

**The Rise of Argentina's Economic Prosperity: An Institutional Analysis.**

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How could a country, which was one of the richest nations of the world at the beginning of the twentieth century, drop to the seventieth place by 1990?

This is not a new question, many scholars have been intrigued in the past by Argentina's uneven and erratic pattern of economic development. It has been called "the Argentine question", the "Argentine paradox". Even the Nobel prize winning economist Simon Kuznets once said that there were four types of countries: the developed, the underdeveloped, Japan and Argentina.

While previous studies have pointed out many structural socioeconomic factors such as late industrialization or external dependency, the aim of this paper is to contribute to this debate from a different perspective.

If anything can be learned from history, an important lesson to understand the factors that lead to Argentina's economic decline can be drawn from the very factors that promoted its economic prosperity. It will be argued that the institutions of limited government have been the fundamental causes of Argentina's economic prosperity in the late nineteenth century. Therefore, the erosion of those institutions in the twentieth century is a plausible way to explain the opposite phenomenon.

Given limitations of time and space, this study will only cover the rise of Argentina's economic prosperity, leaving for further research the problem of the country's economic decline.

The structure of this paper will be organized as follows. The first section consists of the general theoretical framework and a review of the literature that will be used in this study. Section II, briefly discusses the common interpretations of Argentina's economic history. In the next section, the narrative of the period to be studied (1820-1880) will be covered, especially the Rosas regime and the emergence of a constitutional agreement in the second half of the nineteenth century. Finally, in Section IV, a game theoretic model, the main analytical argument, and evidence supporting this thesis will be presented. Conclusions follow.

“... *The despotism of the sovereigns and their underlings, the shortcomings and the instability of the laws, the disorderly excesses of the administration, the uncertainty affecting property, the wars, the chaotic decisions in matters of taxation destroy men and the wealth of the sovereign...*”

- F. Quesnay

## **I. General Analytical Framework.**

### **A. Political Institutions and Economic Performance.**

How do political and legal institutions affect economic performance?

According to the neo-classical perspective, free markets, characterized for a decentralized decision making process by self-interested rational individuals, produce outcomes that maximize both individual and social benefits thanks to the mechanism of the "invisible hand".

Following Adam Smith's assertions in *The Wealth of Nations*, cooperation among individuals will be attained because it entails the achievement of mutual benefits:

"... Man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only. He will more likely to prevail if he can interest their self-love in his favour, and show them that it is for their own advantage to do for him what he requires of them ... Give me that which I want, and you shall have this which you want, is the meaning of every such offer ... It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." (1991: 13).

The same idea lies behind Smith's celebrated metaphor of the invisible hand to represent the complex operations of market forces. Economic agents are motivated purely by self-interest but they serve the general interest without having intended it:

"Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of the society, which he has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to the society" (1991: 398) "He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it ... he intends only his own gain, and he is in this, and in many other cases, led by an invisible hand to promote an end which was not part of his intention ... By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it" (1991: 400).

Reformulating Smith's ideas in more contemporary terms, if the markets are perfectly competitive, they would achieve efficient outcomes measured by the criterion of Pareto optimality. Is in this tradition, that the Walrasian general equilibrium perspective tends to take for granted that markets coordinate.

## 1. The Neoinstitutional Approach.

The tendency to view a system of free exchange -- Adam Smith's "obvious and simple system of natural liberty" -- as the solution of the coordination problem in economics has faced intellectual challenges for the last twenty years claiming that this sort of analysis is insufficient. The main argument is that the neo-classical economists have generally ignored the question of what institutional arrangements are necessary for the emergence of the order upon which the wholeness of their thesis depends. According to this posture, in order to sustain the idea of the coordinating functions of markets it cannot solely be assumed that individual's behaviors in a changing world will automatically be coordinated. Rather, the institutional environment of economic systems, and the appropriateness of such institutions for the emergence of a market order must be emphasized.

These ideas contributed to the emergence and development of a new approach in the study of economics. As Terry Moe points out, this alternative view was adopted by a diverse group of economists "who contended that an understanding of economic activity required systematic inquiry into the institutional context in which such activity takes place" (1984: 742). Among others, some of these early dissenters included the names of Ronald Coase, who focused on the nature of the firm in his classic article by that title in 1937; John Commons with his emphasis in the role of legal institutions included in his book *Institutional Economics*, published in 1934 (Moe, 1984: 742); and even Friedrich A. Hayek, who launched his attack on the static general equilibrium models of mathematical economics in "Economics and Knowledge", in 1936 (O'Driscoll, Jr., 1991: 35).

This line of inquiry, as Eggertsson (1990) notes, did not have a generally accepted name until recently. Such labels as the new economic history, the new industrial organization, the new comparative economic systems, property rights school, transaction costs economics, law and economics, etc., have been often used to designate the various contributions in this area. Most recently it has been broadly given the name of New Institutional Economics.

Although in many ways the New Institutional Economics is complementary to the neo-classical tradition, they differ in terms of behavioral assumptions and the way they conceptualize markets, firms and hybrid forms of economic organization. Therefore, many of the theoretical tools of neo-

classical economics, including the assumption of rational choice, have been the subject of a revisionist debate <sup>1</sup>.

## 2. Economic cooperation in a world with positive transaction costs.

Modern institutional economics seeks to deal with "the man as he is, acting -- as Coase put it -- [with the support and] within the constraints of real institutions". A description of the "institutional man", thus, shall include a cognitive assumption of bounded rationality and a self-interestness postulate that includes opportunism (North, 1993: 34-40; Williamson, 1989: 138-140).

Bounded rationality, according to which economic agents are -- in Herbert Simon's words -- "intendedly rational, but only limited so" is the key cognitive behavioral assumption. Individual human beings have a bounded cognitive competence: they are limited in knowledge, foresight, skill and time (North, 1993: 38). As Kenneth Shepsle indicates, expectations may be rational but wrong, incomplete or vulnerable to unanticipated future developments (1991: 249).

The second assumption, self-interestness, is also conceived differently from the neo-classical tradition of thought. By opportunism, is meant self-interestness with guile, including calculated efforts to mislead, deceive and confuse. Economic agents will sometimes say one thing and do another (if they think they can go away with it). This can involve outright lying, cheating and even stealing. Conditions of adverse selection and moral hazard, thus, are subsumed by this characterization of human condition (North, 1993: 47; Williamson, 1989: 139).

Given these assumptions, individuals will make reasonable commitments, and opportunistic behaviors will be discouraged only if those contracts and their fulfillment can be enforced. Hence, without an enforceable contract system, economic activities, characterized by the exchange of property rights between individuals will give rise to increasing transaction costs <sup>2</sup>.

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According to Moe, this paradigm "represents a less dramatic break with neoclassicism than the behavioral paradigm, and many of its adherents are concerned with seeing it integrated into the broader neoclassical framework (or seeing the latter expanded to include it). Nonetheless, its insistence that firms be viewed as organizations and that explanation of economic outcomes requires an underlying organization theory is a definite, important departure from the mainstream - so much so that it is unclear that an integration with neoclassicism as we know it is even possible" (1984: 750).

Enforcement of contracts is typically imperfect for various reasons. Among others, measurement is costly; the interests of principal and agents are not identical (and sometimes even opposed); the existence of contingencies that are too numerous (or too costly) to be fully anticipated (de Jasay, 1989; Milgrom and Roberts, 1990; North, 1988; Weingast and Marshall, 1988).

In a nutshell, transaction costs consist of the ex-ante costs of negotiating, arranging and drafting an agreement, and, more especially the ex-post costs of monitoring and enforcing it (North, 1993: 43-50).

