanssay and Spindler (1994: 360, 266-367 notes 3 and 4; 1996: 12).

[19] Cf. Eliasson (1998: 56) for a specification of formal institutions that create incentives for industrial dynamics and economic growth.

[20] Such considerations can be expected to play an important role no matter what motivates political decision-makers. If they are self-interested, a growing economy is important to retain popular and interest-group support; and if they are more altruistically inclined, they probably value a growing economy because it makes the lives of the citizens more enjoyable. On how considerations such as these vary with political systems, see Olson (2000).

II.II Constitutional Economics

Whereas the new institutional economics discusses a large number of different institutions, and whereas it primarily views the emergence of institutions as a response to uncertainty and transaction costs, *constitutional economics* has concentrated more on the basic political institutions, not least those at the constitutional level, and on viewing these as having a potential for guiding political decisions so that they are not plagued by shortsightedness or special interests.[21] According to this latter view, political institutions may very well be implemented to *increase* political transaction costs. At the forefront is the motivation of central actors and how this affects the need for and choice of constitutional rules.[22]

The underlying analysis stems from a theoretical view of the political game which essentially identifies three main groups of actors: politicians, voters, and interest groups and which assumes that each strives towards realizing its own goals in a rational manner, i e, gaining as many private benefits as possible for themselves, while letting others bear the costs.[23] The goal of politicians could be to maximize the number of votes or to implement some program on the basis of an ideological conviction, the goal of voters to maximize disposable incomes, and the goal of interest groups to secure various sorts of favors. Policies are formed in a process where politicians pay heed to how (oftentimes less well-informed and less well-organized) voters and (oftentimes well-informed and well-organized) interest groups can be expected to react to decisions. Due to the way in which politics works, in particular in modern media settings, with a focus on shortsighted distributional effects of different decisions, with the influence of interest groups over the political process, and with a possibility for politicians to gain electoral support by offering parts of the electorate various pecuniary advantages, quite a few decisions will be characterized by shortsighted and special interests rather than a long-term public interest, and e g, with the result that political decisions are made with growth-retarding effects.[24] This may be

[21] By "constitution" is meant a set of overriding, durable rules which define the political game. For general presentations of constitutional economics, see, e g, Buchanan (1987, 1990), Brennan and Buchanan (1985), Mueller (1996), and Berggren (1997). On a central issue of the research program, see Buchanan (1993). On the relationship between the new institutional economics and constitutional economics, see Voigt (1999: 2-3).

[22] Generally, in this line of literature, following Buchanan (1959, 1987: 585), it is not seen as worthwhile to try to persuade politicians to revise policy as long as the institutional setting does not give incentives for them to act in accordance with such attempts of persuasion. Rather, focus should first be on trying to devise better rules.

[23] Cf. Downs (1957), Olson (1971) and Peltzman (1976).

[24] A conclusion from the empirical research on the interaction between politicians, voters, and interest groups is that the latter are quite influential in the political process and that they are prepared to invest substantial amounts in lobbying. See, e g, Mueller (1989: parts 3, 4), Crain and Tollison (1990), Potters and Sloof (1996), Tollison (1997),

considered undesirable from the point of view of *the long-term interests* of the polity, as illustrated in the following figure, based on Buchanan and Congleton (1998: 23).

Figure 2. **Payoffs with a simple-majority rule**

	B_1	B_2
A_1	1,1 I	-1,2 II
A_2	2,-1 III	0,0 IV

The logic of the game that underlies Figure 2 is somewhat similar to that of the prisoners' dilemma game. The numbers signify payoffs for different individuals in different outcomes, which are the result of political decisions. The left-hand number in each pair denotes the payoff for decision-maker A and the right-hand number that of decision-maker B. These can be seen as perfect representatives for a deciding simple majority. The one in power can choose between four decisions, represented by the Roman numbers in the boxes. When A is in power, he will choose box III, and when B is in power, he will choose box II, as these choices reward them the most. This illustrates how the simple-majority rule gives rise to sub-optimal social outcomes, as it is possible, in each period, to obtain a total payoff of 2 (box I) instead of the total payoff of 1 given by boxes II and III. The problem is that the majority in power at any point in time always chooses that which gives the own group the highest payoff. The challenge: to devise rules for the political game such that the off-diagonals are eliminated from the choice set of decision-makers – clearly in part a constitutional issue, of how to make it easier for politicians to withstand shortsighted pressure from the public opinion and interest groups.[25]

II.III Choosing Constitutions

This perspective entails a largely instrumental view of how a democracy should be designed. The basic idea is that democracy is desirable but that it will only be sustainable in the long run if it gives rise to good results – as evaluated by the citizens themselves. This in turn implies that the choice of democratic building blocs, within a framework of 'minimal' basic principles of

Bergström (1998), Shleifer and Vishny (1998: 53-90), and Dahlberg and Johansson (1999). On 'institutional sclerosis' and the negative effect on economic growth and prosperity, see Olson (1982).

