The Constitutional Economy of Dynamism and Inclusion: An Inquiry into the Causes of Argentine Economic Decadence

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Abstract

The constitutional structures and traditions that promote corporatism are the main obstacles to economic dynamism and inclusion in societies. Corporatism is the cause of Argentina’s “reversal of development” from the 1930s to the present. If the normative and imperative rules in Constitutions change both incentives and culture, some questions arise: how should we design Constitutional rules that promote economic dynamism? At the same time, is a bad political economy, as occurs in a corporatist economy, promoted by government officials because it allows their perpetuation in government? A corporatist economy could be the basis of a perverse political culture where utility-maximizing leaders will embark on destructive economic policies to enhance their own personal power unless they are appropriately constrained. The Argentine Constitutional economy has both poor incentives and a poor Constitutional culture, which prevent the development of both dynamism and inclusion. Strategic political considerations push rulers into bad economic policies. At the same time, a strong corporate culture favours the resulting mix of authoritarianism, stagnation and social exclusion.
Introduction: Is it the Constitution’s fault?

The purpose of this paper is to determine the Constitutional structures that favour economic dynamism and inclusion in a society, making a separation between Constitutional rules and other norms or traditions, including laws and regulations. The constitutional structures and traditions that promote corporatism are the main obstacles to economic dynamism and inclusion. The methodology of this paper includes the comparison between Constitutional economics and Constitutional cultures and their influences on economic dynamism, as well as the applicability of the contractarian view on social inclusion in the Constitutional legal discourse.

There is a Constitutional economy of corporatism as there is a Constitutional economy of dynamism. As a main example of constitutional corporatism the paper analyses the particular case of Argentina and its ‘reversal of development’. The causes of Argentina’s ‘reversal of development’ are varied but we shall argue that bad incentives in the Constitutional economy and a bad Constitutional culture are most significant. The Constitution could be described as a long-term contract between the government and the governed, where the correct incentives established in its text and practice could transform it into a relational contract from which efficient outcomes could result.

In that sense the Argentine constitution has been a failure: ill-interpreted and cryptic norms have created incentives that favour concentrated government and an inefficient distribution of public and private goods, and these failures then evolved in the creation of a ‘rent seeking Constitution’. The analysis of Constitutional cultures also indicates that

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1 In the description of Edmund S. Phelps: “A corporatist economy today is a private-ownership system with some contrasting features: It is pervaded with most or all of the economic institutions created or built up by the system called corporativismo that arose in interwar Italy: big employer confederations, big labor unions and monopolistic banks – with a large state bureaucracy to monitor, intervene and mediate among them. Yet without some knowledge of the purposes for which the system was constructed it cannot be understood at all adequately. I think it is fair to say that the core function of the distinctive corporatist institutions is to give voice and levers of power to a variety and range of social …so that they might be able to have a say or even a veto in market decisions that would harm them. The individualism of free enterprise is submerged in favor of these entities and the state.” Edmund S. Phelps, *Corporatism and Keynes: His Views on Growth Center of Capitalism and Society*. Center Working Paper No. 20, May 2007.


3 In this model judges, and in particular the Supreme Court, are the structure of governance of the Constitution.

4 ‘Ill interpreted’ because some well intended rules were transformed into monopolies and tax privileges, as in the case of the ‘Welfare Clause’, originally intended to promote economic growth by government spending, and later interpreted to include economic subsidies and tax privileges. ‘Cryptic’ because some regulations are in a way hidden from the public, since they are approved by lesser officials through delegation.
the political system has developed a strong corporatist culture that has influenced the economic and political rules in a way that frustrates the objectives of economic dynamism and inclusion. As a result the Argentine economy is stagnant, agriculture its only dynamic sector, which at the same time has developed a vast class of social outcasts in the last twenty years.

I. Constitutional Economics.

James Buchanan introduced the term ‘Constitutional economics’ to designate a distinct branch of economics to study the ‘Constitutional decision’ as opposed to the ‘legal decision’, which is the main object of study of Public Choice theory. In the 1990s, the focus of Public Choice discussion shifted away from ordinary political choices to the institutional-Constitutional structure within which politics takes place.

Constitutional economics is ‘the economic analysis of Constitutional law’: it uses the economic method to analyze consequences of Constitutional rules, but at the same time attempts to explain the working properties of alternative sets of institutional and Constitutional norms that constrain the choices and activities of economic and political agents. The emphasis is on the rules that define the framework within which the ordinary choices of economic and political agents are made. It examines the choice of constraints as opposed to the choice within constraints. It is aimed at offering guidance to those who participate in the discussion of Constitutional change, which must include not only Constitutional assemblies, as is generally imagined by Buchanan, but also judicial decisions, since judicial precedents are the main basis of Constitutional reform. Constitutional economics has also an element for normative advice in Constitutional decisions. In those cases judges could give normative, and thus obligatory content, to the analysis resulting from the use of the Constitutional economics doctrine.

Thus Public Choice, in its non-Constitutional aspects of inquiry, concentrates attention on analyses of alternative political choice structures and on behaviour within those structures. Its focus is predictive models of political interactions, and it is a preliminary stage in the more general Constitutional inquiry.