The cost of transacting, thus, reintroduces the question of economic cooperation, and makes the institutional structure the key to understand complex economic exchange. Under the neo-classical postulates of behavior and resource allocation, transaction costs are assumed to be zero: it is costless to discover with whom one wishes to exchange, to negotiate and to enforce an agreement. This has been clearly illustrated by the so-called "Coase Theorem": In a world of zero transaction costs, "there are no economic problems short of the over-riding problem of scarcity, and the behavior of economic agents could be predicted simply by the correct specification of production and utility functions in an objective function, appropriately constrained by finite resources" (Breedon and Tomanoff, 1984: 167). But once the existence of transaction costs is acknowledged, the defining, negotiating and enforcing costs may be significant enough to inhibit any agreement. As Coase puts it, if we move from a regime of zero transaction costs to one of positive transaction costs, what becomes immediately clear is the crucial importance of the institutions in this world (1994: 11).

### 3. The role of the institutions.

According to Douglass North, wealth-maximizing individuals will usually find it worthwhile to cooperate with others when the interaction is repeated, when they have information about the other individual's past performance, and when there are small number of them. Opportunism will be constrained, thus, by personalized exchange and repetitive dealings <sup>3</sup>.

But cooperation will be difficult to sustain when the interactions are not repeated, when information on the other persons is lacking and when there is a large number of participants (North, 1993: 52-53). In a world of impersonal contracting, the gains from "defection" (opportunism, cheating, fraud) can be big enough as to forestall the development of complex exchange (North, 1993: 53; McLean, 1994: 35).

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As Kenneth Shepsle (1991) recalls, "the various 'folk theorems' in game theory suggest that, in particular kinds of repeat-play settings, credible punishment regimes do exist that permit trust and cooperation to develop" (253).

Hence, the question is: What will make an economy achieve complex and impersonal economic interactions. From the New Institutional Economics' point of view, this role is played by the institutions. In Mancur Olson's words, "...sometimes, when every individual considers only its own interests, a rational collective outcome emerges automatically...", nonetheless, sometimes "it does not matter how intelligently every individual seeks its own interests, no rational social outcome can spontaneously emerge - only a guiding hand, or an appropriate institution can make efficient collective outcomes to rise... " (cited in Sandler, 1992: vii).

Following North's definition, "Institutions are the humanly devised constraints that structure repeated human interaction" (1993: 13). They are created to produce order and reduce uncertainty in exchange. Institutions are the rules of the game, which include not only both informal constraints (such as sanctions, taboos, customs, traditions and codes of conduct) and formal rules (constitutions, laws, property rights), but also the way in which their enforcement is carried out (North, 1993: 14).

While different forms of institutions (and their enforcement) as a mean of promoting trade can evolve in the early stages of economic development in the form of a system of reputation, ostracism, codes of conduct, etc., for a more complex and interpersonal exchange to arise, a third party to every private contract, an ultimate source of enforceability is needed. Whereas markets take better advantage of self-interest for enforcement purposes, there may be economies of scale that favor administrative institutions. In the new institutional economics' jargon, providing such an enforcement ordering requires a form of *governance structure* (Weingast, 1995: 2). As North indicates, historically this role has been played by the state: governments take over the protection and enforcement of property rights because they can do it at a lower cost than private volunteer groups (North, 1993: 50).

Nonetheless, the introduction of the state as the institution that enforces contracts and property rights poses the following dilemma: A state with sufficient coercive power to do this also has the power to withhold protection or confiscate the wealth of its citizens (North, 1981: 21, Weingast, 1995). Political rulers, following redistributive purposes or purely motivated by predatory reasons, can arbitrarily seize assets or radically alter their value (Levi, 1988; Olson, 1982). Under these circumstances, the question is: what institutional mechanisms will allow the individual citizens to hold the rulers accountable for their public decisions ?



#### 4. The institutions of limited government and the "Rule of Law"

The introduction of the state as a third party enforcer entails the classic problem of the revocable and irrevocable Social Contract. Hobbes' irrevocable Social Contract is a contract between a society of persons in an imperfect state of nature and a state possessing the monopoly of the use of force. The irrevocability of this contract and the establishment of a Leviathan with absolute and discretionary powers is justified by a very narrow definition of the individuals' restricted domain, that of self-preservation (de Jasay, 1989: 73, 85).

By contrast, a revocable contract, based on a more comprehensive definition of the individuals' restricted domain, leaves society and the ruler as two autonomous post-contract parties, both having the material capacity to cease the contract. If there is no overwhelming superiority of force on one side or the other, both civil peace and limited government are mutually achievable (de Jasay, 1989: 75; North, 1981: 22). Thus, the extension of the definition the individuals' restricted domain to include property in its larger Lockean sense (life, liberty, and material goods) constitutes the nature of the rule of law and limited government. Putting it the other way round, the classic liberal conception of limited government under the rule of law is bound to protect individual rights, both economic and political, religious and civil.

Hayek's presentation of the "rule of law" in his *Constitution of Liberty* serves as a clear interpretation of these ideas: "There is only one such principle that can preserve a free society: namely, the strict prevention of all coercion except in the enforcement of general abstract rules equally applicable to all" (1960: 284). The generality of the rules refers to a state where rules, not men, govern the lives of men. These rules must be general, possess certainty, and treat individuals equally (Arnold, 1991: 235). In Hayek's own words, "because the rule of law means that government must never coerce an individual except in the enforcement of a known rule, it constitutes a limitation on the power of all government" (1960: 205). Thus, the rule of law imposes strong limits on the rulers' discretionary behaviors <sup>4</sup>. Moreover, the rulers' commitment to general, prospective rules makes their actions much more predictable. Without a rule of law, the government actions would

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Despite much criticism because of Hayek's reliance on the universality principle to define the rule of law, as John Gray (1986) notes "is not that the rule of law contains freedom as a part of its definition, but rather that a freedom-maximizing rule is unavoidable yielded by it" (68).

include all sorts of arbitrary measures. To make a long story short, unlimited and discretionary government -- using a widely recognizable metaphor -- entails uncertainty about "death and taxes". The rulers can take the individual's life and confiscate their property, without any kind of justification, simply because it is in the government's will to do so.

##### 5. Credible Commitment: The rule of law and economic performance.

Limiting the government's arbitrary powers as a way to enhance individual freedom and the protection of the individual's political liberties and civil rights seems to be somehow evident. According to North, the connection between the political institutions of limited government and economic growth is also straightforward, "the more secure are these freedoms, the lower the costs of transacting; and declining transaction costs are ... a critical historical source of economic growth" (North, 1988: 4). A relatively recent, but now well established, literature in economics has shown that the absence of secure protection for the reward to effort deters investment and, hence, economic development (Cheung, 1974; de Soto, 1986; Eggertsson, 1990; North, 1981, 1990; North and Thomas, 1973; North and Weingast, 1989; Olson, 1982; Schultz and Weingast, 1996, Weingast, 1995a, 1995b, 1996; Williamson, 1994).

As Rosenberg and Birdzell note, the importance of limiting government's discretionary authority for encouraging economic development is clear in the economic history of Western Europe. Among the institutional innovations they claimed that reduced the political risks of trade were a legal system designated to enhance predictability of the rulers' actions, and the "change of governmental revenue systems from discretionary expropriation to systematic taxation - a change closely related to the development of the institution of private property" (1986: 113). Common to all this literature is the notion that the achievement of a stable and recognized institutional framework that specifies property rights and furnishes an effective enforcement of them will provide the necessary incentives for people to seize the economic opportunities offered by that given country. These opportunities will materialize in the form of investments and the subsequent economic growth (North and Thomas, 1973). In the absence of this security, the incentives to invest in physical and human capital are considerably reduced (Shepsle, 1991: 245). People will invest less if they think

there is a risk that the state or another person might take away or confiscate their property. In Shepsle's words, "Discretion is the enemy of optimality, commitment is the ally" (1991: 246) <sup>5</sup>.

As North and Weingast (1989) suggest, a developed market entails security of property rights over time and will evolve efficiently only where the political institutions such as formal rules or constitutional guarantees are honored, and the government credibly commits itself to upholding property rights, protecting the individual's wealth and eliminating confiscatory measures.

