



About this series

The International Institute for Democracy and Electoral Assistance (International IDEA) and the Institute for Autonomy and Governance (IAG), in partnership with the Philippines Congressional Policy and Budget Research Department (CPBRD) and the Senate Economic Planning Office (SEPO), held a series of Learning Sessions on Constitutional Change and Federalism from May 2018 to April 2019.

As the Charter Change debate persists in the Philippines, questions around the substance, process and scope of constitutional reform remain. Regardless of the outcome of these debates, Congress has a substantial role to play in voting on draft texts and amendments, and even possibly drafting constitutional language itself. As such, the Learning Sessions were designed to target members of the House of Representatives and the Senate, providing a safe space for technical discussions on relevant and pressing issues. Each session focused on a specific issue, including a conceptual framework based on international experience and expertise, and a contextualized consideration of the issue as it pertains to the Philippines, presented by national experts. The Charter Change Issues Briefs series consolidates and memorializes these inputs for future reference and further reach.

Constitutional Design and the Promotion of Economic Growth and Competitiveness

Charter Change Issues Brief No. 4 provides an overview of the fourth Learning Session, entitled *Constitutional Design and the Promotion of Economic Growth and Competitiveness*, conducted on 28 June 2018 at the Philippines House of Representatives and on 26 July 2018 at the Senate of the Philippines. The resource persons were: Dr Tom Ginsburg, Leo Spitz Professor of International Law and Professor of Political Science at the University of Chicago Law School and Senior Advisor to International IDEA's Constitution-Building Programme; Dr Ronald U. Mendoza, Dean of the Ateneo School of Government; Dr Romulo Miral Jr, Director General of the Congressional Policy and Budget Research Department (CPBRD) of the Philippines House of Representatives; Dr Alvin P. Ang, Professor, Department of Economics and Director of Ateneo Center for Economic Research and Development; and Professor Edmund Tayao, member of the Consultative Committee to Review the 1987 Constitution. This brief is based on technical insights shared by these experts during the Learning Session.

Learning Session No. 4 overview

The important role of political institutions in advancing economic development cannot be overemphasized. Constitutional design, which includes the form of government and choice of institutions, as well as often defining the relationship between the state and the economy, has an impact on economic performance and competitiveness. Sociopolitical theorist Jon Elster (1994) posited that 'constitutions matter for economic performance to the extent that they promote stability, accountability, and credibility'. On accountability, the constitution must ensure that politicians are held responsible for their actions and that there is a mechanism for voting them out of office. Accountability affects both economic efficiency and security. On stability, the constitution must provide a framework that is relatively stable and immune to strategic

The relation between political institutions and economic performance is not well understood. The causal link goes in both directions: Well-designed institutions can improve economic performance, but some institutions may be feasible or effective only at specific levels of economic development. (Elster, *The Impact of Constitutions on Economic Performance*, 1994)

manipulation. By ensuring stability of the basic framework, the constitution discourages wasteful rent-seeking. And on predictability, constitutions should facilitate and encourage long-term planning by citizens by protecting them against retroactive legislation and taxation and against expropriation without full compensation.

While these studies suggest that constitutional rules appear to shape economic policy, the contrasting results indicate that designing or redesigning constitutions, or what is termed as ‘constitutional engineering’, may prove to be a difficult task requiring trade-offs and compromise. This session discussed several of the constitutional design choices and other factors to keep in mind when encouraging economic competitiveness as an objective of constitutional reform.