The problem of drafting and interpreting a Constitution that would impede dictatorships and prevent rent seeking and corruption is an important task; even

more so if we intend to create a Constitution that promotes economic dynamism and inclusion. Two conflicting visions appear in Constitutional Economics:

1. One view is to create a Constitution with the correct incentives for both citizens and rulers. It could be called the ‘Strategic Constitution.’
2. The second is that it is the existing Constitutional culture what creates the economic organization of a nation. Culture influences the preferences of citizens and governments.

The idea of a ‘strategic constitution’ is as follows: if the Constitution can be considered a long-term contract with a structure of governance by the Supreme Court, it can be transformed into a relational contract, where there is mutual acknowledgement of the gains from the relationship. In that case, the Constitution would be a contract that has all the right incentives and where non-compliance would be minimal. This possibility is desirable but incomplete for it is extremely difficult to find all the correct incentives and include them in a Constitution due to incomplete and asymmetric information. The framers are also politicians who may feel insecure about the future, since the present majority in the Constitutional convention could no longer be in the future government. They are not completely insecure, however, since normally the majority of the framers could be in government in the future and even in the worst scenario they could also participate in government as a minority. Therefore the difficulties in creating Constitutional incentives for republicanism, economic dynamism and social inclusion require of the study of Constitutional cultures.

The study of Constitutional cultures could be linked with Hayek’s older idea of law as a spontaneous order. Hayek reminds us that a spontaneous order can have no purpose although its existence may be very serviceable to the individuals that move within such order. But at the same time very complex orders comprising more particular facts than any brain could ascertain or manipulate can be brought about only through forces inducing the formation of spontaneous orders. We can draft a Constitution with the best incentives and establish a Supreme Court to act as its structure of governance but we may not manage the forces that induce the formation of future spontaneous orders.

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8 This idea was originally developed in the United States in John Calhoun’s *The Concurrent Majority*, but was furthered in European parliaments with proportional electoral systems. The expression ‘government of parties’, or ‘partitocrazia’ in Italian, refers to the method of government in which no political party is completely out of power.


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II. The political logic of bad Constitutional economics: the Argentine case.

If the normative and imperative rules in Constitutions change both incentives and culture, some questions arise. How should we design Constitutional rules that have economic logic? Are bad economics, as occur in a corporatist economy, the politics desired by government officials because it allows their perpetuation in government? A corporatist economy could be the basis of a perverse political culture where utility-maximizing leaders will embark on destructive economic policies to enhance their own personal power unless they are appropriately constrained. The coordination costs for the opposition are extreme, which can prevent their attempts to limit corrupt and authoritarian regimes. The constraint must come from a Constitution that reduces transaction costs to limit political power.10

The time horizon

Incentives that could be determined by the ‘time horizon’ have two elements:

1. Rulers discount the future and have an incentive to spend available resources and ignore the long-term growth. This is the case of Argentine economic policy since 1946, particularly during the 50’s to the 70’s.
2. Since political power is not eternal, leaders want to build a political and personal wealth base that will allow them to survive — politically and otherwise — once they have left government. This situation has been developing in Argentina since 1989 and has had particular importance since 2003.

The size of the support group

The other group of incentives is based on the ‘size of the support group’: rulers who rely on small support groups thrive politically by transferring resources to their small party of supporters even during economic decline. In the Argentine case, the group of politicians directly associated with power has reduced considerably. The leader, in Spanish ‘conductor’, extends his power through a small base of immediate followers. There is no strict negotiation with political leaders in Congress, only the governors of important provinces have an

opportunity to influence the president’s decisions. The reason that rulers prefer a small coalition to a larger one is that larger groups demand a bigger proportion of the government budget. Smaller groups permit a bigger part for each political actor and an even greater portion for the president’s pet projects. The doctrine of a ‘unitary executive’ is the legal basis of the reduction of transaction costs for the president, reducing the participation in decisions of cabinet ministers, Congress and the Courts. This doctrine is also called ‘hyperpresidentialism’. A hyperpresidential system is built by the introduction of parliamentarian institutions into a division of powers stated in the Constitution. Two are generally used: the wide delegation of powers by Congress directly to the President and not to executive agencies, and the permission of ‘legislative executive orders’. The paradox is that these parliamentary institutions were introduced in the Constitutional reform of 1994 in order to limit presidential power rather than to enhance it.

**Constitutional Economy limits for government**

The Constitutional Economy requires at least three elements for good government:

1. Protect capital assets against arbitrary seizure by private and public actors. Although there is a traditional legal protection against such seizure it is insufficient against ‘regulatory takings’. These occur when government regulation diminishes the value of an asset in order that it could be bought later for a lesser price by the state itself or by members of the presidential group.

2. Support institutions that lower transaction costs in productive activity. To do this, a clear definition and the protection of property rights are usually mentioned. The use of the judicial system to lower transaction cost in claims against the government could be added, including the use of class actions, amicus curiae and a strict use of *stare decisis*.

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11 This situation is influenced by both the electoral and tax systems that make legislators dependent on the governor or political leader of the province and, in turn, the governors financially dependent from the president.


13 The term used in the Constitutions for the legislative executive orders’ is ‘decretos de necesidad y urgencia’, literally ‘executive orders of need and urgency’, which is ironic since there are hundreds of them and neither need nor urgency were required in establishing them.
3. Provide macroeconomic stability and essential public or merit goods and encourage the production of pure and applied knowledge. The desire of rulers to accept inflation in order to obtain resources and the use of exchange rates for political reasons limits macroeconomic stability.