[25] In order to achieve this, Buchanan and Congleton (1998) propose that the simple-majority rule be complemented with the generality principle, requiring all political decisions to treat all citizens equally qua citizens. Cf. Buchanan (1993). For an application of this approach to Swedish industrial policy, see Berggren and Bergström (1999a). On the desirability of constitutional reform in Sweden, in order to induce long-term efficiency, see Åberg (1997).

democracy, is a rather open question which depends on to what extent the alternative arrangements contribute to this satisfaction of citizen preferences.[26] This starting-point for the analysis can be used to generate more precise insights, some general examples of which will now be mentioned. Specifically we will distinguish between (1) rights, (2) decision rules, (3) electoral systems, and (4) separation of powers.[27]

Rights

If we conceive the rights of individuals as being what has traditionally been called 'negative' rights, i e, as restrictions upon what others may do to an individual, then constitutionally protecting individual rights from interference from temporary political majorities, as well as from other individuals, may have a number of positive effects on human cooperation and hence human welfare. Most fundamentally, they limit – if successfully protected – the costs which other actors, private and political, can impose on individuals, and hence makes it worthwhile for economic actors to invest their time and resources in productive efforts. This is, most obviously, the case with such classical 'negative' rights as the right own property, to contract and trade, etc., without interference from government. But protecting such individual rights furthermore lowers the costs of collective decision-making through a decrease in decision-making costs of individual action by according to each individual a sphere within which he can ultimately act according to his own judgment. Also, the expected external costs of the choices made by others become lower, cf. Buchanan and Tullock (1962).

It may, in contrast, be argued that the constitutional 'guaranteeing' of so-called 'positive' rights may have exactly the opposite effect. If the citizens of a state through the constitution have a 'right' to, e g, a certain living standard or other politically provided special benefits, this will per definition entail that others must bear the cost, and hence be restricted in their enjoyment of their (negative) rights. To the extent that such constitutionally mandated 'positive' rights are successfully implemented, the result may easily be redistribution far beyond what an economy can bear without significantly negative effects on wealth and productivity. Furthermore, by opening up for constitutional mandates for redistribution, the lid may be taken off a Pandora's

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[26] For an elaborated argument, see Berggren and Bergström (1999b). This view presumes that citizens primarily do not value a particular institution for its own sake but only proportionally to its ability to generate well-being. Overall, political legitimacy is then a positive function of how the *set* of relevant institutions contribute to this goal. It bears noting that there are different normative bases for this line of reasoning, e g, a contractarian one and a utilitarian one. On the former, see Coleman (1990); on the latter, see Berggren (1999).

[27] Other categorizations of the constitutional aspects could be made; this is only for heuristic purposes.

Box of rent-seeking, whereby special interest groups may gain a considerable interest in ensuring that exactly their narrow benefits are institutionalized on a permanent basis.[28] In this way 'positive' rights will increase both the external costs and the collective decision-making costs of the constitution.

The concept of economic freedom can be used to assess the degree to which negative rights are upheld and the degree to which positive economic rights are absent in an economy and also to analyze how this affects the economy. It is important to note that this is only partly a question of a relationship between institutions and economic performance; economic freedom may indeed prevail in many different institutional settings and is also a function of other things than institutions, e g, regular policies which, in turn, are also influenced by such things as external shocks and political preferences. But one could perhaps argue that these latter things are, in turn, influenced by institutions, and thus it seems appropriate to posit that institutions largely determine the degree of economic freedom, which in turn affects the working properties of an economy.

Decision rules

The specific types of decision-rules may have a significant effect on the types of choices made and the outcomes; on this, see Mueller (1989: part II). E g, the simple-majority rule may very well contribute to facilitating decisions where majorities exploit minorities or where influential groups manage to steer politics in ways favorable to them but not others, which, among other things, can have negative efficiency effects. One implication is that qualified-majority rules or institutions which complement the simple-majority rule in the decision-making procedure could be preferable.[29] Legislative institutions, such as a particular budget process or a committee system, may steer outcomes in ways more conducive to sound economic policy.[30]

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28 On rent-seeking, see, e g, Tullock (1993).

29 See, in general, Riker (1982), and on the simple-majority rule in particular, Buchanan and Tullock (1962: 63-91).

30 This line of inquiry is akin to the one addressed in the literature on structure-induced equilibria (e g, Shepsle and Weingast, 1981, Shepsle, 1986, and Weingast and Marshall, 1988). There, the issue is how institutional arrangements that complement the pure majority rule, primarily in the form of the way the legislature is organized, can instill legislative stability. The idea is to restrict the domain and the content of legislative exchange.