The phenomenon of credible commitment, thus, is crucial to this perspective. the critical political factor is the degree to which the regime or ruler is committed to or bound by the rule of law. The observance of "general rules equally applied to all" add predictability to the governmental decisions and eventually constitute the necessary conditions for a credible investment climate to emerge.

#### 6. The coordination problem once again.

Economic growth depends on legal and stable institutions that provide low costs of transacting in impersonal political and economic markets. Yet, the rule of law is a meta-legal principle, and, as Putnam observes, it seems that the individuals would not be able to reach such principle for the same reason they needed in the first place, whereas an impartial "lawgiver" is as problematic as an impartial Hobbesian sovereign (1993: 166).

Thus, for such principle to arise and be effectively imposed over the government's actions, there must be a consensus among the individuals about its definition, scope and characteristics (Binmore, 1984) <sup>6</sup>.

As Barry Weingast points out, given the natural diversity of preferences, opinions and values of the individuals about the appropriate limits of government, only if there is a consensus among them about the legitimate boundaries of the state and they are willing to withdraw their support from a ruler who violates them, then the ruler will avoid violating these boundaries. In contrast, if citizens

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The original statement of the potential conflict between discretion and optimality can be found in Finn Kydland and Edward Prescott (1977). According to them, discretion is associated with the idea of exercising discretionary authority, optimizing a period at a time.

Iain McLean makes a similar argument in a recent article (1994).

hold different views about the legitimate boundaries of the state -- or if they are unwilling to take costly actions to defend these boundaries -- then the ruler will be able to violate these boundaries and still retain enough support to survive (Weingast, 1996: 4).

From this perspective, the establishment of limited government under the rule of law is a type of coordination problem among citizens: "Because citizens have different views about what limits are most appropriate" Weingast states, "a unique, widely held ideal set of limits is unlikely to exist. Coordination requires that most, if not all, citizens compromise their ideal limit. Paradoxically, when citizens disagree, if all hold out from their ideal limit, citizens cannot coordinate and hence cannot police limits on the state" (1996: 12) <sup>7</sup>.

Building on Weingast's analysis, the case of 19th century Argentina presented in Section III will be used to illustrate this point of view: "the effects of the lack of social consensus and the importance of constructing a coordinating device for resolving problems about maintaining political rights and other limits on the state" (1996: 29).

## **II. Common Interpretations of Argentina's Economic Performance.**

Traditional interpretations of Argentina's economic performance focused almost exclusively on factor endowments (land, labor, population, technology) from a purely neo-classical perspective. Thus, they were unable to explain the country's economic decline. Alternative, neo-structuralist economic historians and economists stressed external factors to explain Argentina's development and underdevelopment: the changes in the international trade and the world economy.

These rival views responded to different and often conflicting traditions in economics: the orthodox/neo-classical, and neo-structuralist/dependentist approach. To give an example, during the 1960s two works in this field were to have a significant influence: Guido Di Tella and Manuel Zymelman's *Las etapas del desarrollo económico argentino* [the Stages of Argentina's Economic Growth] (1967), and Aldo Ferrer's *La economía argentina: Las etapas de su desarrollo y sus problemas actuales* [the Argentine Economy: Its Development Stages and Current Problems] (1963). The former was conceived as a thesis under the supervision of W. W. Rostow, which accepts

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Hayek addresses this point recognizing that generality, like equality before the law remain an ideal beyond our ability of accomplishment. See also de Jasay (1989), Ch. 5.

the rapid growth of the period 1880-1914 and seeks to explain why it was not sustained after 1914 with the same parameters. The latter, like Celso Furtado's study of Brazil, examines the structure of the economy from the colonial period to the present and it is strongly influenced by the literature on development from ECLA/CEPAL.

The distinctive characteristics of a strict neo-classical analysis, and its limitations have been already mentioned. As Douglass North has pointed out, growth theory -- as it has evolved from the neo-classical approach -- focuses almost exclusively on factor endowments in accounting for the record of the different countries' economic development, taking the institutions as given (1995). The experience of Argentina, with similar if not less favorable factor endowments than the US. and Canada, but yet very different in its economic performance, suggests that factor endowments alone cannot explain this stark contrast of outcomes.

As for the neo-structuralist view -- as Jeremy Adelman (1994: 5) notes in a recent book -- even when the process of economic expansion of Argentina in the second half of the 19th century would be unintelligible without reference of external factors, this approach, as a full explanation of *how* growth occurred in also insufficient <sup>8</sup>.

From both, the neo-classical, and neo-structuralist perspective, the evolution of the economic variables is seen as either independent of the existing political institutions, or the cause of a specific development of them <sup>9</sup>.

Conversely, the proposed argument in this paper is to provide an endogenous role for the political institutions in the process of economic development, as a fundamental factor for the emergence and expansion of markets in the late nineteenth-century Argentina.

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Although Adelman (1994) correctly points out that understanding the role of the institutions is crucial to explain Argentina's economic expansion in the late 19th century, he does not fully understand the neoinstitutional approach, specially on property rights.

A healthy exception are the seminal works of Roberto Cortes Conde and Ezequiel Gallo (1972; 1973), and Cortes Conde (1974). Yet, as Cortes Conde put it, his concern with more structural factors lead him to devote little attention to the political and institutional variables (1974: 188).

*"... A Nation that demands from its government nothing but the maintenance of order is already a slave in the bottom of its heart; it is the slave of its well-being, and the man who is to chain it can arrive on the scene."*

- A. De Tocqueville

### **III. The Argentine Republic: From The Uncertainty of Independence to a Constitutional Rule of Law.**

#### **A. The Quest for Order.**

As many historians have pointed out the early years of independence brought chaotic struggles and deep political instability to the former Viceroyalty of Rio de la Plata.

In May 25, 1810, following the news of the Central Junta's dissolution in Spain, the Viceroy and Municipal Junta of the United Provinces of the Río de la Plata turn authority over to a Creole provisional junta, ruling in the name of Ferdinand VII. This alleged loyalty to the Spanish Crown was just a masquerade. The Argentine revolutionaries, once they had established a governing junta at Buenos Aires, claimed to exercise the supreme authority over the entire Viceroyalty.

#### **1. Unitarios and Federales.**

The elites of Buenos Aires were well aware that their objective to extend the results of the revolutionary pronouncement to the whole country would face the resistance of the Spanish forces. Yet, they took for granted that the provinces would support the movement and agree upon joining the new government, especially since they had been offered to send deputies to a constituent congress that would decide the future organization of power. However, the different interests and perspectives between the regions were going to potentially unfold into the foremost political problem (Di Tella, 1994).

As soon as the deliberations on the future political organizations were held, the political issue that would be at the center of the stage for the subsequent decades rose: the dilemma between a centralized government or a decentralized one. As James Scobie points out, this was the principal schism of the early national period, the debate "between centralists (unitarios) and autonomists

(federales), or between the advocates of strong central government and the supporters of a loose confederation of provinces" (1971: 88-89).

The unitarians (often represented by the Buenos Aires elite holding radical Jacobinist ideas) contended that if the country were to resist the assaults of the Spanish forces, and subsequently, to achieve political stability, it was essential to establish a strong and centralized national government. From their point of view, the sacrifice of provincial autonomy was justified on the ground that the political unit should be "one and indivisible", and thus, internal political factions should be eliminated (Burgin, 1946: 79-80).

The federalists rejected the unitarians' argument that the nation had neither the necessary resources nor the experience for an elaborate system of overlapping authorities. They stood for the autonomy and self-government for each of the provinces, claiming not only that the country's vast territory and regional differences made it necessary, but also, that it was deeply rooted in the traditions of the Argentine people (Burgin, 1946: 80).

## 2. The Rivadavia experience.

In the following years, the centralist unitarios' attempts to constitute a national political order clashed with the provincial *caudillos*'s intents on carving out separate domains for themselves (Williamson, 1992: 274). As Klaus Gallo suggests, during the Pueyrredón administration, from 1818 to 1819, a federal system or some sort of policies favoring more political participation of the provinces were absent. Thus, the tensions between the interior and Buenos Aires intensified considerably, making the prospects for a national union seem extremely remote (1995: 23).