**Leaders and winning coalitions**

Bueno de Mesquita\textsuperscript{14} indicates that the political life of a leader depends on the loyalty of a winning coalition. A government buys support from his winning coalition in exchange for very generally defined public, or merit, goods and private goods. In this case the ‘private goods’ are grants and privileges to friends and represent a drawback to economic growth. Strategies differ for buying support from small winning coalitions rather than from large ones. The supply of growth-friendly merit goods by the government is an increasing function of the size of the winning coalition. Conversely, the supply of private goods is in inverse function of the coalition size. A president who relies on a small number of political friends minimizes costs if he buys their support mainly with private goods, gifts and privileges. But that is impossible if he depends on a very large winning coalition, because he would have to minimize costs.

Eggerston, following Bueno de Mesquita, suggests that economic stagnation is inversely related to the size of a regime-winning coalition. Therefore small winning coalitions, generally dictatorships, tend to perform poorly.\textsuperscript{15} But small winning coalitions are not limited to non-democratic governments and could include some elected systems where, due to high transaction costs for other possible coalitions, the government does not need to widen its political partners. This is the case of Argentina where the proportional electoral system\textsuperscript{16} tends to fracture the representation in Congress of the most populated provinces. It also creates a likelihood that political leaders, including presidents, will come from under-populated provinces — where representation is less fractured — that are over represented in Congress.\textsuperscript{17} At the same time the characteristics of the tax system allow the federal government to collect taxes and distribute funds among the provinces following an established rule based in numerous criteria, and not exclusively on the origin of the funds. This centralizes the ‘power of the purse’ in the presidential will. Since not all taxes are distributed, such as export taxes

\textsuperscript{14} Quoted by Eggerston, *Imperfect Institutions*, op. Cit. P. 62.
\textsuperscript{15} Eggertsson, *Imperfect Institutions*, op. Cit. P. 64.
\textsuperscript{16} Argentina has party-list proportional representation and uses the D'Hondt, a highest averages method for allocating seats.
\textsuperscript{17} That is the case of Presidents Menem (1989-1999), who came from the small province of La Rioja, Nestor Kirchner (2003-2007), and Cristina Fernandez de Kirchner (2007…) who come from the even less populated province of Santa Cruz.
recently established, the President could, following very general rules included in the budget, distribute funds among friendly governors and punish those who oppose him. This situation allows the President to govern with a minimal political coalition and, following the model described by Eggerston, limit the country’s economic growth.18

III. Constitutional cultures.

The idea that a Constitutional use or convention could be considered a custom and therefore obligatory has an ancient tradition in Roman law19 and was described by Dicey as a way to limit the sovereignty of parliament without a written constitution.20 Although Dicey thought that ‘Constitutional conventions’ were non-binding and had a similar power to an act of legislation, he considered them part of political ethics. The distinction between what is binding and what is purely a political habit is critical to avoid the ‘naturalistic fallacy’.21

Both Constitutional law and culture are locked in a dialectical relationship, so that Constitutional law both arises from and in turn regulates culture.22 We can identify, for example, a specific subset of culture that encompasses extrajudicial and therefore non-binding beliefs about the substance of the Constitution. This subset could be called ‘Constitutional culture’; the legitimacy of Constitutional law depends in part upon what extrajudicial actors explicitly believe about the Constitution. Judges construct the separation between Constitutional law and Constitutional culture but normally they allow this membrane to remain quite porous, facilitating a free and continuous exchange between Constitutional law and Constitutional culture. The courts can stiffen the membrane, dividing Constitutional law from Constitutional culture whenever they perceive that Constitutional culture threatens Constitutional values that they wish to protect.

This occurs typically, but not exclusively, in the context of Constitutional rights. Even when safeguarding precious Constitutional rights, however, Constitutional law will nevertheless both reflect and regulate Constitutional

18 Eggerston describes a model originally developed by Bueno de Mesquita in 2000.
19 For a common usage to be considered a custom and therefore binding requires two elements, a continuous practice (the material element), and a conviction that it is obligatory (the moral element).
20 The “conventions of the constitution,” which consisting (as they do) of customs, practices, maxims, or precepts which are not enforced or recognized by the Courts, make up a body not of laws, but of Constitutional or political ethics;’ A. V. Dicey. An Introduction to the Study of the Law of the Constitution (1885).
21 The naturalistic fallacy, or the is-ought problem, was raised by David Hume, who noted that many writers make claims about what ought to be on the basis of statements about what is. In book III, part I, section I of his A Treatise of Human Nature.
culture, because rights protect Constitutional values that are themselves rooted in Constitutional culture. Constitutional law could not advance without incorporating the values and beliefs of non-judicial actors. A necessary consequence is that Constitutional law will be as dynamic and as contested as the cultural values and beliefs that inevitably form part of the substance of Constitutional law. If Constitutional law emerges from an ongoing dialectic between Constitutional culture and the institutional practices of Constitutional adjudication, it is neither autonomous nor fixed. Judges and lawyers will continue to appeal to the autonomy of Constitutional law, however, precisely to the extent that they believe an independent and determinate Constitutional law the necessary foundation for judicial authority to constrain democratic legislation. Courts can neither create Constitutional law that is indistinguishable from culture nor create Constitutional law that seeks unilaterally to subordinate Constitutional culture to the independent dictates of legal practice. But apart from these extreme positions, the courts must be guided by both practical tact and judgment, which has been called statesmanship. Debate about how much weight should be assigned to rule of law virtues, as opposed to Constitutional culture, is a persistent feature of Constitutional adjudication.

