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be the beneficiary of the crude oil boom. Armenians have lost all the above chances in exchange for the former Nagorno-Karabakh Autonomous Oblast with some adjacent territories.

The Armenian public is not ready to acknowledge the above facts, because that would undermine the only acceptable narrative on Karabakh (that the conflict had to break out and that the fault for its outbreak lies entirely on Azerbaijan<sup>4</sup>), and question the significance of the victims and sacrifice that Armenians have endured since 1988 in the name of separating Karabakh from Azerbaijan. The only politician who over 15 years ago openly spoke about the necessity of a compromise solution of the Karabakh conflict so that Armenia

could develop was former President Levon Ter-Petrosyan. Because of this, he had to resign.

Viewed from the above perspective, recent protests in Yerevan although a new and interesting phenomenon in the political life of Armenia, do not *de facto* mean much and cannot generate processes which could seriously influence the direction of developments in that country. The key to changes in Armenia does not lie within the country, but in the geopolitical situation of the region. Furthermore, Armenia has very little influence on these changes, as it is a hostage of the Nagorno-Karabakh conflict and finds itself in a geopolitical trap, remaining an object rather than a subject of international relations.

#### *About the Author*

Maciej Falkowski is a Senior Fellow at the Centre for Eastern Studies in Warsaw, Poland.

4 There are many versions concerning possible scenarios explaining the outbreak of the Nagorno-Karabakh conflict. Many participants of those events, from both the Armenian and the Azerbaijani side, claim that the conflict could have been triggered by opponents of perestroika within the Soviet elite (mainly in the secret service) in order to spark the outbreak of ethnic conflicts in the periphery of the Soviet empire and force Gorbachev to back away from his reform policy.

## Some Observations on the Economic Implications of Constitutional Reform in Armenia

By Zareh Asatryan, Mannheim and Freiburg

### **Abstract:**

Armenia is preparing for a major reform of its constitution. The draft of the new constitution proposes a switch to a parliamentary system from the current (semi-) presidential system and to a proportional electoral rule from the existing (semi-) majoritarian system, among other changes. In this short article, I present some stylized facts and summarize the existing knowledge about the economic effects of constitutions. This body of evidence suggests that a switch to a parliamentary system with proportional representation may create political institutions that favor a larger public sector in Armenia with a particular pro-spending bias in social insurance programs. On the political side, descriptive evidence based on conventional democracy scores suggests that parliamentary countries, on average, have more developed democratic institutions. However, a closer look at countries that switched to parliamentary systems in the 1990s and 2000s reveals that governments opt for a constitutional change primarily to utilize more not less political power.

### **Introduction**

On the 4<sup>th</sup> of September, 2013—six months into his last term in office—the outgoing president of Armenia signed a decree forming a specialized commission on constitutional reforms. In March 2014 the commission published its concept-paper for the constitutional

reform, motivating the proposal by “the necessity for implementing the principle of the rule of law, improving the constitutional mechanisms for guaranteeing fundamental human rights and freedoms, ensuring the complete balancing of powers, and increasing the efficiency of public administration.” In July 2015 the proposed

new constitution was made available to the public and a month later the president sent the draft proposal to the parliament to kick-off the formal process before seeking approval by national referendum.

The reform proposes changes at a scale that the country has not seen in its governance structures. Among other changes, the proposal suggests a switch to a parliamentary system from the current (semi-) presidential system, where the president will be elected indirectly for a maximum of one term of seven years (instead of the current two five-year terms) by the electoral college (the president is elected in a national vote now) consisting of members of parliament and elected representatives of local authorities. According to the new constitution, the powers of the president will be largely limited in favor of the legislature, and the executive branch will be directly subordinate to the parliamentary majority. The change also proposes a shift to a proportional electoral rule when electing the legislature instead of the current (semi-) majoritarian rule where some members of the parliament are elected directly from districts without party lists. These are the two broad aspects of the constitutional change in Armenia on which I will focus my attention.

The scale of the change raises several natural questions both on the motivation to reform and the possible implications of the reform. On the former, proponents of the reform argue that a parliamentary regime will provide more flexible institutions of governance, for example, by means of stronger power-sharing mechanisms, and result in better democratic institutions. Opponents, on the other hand, argue that the outgoing president, tied by a two-term limit, aims at remaining in power by controlling a strong parliament led by his party. What is clear is that the reform comes exclusively as a top-down initiative; therefore, it is important to understand why a self-interested, some may say rent-seeking, government opts for a change that will reduce its political monopoly in favor of empowering more political groups. By comparing democratic developments before and after regime changes in the 1990s and 2000s across the world, one aim of the article is to shed more light on this controversy.