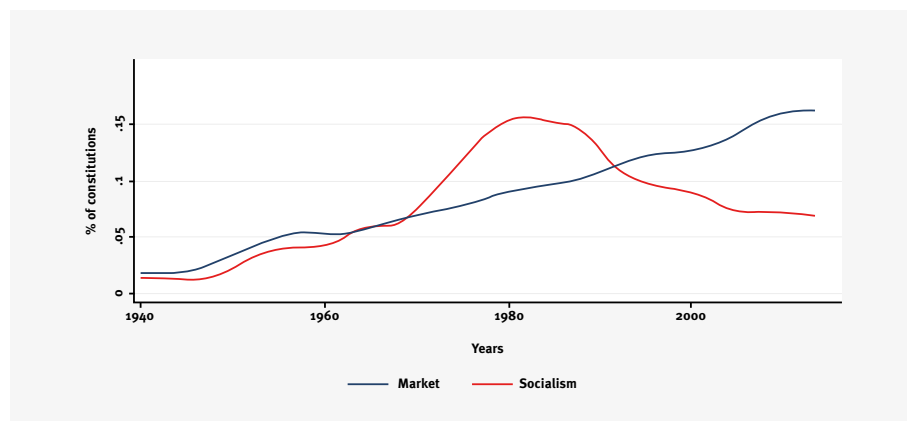
Conceptual framework

Constitutional design and the Promotion of Economic Growth

Dr Tom Ginsburg, Leo Spitz Professor of International Law and Professor of Political Science at the University of Chicago Law School and Senior Advisor to International IDEA’s Constitution-Building Programme

Since 1789, about 900 constitutions and nearly 2,500 amendments have been written (Elkins et al. 2009). Over the years, the number of countries has risen but so has the percentage of those countries that have written constitutions, such that now almost every independent country in the world has a written constitution. Trend analysis also shows that constitution-making tends to come in waves and often follows conflict (Comparative Constitutions Project 2016). There is also a good deal of borrowing among constitutions and constitution-makers, which raises questions about how domestic the exercise of constitution-building is. The contents of constitutions reflect how ideas have emerged and spread through time. For example, in the past many constitutions referred to socialism, whereas today more constitutions refer to the market (see Figure 1). Constitutions affect the economy in many ways, mostly in an indirect manner.

Figure 1. Economic ideas reflected in constitutions over time



Source: Comparative Constitutions Project, Database, 2016

Constitutions provide a framework for market activity. Constitutions do not generate wealth themselves but structure political outcomes, which, in turn, affect market growth and competitiveness.

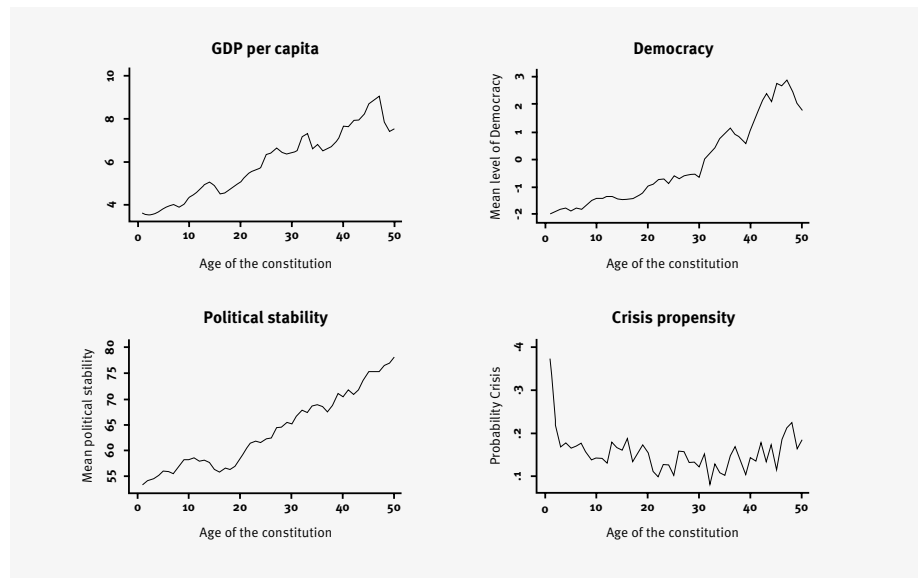
Providing a framework for market activity ‘empowering the market’

Constitutions serve as frameworks for governments to make policies and decisions, and this affects the economy. Some constitutions require governments to make detailed economic plans, set up the framework for the national budgeting process, or demand the establishment of an independent central bank, among other requirements that shape economic policies and institutions. As such, in turn, constitutions provide a framework for market activity. Constitutions do not generate wealth themselves but structure political outcomes, which, in turn, affect market growth and competitiveness.