But can a judicial decision change a strong economic culture? Because some justices evidently do not place a high legal value on the Constitutional objective of protecting economic liberty, they view potential public criticism of the Court as a reason to abandon substantive due process doctrine.

Juan Bautista Alberdi writing on the new and liberal Argentine Constitution of 1853 said it had ‘abrogating power’ over the existing legal system that was inherited from the colonial Spanish legislation, including a state monopoly of foreign trade. Although great efforts were made between 1862 and 1930 to establish an open economy, a mercantilist economic culture has prevailed: the 1930s saw the establishment of a corporatist Constitutional culture, which was sustained by a strong Keynesian normative economic discourse from the 1940s onwards.

23 By Justice Brandeis.
24 John Harrison, Substantive Due Process and the Constitutional Text, 83 Va. L. Rev. 493, 494-95 (1997), suggesting that because substantive due process comes from beyond the text of the Constitution, its “precedential authority ...is less than it might seem”.
25 An Argentine publicist (29 August 1810 - 19 June 1884), he wrote several books that influenced the 1853 drafting of the Constitution.
26 Juan Bautista Alberdi. Sistema Económico y Rentístico de la Constitución Argentina de 1853. Published originally in 1857. The Spanish colonial legal system was established in the Recopilación de Leyes de Indias (1688); see also, Juan de Solórzano y Pereyra. Política Indiana. (1640)
27 Keynes’s influence in legal discourse was mainly due to the widespread influence of the last chapters, 23 and 24, of the General Theory. Expressions like the ‘euthanasia of the rentier’ and his
IV. The corporatist Constitution.

In strict terms, corporatist Constitutions appeared in the midst of the 1930s as an alternative to presidential and parliamentarian constitutions, establishing a ‘functional’ political representation as opposed to a democratic. There were no citizens, but members of corporations that elected their representatives, which by indirect voting schemes ended in corporatist chambers. The main example is the Portuguese Constitution of 1933 under the influence of Salazar that created the ‘Estado novo’. Under Fascism in Italy, all economic classes were organized into 22 guilds, or associations, known as "corporations" according to their industries, and these groups were given representation in a legislative body known as the Camera dei Fasci e delle Corporazioni. Although ‘Corporatist’ Constitutions in this strict view were basically extinct after World War II, much of the ideology and some of the institutions persisted. Corporatist Constitutional culture has had a long intellectual tradition that subsists in many countries with deleterious economic effects, the unwanted consequences of good intentions.

The origins of corporatist culture could be extended to the debate of social rights that appeared as a reaction to the appalling social conditions in factories in the midst of the 19th century. The images of child labour, sweatshops and slums were nightmares of the Victorian times. The first reaction to the growing awareness of this problem was the socialist movement, epitomized in the publication of the Communist Manifesto in 1848 and its more formidable sequel, the three volumes of Capital, published in 1867, 1885 and 1894. One of the ideals of socialism was to create a humane system in which workers and employers would be part of the same enterprise. Marx and Engels were not the only ones to espouse this: Pope Leo the XIII in the Encyclical letter De Rerum Novarum described the of an enterprise which includes workers. The worker was no longer selling his energy for pay in the market but was part of a joint organization for the creation of wealth. The Pontiff’s description expressed the idea that the problem of capitalism was that the worker no longer owned the product of his work, and that was a negative situation compared to the work of the artisan, who was the owner of his own tools and of the product of his work. The Pontiff saw the artisan as creative, and at the same time enjoying his task since he was able see the

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28 António de Oliveira Salazar, Prime Minister of Portugal from 1932 to 1968, was a professor of economics at the University of Coimbra.
29 For example, see the Economic and Social Councils, which exist in some European countries, among them France (‘Conseil Economic et Social’) and Spain. They are also a part of international organizations, such as the United Nations, the Organization of American States, and particularly the International Labour Organization that has a tripartite structure, formed by representatives of the member states, the business organizations and trade unions.
results of his efforts, in part because he controlled the whole of the productive process. In the mind of some the artisan was associated with the medieval society; this became an idealized and imaginary world where a respect existed for the artisan and his work. The view of a new mediævalism that would replace capitalism was embedded inside the corporatist state. The idea of establishing corporations and medieval organization is visible in the structure of Italian Fascism and Nazism, and even more obvious in Franquist Spain (perhaps because it lasted longer).

Curiously enough, the creative power of artisans stems not from medieval times but from the Renaissance, when the whole power of creation was released from the strict medieval regulations of guilds. The French Revolution abolished guilds with the Le Chapelier Law; this was in a way the start of modern capitalism. This abolition came to be criticized by corporatist and socialist thought, the former because they considered guilds, like the family, to be a natural organization of society; and the latter because they considered that they were a predecessor of trade unions.

A debate was established in the first part of the 20th century between corporatist and socialist views that each claimed the defence of ‘modernity’ and ‘social progress’ in opposition to the reactionary images of capitalism. Both fascism and communism have disappeared from everyday politics, so it is difficult nowadays to envisage that for a long time, even after World War II, they were the centre of political discourse.