Perhaps the more important contribution, however, is to study the possible implications of the reform and particularly its economic implications. The public debate, in my view, has been somewhat trapped in discussing the motivation to reform and has not paid enough attention to the potential economic consequences of the reform. This is especially important because the early attempts of opposition parties that were trying to form a coalition against the reform were effectively crashed by the governing elite. At this

stage, while consolidation opportunities remain, it does not seem very likely that the reform will not pass the referendum.

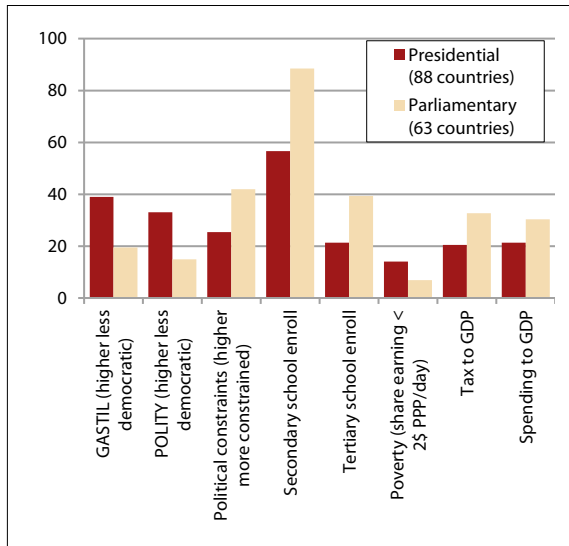
Following the literature on economic effects of constitutions (e.g., Torsten Persson and Guido Tabellini, 2003, *The Economic Effects of Constitutions*, Cambridge, MA: MIT Press) I ask whether the (change of) constitution matters for economic outcomes. Why may it matter? Because, at least in theory, constitutional electoral rules shape the electoral incentives of politicians in representing voters' preferences, and the constitutional division of powers between politicians shapes their decisions when approving and executing legislation. The budget being the politicians' main tool of economic policy, I particularly focus on fiscal outcomes and ask whether there are systematic differences in fiscal policy outcomes between presidential vs parliamentary and majoritarian vs proportional systems.

If it is true that presidential systems have more clear separation of powers than parliamentary systems, then stronger checks and balances between executive and legislative arms of the government in presidential systems may more effectively constrain politicians and result in smaller governments. If the majoritarian vs proportional debate really connotes a tradeoff between accountability and representation, then one might expect more accountable politicians to have fewer opportunities to be involved in rent-seeking behavior in majoritarian systems, while broader spending programs that benefit the wider population may result in proportional systems. Drawing on international evidence the aim of the next two sections is to study whether these theoretical predictions prevail in practice, and whether they may be informative in making conclusions for the case of Armenia. The final section discusses the motivation of a non-benevolent government to change a constitution.

### **Are There Systematic Differences between Presidential and Parliamentary Systems?**

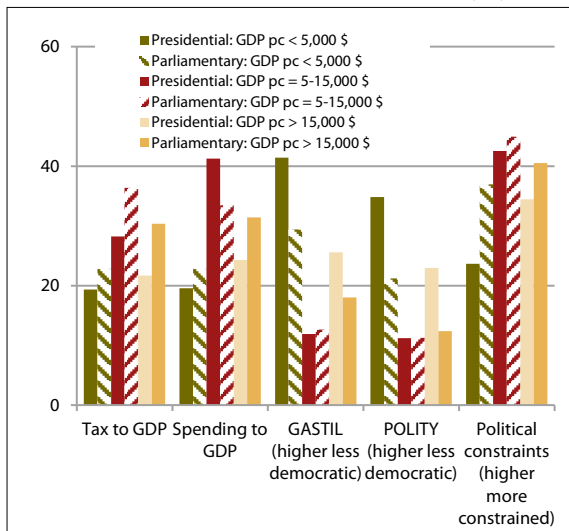
In Figure 1 I plot (unweighted) averages of several political, demographic and economic indicators separately for 88 presidential and 63 parliamentary countries. It seems that parliamentary countries are, on average, about twice as democratic, have more educated and less poor populations, and have around 50 percent larger governments measured by the share of spending and tax revenue in GDP. Simple averages, of course, hide many factors that may drive these correlations. One notable difference is the level of income. Interestingly, parliamentary countries are much wealthier with an average of 19,000 USD of per capita GDP in 2012 against only 3,000 USD for presidential countries.