The last vestige of national authority expired in 1820, and successive efforts to recreate a national government in 1825-27 proved unsuccessful. From 1821 to 1827 a program of reforms was adopted in Buenos Aires. The man behind them was Bernardino Rivadavia. Representative of the Creole liberal thought, Rivadavia believed in a unitary liberal state. His project was to create a European state in the Southern Hemisphere, by means of imitation and transplant of the institutions prevailing in the "civilized world." He attempted to define more clearly the limits of the Executive,

Legislative and the Judiciary to achieve credibility among European observers (Gallo, 1995: 27)<sup>10</sup>. Nonetheless, this recreation was condemned to be just a matter of decrees and imitations, a facade. His big dream of peace, prosperity and civilization was nothing but an impracticable fiction in a deeply divided country like Argentina (Shumway, 1991).

By early 1827, Rivadavia's government was on the brink of dissolution. Four provinces -- Cordoba, La Rioja, Catamarca and Santiago del Estero -- had formed a military alliance to resist the 1826 constitutional proposal. General Bustos, of Cordoba, declared that his province refused to recognize the law of the National Congress which had established the National Executive and had allowed the election of Rivadavia to the presidency. In July 1827, barely six months after being designated president by the 1826 constitution, Rivadavia resigned (Rock, 1985: 103). His resignation and subsequent departure into voluntary exile also signaled an abandonment, for the following 25 years, of the attempt to create a national government (Bushnell, 1983: 50).

### B. The Rosas Regime.

Following Rivadavia's overthrow, after more than twenty years of failed attempts to establish a constitutional political order since the country's independence, and in the midst of a new civil war, with the support of the federales, Juan Manuel de Rosas was elected to the governorship of Buenos Aires.

Since the resignation of Rivadavia, the province of Buenos Aires, and the country had been in a state of turmoil. Under these circumstances, Rosas clothed himself with dictatorial powers. He took the title "Restorer of the Laws" (Restaurador de las Leyes), and five days after his installation as governor, he was voted extraordinary faculties to "restore" the order. In March 1835, he finally requested, and received from the Junta de Representantes, full dictatorial authority. He was invested with the "Plenitude of Public Power" (Suma del Poder Público). According to Gallo, "this device enabled him to remain in power for so long, forcing political opposition to exile, and transforming him as the fearful and undisputed guarantor of political and social order" (1995: 33).

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According to K. Gallo, "the years spent as a diplomatic envoy in Europe during 1816-19, had considerable effect on Rivadavia, and put him up-to-date with European politics and the main ideological trends prevalent at that time. Meeting up with prominent politicians in France, England, and Spain, and establishing connections with influential political thinkers, such as Destutt de Tracy and Bentham, no doubt helped to expand his own political scope" (1995: 27).



This grant to Rosas of supreme and absolute powers represented a formal abandonment of liberal political faith. The result was a very personalistic and centralized type of rule that discouraged any kind of institutionalization. Strongly opposed to liberalism and all its works, Rosas "manipulated the law as he saw fit" (Williamson, 1992: 275).

### 1. The economics of Rosas.

From the point of view of the theoretical approach presented above, the Rosas years had serious effects on Argentina's economic performance. On the one hand, his regime imposed a degree of order and unity on the scattered towns of Argentina. According to Ferns, order was preserved within the extensive province of Buenos Aires, the frontier was pushed southward and westward, the national independence was preserved, and for many who had experienced the social instability and political anarchy so close at hand, the regime of Rosas was a working alternative not to good government but to no government (1973: 216). On the other hand, the threat to liberty and property did not cease; rather the damaging consequences of the preceding anarchic era were replaced by the discretionary rule of a central authority.

#### 1.1. The expenditures' problem.

By the time Rosas took power, the economic conditions in Buenos Aires at the time were far from being prosperous. The situation was described in January 7, 1832 by the *British Packet and Argentine News* in these terms:

"The country is now suffering from the calamity of a long drought and the stagnation of trade occasioned in great part by the late contentions amongst its citizens. It would be folly to disguise the fact that these disputes have not only paralyzed commerce, but they have struck a severe blow against that which is always its main support, viz.: credit; and nothing but a continuance of internal peace can restore confidence, and renovate the nearly despairing hopes of the merchant and trader" (cited in Burgin, 1946: 157).

Rosas not only had to cope with such adverse economic conditions but he also had to deal with an enormous deficit and a large public debt inherited from his predecessors. The financial problems of his government were similar of those of the previous administrations. As Burgin points out, "that

deficits were at the root of financial difficulties was recognized by everyone. It was also generally agreed that so long as the political situation remained unsettled deficits were unavoidable. Restoration of financial stability presupposed long-range planning on the part of the government. Such planning entailed drastic changes in the pattern of both expenditures and revenues" (1946: 158). By dint of strict and careful accounting Rosas was able to close the first year of his administration with a surplus of nearly 1,800,000 pesos. However, in each of the four following years revenues were again short of expenditures. In the course of these years, from 1830 to 1833, the treasury had accumulated a deficit of nearly 5,000,000 pesos (Burgin, 1946: 166 and 169). Under these circumstances, Rosas attempted to put in practice a program of financial rehabilitation based on a strict economy in expenditures, efficiency in the administration, and collection of revenues. Nevertheless, in spite of all these efforts, he never succeeded in meeting expenditures out of ordinary revenues.

The province's expenditures rose year after year. By far, the largest proportion of the government's expenditures originated in the Ministry of War (Ministerio de Guerra). As Burgin, Rock, and others noted, this was perhaps inevitable, given the uncompromising and absolutist character of the regime established by Rosas (Burgin, 1946: 286; Rock, 1985: 110; Gallo, 1995: 33). As a result of the needs of periodic terror and constant repression, Rosas maintained a large standing army, of 20,000 men, and a militia of around 15,000. These military demands on the budget rarely dropped below half total expenditures. In 1841, for example, military expenses absorbed three-quarters of the budget of Buenos Aires (Rock, 1985: 107).

< Place Table 1 Here >

As the regime's permanent military expenses grew, Rosas was constantly forced into measures to amplify revenues. Invested with dictatorial powers, he thus had ample and discretionary authority to conduct the financial affairs of the province without consulting the provincial assembly. Therefore, -- as Burgin remarks, -- to meet the ever mounting deficits, Rosas "followed the line of least resistance" (1946: 204).

## 1.2. Rosas' financial schemes: Issuing bonds and printing money.

The revenues from ordinary taxation were scant, so Rosas decided to use the government power in different ways to raise income.

Commanded by Rosas' unlimited authority, agents of the regime (*La Mazorca*) seized various goods for "public purposes". This para-military body was financed, in part, through the profits of state-run cattle ranches confiscated from the regime's "enemies". Rosas also relied on the exploitation and sale of public lands. From these public lands, the province derived revenue in two ways. One was in the form of rentals on government-owned lands held in emphyteusis, but this income was relatively modest. By 1838, rather than extending the emphyteusis system and improving its administration Rosas preferred to sell public land outright. In 1839 the sale of public lands yielded 1,062,000 pesos, but one year later, in 1840, the province received only 101,000 pesos and thereafter no income from this source were reported by the treasury (Burgin, 1946: 199 and 200)<sup>11</sup>.