Quadragesimo Anno

The Encyclical letter Quadragesimo Anno had an enormous influence on the promotion of a corporatist view of society and government. This encyclical letter is generally associated with the principle of subsidiarity, which was transformed into a Constitutional principle of the European Union. But there are less quoted

32 Schumpeter’s Capitalism, Socialism and Democracy could be mentioned as an example of the difficulty of the defense of capitalism. In many European nations corporatist ideas were quoted as an intellectual alternative to socialism.
33 Quadragesimo Anno, Encyclical on Reconstruction of the Social Order, His Holiness Pope Pius XI, May 15, 1931. Its name arose from its publication date forty years after Rerum Novarum.
34 The principle of subsidiarity is described in paragraph 80. The supreme authority of the State ought, therefore, to let subordinate groups handle matters and concerns of lesser importance, which would otherwise dissipate its efforts greatly. Thereby the State will more freely, powerfully,
parts of the encyclical — doubtless a product of the difficult times during which it was written — that still influence the Constitutional culture of corporatism. It condemns ‘liberalism’ and proposes new ways of organizing economic production and society. This has brought about some of the confusion about the meaning of ‘liberalism’. It indicates a free market economy but during the 19th and part of the 20th centuries, particularly in Catholic countries, it was understood as the party of secularism. This confusion has remained on a large scale, with many believing it impossible to be religious and liberal since the latter word implied your agnosticism and secularism. In this way Pius XI praised the previous Encyclical *Rerum Novarum*: ‘For it boldly attacked and overturned the idols of Liberalism,’ and also invokes ‘the unbridled greed of competitors’.

Some paragraphs of the *Quadragessimo Anno* give the basis of corporatist culture.

82. The social policy of the State, therefore, must devote itself to the re-establishment of the Industries and Professions. ‘Re-establishment means in this case a corporate state similar to the middle ages. But complete cure will not come until this opposition (between employers and workers) has been abolished and well-ordered members of the social body--Industries and Professions--are constituted in which men may have their place, not according to the position each has in the labor market but according to the respective social functions which each performs.

(83)… For under nature's guidance it comes to pass that just as those who are joined together by nearness of habitation establish towns, so those who follow the same industry or profession--whether in the economic or other field--form guilds or associations, so that many are wont to consider these self-governing organizations, if not essential, at least natural to civil society.

84. Because order, as St. Thomas well explains, is unity arising from the harmonious arrangement of many objects, a true, genuine social order demands that the various members of a society be united together by some strong bond.... Just as the unity of human society cannot be founded on an opposition of classes, so also the right ordering of economic life cannot be

—and effectively do all those things that belong to it alone because it alone can do them: directing, watching, urging, restraining, as occasion requires and necessity demands. Therefore, those in power should be sure that the more perfectly a graduated order is kept among the various associations, in observance of the principle of "subsidiary function," the stronger social authority and effectiveness will be the happier and more prosperous the condition of the State.

35 In the Spanish Civil Wars of the nineteenth century, generally called ‘Carlist’ due to the name of the pretender, the two parties were called ‘tradicionalistas’ which could be translated as ‘traditionalists’ and ‘liberales’, liberals.

36 St. Thomas, *Contra Gentiles*, III, 71
left to a free competition of forces. For from this source, as from a poisoned spring, have originated and spread all the errors of individualist economic teaching.\(^\text{37}\)

He attacks also the executives of public corporations who are described as economic dictators.\(^\text{38}\) ‘Free competition has destroyed itself,’ he writes: ‘economic dictatorship has supplanted the free market; unbridled ambition for power has likewise succeeded greed for gain; all economic life has become tragically hard, inexorable, and cruel.’ (109)

The Corporatist view did not last in the pontifical documents. The Apostolic Letter written by Pope Paul VI Octogesima Adveniens and promulgated on May 14, 1971, upon the occasion of the eightieth anniversary of Pope Leo XIII’s encyclical Rerum Novarum, discusses themes such as the securing of democratic foundations in society.

**Autarchy and the attraction for big institutions**

The economic rule of corporatism is autarchy, a closed economy where an intense protection is established to produce all goods and services at home. This strict mercantilism was applied in Italy and Spain but also had a strong influence in Argentina. An Argentine economist coined the motto ‘vivir con lo nuestro’,\(^\text{39}\) reminiscent of Keynes’s article: ‘Let goods be homespun’.\(^\text{40}\)

Corporatist mediation by the State is associated with big institutions that represent a large part of the economic, social or labor activity. The Corporatist State requires that every organization and individual be a member of a corporation. No one can be outside a corporation, and in a pyramidal structure they all form the big organizations. Associated with this hierarchical pyramid is

\(^{37}\) The Encyclical contains a description of the structure of fascist trade unions. 91. “Recently, as all know, there has been inaugurated a special system of syndicates and corporations of the various callings which in view of the theme of this Encyclical it would seem necessary to describe here briefly and comment upon appropriately.” 94. “Strikes and lock-outs are forbidden; if the parties cannot settle their dispute, public authority intervenes.”

\(^{38}\) 105. “In the first place, it is obvious that not only is wealth concentrated in our times but an immense power and despotic economic dictatorship is consolidated in the hands of a few, who often are not owners but only the trustees and managing directors of invested funds which they administer according to their own arbitrary will and pleasure.”