Electoral system

The electoral system itself may also have effects on the policies adopted. In an analysis of how parliamentary democracies with proportional electoral systems work, Moberg (1998) argues that they have a relatively strong innate tendency for constant expansion of public expenditures and taxes, which leads to a dysfunctional economy. A central mechanism for this is that the party system typical of such constitutional settings, with a number of homogeneous, disciplined parties, facilitates the forming of majority coalitions which ally themselves with interest groups and voter groups requiring higher expenditures.[31] A change of the electoral system to a "first-past-the-post", or plurality, system, in combination with an independently elected executive, would plausibly dampen this tendency.[32]

Separation of powers

Finally, the organization of the state may have effects on the choices made. Persson, Roland and Tabellini (1997) show that separation of powers with "checks and balances" between the executive and the legislature, in conjunction with a constitutional court which supervises that the constitution is upheld, can increase social utility, primarily because such an arrangement creates conflicts of interest between the two power centers while they, at the same time, must agree. Thereby, they monitor each other and contribute to the denouncement of power abuse, such as in the budgetary process (where the constitution can divide the process into two steps while requiring that both instances of power agree at each step: the first one entails one of them proposing a budget size and the second one entails the other proposing how to allocate budget resources between alternative uses). This implies that to the degree, to which monistic constitutional arrangements are thought to have too weak a mechanism for assuring that long-

[31] A somewhat similar conclusion has been reached in a sophisticated game theoretical analysis (Austen-Smith, 1998). The somewhat stylized equilibrium model demonstrates that there is a tendency for political systems with proportional representation and more than two parties to result in higher taxes (but also flatter distributions of income) than is the case in political systems with "first-past-the-post" systems and only two parties. The reason is that since no political party has an absolute majority of the votes, the parties need to engage in legislative bargaining, which drives up redistribution.

[32] Cf. Grilli *et al* (1991). For a general discussions of pros and cons of the two alternative electoral systems, see, e g, Cox (1997) and Dummett (1997).

term and general interests are taken into account properly in political decision-making, constitutional reform is a possible avenue forward.[33]

But referendums may also serve as a check-and-balance, in particular if such can be initiated by the citizens as so-called 'voter initiatives'. It has, for example, been argued by Romer and Rosenthal (1979) that referendums generally will tend to restrain public agencies from overspending. This point has been extended theoretically by Gerber (1996), who has developed a uni-dimensional model showing that the existence of a possible threat of a referendum will tend to move public policy closer to the position of the median voter. The implication would then be that if the citizens have the right to demand that issues be put to a popular vote, the policies would be closer to those of the median voter.[34] Naturally, as noted below, this might yield policies which do not enhance long-term economic performance; but, depending on how the system of referendums and initiatives is designed, the opposite can also be obtained.

Federalism, lastly, can also be expected to influence the character of political decisions taken. Hamlin (1985: 189) defines it as an institutional structure with "a multiplicity of competing government units within a single nation." The main purposes of such a system is to provide decentralization in order to "attain a better correspondence between the package of goods and services provided by government and the preferences of individuals by allowing the content of the package to vary across regions" (Hamlin, 1991: 194) and competition, which leads to increased efficiency as "a multiplicity of governments will compete with each other both with respect to resources (seen as tax bases) and with respect to voter-citizens" (Hamlin, 1991: 194).[35]

III An Empirical Survey

Let us now see what empirical support there is for the contention of this section: do constitutions *de facto* matter for how economies function and, if so, how?[36]

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[33] On the division of power more generally, see, e g, Dorn (1988), Vile (1998), and Nergelius (1999).

[34] For a systematic treatment of the basis for referendums and initiatives in constitutional democracies, see Moberg (1999).

[35] Cf. Wildavsky (1990) and Casella and Frey (1992). For a more critical perspective of federalism and institutional competition, but in agreement insofar as the principle, that federalism affects the working properties of politics, is concerned, see Moberg (2000b).

[36] For a broader survey of the consequences of various institutional set-ups, see Moser (1999).

III.I Rights

Given the theoretical perspective adopted a fundamental question must be how important formal rights, e g, as partly captured by the concepts economic freedom and political freedom, are for economic growth and prosperity.[37] Research in economic history has shown that in societies which have obtained a high and enduring level of material wealth, well-defined and protected private ownership rights have been of central importance, not the least when the Western world was industrialized and when growth accelerated in the beginning of the 19th century.[38]

Political freedom

Studies of the possible relationship between political freedom and economic growth have been relatively frequent for some decades, no doubt due to the wide availability of obvious data (e g, the annual Freedom House reports). For the present purpose we may view political freedom as consisting of two essential components: Political rights and civil liberties.[39] Political freedom in the form of political rights are typically in the form of such 'positive' rights as, e g, the rights of citizens to participate in elections (i e, universal franchise), free and open elections (i e, between alternative parties), etc. Furthermore such 'positive' political rights may also be seen as including the various types of politically provided entitlements, e g, to social security, medical care, housing, work, etc. In contrast, political freedom in the form of civil liberties is typically conceived of as 'negative' rights (other than economic rights), e g, freedom of religion, freedom of speech, freedom of the press, freedom of association, freedom against unreasonable searches, due process, etc., i e, what we would often associate with 'rule of law' broadly conceived.[40]

There is hardly any consensus on the possible relationship between political rights and economic growth, with conclusions ranging from a positive relationship over no relationship at all to a negative one, no doubt partly due to the fact that such a very wide and complex set of concepts is subsumed under the broader concept (see Wu and Davis, 1999: 40). There would,

[37] For a discussion of some of the conceptual problems involved in distinguishing between economic freedom, and political freedom, as well as some of the problems involved in measuring and comparing freedoms, see Hanke and Walters (1997) and de Haan and Sturm (1999).