Figure 1: Averages of Democratic and Economic Indicators for Presidential vs Parliamentary Systems



Notes: Unbalanced panel data of around 150 countries from 1986 to 2012. The two democracy scores, Gastil and Polity, are normalized and come from the respective databases. Political constraints index, again normalized, is from the Polcon database (see: Henisz, W. J. 2006. Polcon 2005 Codebook). Constitutions are coded according to WB's DPI. All other measures (except otherwise noted) are from the WB's WDI.

Figure 2: Does the Level of Income Explain the Differences in Presidential vs Parliamentary Systems?

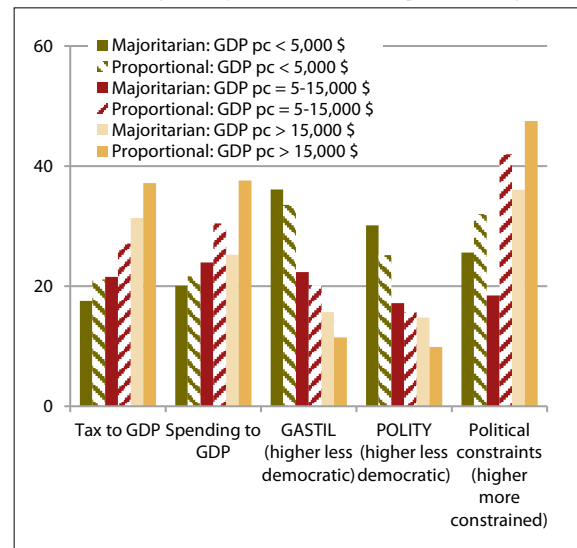


Therefore, it is important to test whether these strikingly large differences between the two systems are driven by some other factor such as the levels of income. Figure 2 builds on the previous figure by additionally distinguishing between groups of countries (and years) according to GDP per capita levels of less than 5,000, between

5,000 and 15,000, and over 15,000 USD. In each of the three income bins I observe the same relation as before; that is parliamentary countries have higher taxing and spending ratios, more developed institutions of democracy (with the exception of the middle-income group) and more constrained politics. At least on the part of fiscal measures, I refer to Persson and Tabellini (2003) and the related work both by economists and political scientists, who show that these differences persist when conditioning the correlations on many observable country characteristics.

As a next step I replicate the previous figure for majoritarian and proportional systems. As before, in Figure 3 I observe that correlations are consistent with the theoretical arguments: Countries with proportional electoral rules, on average, collect more taxes and spend more, have more developed democratic institutions and more constrained politicians. These differences persist over income groups.

Figure 3: Averages of Democratic and Economic Indicators for Majoritarian and Proportional Systems

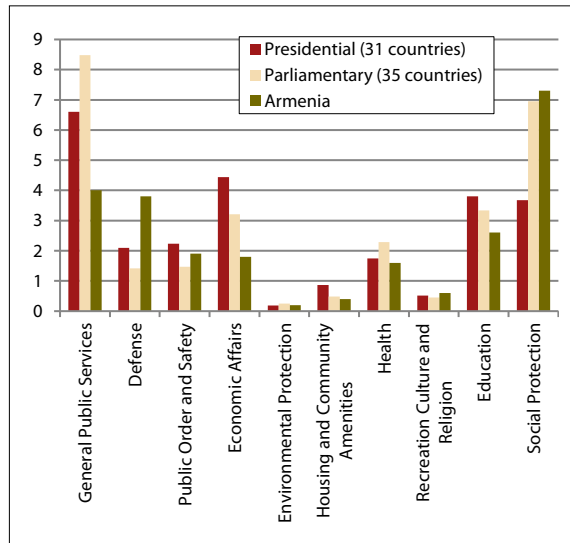


### What Are the Potential Implications for the Case of Armenian Public Finances?

In this section I take a closer look at the presidential-parliamentary dis-balance in their propensity to tax and spend, and ask whether a switch to a parliamentary system in Armenia along with proportional electoral rules may change the size and composition of the budget. For this purpose I first plot the composition of government spending for presidential and parliamentary countries in 2012. Consistent with previous literature, Figure 4 demonstrates that presidential countries, on average, have more targeted spending programs that go into economic affairs, defense, public order and safety. On the

other hand, parliamentary countries can be characterized with broader spending programs that benefit the wider population, such as higher spending on general public services or social protection.

Figure 4: Do Parliamentary Systems Produce Larger Welfare States Than Presidential Systems?



Notes: Data on spending-to-GDP (%) from IMF-GFS for the year 2012 (or 2011 when not available).