In order to make up annual short falls, thus, Rosas relied chiefly on financial and monetary measures to increase revenues. In 1831, under his influence, the legislature approved the issue of 6,000,000 pesos in bonds of the Fondo Público for budgetary purposes. Again, in 1832, 4,000,000 pesos in bonds at 50 per cent par were distributed among merchants, landowners, and cattle breeders by the Tribunal de Comercio on behalf of the provincial government. As Burgin observes, "the bonds were fully subscribed, although not without considerable pressure on the part of the government. On February 14, 1832 the *Gaceta Mercantil* claimed in a leading article that the proposed distribution of bonds was neither a loan nor a forced contribution, but rather 'a spontaneous private undertaking' " (the prices depreciated by more than 15 per cent immediately after the bond was launched) (1946: 169). Still, the loan brought only temporary relief and the provincial government was once again forced to borrow. In March 1834, the Junta de Representantes

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In a recent paper, Stanley Engerman and Kenneth Socoloff (1995) claim that the role of factor endowments "had been underestimated, and the independence of institutional development from the factor endowments exaggerated" in current explanations of 19th century Latin American economic development (2). When referring to the Argentine case, they posit that the substantial inequality in the distribution of land "may have persisted because of scale economies in raising cattle on the Pampas" (17). However, they disregard that this unequal distribution of land was more a consequence of policies adopted by financially challenged administrations in need of revenue, than a result of policies taken because of the existing factor endowments and the particular crops grown in the Argentinean soils.

authorized a loan of 3,000,000 pesos. Seven months later, in November, the legislature sanctioned another issue of 5,000,000 pesos in Fondos Públicos (Burgin, 1946: 170-171).

The financial market of Buenos Aires was rapidly approaching its point of saturation. Moreover, as the public debt grew in volume, interest charges and amortization service consumed an increasing portion of the province's revenues. It was becoming increasingly evident that short-term borrowing could not offer a permanent solution to the financial difficulties of Buenos Aires. Still, Rosas argued that the money market was far from saturated, and in 1837 the government issued 17,000,000 pesos in bonds, the largest operation in the history of the Fondos Públicos. However, as soon as it became known in Buenos Aires that a new issue of bonds was contemplated the bond market became fully discouraged. In March 28, 1840, the last bond issue under Rosas (to the amount of 10,000,000 pesos) took place. In view of the circumstances, the treasury was seldom able to dispose the bonds at less than 40 per cent discount, nor were the moneyed classes of Buenos Aires very receptive to continued bond issues (Burgin, 1946: 204-205).

Lacking bond sales as a resource for revenue, the Rosas administration turned to other, much more distortionary mechanisms of finance. As a result of its uncontested authority, the government had at its disposal a much less constraining method of finance, namely the issue of paper money. At this stage, Rosas concluded that inflation was preferable to borrowing, and thus, the government resorted to the printing press. In March 1837 -- with the justification that it was a temporary measure intended to tide the treasury over until the market for Fondos Públicos improved -- 4,200,000 pesos in currency were issued (Burgin, 1946: 208). In December 1838, the Casa de la Moneda turned over to the treasury 8,000,000 pesos in new notes. An additional issue of seven monthly installments of 1,225,000 pesos each was made available in the subsequent months. Yet, by August of 1839 these funds were exhausted, and revenues were still far below expenditures (Burgin, 1946: 213).

### 1.3 The lack of long-term borrowing.

It is worth noting that even when the money market showed increasing resistance to new issues of bonds, and the creation of more money was not enough to cover the deficits, the government never turned to long term borrowing. The reasons which precluded Rosas to having recourse to long term borrowing seem to be clear. According to the theory of sovereign debt (Bulow and Rogoff, 1989;

Conklin, 1995; Eaton, Gersovitz, Stiglitz, 1986; Root, 1989; Veitch, 1986), the main obstacle to efficient state finance during the Rosas regime was that the principal player -- Rosas himself -- was above the law. This meant that he could not be compelled to honor his debts.

Schultz and Weingast observe that the central issue motivating the literature on sovereign debt is how private lenders enforce loan agreements with a sovereign who possess -- as in the case of Rosas -- a monopoly of the state coercive powers (1996: 7). Paradoxically, as Root notes, because the sovereign claims full discretion, he has less real power: claiming to be above the law in fiscal matters makes it more difficult for the ruler to find partners from trade. The use of discretion reduces his payoffs in equilibrium because utilizing absolute power destroys his credibility (1989: 253)<sup>12</sup>.

An additional difficulty was that, in spite of Rosas' inflationary policies, loanable capital was chronically scarce in Buenos Aires, and thus, had to be sought overseas. As Ferns indicates, the dominant classes of Argentina were a class of poor rich, "rich in land but poor in capital". Hence, they were seriously dependent upon foreign communities for capital (1977: 144). However, foreign credit was even more difficult to obtain for the Rosas regime. He was not a very attractive borrower: his recurrent episodes of fiscal irresponsibility, property confiscation, currency devaluation, etc. were not ignored overseas. Depreciation of the peso was a strong obstacle to international long term borrowing operations, but most important was the regime's reputation. Argentina's poor track record as a debtor also complicated its search for external sources of credit. The default of the Baring loan, obtained by Rivadavia in 1824, forestalled prospects of renewed British and other foreign capitals' investment.

#### 1.4 The financial crisis.

Deprived from long-term borrowing, Rosas turn to currency issue as a means of financing deficits. He realized that currency expansion imposed no additional burden upon the treasury in the form of interests and amortization (in contrast to the public bonds issue). Furthermore, *fiat* money made it possible for his administration to reduce the public indebtedness of the province at a rate which

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In a recent study Schultz and Weingast (1996) present this problem in these terms: "Suppose that a sovereign seeks a loan of value  $L$  at an interest rate of  $i$  and that the lender can impose a penalty of  $P$  in the event of a default ... When the loan becomes due, the sovereign must choose to repay the creditors  $L(1+i)$  or default and suffer penalty  $P$ . Obviously, the sovereign will honor the loan agreement if and only if the following relationship holds:  $L(1+i) \leq P$ ." (7).

would have been impossible under conditions of stable money (Burgin, 1946: 216). As Burgin stresses, "no commentary on Rosas' monetary policy is more revealing than a comparison of the amount of money in circulation before and after the federalist regime. In May 1836, ... the currency of the province amounted to 15,283,540 pesos in notes of bank. At the close of 1851 the last full year of Rosas's administration, the quantity of paper money in circulation rose to 125,264,294 pesos. The regime was thus responsible for the issue of 109,980,854 pesos, in a period of slightly over eleven years" (1946: 216). Clearly, this was just another way to renege on the public debt, facing the fiscal obligations with depreciated paper money.

< Place Table 2 Here >

Overall, this mechanism of debt finance had disastrous consequences for the economy, fostering Rosas eventual collapse. In many respects his dictatorship brought, in economic terms, little more than stagnation and decline. The old routes between Buenos Aires and the interior continued to be transited by ox carts and mule trains, and, immense regions in the far north and south reminded "unconquered and untrammelled" (Rock, 1985: 113).

### C. Rosas's fall, and the march towards the 1853 constitutional arrangement.

Although federalism and liberalism are associated in conventional interpretations of nineteenth-century Latin America, Argentina is commonly cited as an exception. Rosas, though nominally a federalist, with his anti-liberal policies did more than anyone to ensure the political and economic dominance of Buenos Aires over the other provinces. To sustain this status quo he had to face the costs associated with constant vigilance and frequent use of military force against nonconformist provinces and unmanageable *caudillos*.

The biggest irony of the period is that the authoritarian character of the Rosas regime, thus, unwittingly prepared the ground for the eventual unification of Argentina (Williamson, 1992: 276).

In 1852, the *caudillo* of Entre Rios, Justo Jose de Urquiza, with the support of military forces from Brazil and Uruguay and the liberal unitarios in exile, defeated Rosas's men in the battle of

Monte Caseros. The defeat of Rosas at Caseros, February 3, 1852, opened the door for a political program "based on the principles of order, fraternity, and a forgetting of the past", in Urquiza's words. In May 1852, the provincial governors met at San Nicolás de los Arroyos -- a small city in the north of the province of Buenos Aires, close to the border with Santa Fé --, and they reissued the old federales' demands for the sharing of trade revenues and an end on restrictions on river commerce. At the conclusion of the convention, the *Acuerdo de San Nicolás*, as the agreement was called, endorsed the call of a Constituent Assembly for the establishment of a constitution that would both erect a strong central government and eradicate internal restraints on trade (Rock, 1985: 120).