[38] See North and Thomas (1973, 1977), Rosenberg and Birdzell (1986), Hodgson (1988), Jones (1988), and North, (1992). Cf. Olson (1996).

[39] Cf. Farr, Lord, and Wolfenbarger (1998: 253), de Haan and Siermann (1998: 364-365), and Wu and Davis (1999: 41).

[40] Cf. Hayek (1960).

however, in recent studies seem to be an emerging conclusion that while civil liberties may play an important role (cf. *infra*), political freedom as such does not lead to economic growth.

Vanssay and Spindler have in two studies examined data from a sample of approximately 100 countries for the period 1960-90.[41] They have done so by transforming the presence or absence of a number of political and economic rights into a set of dummy-variables as well as the general, over-all level of freedom, and the political structure. They found that political rights, i e, the political structure and various forms of constitutional 'guarantees' of positive rights (entitlements), have no significant effect on economic growth and economic wealth.

Similar conclusions have been reached by others who have investigated the possible correlation and/or causality between political freedom and economic growth and prosperity, e g, Farr, Lord and Wolfenbarger (1998) and Wu and Davis (1999). Most recently Barro (1997; 2000) has similarly concluded that the extent of democracy as such has little effect on subsequent economic performance.[42]

In partial contrast, Lane (1996) has found that positive rights may have some significant effect on prosperity and economic growth, albeit a negative one. He found, studying a comprehensive set of institutional data from the OECD-countries, that states with more 'universal' welfare state entitlements tend to have less economic growth than states with more 'selective' transfers (e g, on the basis of some estimate of 'need'). In the period 1965-80, economic growth (measured as change in GNP per capita) was 2.3 percent vs. 1.8 percent in the two types of systems respectively, and in the period 1980-91 the corresponding figures were 2.3 percent and 1.8 percent. This suggests that the inclusion of 'positive' rights to specific entitlements into the constitutional framework will have a growth retarding effect over time.[43]

Economic freedom

The importance of good institutions has also been observed in studies looking at the connection between the degree of economic freedom, on the one hand, and economic wealth and economic growth, on the other hand. But while many studies have attempted to find the possible

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[41] See Vanssay and Spindler (1994, 1996), who used the Scully-Slottje index as well as other sources. The data for income and growth used in the two studies were different, but the results of the two studies are more or less consistent.

[42] Barro (1997; 2000) used the Gastil index to measure the extent of democracy. Barro also finds that democracy does not have a strong effect in fostering rule of law and hence not even in this way an indirect effect on economic growth.

[43] See Lane (1996: 209-211).

relationship between political freedom and economic growth, it is only within very recent years that something similar has been done in regard to economic freedom.[44] This has no doubt been due to the lack of systematic data, but at least three such attempts have been developed in recent years, e g, the Scully-Slottje index of economic liberty (1994), the *Economic Freedom of the World Index* (1996 ff.), and the Wall Street Journal/Heritage Foundation *Index of Economic Freedom* (1996 ff.).[45] With economic freedom one would typically associate a free market economy, i e, the property rights of individuals, freedom of choice and voluntary exchange, freedom of contract and the enforcement of contracts, the absence of taxation, regulation, etc.[46]

By now the studies seem to be almost unanimous in their verdict: Countries which have higher economic freedom (lower taxes, smaller public sector, more deregulated markets and trade, lower inflation, etc.) tend systematically to have greater wealth and higher economic growth than other countries.[47] In fact, no matter which of three major attempts at indexing economic freedom is used, there is a statistically significant positive relationship between economic freedom and per capita national income.[48]

Vanssay and Spindler (1994, 1996) have, in their studies of political and economic rights and their effect on growth and prosperity, found a significant positive relationship between economic freedom and economic growth. Furthermore, economic freedom together with the savings ratio, population growth and education, explains more than 75 percent of cross-country variation in per capita income.

The studies by Vanssay and Spindler were, however, among the first to attempt an investigation of the possible relationship between economic freedom and economic growth, and they accordingly did not compare the results of their use of the Scully-Slottje index with those resulting from other measures. An important study by de Haan and Siermann (1998) has considered not only whether economic freedom has an effect on economic growth, but also which kinds of economic freedom may have a larger or smaller effect.[49] Their conclusion is that the robustness of the results depends on the specific indices used; for some measures of

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44 For a survey and comparison of the various major attempts, see Hanke and Walters (1997).

45 See Scully and Slottje (1991); Gwartney, Lawson and Block (1996) and Gwartney and Lawson (1997, 2000); and Johnson and Sheehy (1996), Holmes, Johnson and Kirkpatrick (1997) and O'Driscoll, Holmes and Kirkpatrick (2000).