Constitutions should be able to place limits on government action (see Charter Change Issues Brief No. 1). They do this by reducing the stakes of politics; for example, by making it so that every new government cannot change the religion of the country. This is an important concept in relation to property rights; if every government could come in and change the rules of the game, no one would invest, and economic activity would be insecure. As such, basic stability of property rights is fundamental to a market economy. Constitutions also incentivize investment through the protection of people’s other core interests; for example, ensuring non-discrimination in transactions, and non-interference of the government in enforcing contracts. These are some general principles that limit government power in a way that permits a market economy. The challenge, then, is to design, establish and operate good institutions to apply the principles. A constitution can also play an important role here.

Overall, when thinking about the role of a constitution in providing a framework for government action with regard to empowering markets, stability is very important. Rather than considering which particular rules are in place (for example, high or low rates of taxation), investors tend to look for places that do not exhibit frequent, fundamental changes in the governmental framework, which indicate instability. Indeed, data suggests that constitutional stability (durability) is good for growth and investment in the economy. Figure 2 shows the average levels of various characteristics, correlated with the age of a constitution, and demonstrates that where older constitutional orders persist, higher wealth, greater stability and deeper democracy are also present. This demonstrates that a stable framework manifested in a durable constitutional order can bode well for economic growth.

Figure 2. Correlates of constitutional duration



Source: Comparative Constitutions Project, Database, 2016

Creating and allocating public goods

Constitutions should also provide frameworks for the provision and allocation of public goods. Public goods are things that the market cannot be counted on to provide. A classic example is national defence: this cannot be produced by the market, and if left to the market, probably would not be provided for sufficiently. Public goods also include parks, environmental protection, and basic services and utilities. These goods can be produced at different levels of government and the question becomes what is the right level at which to produce and provide for public goods. As such, the provision of public goods relates to decisions about how governmental powers are allocated, both between the centre and other levels of government, and in terms of different forms of government (see Charter Change Issues Briefs No. 1 and No. 5). Separation of government powers can occur along different dimensions, namely vertically (between levels of government) and horizontally (between branches). These are substantive constitutional design questions, that require the consideration of pathways of power, fiscal resources and information, as well as an understanding of associated risks and externalities. Regardless of the design choices made, how powers are distributed will inevitably have an impact on the provision of public goods, which in turn affects the economy and prospects for economic growth.

Choice of form of government

There is an open debate in political science on what form of government is most likely to promote economic growth and competitiveness. Some literature suggests that parliamentary governments are better at fiscal redistribution than presidential systems; conversely, presidential systems allow for more checks and balances in the budget process, which can lead to more efficient spending (Akee et al. 2012).

The central fact that drove the literature on this issue was the observation that presidential democracies seem to collapse more frequently than parliamentary democracies, and when they collapse, they are often replaced by dictatorial regimes. Later research has established that this is because these countries were already prone to dictatorship, not because there is a causal relationship between presidential systems and weak democracies. There is also a large and contested literature on whether democracy is itself good for growth. There does not seem to be firm evidence on this point, but it does seem clear that dictatorships have more variable outcomes, with some performing very badly economically. Venezuela is a good contemporary example.

Some literature suggests that presidential systems result in more efficient and limited government spending. The study by Persson and Tabellini (2003), which used econometrics to investigate the ‘missing link’ between constitutional systems and economic policy in 75 democracies, showed that presidential/parliamentary and majoritarian/proportional dichotomies influence several economic variables. The study showed that presidential regimes tend to have smaller public sectors, and proportional elections lead to greater and less targeted government spending and larger budget deficits. Moreover, the details of the electoral system (such as district magnitude and ballot structure) influence corruption and structural policies, and can thereby inadvertently promote economic growth.

Another study by Knutsen (2009), which re-estimated the effects of constitutions on economic growth on a much larger sample of data, showed that the distinction between presidential and parliamentary democracies does not have any robust effect on economic growth. Electoral systems, however, seemed to matter systematically for economic growth. Plural-majoritarian systems tend to produce lower economic growth than proportional representation (PR) and semi-PR systems (for more on electoral system design, see Charter Change Issues Brief No. 4).