\(^{40}\) ‘But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, let finance be primarily national.’ John Maynard Keynes, “National Self-Sufficiency,” The Yale Review, Vol. 22, no. 4 (June 1933), pp. 755-769.
the desire that all economic activity be carried out by large companies, which could be simpler to regulate but are ultimately simpler to negotiate with.

V. The Constitutional economics of dynamism and inclusion

In general terms, innovation occurs whenever people invent new technological, procedural, and organizational recipes to use, arrange, and rearrange in increasingly more valuable ways. The focus here is on novelty: given scarce resources, the issue of growth is not about doing more and more of the same stuff but rather about inventing new methods, procedures and techniques that generate more economic value per unit of unprocessed resources. Incentives to innovate flow from the ability to profit from innovative ideas in the form of new products; innovators will primarily appropriate these profits to "keep ahead of the parade" by maintaining their technological capacities. None of these incentives limit competition as the most efficient market structure in the case of ideas, innovations, and new recipes. History witnesses that with respect to investments in the production of ideas, free market systems have historically shown an unrivalled capacity to promote both the growth of technological knowledge and its transformation into new, better, and more valuable products and cheaper production processes. Capitalism has reached this goal mainly by combining decentralization (and therefore multiplicity and diversity of innovative efforts), which avoids the regulation that prevents the access to the markets, with the certainty that the product of their industry is not expropriated by the state through excessive regulation or by the obligation to be associated with friends of government.

The Constitution of inclusion

Is the quest for inclusion compatible with Constitutionalism? Answers are varied; one possibility is the inclusion in the Constitutional text of social rights as originated in Mexico in 1917 and Germany in 1918, in vast definitions that have

43 Commentators indicate that Argentina has a vast number of businessmen that receive subsidies and other forms of protection from the government; public expenditures are 33% of the GNP. Article by José Luis Espert in La Nación, ‘Kircher el Chavez rubio.’ Buenos Aires, November 09, 2008.
been described as ‘catalogues of illusions’. But a more useful Constitutional reading of inclusion was incorporated in the already mentioned note N° 4 in the case United States v. Carolene Products Company. Chief Justice Stone suggested there were reasons to apply a more exacting standard of judicial review to cases regarding legislation aimed at discrete and insular minorities, who lack the normal protections of the political process. These should be an exception to the presumption of Constitutionality, and a heightened standard of judicial review should be applied. This idea has greatly influenced equal protection jurisprudence, and judicial review:

...the review of statutes directed at particular religious ... or national ... or racial minorities ...: whether prejudice against discrete and insular minorities may be a special condition, which tends seriously to curtail the operation of those political processes ordinarily to be relied upon to protect minorities, and which may call for a correspondingly more searching judicial inquiry.  

Bruce Ackerman thinks that the definition of discrete and insular minorities should be enlarged. The victims of sexual discrimination or poverty, rather than racial or religious minorities, will increasingly constitute the groups with the greatest claim upon Carolene's concern with the fairness of pluralist process. The problem with discrete minorities is that they cannot forward their problems to the political system or if they do, it would have no effect. Following Albert Hirschmann, they cannot apply the 'voice' that is to complain about it or the 'exit', that is to leave, but only the 'loyalty'. The can only wait and hope for the best to happen.

Another possible interpretation is that of judicial deference to political authorities if the case is related to the regulation of economic liberties. In this

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44 For different reasons, none of these Constitutions had any influence over the development of social inclusion. This was primarily because of the high cost of implementing social rights. For a general treatment of the subject see: Stephen Holmes, Cass R. Sunstein, The Cost of Rights: Why Liberty Depends on Taxes, W. W. Norton & Company, 2000.
45 United States v. Carolene Products Company, 304 U.S. 144 (1938). This was an April 25, 1938 decision by the United States Supreme Court on a case dealing with a federal law that prohibited filled milk (skimmed milk compounded with any fat or oil other than milk fat, so as to resemble milk or cream) from being shipped in interstate commerce. A wide analysis of this case is made in John Hart Ely, Democracy and Distrust: A Theory of Judicial Review. Harvard University Press, 1980. Pp. 77 ss.
46 Bruce A. Ackerman, Beyond Carolene Products 98 Harv. L. Rev. 713. Ackerman is critical of the blurry definitions of 'discrete' and 'insular' when used as legal terms, essentially because he thinks that the question should be resolved through values, rather than procedures in the interpretation of the Constitution.
view, judges protect political participation and the other rights listed in the Bill of Rights and pretty much leave it to legislatures to regulate economic affairs. The only condition for valid economic regulation is reasonableness. But this division between civil liberties protected and economic liberties unprotected, an interpretation called dualism by Richard Posner, has no other purpose than to enhance political discretion. This dichotomy only fortifies public officials’ will in pushing economic regulation outside the public interest and into their own personal interests.

VI. The Argentine road to economic decadence.

The Argentine Constitutional economy has both poor incentives and a poor Constitutional culture, which prevent the development of both dynamism and inclusion. Strategic political considerations push rulers into bad economic policies. At the same time, a strong corporate culture favours the resulting mix of authoritarianism, stagnation and social exclusion.

If a dynamic economy is one that is constantly innovating to reduce costs of expanding markets to improve demand, and is constantly weeding out producers that have not innovated or have done so badly, we have to recognize that Argentine Constitutional economy impedes dynamism.