46 Cf. de Haan and Siermann (1998: 364-365) and Wu and Davis (1999: 40-41).

47 See, e g, Scully (1992), Vanssay and Spindler (1994, 1996), Grubel (1998), de Haan and Siermann (1998), de Haan and Sturm (1999), Wu and Davis (1999), and Gwartney and Lawson (2000).

48 See Hanke and Walters (1997).

49 The authors employed the *Economic Freedom of the World Index* by Gwartney, Lawson and Block (1996).

economic freedom, there is a positive relationship – and a strong one – while for others there is no relationship. They also found that some forms of economic freedom seem to have larger effect than others.[50]

Similarly Grubel (1998) has used some relatively simple comparisons to find some quite clear positive relationships between levels of economic freedom and wealth (measured as GDP per capita) and between levels of economic freedom and economic growth (measured as growth of real GDP per capita 1985-96). He has also, by relying on data from 20 OECD-countries 1993-96, established similar, but negative, relationships between levels of economic freedom and unemployment rates.

The two freedoms

An important question relating to the importance of the various types of rights for growth and prosperity is how much importance they have together and relative to each other. Wu and Davis (1999) have examined data from approximately 100 countries in the period 1975-90 by using log-linear models to test the association and hence possible relationship between four variables: Economic freedom, political freedom, levels of income (GDP per capita) and rates of economic growth. The results indicate, on the one hand, that given economic freedom, economic growth has no association with political freedom and the level of income, while on the other hand, given the level of income, political freedom is independent of economic freedom and the rate of economic growth. The analysis thus provides suggestive evidence for the theoretical argument that economic growth leads to an increase in political freedom, and further suggests as general hypothesis that economic freedom promotes economic growth, and that an increased level of income leads to political freedom.

It would thus seem that what really matters for economic growth is *de facto* economic freedom, while the connection between political freedom and economic growth is, at best, fragile and highly dependent on the exact content of political freedom. And to the extent that there is a relationship between economic growth and political freedom it would seem more likely that the former leads to the latter than the reverse.

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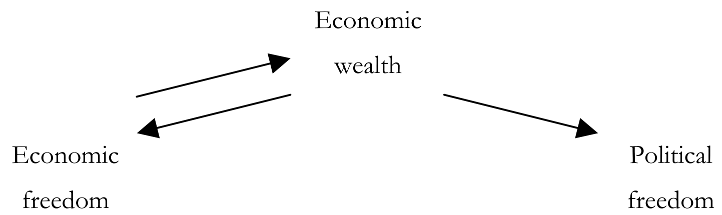
[50] For analyses of how government expenditure levels affect economic growth, see Gwartney, Lawson, and Holcombe (1998), Gwartney, Holcombe, and Lawson (1998), and Fölster and Henrekson (1988, 1999). Barro (1997) has similarly examined the effects of what he calls 'nonproductive government spending' (i e, total government spending minus defense and education) and found a significantly negative relationship between the level of government spending and growth in GDP per capita.

The results found by Wu and Davis are reflected in a study by Farr, Lord and Wolfenbarger (1998), which has attempted not simply to measure any possible correlation between economic freedom, political freedom and economic growth/economic wealth, but has investigated the possible direction of causality between the variables. The results may be summarized as done in the figure 3, where the arrows (→) symbolize an empirically detected causality:

Figure 3. **Causal relations between economic freedom, political freedom and economic wealth**



The same pattern characterized both industrialized and non-industrialized countries: Economic freedom at one time significantly causes economic wealth at a later time, and economic wealth at one time similarly causes both economic freedom and political freedom at a later time. There is, in other words, a feedback effect between economic freedom and economic wealth and through this an indirect effect of economic freedom upon political freedom. Political freedom, in contrast, seems to have no significant effect upon economic freedom or economic wealth, directly or indirectly.

The results may all together seem to indicate that some freedoms have a great importance, but what is important is not the formal enumeration of *de jure* rights or the summarization of what rights the citizens have, but the *de facto* protection of rights.

The rule of law

Thus, more important than the formal constitutional guarantees of various rights seems to be the real protection of such rights, and here some would seem to be more important than others, in particular rule of law and the protection of property rights.

Vanssay and Spindler did not, in their studies, find any significant effect of, e g, traditional civil liberties, independent supreme courts, etc., on growth and prosperity. But the authors themselves suggest that the reason may be that what is important is not the formal constitution itself but rather the extended, 'effective' constitution.

Furthermore, the important role of the ‘rule of law’, broadly conceived, in stimulating prosperity has indeed been emphasized in a number of studies, historical as well as contemporary. De Long and Shleifer (1993) have, for example, shown how the absence of arbitrary absolutism was very important in stimulating economic growth in medieval Europe; in general, the more absolutist, the less growth. North and Weingast (1989) specifically demonstrated how the Glorious Revolution of 1688 led to the creation of institutions credibly securing property rights, protecting wealth and eliminating confiscation, resulting in a stimulation of economic growth.