Plotting the numbers for Armenia next to these presidential- and parliamentary-averages may be informative. Regarding the overall size of the government, Armenia has quite low spending and taxing levels. Broader representation may help to tax more and consequently spend more. Regarding the composition of spending, however, Armenia already has a very high relative spending on social protection and a parliamentary system may create political institutions that favor an even further increase of this category. A good system of social insurance is, of course, not bad, but the trade-off for a poor country is that scarce funds are spent to solve current problems often at the expense of not spending on perhaps more strategic long-term development projects. With similar reasoning, Armenia's low spending levels on economic affairs need a boost, but a parliamentary system may discourage the allocation of funds in this direction in favor of more popular projects.

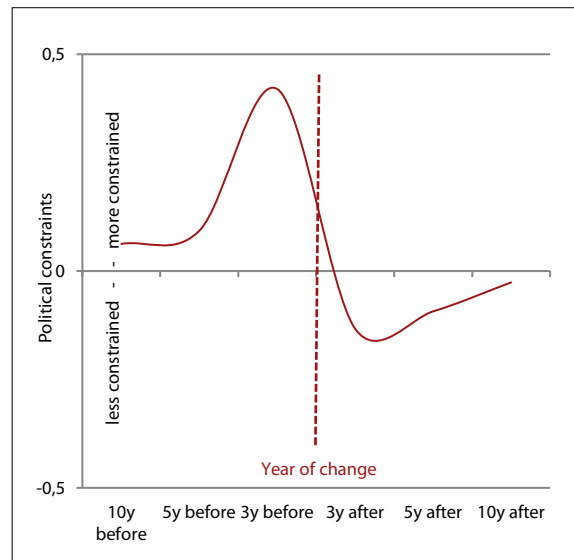
### Why Change the Constitution?

In this section I return to the question where the article started, namely the motivation of a non-benevolent government to reform the constitution. We have seen that, on average, parliamentary systems are more democratic and the politicians in these systems are more constrained. Therefore, the question is whether this stylized

fact can support the arguments of pro-reform officials who claim that a switch to a parliamentary system is primarily motivated by their willingness to democratize and empower more political groups. Or, can it go the other way around? Namely, governments, knowing that parliamentary systems are recognized to be more democratic, select themselves into such a system in order to utilize more political power. If the alternative option for any given autocratic ruler is to ignore (or abolish) the two-term limit and stay in power through quasi-legitimate means, it may well pay off to try the "second-best" parliamentary option.

To answer this puzzle, I again rely on international evidence and study the countries which during the 1990s and 2000s have changed their form of government. In my dataset there are 22 and 25 countries that have switched towards presidential and parliamentary systems, respectively. The majority of countries that have changed their constitutions in either direction are the poorer and less democratic countries (Israel's change to a parliamentary system in 1997 and its reversal in 2002 is one exception).

Figure 5: Evolution of Political Constraints Before and After a Change To a Parliamentary System



Notes: Political constraints index is from the Polcon database. Figure shows the growth of the index from the year of change compared to the growth in countries that did not change.

I then study the level of political constraints of countries before and after a constitution is changed compared to the counterfactual where the constitution has not changed. If a government becomes politically more constrained after a change that would indicate that, indeed, the government has given up some of its politi-

cal power and has made the political institutions more inclusive. If, on the other hand, we observe a drop in the level of political constraints that would indicate that governments gain politically from a constitutional change, and perhaps do so at the expense of marginalizing other political groups.

Figure 5 shows the evolution of political constraints indicator 3-, 5-, and 10-years before and after a constitutional change compared to countries which did not see a change. The results are striking: Politics is most constrained in the 3 years immediately preceding a change to a parliamentary system, however once the change happens, the indicator reverses sharply. Thereafter, the tendency is towards more constrained politics in the long-run. This suggests that reforms, on average, utilize more political power for the government, and that a change is likely to be implemented when governments lose some of their monopoly over politics.

### Conclusions

The body of evidence presented here suggests striking differences between parliamentary and presidential systems. Particularly, countries with parliamentary systems (along with proportional electoral rules), on average, collect more taxes, spend more especially on social programs, have more developed democratic institutions, and more constraint politicians. These differences persist over income groups.

Of course, this descriptive evidence cannot be interpreted causally, such as arguing that a parliamentary system in Armenia will necessarily push for a larger government or for a relatively larger welfare state. The problem is not only the general complexity of identifying the detailed causal mechanisms, but also the deeper contexts of individual countries including issues related to how well are the constitutional rules actually enforced in practice.