Both norms and constitutional culture obstruct the complying of the three structural parameters of dynamism, laid out as follows:

1. The capacity that owners of wealth and of borrowers have to invest in the economy, including free entry rather than charter and licenses, rent seeking and corruption.
2. The extent to which large stake owners of firms can exert control over self-interested managers and can exert autonomy from interventionist state agencies.
3. The degree to which poorly performing enterprises must undergo the discipline of private capital financing and the risks of bankruptcy without financial rescue by the state.

Argentine regulation prevents the application of these three principles in a number of ways: by the existence of widespread rent seeking practices; by the control of enterprises and economic activity by interventionist state agencies; and by the protection of inefficient enterprises by public financing and by the bankruptcy legislation and practice. All these institutions limiting dynamism are

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50 Edmund Phelps op. cit. *Enterprise and Inclusion in Italy*, p. 2.
not formally written into the Constitution but are derived from a wider legal and cultural practice so strong in its scope and compliance that has the characteristics of a constitutional decision. It’s what was defined as a Corporatist Constitution.

The Argentine Republic is a laboratory case of the failure of the corporatist political economy. The origin of this well-rooted political and economic corporatism is, in great part, the fear of communism that was very strong before World War II and gave rise to the fascism in the 1930s. After the war, even when the purely fascist influence had diminished, the new political movement ‘Peronismo’ had a very strong corporatist political theory. Although Peronism had at the time a relatively limited political theory there are two documents worth mentioning: the debates of the Constitutional Convention of 1949, which allowed the permanent reelection of the President, and the Conference given by Juan Domingo Peron in 1950 called ‘La Comunidad Organizada’. The ‘organized community’ required that society respect the natural order and that no one could be outside the organization.

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51 In 1930 there was a nationalist coup d’état in Argentina in which the possibility of changing the Constitution and the creation of a corporatist state were considered. The division of the army prevented this. In the same year in Brazil a similar coup took place, although not of a purely military character. The new president, Getulio Vargas, succeeded in establishing a corporatist Constitution in 1936 called the ‘Estado Novo’, or the ‘new state’, which followed the Italian and Portuguese influence.

52 Peron had participated as a young officer in the 1930 coup; afterwards he was sent to Italy to study with the Alpine mountain forces. In later years he claimed that had met Mussolini and even had given him some advice, though the story was an invention. Cf. Joseph Page. *Peron: A Biography*. Random House; 1983.

53 The ‘Organized Community’ Speech given by the President of the Republic General Juan Domingo Perón in the National Congress of Philosophy, Mendoza 1949. The language is turgid, similar to the speeches of the corporatist writers of the 30’s: “Superación de la lucha de clases por la colaboración social y la dignificación humana…”

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54 The main institutions -- the State, the Church, the Armed Forces, the trade unions – became centralized in the General Confederation of Labor, the enterprises in the General Economic

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The political system: the ‘conductor’

The Argentine presidential system evolved into what is called ‘hyper presidentialism’, due to bad incentives. An example of this can be seen in the fact that the President is at the same time the leader of the governing political party. This unity in the political leadership is traditional in parliamentary systems but less so in presidential ones. It was corporatist political culture that established the rise of the ‘conductor’. The expression ‘conductor’ for political leader and ‘conducción’ for leadership was introduced by Perón in his first presidency in 1946 and became established in the Argentine political vocabulary. In 1952 Perón himself gave a series of conferences for political and trade union leaders, which were edited as the ‘Manual de Conducción Política’. He introduced terms from military thought, such as ‘strategic and tactical leadership’, into the economic policy, thereby creating an idea of economic activity as similar to warfare and requiring central planning and a rigid hierarchy.

Congress, Federalism and the tax system

The distribution of the power to tax is the basis of Argentine political power. Local government originated in Argentina in 1820 and the first federal Constitution was sanctioned in 1853 after thirty years of civil wars. Although governors have important political powers the collection and distribution of taxes by the federal government among the provinces has limited federalism and transformed the influence of Congress. This has enhanced the power of the President overall and that of the governors of provinces over their representatives in Congress. The combination of centralized collection of taxes and the proportional electoral system with party lists is at the basis of the political evolution that created a strong president, a weak Congress and authoritarian provincial governors. Fiscal federalism considerations are a factor in almost every policy issue, adding transaction difficulties and rigidities to policy making.

Confederation, the students in the General University Confederation and secondary students in the Union of Secondary Students, also in addition to “el Movimiento” as the official party was described. Many of these institutions have disappeared but many of the ideas that originated them and the speech that defined them have survived.


56 In Spanish, ‘Conducción estratégica y conducción táctica.’
Legislators depend on the governors who lead the local political parties. It is governors who make the electoral list of their party for the general elections. This legislative dependence enhances the presidential power, since the president can negotiate needed legislation with governors, and governors have are dependent upon the president’s power of the purse.\textsuperscript{57} Governors receive the product of taxes collected by the federal government and redistributed according to a fixed plan unaffected by the amount that each province has effectively integrated into the common fund. The federal government’s policy is generally to impose taxes that are not to be distributed between the provinces. Through the governors’ influence, the legislators become dependent upon the president. There is a symbiotic interaction between national and provincial policymaking that operates through political and federal fiscal channels.\textsuperscript{58}

\textit{The proportional electoral systems and fracture in representation}

Argentine legislators have the wrong incentives. To be a legislator requires being on the electoral list, since there are no individual constituencies. To be on the list a legislator must obey those who make the list — that is, the provincial governors and the political bosses in the case of opposition parties. This makes them dependent upon the political leaders and at the same time distant from public opinion. The personal popularity of legislators is basically irrelevant for their reelection; on the contrary, if they become too popular the political bosses may be reluctant to keep their name on the list. Having only a distant contact with their electors, legislators prefer that the President makes the significant and less popular decisions and that they themselves avoid any remnant of political pressure from their constituents.