More contemporary data would seem to point in the same direction. While Barro (1997; 2000) found that the extent of democracy as such has little effect on prosperity, he also – and in somewhat contrast – found that the most important factor for developing countries is the rule of law. And even for non-developing countries the rule of law is important. This is a finding, which is also supported by, e g, Scully (1992), who in a study of 115 market economies between 1960 and 1980 shows, that politically open societies respecting the rule of law display higher economic growth during the period; cf. Scully (1988, 1991).

In a recent study Olson, Sarna, and Swamy (2000) have investigated the importance of good governance in developing countries on the basis of a hypothesis that differences in governance explains why most developing countries grow slower than high income countries, while a few developing countries grow faster. They did so by considering GDP per capita data for 68 developing countries in the period 1960-87, and comparing these with variables such as indices measuring the risk of expropriation and nationalization of foreign enterprises, the risk that governments will renege on contracts with foreign investors, the quality of the bureaucracy, the level of corruption and the level of national respect for public authority (e g, the strength of the court system and the political stability). The analysis showed that all the variables had a significant effect, but the most important were the risk of expropriation and of repudiation of contracts, i e, on violations of property rights. If countries such as Haiti and Syria had had a rule of law such as that of Hong Kong, their annual growth in productivity would have been 2-3 percent higher than it actually was.

Similar results are obtained in Knack and Keefer (1995), where property rights are found to have a great impact on investment and growth, sometimes even higher than the impact of education. The effect of institutions of growth persists even after controlling for investments, which implies that secure property rights not only affect the size of investment but also the efficiency with which inputs are allocated. Rates of convergence to U.S. level incomes also increase notably when property rights variables are included in the growth regressions; cf. Keefer (1999).

Another study, by Norton (1998), highlights that well-defined and enforced property rights seem to be particularly important for the well being of the poorest people in the world.[51] The stronger the delineation and constitutional protection of property rights, the smaller the poverty and the higher the extent of 'human development', which may be interpreted as a clear sign that the safer the property rights, the greater the opportunity to engage in wealth-maximizing behavior. For example, in societies with strong property rights the proportion of people not expected to live to the age of 40 is 6-9 percent, while it is more than 25 percent for those societies with weak property rights (see Norton, 1998: 243).

III.II Decision Rules

One group of studies has investigated the effects of procedural design: whether there are any relationships between the types of decision rules and the types of decisions made, e g, the level or types of spending. Not all of these rules are constitutionally mandated, but some are and most could be seen as being at least a part of the 'effective' constitution.

Budget rules

Attempts have, for example, been made at testing how budget process rules may affect the size of budget deficits and the public debt. Hagen (1991) has compared the budget process in the individual US states, and concluded that the more restrictive the rules governing the budgetary process, the smaller the budget deficit and the public debt. But the restrictions also have some effect in simple shifting debt from restricted areas to non-restricted areas.

Similar results have been found by Krol (1997), who has also studied the effects of various budget rules in the US states. Specifically, Krol has surveyed the effects of limitations on how much taxes and expenditures can increase per year, the line-item veto where governors can veto and reduce spending on a line-by-line basis, and balanced-budget laws in the states. He found that all these measures have the intended effect: They reduce state spending, state taxes and state

[51] Norton tests the level of extent and character of poverty by using the UN Human Development Index and Human Poverty Index also utilized by Grubel and by testing these against several measures of the extent of protection of property rights derived both from the *Economic Freedom of World Index* by Gwartney and Lawson (1997) and from the *Index of Economic Freedom* by Holmes, Johnson and Kirkpatrick (1997).

debt. Not all of these restrictions are in the form of formal constitutional rules in a narrow sense; some are simply in the form of statutory laws, and the empirical evidence suggests that the former are more effective than the latter, just as it seems as if restrictions on spending are more effective than restrictions on taxation.[52]

Other studies, e g, Alt and Lowry (1994) and Poterba (1994), have focused on how budget rules limiting the possibility of transferring budget deficits from one year to another, as well as substantive restrictions in the form of fixed limits on taxes and spending. These studies have demonstrated that such rules do have an effect, e g, by leading to a more rapid reconstruction following sudden fiscal crises. Similarly studies by, e g, Lopez-de-Silane *et al.* (1995), have shown that states with strict budgetary restrictions also tend to privatize more than states with less strict rules.[53]

These findings would together with the many studies finding a negative relationship between the level of government spending and the level of economic growth seem to suggest that there is empirical basis for expecting that tax and spending restrictions over time will tend to favor economic growth.

The size of the constitution

It may finally be noted that there seems to be an empirical relationship between the length of a constitution and economic wealth, and a negative one. Specifically, Montenegro (1995) shows in a study of 38 countries, the length of their constitutions and their GDP in the late 1980s that there is a clear negative relationship between the length of the constitution (measured by the number of articles as a proxy) and the level of GDP per capita. In fact, the conclusion is that no country with a high GDP per capita has a long constitution.

This is a finding, which is in partial agreement with other studies concluding that the formal enumeration of rights in a constitution has no positive effect on economic wealth.[54] The obvious interpretation is that the formal *de jure* enumeration of rights is irrelevant for the factors resulting in economic growth; in fact, a complicated and detailed constitution may rather be seen as the result of the amount of influence exerted by various rent-seeking special interest groups. What is

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[52] See also, e g, Stansel (1994).