However, the majority of opinion in Buenos Aires opposed it. As Rock argues, Buenos Aires' acquiescence in the fall of Rosas did not imply a willingness to jettison the privileges he had given the province: "Buenos Aires wanted neither to open up the rivers nor surrender control over its revenues" (1985: 121). The agreement, thus, broke down with the formation of three groups: the federal Urquiza group that favored national union; the followers of the Buenos Aires' politician Valentin Alsina, who insisted on an independent Buenos Aires province; and a group led by Bartolomé Mitre, that favored national organization, but only under the recognized leadership of Buenos Aires.

In early 1853, the liberal regime in Buenos Aires rejected the San Nicolás accord and withdrew from the constitutional convention. Nevertheless, the constituent assembly pressed ahead. The provincial delegates to the convention sought to create a new federal constitution in which Buenos Aires would have a place, but not a dominant one. The constitution had particular federal features, like a national Senate, a body designed to safeguard the interests of the interior. Yet, overall, the constituent congress produced a constitution about which the unitarios could have few complaints and liberals none. It created a strong national executive with the faculty of federal intervention (intervencion federal) in the provinces. The constituents had also seized the mantle of liberalism.

As Ferns puts it, the liberals of Buenos Aires, thus, were being beaten at their own game. It was no longer possible for them to quarrel about principles (1977: 295-296). There remained now only a naked struggle for power: Buenos Aires refusal to rejoin the other provinces had little to do with political differences but was based on economic motives. As he notes, the constitution had placed in the hands of the national government the power to tax and, thus, to mobilize the financial resources not just of the poor provinces but of the rich province of Buenos Aires.

In 1854 Urquiza became president of a new Argentine Confederation with its capital at Concepcion del Uruguay, in Entre Rios. Buenos Aires severed all links with his regime and seceded under its governor's leadership. For the next six years, 1852-58, Buenos Aires remained independent of the Confederation, each maneuvering against the other, sometimes engaging in token wars, but more commonly resorting to blockades or discriminatory tariffs (Rock, 1985: 121; Ferns, 1977: 296).

In 1858, a tariff war broke out, and eventually turned into an armed conflict in the spring of 1859. Urquiza's forces, then, moved upon Buenos Aires, and defeated its forces at the battle of Cepeda. In response, the politicians of Buenos Aires agreed to enter the Confederations if some modifications in the 1853 constitution were made. On October 21, 1860, the amended constitution was accepted, but new tensions became evident immediately. The credentials of the Buenos Aires representatives to congress were rejected as their number, determined by the provincial constitution was greater than the allowed by the national one <sup>13</sup>.

Buenos Aires, thus, declared all agreements null and void and prepared for war. In addition, as Urquiza's constitutional term in office came to an end, he was succeeded by his minister of interior, Derqui. This was enough for the politicians of Buenos Aires. Bartolome Mitre, the governor of the province, took the field. At Pavon, in September 1860, an inconclusive engagement was fought. Mitre's city militia, equipped with new imported rifles and cannon, finally managed to withstand Urquiza's cavalry (Rock, 1985: 123).

Although Pavon was scarcely a military victory for Buenos Aires, Urquiza elected to retreat. He announced his retirement from politics and the Confederation's president Derqui resigned the Presidency. The Federal Congress dissolved itself, and new elections were held in May 1862. A few months later, an electoral college of delegates from the provinces voted Mitre the first president of a united Argentine Republic.

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A key provision of the constitution gave the province of Buenos Aires less than proportionate representation in the congress to prevent their domination.



*"...In constraining any system of government, and fixing the several checks and controls of the constitution, every man ought to be supposed a knave, and to have no other end, in all his actions, than private interest"*

- D. Hume

#### **IV. The Model, Argument and Indicators.**

##### **A. The 1853 Constitution as a Self-Enforcing Equilibrium:**

With the adoption of the 1853/60 constitution the basis for a united Argentine Republic was set in place. This raises the issue of why could Buenos Aires and the provinces, finally did reach an agreement upon the institutions created by the 1853 constitution ?

The main reason seems to be straightforward: complementarity and mutual interest laid at the heart of the national unification under the 1853 constitution. Both parts had, at this time, the understanding that political unification and economic growth were reciprocal and mutually reinforcing. Security and the creation of a common market were the two main important sources of mutual gain (Weingast, 1995b: 23). Therefore, the provinces were persuaded to accept government from Buenos Aires, which in turn gave them a share in prosperity and power (Rock, 1985: 123).

Yet, as it was related in the previous section, such an understanding was reached only after several decades of internal wars, the drafting of two failed constitutions and more than twenty years of authoritarian government. Lets examine this from a theoretical point of view.

##### **1. The Coordination Problem.**

As argued above, the post-independence political stability and the rise of Rosas in nineteenth-century Argentina can be seen as a coordination problem. Throughout the forty years that followed the independence, the Argentineans were deeply divided over the scopes and limits of the federal government and the appropriate limits on state behavior. Under these circumstances two main political coalitions, the unitarios and the federales came forth <sup>14</sup>.

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In 1830, *The British Packet and Argentine News*, a periodical published in English for the British community in Buenos Aires, trying to explain to its readers the differences between the unitarios and the federales refers to them as " the Whigs and Tories of this land" (Lapido and Spota de Lapiezi, Eds., 1976: 333-334).

These groups got locked in a struggle that surrendered economic cooperation and prosperity in favor of fratricidal violence and economic hardship. Despite the potentially large gains from cooperation, neither group was able to credibly commit itself from taking advantage of the other once a new, post-colonial, political order was created. This resulted in a classic Prisoner's Dilemma situation. As it is shown in Figure 1, in equilibrium both groups tried to impose their own political program. Hence, even though they could have been better off by reaching a constitutional compromise, their self-interested strategies lead them to anarchy and civil war.

< Place Figure 1 here >

For almost twenty years, after the revolutionary movement of 1810, thus, the central problem was the impossibility of the federales to trust the unitarios's proclamations that the provinces would keep their autonomy in the new federal structure. Certainly, the Pueyrredón and Rivadavia administrations, and the 1819 and 1826 unitarian constitutional attempts hardly served to support the view that the federal government was willing to respect the interests of the provinces.

## 2. A Simple Model of Equilibrium under Uncertainty (The Rosas Game).

This polarization, eventually opened the way in 1829 for an asymmetric equilibrium represented by the Rosas regime.

The federales supported Rosas despite his likelihood in becoming an autonomous dictator. The main reason for this was that many of the federal leaders -- specially the province's *caudillos* were not sure of Rosas' real intentions, whether he was really going to implement a federal program or whether he had his own agenda <sup>15</sup>.

In the model below, the game is played between the federales and Rosas (the unitarios represent only an outside option for the federales, but they are not considered a player in this game). The federales prefer a federal Rosas, F, to a constitutional agreement with the unitarios, C, and the

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In Williamson's words, "He was the most influential of the *caudillos*, but was willing to do little to develop the United Provinces into a Nation State as such" (1992: 275).

latter over a rule of an autonomous Rosas, R. The model also captures the differences between the two types of Rosas via his preferences. A true federal Rosas prefers the federales' program over his own agenda F\*, whereas an autonomous Rosas prefers to pursue his personal political goals over the federal ones, R. In terms of the payoffs, this implies that if the federales trust Rosas, they will consent an unlimited government under his leadership, but if they do not expect Rosas to implement their program they would be better off reaching a constitutional agreement with the unitarios. The problem is that they can not be sure about Rosas's intentions.