At the same time, the Argentine party system has evolved from a bipartisan one to a pluripartisan system with a dominant party. This change was determined and the incentives created by the electoral system in spite of a strong political culture for bipartisanship that has existed for over a century. The electoral system was changed in 1962 from a majoritarian to a proportional party list system. Following the first law of Duverger, majoritarian electoral systems tend to the consolidation of a two party system, but proportional systems tend to fracture representation.\textsuperscript{59} This is what happened in Argentina, where the new plural party system created by the electoral legislation helped the consolidation of a dominant party. This party does not obtain a majority of votes but is simply larger than the fractured opponents.

\textsuperscript{57} The Argentine slang is even more eloquent: it is called the ‘box’ (caja).
\textsuperscript{59} Maurice Duverger. \textit{La République des citoyens}. Ramsay, 1982.
The labor system

The Argentine labor system originated in the Italian laws of the 1930s and was established in the period between 1936, with significant patterns established after 1943. It has undergone many reforms but still includes:

1. The labor contracts. Individual labor contracts follow the Italian ‘Carta del Lavoro’. The basic regulation is similar to all labor contracts and establishes a compensation paid by the employer when he ceases the labor relation.
2. Centralized trade unions. There is one authorized trade union per activity.
3. Compulsory affiliation to trade unions. If the employee declines to be a member he must pay compensation to the trade union.
4. Health services organized by trade unions.
5. Binding collective contracts for all employers and employees in the same branch of activity. There is no collective bargaining by enterprise.
6. Collective contracts are binding to all employers and employees in the same branch of activity.
7. A specialized judicial system for labor disputes.

A closed economy

Due mainly to the influence of Raúl Prebisch, in the 1940s Argentina adopted the doctrine of import substitution industrialization, in which a nation isolates itself from trade and tries to industrialize using only its domestic market to promote growth. This new mercantilism evolved into a tax system that was agreed upon with industrial manufacturers; this included negotiation of import taxes to avoid

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60 In 1943 a nationalist coup d’état overturned the conservative but not sufficiently pro-Allied government of Argentina. In the period that followed, Colonel Peron began applying labor laws taken from Italian models. As mentioned before, Peron had military training in Italy before World War II.
61 The Carta del Lavoro was approved by Gran Consiglio Fascista on April 21st. 1927 and was copied by Argentine legislators in the 1930’s. See Ludovico Barassi. Tratado del derecho del trabajo, translated by Mario Deveali, Alfa, 1953, which makes a comparison between the two systems.
62 The Argentine Supreme Court declared this limitation unconstitutional on November 2008.
63 This is the main source of funding for the political activities of trade unions. This concession was given to trade unions by the military government in 1967.
foreign competition, subsidies to export of industrial goods and the exemption of income taxes and VAT. When the bilateralism of foreign trade was replaced by multilateralism in the sixties, dumping rules and procedures were established to protect industry from foreign imports. This neo-mercantilism evolved into a strong incentive for rent seeking.

A. A rent seeking constitution.

Both wide legislative delegation and autonomous legislative executive orders are the cause of the lack of common criteria in economic regulation, and each sector has its own guidelines, therefore there is ample space for rent seeking and the buying of regulation.

The reasons for executive legislation can be found in the influence of parliamentarian institutions that are exogenous to presidential system. In perhaps the ultimate paradox of the Argentine constitution, it is the introduction of parliamentarian practices that were intended to limit the hyperpresidentialism that have enforced it.

In parliamentarian systems the government is chosen by and represents the political will of parliament. It is the depositary of its trust and if this ends, it can be forced to resign by a vote of censure. A principal agent relation exists between Parliament and Government, as his agent government legislates following the parliamentary instructions. This system is rightly called a ‘confusion of powers’ rather than a ‘separation of powers’.

But for a government with a separation of powers to give the President the powers of a parliamentary government, including the capacity to receive wide delegations from Congress and to sign legislative decrees, is a way not only to court dictatorship but also to grant privileges to political friends and cronies without much publicity. It is the basis of a ‘rent seeking’ Constitution.

VII. The Ineffectual absolutism.

Hyperpresidentialism is a paradoxical despotism. It encompasses abuse of power and impotence to govern, arbitrariness and indecision, the illusion of infallibility and the accumulation of unresolved problems. It is an all-powerful universal power that has no positive results. The product is the mix of perverse incentives hidden in the Constitution together with the corporatist culture, although personal vices of rulers need not be excluded. This is also enhanced by the political practice of presidents as despotic rulers of small provinces.

65 Known as decrees of need and urgency, or “decretos de necesidad y urgencia”.
With this double problem of bad incentives and authoritarian culture the Argentine hyperpresidentialist state cannot make the necessary reforms needed for stable growth. In this way paradoxes appear, a large state budget for the production of energy produces rationing, extraordinary international prices for agricultural commodities diminish local production, and important economic growth diminishes investment and the flight of capital.

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