[53] It should be noted that not all studies have found a relationship between constitutions and the economy. Abrams and Dougan (1986) found that the types of constitutional rules in operation do not affect the total level of public expenditure. But against this it might conceivably be countered that not all constitutional rules are equally effective in practice; some may be circumscribed more easily than others.

[54] See Vanssay and Spindler (1994, 1996).

relevant is a simple and understandable constitution and the actual *de facto* protection of those rights supporting wealth-creating activities.

III.III Electoral Systems

The many studies, which have investigated the possible relationship between the presence of a democratic system and economic wealth and economic growth, have not found significant evidence of a relationship between the two. To the extent that democracy is seen as entailing such other aspects as rule of law, etc., there may be a connection between democracy in this broader sense, but not between a democratic political system as such and economic wealth (cf. Barro (2000).). Similarly, democracy may be seen as being caused by previous wealth, which again may be seen as being caused by economic freedom, but the causality does not run in the reverse direction.[55]

But while there is no necessary connection between democracy and prosperity, the specific forms of electoral systems in democracies may have some effects. Grilli, Masciandaro and Tabellini (1991) investigated the possible relationship between political and monetary institutions and public finance policies. These policies, they argue, reasonably differed because governments of different countries were subjected to different political and economic incentives. They found that in political systems with a proportional representation system and fractionalized party system, budget deficits and public debt tend to be higher than in democracies with majoritarian electoral systems.

In another study de Haan, Sturm and Beekhuis (1999) demonstrate that coalition governments tend to find it more difficult to remain within their budgets after an adverse economic shock than is the case with one-party majoritarian governments. Furthermore, there is evidence that the number of political parties tend to go along with a growth in the size of the government debt. Since coalition governments tend to be more prevalent in systems with proportional representation, there would seem to be good reasons for why to believe that an electoral system, which creates clear choices between alternative majority governments, would tend have a positive effect on sound fiscal behavior. This is also supported by de Haan and Volkerink (2000), who find that more fragmented governments have higher deficits, and by Ashworth and Heyndels (2000), who find that the larger the fragmentation of government, the greater is the persistence of deviations, after shocks, from the desired tax structure. Fragmentation, in turn, is reasonably a

[55] Cf. Farr, Lord, and Wolfenbarger (1998).

direct result of the type electoral system in use, as argued by Moberg (1998, 2000a) and Härd (2000).

III.IV Separation of Powers

Quite often a constitutional separation of powers will not in itself guarantee that the separation will remain in place. It is, for example, the US and Swiss experience that constitutional safeguards are not completely immune to changes in the preferences and behavior of rent-seeking special interest groups, especially not in times of crises and war.[56]

Nonetheless, the fundamental constitutional structure may have important effects. Lane (1996) has conducted a comprehensive study comparing a wide range of data from the OECD countries and spanning several decades. Lane found some significant relationships – and some less significant ones. The study shows that by 1991 OECD-countries characterized by federalism, presidentialism and bicameralism had significantly less public spending and greater wealth (measured as GDP per capita) than countries which did not. The results, however, were not completely unequivocal since economic growth was less in countries with presidentialism and federalism in the period 1965-91.

Crain (1999) has undertaken a study comparing data from 47 countries from the 1970s and 1980s with regard to the possible relationship between institutional characteristics and the character of public investment, specifically whether or not certain types of institutions promotes 'political business cycles', i e, oversupply policies with pre-election benefits and post-election costs. The analysis compared, on the one hand, the length of legislative terms, the number of chambers in the parliament (one or two), the formal separation of powers, and whether legislators are elected simultaneously or with over-lapping terms, and on the other hand the relative weight of types of public expenditures (consumption or investment). The finding was that institutional set-up had some effects, among other things that longer legislative terms led to an increase in public investments relative to public consumption. In other words, the time horizon of the legislators is extended. In contrast, a formal separation of powers between the legislative and the executive branch seems to have a negative effect on the share of public investments.[57]

[56] See Moser (1994). Cf. also Higgs (1987).

[57] See Crain (1999: 10-11).

Federalism

In a federal state there is, per definition, a specified division of authority – a vertical separation of powers – between the various levels of government, which is not necessarily present in a unified single-level state, and there seems to be evidence that the federal element has systematic effects on the nature of public spending.

Vaubel (1996) has examined data from 65 countries, primarily from 1989-91. The analysis found that federalism has an impact on the total size and relative centralization of government spending, and hence possibly also on the economy. Specifically, federal states on average tend to be more decentralized in their composition of public spending than non-federal states, and the share of the central government is significantly smaller, if income per capita and the area of the state is large and if it is a federal state.[58]

Federal states do, however, often exhibit a tendency of a gradual centralization, with power shifting away from the individual states and to the federal state. Vaubel's study indeed shows that the most important factor making upon federalism when it comes to constraining the federal government is the presence and independence of a constitutional court.