< Place Figure 2 Here >

Let  $\pi$  be the federales' subjective estimate of the probability that Rosas is a true federal. The federales' expected payoffs from each of their strategies are as follows. If they decide to reach a constitutional agreement with the unitarios they obtain the payoff C; when they support Rosas, they expect to receive the federal payoff F with probability  $\pi$ , but with probability  $(1-\pi)$  they expect Rosas to implement his own agenda, receiving a payoff of R. The expected payoff of the Rosas solution is:

$$\pi F + (1-\pi) R$$

Assuming that C is the value of the constitutional compromise with the unitarios, the federales would favor the Rosas regime over the constitutional agreement when,

$$C \leq \pi F + (1-\pi) R$$

The federales' choice critically depends upon  $\pi$ . For high values of  $\pi$ , they will support Rosas, for very low values, they will seek a constitutional compromise with the unitarios. The critical value of  $\pi$  is  $\pi^*$ , for  $\pi \geq \pi^*$ , the federales will trust Rosas, and for  $\pi < \pi^*$ , they will seek a constitutional arrangement, given that  $\pi^* = (C-R)/(F-R)$ .

Supposing, for example, that the federales' value of reaching an agreement with the unitarios, C, is 2, of being under an autonomous Rosas' rule, R, 1, and of having Rosas implement their

program, F, 3. These values indicate that the minimum probability necessary for the federales to prefer the Rosas solution is .5.

< Place Figure 3 Here >

This model can predict also the fall of Rosas. If the federales can make a more precise judgment of Rosas intentions as a ruler, this is, have an accurate appraisal of his true type, this will be reflected in the value of  $\pi$ . When this value is below the critical point  $\pi^*$ , the federales will find more attractive a constitutional agreement with the unitarios, even though they were not willing to do so before Rosas' appearance.

As it was noted above, as a consequence of Rosas' personal political goals, the maintenance of his regime needed a huge amount of military expenditures, leading eventually to inflation and recurrent financial crises. By 1852, the Rosas regime was in serious trouble, faced with the opposition of the federales of the interior like the Entre Rios *caudillo*, Urquiza, earlier Rosas' most devoted henchman. At this time they were certain about Rosas' true type, and their costs of supporting his regime outweighed the advantages it offered. Or, put another way, the two types of Rosas eventually separated while in office, and the federales updated their information.

As a result of this situation, the once irreconcilable parties perceived that they could do better under a stable and limited political order <sup>16</sup>.

### 3. The Rosas aftermath: Mutual Cooperation.

Initiating a stable period of peace and mutual cooperation, according to Weingast, requires the construction of a coordination device specifying generally accepted and unambiguous limits on the state and this can be achieved by writing a constitution (1996: 33). As he points out -- commenting on seventeenth-century England --, the emergence of such political consensus is critical to preventing further transgressions by the rulers: "Because the new boundaries were both explicit and

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This is consistent with Weingast's Sovereign-Constituency Transgression Game. According to him, because the state and its supporters benefit from transgressions against other citizens, an asymmetric equilibrium of this type is stable. Thus, "... breaking this equilibrium is difficult and requires something exogenous to the model. A crisis for example, might destroy the status quo." (1996: 33).

consensual, they fundamentally changed the interaction between citizenry and the new sovereign" (1995a: 17).

Similarly, in nineteenth-century Argentina, the fall of Rosas, led to the emergence of a new consensus inspired by the liberal principles of limited government and the federal claims of provincial autonomy. The participants of the 1853 constitutional debate generally agree to adopt a form of government, conceived in terms of the dominant 19th century liberalism. This was not fortuitous: liberal principles and ideas were long ago present in the Argentine political culture. The men who made the revolution in 1810 were in the main liberals with a strong tendency towards *laissez faire* economic and fiscal policy. According to Ferns, "their ideas differed in certain particulars of principle and emphasis, but they had common themes: the need for world-wide markets and free trade; the need to strengthen the institution of private property as a basis of independent self-interested decision-making; the need to recognize work as the true source of wealth; and the need for improved education and technical instruction" (1973: 21).

This liberal tradition re-emerged after the Rosas regime fell. This was precisely Alberdi's thought, "... if the individual's civil rights could stand by themselves from any attack, that is, if nobody attempts against our life, person, property, freedom, etc., the government would be needless, it would have no reason to exist" (cited in Iturrieta and Roman, 1988: 16). The state itself, was visualized as just a governing institution to enforce the laws made by a representative institution. In his most influential treaty, Alberdi wrote: "to govern little, intervene the least, let do the most, and make authority unperceivable, is the best way to make it appreciable" (cited in Iturrieta and Roman, 1988: 16).

Moreover, as the results of the model have shown, there were not only ideological reasons for the adoption of these principles and ideas. Given the strong tradition of despotism and autocratic rule that was also present in the minds of these intellectuals, particularly after the recent and traumatic Rosas experience, they were still very sensitive to the adversities of arbitrary and confiscatory government. They believed that a written constitution with very explicit provisions protecting individual rights and economic liberties was crucial to secure a process of peace and economic development in Argentina's future.

In a sense, the 1853 constitution was clearly the response to the decades of political and economic turmoil the Argentines suffered since their independence. Its main objective was to institutionalize the Argentine Republic into a representative and equilibrated federal organization of power in order to build a prosperous and modern society.

The adoption of the 1853/60 constitution, thus, represented a new consensus in Argentine politics. As it was related above, between the overthrow of Rosas in February 1852 and the presidency of Bartolome Mitre, in August 1862, Buenos Aires and the provinces got locked again in a struggle over the national organization. Yet, in contrast to the succession of conflicts before the Rosas regime, the antagonisms of these years were characterized by two decisive features: First, the absence of a full-scale civil war between Buenos Aires and the states of the Confederation. Second, the early economic development that followed the establishment of equal economic and commercial rights for all the provinces.

Complementarity and mutual interest, thus, laid at the heart of the unification. Security and the creation of a common market were the two main important sources of mutual gain (Weingast, 1995b: 23).

This was especially true for the provinces of the Confederation. Militarily, Urquiza had shown repeatedly that he could defeat Buenos Aires, and if he wished take the city, but he had never been able to maintain his position for any length of time in the face of local resistance (Rock, 1985: 122). Economically, in 1861, as a consequence of the North American Civil War, the Argentine litoral witnessed an unexpected boom led by wool exports. Still, to profit from the boom, the litoral provinces needed an accord with Buenos Aires.

As for Buenos Aires, after his victory at Pavon, and Urquiza's retirement from politics, Mitre wished to revive the constitutional notions of Rivadavia in the matter of Buenos Aires' place in the Republic. Yet, he understood that this plan would only lead to further war and he accepted the 1853 constitution (Ferns, 1977: 322)

In 1861, Buenos Aires and the other provinces, thus, finally conceded their mutual needs, a complementarity of interests that bred both conciliation and consensus. They came to an equilibrium. The provinces were persuaded to accept Buenos Aires' requests, in turn this gave them a share in property and power. In addition, the eventual integration of Buenos Aires in the Republic placed the financial resources of the richest area at the disposal of the whole country.

As Ferns puts it, with Mitre's inauguration as the constitutional president of the Argentine Republic, the basic compromise or general will of the Argentine community had been expressed in a social form: "it was agreed that the National Government and the Provincial Government of Buenos Aires should exist side by side in Buenos Aires, a living proof that the powerful interests of the community had ceased to seek dominance one over the other" (1977: 322).

The rules of the game were now set and it seemed that every player was ready to play by them. This is certainly consistent with the general theoretical framework presented in the first part of this study. The concept that lays behind this account is that of self-enforcement. Even when the institutions created by the constitutional arrangement limited the actors' behaviors, it was in their interest to abide by those limits. A new equilibrium, thus, was achieved. Once the new institutions were in place, it was in nobody's interest to change them, except in incremental and basically consensual ways (Weingast, forthcoming: 10).

Hence, the decline in military virtue and the rising esteem for money produced an equilibrium in Argentine politics, which in turn made the 1853 constitution self-enforcing.

## B. Credible Commitments: Institutionalization and Economic

### Progress.

According to the main theoretical framework presented in section I, the institutions of limited government conferred the necessary political foundation for economic growth. In this part, it will be shown that the fundamental institutions of representative government emerging out of the 1853 constitution (although they were very restrictive measured by today's standards) provided the necessary incentives for responsible government, allowing private rights and markets to prevail and develop.