All of these studies are meant to be informative, and representative of statistical results, but are not determinative of outcomes in any particular country. That is, just because a country selects one form of government does not guarantee a certain economic or political outcome.

As a corollary and noteworthy point, if local government autonomy is constitutionally protected, local governments can also be sites of innovation and learning by allowing for experimentation in choice of form of government at the local level. Diversity in the forms of local governments can be beneficial. For example, studies have shown that mayor-oriented (more presidential) municipalities have less spending and less redistribution than municipalities with city councils (more parliamentary style) (Coate and Knight 2011).

Constitutional federalism for economic growth

Besides the horizontal division of powers between executive and legislative branches, the vertical division of powers, through a federal, decentralized or devolved system, also has an impact on economic

**That kind of tension which federalism has is part of its benefit: that you can have change in the law because of different centers of power.
(Tom Ginsburg)**

policy and growth. There are many definitions of federalism, and in some places, it is a very sensitive concept, but since it is being openly considered in the Philippines, it is worth discussing here as a constitutional change reform related to encouraging economic growth, equitably, across a nation. There are, of course, many motivations for countries considering the transition to federalism, but economic performance is one of them. For more general information on federalism, see Charter Change Issues Brief No. 5.

The key condition to keep in mind when considering whether a country is ‘federal’ is whether or not subnational jurisdictions have the power or authority to make final decisions on any area of authority/competency, independent from the central authority. This authority should be explicitly provided for in a federal constitution, and it is important to consider which authorities pertain to economic growth and development. For one, the powers and authorities devolved in a federal system can allow for and encourage **policy experimentation** and diversity in approaches to market, allowing ultimately for better alignment between policies and local preferences and interests.

Moreover—and this is critical from an economic growth perspective—federalism can encourage **policy competition**. If a federal constitution allows state/provincial governments to collect local taxes, for example, this gives constituent units incentives to increase their tax bases, often by competing against each other for more businesses and residents. For example, a state could provide tax breaks for corporations so they register in the state and ultimately increase their overall tax break. This environment for competition leads, in theory, to the optimal level of policies and regulations for economic growth.

Limiting corruption and agency costs

Increasingly, constitutions also monitor economic activity by limiting corruption or providing mechanisms for government oversight to ensure that the government is acting in the public interest (as opposed to officials acting out of self-interest). There is a trend in constitutional design to establish special institutions whose mandate is to combat corruption (Comparative Constitutions Project 2016); approximately 10 per cent of constitutions currently include anti-corruption institutions. The act of expressly providing for, and specifying the powers of, these institutions in the constitution gives them a higher status in government and theoretically protects them from political capture.

Redistribution

It is important to remember that almost all governments play some role in economic redistribution; there is no truly free market in the world. As such, another aspect of constitutions that can have an impact on economic growth and competitiveness is how they perform their redistributive function.

Federal systems often include a formula by which the national/federal government collects and redistributes tax revenue across states/provinces, often in the name of equalization (see Charter Change

Issues Brief No. 5). This is very important in places like the Philippines where there are stark differences in GDP between regions (see the section titled Economic competitiveness of the Philippines and its regions). Grafting a federal system onto a state that has such a high level of internal inequity in economic development and potential can be problematic. If the system allowed provinces to issue their own taxes, the existing disparities would be likely to grow. As such, federal systems often provide for redistribution of revenue through formulas. There are a number of ways to accomplish this. One is a block grant system, like the one currently used in the Philippines, where revenue proceeds will be sent to the central authority, and it will redistribute the monies back to the state governments. These arrangements of revenue redistribution should be clearly established between levels of government to avoid conflicts. Another way is to establish an independent (and expert) commission to develop special rules and formulas for fiscal redistribution and equalization; often these commissions are depoliticized through constitutional protection like in Nepal and South Africa (see Charter Change Issues Brief No. 5).