Moser (1994) has similarly evaluated the experience from both the U.S. and Switzerland, and concluded that it is very difficult to constrain the federal government by its own federal institutions alone. What seems to be effective are precise and narrow rules limiting what can be done.

Popular initiatives and referenda

While democracy as such seems to have no systematic effect on economic growth and prosperity, one particular aspect of democracy, the direct democracy in form of referendums, seems empirically to work as a form of separation of powers.

Matsusaka (1995) has, drawing upon extensive data from the 50 states of the USA in the period 1960-90, demonstrated empirically that there is a systematic tendency for the total public spending, state and local, to be lower in states that have voter initiative referendums than in states, where the political decision-making lies exclusively with the legislature. Furthermore states with voter initiative had more decentralized spending and utilized less redistributional spending. Matsusaka's reasoning is that direct democracy will result in the adoption of policies favored by

[58] Grossman (1989, 1992) and Vaubel (1994) find that the higher the degree of fiscal centralization, i e, the share of public expenditures controlled by the central government, the larger the public sector.

the median voter in the electorate as a whole, while this may not necessarily be the case with representative democracy. In that respect the findings seem similar to a number of others, concluding that the use of direct democracy may tend to lower the level of public debt and – at least – coincide with higher GDP per capita.[59]

This logic does, however, cut both ways in practice: If the median voter wants higher spending, more regulation, etc., the institution of public initiative could counteract growth supporting policies. Matsusaka (1999) has indeed demonstrated, by looking at data for the US states for the period 1900-49, that the voter initiative in the first half of the century would seem to have had the opposite effect: Public spending was higher in states which had the possibility of voter initiatives than in states which did not. The empirical results then seem less than unequivocal in terms of whether referendums generally will have one result or another, and Matsusaka (1999) has hence suggested that the explanation may be that the preferred policy of the median voter has changed during the 20th century and thus does not have a consistent effect on the overall size of state and local public spending. But one important finding is that the voter initiative does systematically lead to more decentralized public spending, i e, at local rather than state level.

Research by Feld and Matsusaka (2000) further indicates, in the form of a panel-data study of Swiss cantons, that where new government spending programs must be approved by mandatory citizen referendums, this reduces the size of the budget by 15 percent for the median canton.

IV Conclusion

Institutions matter: this presumption is at the center of attention in institutional and constitutional economics. Here, we look at political institutions, in particular constitutional ones, and predict that they influence the character of political decision-making, which, in turn, strongly influences economic outcomes. At the basis of this prediction is an incentive-based understanding of human action, which stresses that institutions constitute constraints and rights that direct choices in a systematic fashion. If there is a rule prohibiting action x, and if there is some type of sanction attached to breaking this rule, then, all else equal, action x is less probable than in the absence of the rule. The issue at hand: is this in accordance with the facts?

There are indications that if government is constitutionally unlimited and expands greatly, it will have a negative effect on the economy, and that, in contrast, there may be significant rewards

[59] For a review of some of these studies, see Moser (1999).

to reap for society by moving towards a more constitutionally limited government (see, e g, Gwartney, Lawson, and Holcombe, 1998, and Gwartney, Holcombe, and Lawson, 1998). Certain sets of political institutions hence seem more conducive than others to good economic development and good macroeconomic policies.

Clearly, constitutions are complex documents with a number of different components, and one can imagine a great number of combinations that function equally well. Also, other things than constitutions shape policies and economic outcomes. However, based on the survey above, we posit that if a government contemplates reforming its constitution, and to the extent that economic progress is made a high priority, it is wise to consider the following institutional arrangements:

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- Upholding negative economic rights, especially secure private property rights.
- An electoral system favoring strong, non-fragmented majorities.
- Some form of decentralized - hierarchical or federal - structure in the public sector, with a vertical separation of powers.
- A horizontal separation of powers at each level of government.
- Levels on spending, taxes, and public debt.
- The possibility of popular initiatives for certain types of decisions, e g, taxes, or the possibility of requiring referendums on expropriation, new taxes, regulation, etc.
- Strict budget processes in legislatures.

What is important to note is, however, that the specific effects of a particular constitutional arrangement may be highly dependent on the point in time and development, where and when reforms are introduced. Some institutions, which may work favorably in terms of making it more difficult to enact policies with growth-retarding effects, may under different circumstances have the opposite effects. A bicameral system and a strong separation of powers may, for example, be important in deterring narrowly redistributive policies and hence be effective in maintaining a limited government. But if the point of departure instead is an expansive welfare state such as found in the Nordic countries, the effect could conceivably be the opposite, i e, the institutions may make it difficult to adopt policies which will favor general growth and prosperity at the cost of narrow special interests. This factor has to be kept in mind when considering constitutional engineering.

It should also be stressed that there are other goals for the political system than economic ones. But we submit that economic ones are important – both in themselves and in that the realization of other goals often hinges upon there being sufficient economic resources available - and that, as a consequence, constitutional reforms should note what economic effects some of their reform choices entail. Only then can proper trade-offs between various goals be made.

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