What this general patterns suggest, however, is that constitutional rules do matter for economic outcomes. An uncontroversial conclusion, therefore, is to pay more, and perhaps much more, attention to these issues in the public debate. Ultimately, state budgets are one of the main battle grounds in democratic societies where groups with leftist and rightist ideologies can bargain.

This work also sheds some light on the government's motivation to reform. It is true that parliamentary systems are, on average, more democratic than presidential ones. However, a closer look at countries that switched to parliamentary systems in the 1990s and 2000s reveals that governments are most likely to opt for a change when their monopoly over politics is declining. The situation is reversed—that is more political power is utilized—in the initial years following a constitutional change. These results are consistent with the view of the government as a self-interested non-benevolent actor trying to maximize its political power.

#### *About the Author*

Zareh Asatryan is a researcher at ZEW Mannheim and a PhD student at the University of Freiburg.



## CHRONICLE

## From 8 July to 3 September 2015

8 July 2015	The Russian-owned firm Electric Networks of Armenia (ENA) is fined by the Armenian Public Services Regulatory Commission for violation of consumer rights following demonstrations in Yerevan and other cities against electricity price hikes
11 July 2015	Georgian opposition politician and former Parliament Speaker Nino Burjanadze meets with Russian Deputy Foreign Minister Grigory Karasin and State Duma speaker Sergey Naryshkin during a visit to Moscow
12 July 2015	The Georgian Prime Minister's special representative for relations with Russia, Zurab Abashidze, says that recent activity by Russian border guard forces placing banners to mark the "border" with South Ossetia is a "provocation"
13 July 2015	European Council President Donald Tusk postpones his planned visit to Armenia and Georgia due to the Greek debt crisis
13 July 2015	Georgian Agriculture Minister Otar Danelia meets with his Chinese counterpart Han Changfu in Beijing to discuss cooperation between the two countries, including exports of Georgian wine to China
15 July 2015	Georgian President Giorgi Margvelashvili signs a bill on the decoupling of security and intelligence agencies from the Interior Ministry into law
15 July 2015	The Special Commission on Constitutional Reforms releases draft articles of a draft constitution for Armenia that would transform the country into a parliamentary republic
17 July 2015	SOCAR Georgia Petroleum and Sun Petroleum Georgia say that they will challenge fines imposed by the Competition Agency following accusations of price-fixing
20 July 2015	European Council President Donald Tusk starts his visit to the three South Caucasus countries in Tbilisi and notes that Georgia is "definitely a front-runner" in the Eastern Partnership program, while condemning recent demarcation signposts at the South Ossetian administrative boundary line as a "provocation"
22 July 2015	Georgian parliament speaker Davit Usupashvili says that Georgia expects more from NATO to speed up the process of the country's integration into the Alliance following a meeting with NATO Deputy Secretary General Alexander Vershbow in Brussels
24 July 2015	Georgian Prime Minister Irakli Garibashvili says that the government will subsidize increased electricity tariffs from 1 August for vulnerable families
27 July 2015	Dozens of people resume protest against electricity price hikes in the central square of Yerevan
27 July 2015	The brother-in-law of Azerbaijani activist Emin Milli, Nazim Agabeyov, is arrested in Baku on drug charges
29 July 2015	A group of six Iranian lawmakers start a visit to Georgia to study reforms that have helped the country ease regulations and facilitate business activity
1 August 2015	Armenian Prime Minister Hovik Abrahamian says that money from the sale of one of the country's power stations could be used to subsidize an increase in electricity prices
3 August 2015	Ukraine's state security service denies reports on declaring Georgian opposition politician Nino Burjanadze persona non grata in Ukraine
5 August 2015	The Georgian Prime Minister's special representative for relations with Russia, Zurab Abashidze, says that it would be a wrong decision if Russia decided to reinstate trade restrictions on Georgian products
8 August 2015	Georgian Prime Minister Irakli Garibashvili says that "peace has no alternative" on the seventh anniversary of the Georgian–Russian war
9 August 2015	Iranian Parliament speaker Ali Larijani says at a meeting with Georgian MPs in Tehran that the Iran nuclear deal has opened a "new chapter" that will encourage political and economic cooperation between the two countries
11 August 2015	The Azerbaijani police arrests a football player on charges of not reporting a crime in the stage of its planning in relation to the beating of a journalist to death
12 August 2015	A Russian military court in Armenia sentences a Russian soldier accused of killing an Armenian family to ten years in prison
13 August 2015	A Baku court sentences Azerbaijani human rights activists Leyla Yunus to 8 and a half years in prison and her husband Arif Yunus to seven years on charges of economic crimes