Redistribution is a particularly acute issue in places where some regions might have natural resources, while other regions are resource poor. An example of this can be found in Nigeria, where in response to repeated conflict, a policy was put in place to allow oil-producing state governments to keep 13 per cent of the total oil revenues, while the rest goes to the centre to be redistributed and shared among non-oil-producing states. Revenue allocation arrangements can be decided by the parliament through legislation, often by giving the upper house a special role. For example, in Germany, the upper house has an absolute veto over bills related to the apportionment of tax revenues between the Federation and the states.

Besides the redistribution of tax revenues, constitutions can—and increasingly do—provide for redistribution through the embodiment of social and economic rights. This is a trend in contemporary constitutions; for example, there is a rise in the recognition of the right to healthcare in national constitutions over time, such that over 50 per cent of constitutions included this by the year 2000 (Comparative Constitutions Project 2016).

Rights are powerful and the increasing inclusion of social and economic rights signifies that many countries around the world believe people have the right to live with a certain level of welfare or dignity. There are some important considerations related to the recognition of social and economic rights, however. For one, they should not necessarily be promised if the state does not have the capacity to deliver on the rights, as this can create conflict (see Charter Change Issues Brief No. 3). Another consideration is that including social and economic rights in a constitution allows courts to be involved in making redistributive decisions. Latin America provides a number of lessons that can be learned on this point, especially relating to the implementation of the right to healthcare in Brazil, Colombia and Mexico. In fact, the people who can actually hire a lawyer and bring a claim to court for enforcing the right to healthcare are middle class, so the right has not had an impact on access to healthcare for the very poorest, as it was meant to.

This point unites many of the above issues: government is costly. The more branches of government a country has, the more civil servants, houses and legislatures. The more rights included, especially to basic services like health, education and housing, and the more levels of government, the higher the fixed cost to government overall. This doesn't mean that more government or more rights is not good but in considering constitutional reform to empower economic growth, it is important to look at the costs of the reforms planned in relation to the expected economic benefits.

Expert insights

Economic competitiveness of the Philippines and its regions

Dr Ronald U. Mendoza, Dean, Ateneo School of Government

The growth trajectories of the Philippines and its ASEAN neighbours; Indonesia and Malaysia, are similar but significantly differ in terms of how they recovered from the 1997 Asian financial crisis. In the 1960s, the Philippines saw real GDP per capita of about PHP1,000, which was higher than Indonesia's GDP but lower than Malaysia's. However, following the financial crisis, both Indonesia and Malaysia were able to quickly return to their development trajectories following a V-shaped recovery, characterized by a sharp decline financially then a sharp rise back up again to recovery. On the other hand, the Philippines suffered a prolonged period of economic underperformance following the crisis, arguably due to political unrest and weak institutions.

In recovering from economic crises, it is critical to get quickly back on a relatively normal development trajectory, and strong institutions play a key role in steering the economy as mentioned in the expert framework above. The government must be able to convey to investors and trade partners that the country's strong institutions—a trustworthy central bank and department of finance, well-managed public debt—will quickly bring the economy back on track in the event of a crisis. Without this, economic competitiveness will suffer.

The Philippines is currently considered to be a potential East Asian tiger. However, the country is facing important challenges that may jeopardize its growth trajectory towards inclusive development. This is shown, particularly, in how the Philippines underperformed in the latest World Competitiveness Yearbook by the International Institute of Management Development. After experiencing significant gains in the past, the country's overall competitiveness reverted back to where it was in 2004. In 2018, the Philippines dropped to be ranked 50th (out of 63 countries) from 41st in World Competitiveness in 2017, the biggest year-to-year decline over the last decade, and the sharpest drop among peers in the Asia-Pacific region.

In recent months, the inflation rate, which is an important barometer of how inclusive a growth pattern is, is actually on an uptick, partly as a result of the government's implementation of the Tax Reform for Acceleration and Inclusion Act (TRAIN) Package 1 at the beginning of 2018. Food prices are on the rise, especially for basic commodities

We should welcome competition. Not protect ourselves against it. Otherwise [the Philippines] will not be able to compete in the fourth industrial revolution if we prevent thinkers and technologies from reaching our shores ... If we do that our young people will go to their shores. Until we fix our domestic institutions and our domestic competitiveness, investments will not locate here, and the value and the GDP per capita will not be created in our country.
(Ronald U. Mendoza)

consumed by ordinary Filipinos. Indeed, Filipinos are experiencing less and less purchasing power as a result of inflation. Worse, the inflation pressures could well persist in the medium term, especially with the government's plan to ramp up infrastructure spending under the 'Build, Build, Build' programme. The challenge is to find structural solutions to inflation, for instance the urgent passage of the proposed Rice Tariffication Law that has long been languishing in Congress.

Industrial growth in the Philippines is not necessarily inclusive, meaning that many are excluded from the market; there is a lack of the high-value-added and employment-generating export industries, which were critical to the growth of South Korea, for example. This is partially because the Philippines has been a 'hard sell' to foreign investors in recent years due to perceived disregard for the rule of law, as well as institutional weaknesses. In today's interconnected world, it matters how you produce things. It matters what your 'brand' is linked to from a principled standpoint, for example how you treat women, children and poor communities; and the environment. Foreign direct investment depends on appraisals of these sorts of principles and values. Many investors will not work in or with countries that backtrack on fundamental values and human rights; for example, Prime Minister Mahathir of Malaysia commented that the extra judicial killings occurring in the Philippines would scare off foreign investors (Mendoza and Banaag 2018).

The Philippines, like all countries, is part of what is known as the 'global value chain', greatly vulnerable to the continued increase in interest rates of the major economies of the world, the significant drop in the global stock market performance, the end of free money, as well as the trade war between the China and US. The trade deficit problem the country is facing is caused by the higher amount of dollars going out than coming in, and the poor ratio of exports to imports. Constitutional amendments proposed should seek to address these economic challenges, perhaps by relaxing the foreign equity restrictions in key industries. Foreign direct investment is needed to facilitate the transfer of knowledge and technology to make the Philippines' industries and workers competitive in the face of globalization.

Therefore, there are several points to consider if the Philippines were to proceed with constitutional change. The first is the timing of this endeavour with regard to the global environment; if the country undertakes constitutional reform, will that help it to meet the needs of the global economy and the challenges that represents? The second, related issue is the question of whether constitutional change will address the particular issues that slow economic growth in the Philippines, such as infrastructure and inefficient bureaucracy? Lastly, will federalism make Filipinos take advantage of what wealth they do have and will it help to distribute economic growth across regions? How will these benefits be related to the costs of federalization?

Charter Change Proposals

How Bayanihan Federalism could promote economic competitiveness: Proposals by the Consultative Committee to Review the 1987 Constitution

Professor Ed Tayao, Chairman of the Consultative Committee's (2018) Subcommittee on the Formation and Structure of Federated Regions

The federal system proposed by the Consultative Committee to Review the 1987 Constitution (ConCom) aims at addressing the current challenges, many related to local governance, that have an impact on economic growth in the Philippines. Namely, the proposed federal system seeks to address issues with the fragmentation and limited jurisdiction of LGUs, which render them ineffective at service delivery and prone to rent-seeking politics. The proposed federal reforms are meant to make public administration more effective and to strengthen local political institutions by empowering local and regional governments.

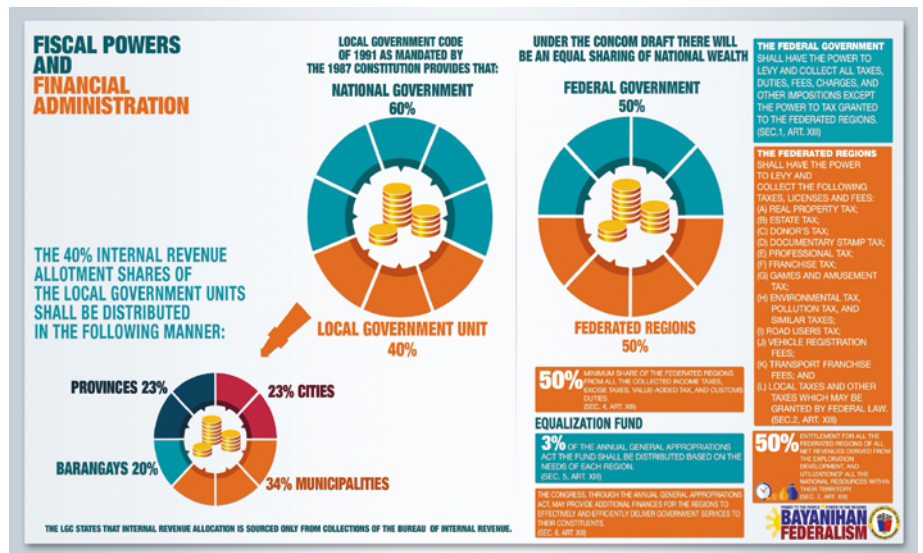
Figure 3. The ConCom's proposal for economic reforms



Source: Consultative Committee to Review the 1987 Constitution (ConCom 2018)

There are three main roles that federalism could play in the economic development in the Philippines (see Figure 3). The first is ensuring integrated economies and placing greater value on creating a business-friendly environment. The ConCom draft constitution envisages an integrated approach to economic development with powers being shared rather than devolved or delegated by the central government. Federated regions are to be partners of the national government (see Charter Change Issues Brief No. 5 for proposed power distributions and more information on federalism generally). Policies or programmes that the federal government comes up with will have to have been developed with the participation of federated regions and to have their approval (see Charter Change Issues Brief No. 5 for proposed power distributions and more information on federalism more generally).

Figure 4. The ConCom's proposal for fiscal powers and financial administration



Source: Consultative Committee to Review the 1987 Constitution (ConCom 2018)

Second, the ConCom federalism aims to increase the economic viability of the regions by enhancing their own revenue-generating powers. Federated regions will be given taxing powers for them to raise their own revenues, aside from the Internal Revenue Allotment, which may then increase their economic viability, for example road users' tax would be at the federated region level. By giving them taxing powers, federated regions could not only collect fees in their region, but they would also have the incentive to find sensible solutions to traffic management, security and road management or maintenance, so as to attract residents, as noted in the expert framework. They would also be able to address the accountability challenges under which the regional and local governments are currently accountable to and dependent on the central government for resources. Additionally, the proposed federal system in the ConCom draft calls for redistributive revenue-sharing within the national budget, with 50 per cent allocated to the federal government to support broader functions and to ensure macro-economic stability, and 50 per cent allocated to the federated regions (see Figure 4 for more details).

Thirdly, federated regions are designed to be more responsive to local development needs, both for LGUs and communities. According to the ConCom draft, decisions, plans and actions by the regional assembly have to be agreed upon by the local governments, in order to make political decision-making more collective, responsive and flexible to the needs of the different units. In theory, this should make units more empowered and stable, as well as more accountable, in turn promoting economic growth.

One often-cited criticism of Charter Change is that it is unnecessary for reconfiguring local governments, and simply revising the local government code would suffice (for more on deciding between constitutional and legislative change see Charter Change Issues Brief No. 1). Legislative reform, however, could be problematic with the current 'piecemeal' approach to policymaking in the Philippines. This approach has meant that policies are sometimes inconsistent, if not

in direct conflict, with one another; the outcome is haphazard policy reform with a great risk of unintended consequences. Furthermore, without the constitutional guarantee of the division of powers provided by federalism (see Charter Change Issues Brief No. 5), decentralization of powers can be as easily constricted as expanded through legislative change.

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About CPBRD

The Congressional Policy and Budget Research Department is the think tank of the Philippines House of Representatives that provides ideas, policy advice, technical assistance, and information support in the formulation and oversight of socio-economic legislation that promotes sustained inclusive growth.
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The Senate Economic Planning Office provides the Senate President and the Members of the Senate of the Philippines with proper research and in-depth policy analysis on economic and social issues as well as data and statistics which would assist various committees in the discharge of all matters within their jurisdiction, including information with respect to economic plans and programs, domestic and foreign indebtedness, and the promotion, regulation and diversification of economic sectors and sub sectors.

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