As discussed also in section I above, liberal political institutions give states the ability to commit to limits on their behavior, which means that limited governments have far greater access to credit and are able to raise large amounts of money in ways that are consistent with the long-term health of the economy (Shultz and Weingast, 1996: 3; North and Weingast, 1989). Evidence of how the institutions of limited government made credible the government's commitment to the established set of rights in nineteenth-century Argentina will be presented. Following North and Weingast's analysis of seventeenth-century England (1989), public finances and specifically the

evolution of government borrowing will be observed. The assumption is that these indicators will display a change in the attitudes of the economic agents based on their trust in the newly established political institutions.

### 1. Liberal Institutions as a "Commitment Technology"

By mid-nineteen century, the capital investment and technical expertise required for the country's economic transformation were beyond the available resources after so many years of military upheavals, civil wars, and economic stagnation.

For most of the reasons presented above, from 1820 until approximately 1862 it was only with the utmost difficulty that domestic and foreign capitalists could be induced to supply the required resources for development (Ferns, 1977: 144). They wanted not only rewards, but also security for the use of their wealth. In Argentina, as Ferns suggests, a belief of this kind could not be founded on experience, quite the opposite: "Two generations of Argentines had had experience of forced loans either repudiated or paid in currency much reduced in purchasing power to that taken from them" (1973: 47).

Argentina's capability to obtain long-term loans depended, thus, on the ability to make credible commitments. Showing an increased likelihood that debts would be honored was critical to improve the lender's willingness to provide funds. As Schultz and Weingast point out, the institutions of limited government serve as a "commitment technology by taking discretion away from the ruler and forcing him to live up his contracts". Therefore, constitutional limitations of power would enhance a state's borrowing ability by "... making it easier for those with a stake in the repayment of debt to punish the sovereign in the event of default" (1996: 4, 9; Root, 1989: 243).

Accordingly, to provide economic securities and guarantees for the domestic and foreign capitals was one of the central features of the 1853 constitution.

As David Rock notes, under the influence of liberal intellectuals, like Sarmiento and Alberdi, the quest for a constitutional order and national unity were not seen separately from the aspiration of economic recovery and progress (1985: 120). Drawing on the classic principles of liberalism, and in particular a recent tract by Juan Bautista Alberdi, *Las Bases*, the 1853 Constitution sought to create



the political conditions necessary to create wealth and, thus, to overcome poverty and economic backwardness<sup>17</sup>.

The key word in creating such conditions was "confidence", or to put it in other words to establish a "credible commitment".

### 1.1. The 1853/60 Constitution.

To ensure that the institutions of limited government were credible, a number of specific institutional structures and procedures were established in the constitution.

First and foremost, the constitution enacted a well-defined structure of horizontal and vertical accountability framed by Juan B. Alberdi, but modeled after that of the United States constitution<sup>18</sup>. Namely, it provided for a federal system of representative government (CN: art.1) based on a division of power between the central government and the provinces (CN: art.5)<sup>19</sup>, and on the separation of executive, legislative and judicial powers. These were vested, respectively, in a President (CN: art.74), a Bicameral Congress (CN: art.36), and a hierarchy of Federal Courts headed by a Supreme Court (CN: art.94). The three powers were interconnected by a system of checks and balances (CN: arts.67, 69, 70, 86, 91, 95, 96, 100).

The introduction of this institutional structure provided explicit limits on the government's behavior, undermining the opportunities for confiscatory and arbitrary government. As a result of this, despite being the "Supreme head of the nation", responsible for the country's "general administration" (CN: art.86(1)), the executive power was explicitly constrained in financial matters by the legislative branch. The Congress was given a central role in these matters by the constitution. Its powers included, "regulating foreign trade; fixing import and export duties; levying taxes for a specified time whenever the defense, common safety or general welfare of the State so require;

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"...el Derecho Constitucional de la América del Sur está en oposición con los intereses de su progreso material e industrial, de que hoy depende todo su porvenir" (Alberdi, 1978: 36).

For a complete account on the constitutional debate and the extent of the American constitution's influence in Alberdi and Sarmiento's thoughts see Botana (1984).

The provinces retained all the power not delegated to the federal government (CN: art.104). They were to be governed by their own institutions, elect their own government, legislators and officials (CN: art. 105), and they had the right to exercise their own administration of justice, municipal system and primary education (CN: art.5).

contracting loans on the nation's credit; regulating the internal and external debt and currency system of the country; fixing the budget and providing for whatever is conducive to the prosperity and welfare of the nation" (CN: art.67). Therefore, the executive could not unilaterally decide matters of fiscal policy. Instead a bargain with a body of elected representatives was required (Schultz and Weingast, 1996: 10)

Second, the constitution included among its specific terms a comprehensive list of individual rights and guarantees. These included, the final extinction of slavery (CN: art.15); the abolition of all *fueros* and any prerogative of blood, birth, privilege or titles of nobility (CN: art.16); the declaration of equality as the basis of all duties and public offices (CN: art.16); that no citizens could be detained, except for reasons and in the manner prescribed by the law, or sentenced other than by virtue of a law existing prior to the offense and by decision of the competent tribunal after the hearing and defense of the person concerned (CN: art.18); and, a legally recognized restricted domain (CN: art.19).

The Argentine constitution was meant to be, in Alberdi's words, an "iron lock" against arbitrary government. As Kaufman suggests, this fear of the possibility that in the future the constitutional provisions would be used in a discretionary way is reflected in the somehow exaggerated language of Argentina's supreme law: the property is "inviolable", the confiscation of goods is "deleted for ever" from the Argentine Penal Code (1993: 63).

Third, a whole array of provisions based on the principles of economic liberalism were specified throughout the constitutional text. As Ferns argues, the government adopted by the constitutional assembly "was conceived of as a neutral factor which could not and should not undertake economic and social tasks which, with the exemption of education, could best be left to private initiative and organization" (1973: 38). Among the more important provisions were those included in article 17 regarding private property: the inviolability of private residence, property and correspondence; the stipulation that no one could suffer expropriation, except in case of public necessity and provided that the appropriate compensation be paid in accordance with the provisions of the laws; and that in no case the penalty of confiscation of property be imposed. Along with the rights recognized for all the inhabitants of the country, by article 14, to work and exercise any legal trade; to petition the authorities; to leave or enter the Argentine territory; to use or dispose of their

properties; to associate for a peaceable or useful purpose; and, to teach and acquire education. Under the influence of Alberdi's ideas, specific clauses to stimulate the nation's progress were also adopted: the encouragement of immigration (CN: arts.20, 25), and most important, the creation of a common market: all internal restraints on trade were banned (CN: arts.9, 10, 11, 26) showing a great symbolic break with the colonial mercantilist and *comunero* traditions.

Hence, these provisions promoting free trade, foreign investment, immigration and education not only were incorporated in the 1853 constitution, but in Alberdi's view, they constituted a complete system of political economy, provided that they guaranteed, by unequivocal provisions, the free disposition of labor, capital and land, as principal agents of production; ratifying "the natural law of equilibrium that presides the phenomenon of distribution of wealth; and constraints to just and discreet limits those acts related to the phenomenon of public consumption" (cited in Kaufman, 1993: 61).

## 2. Other Institutional Innovations.

Following the adoption of the 1853/60 constitution a series of institutional innovations and additional measures to enhance the government's credibility were taken by the successive administrations.

### 2.1. Honoring Debts.

As it has already been observed, in Argentina in the 1860's, very little capital, foreign or native was available. This was precisely a consequence of the lack of confidence in the newly constituted authorities and the history of debt renegeing in the past. In fact, as Ferns notes, no serious European institution could decide on investment in Argentina (1973: 48). This also manifested itself in the high interest rates the government had to pay in the Buenos Aires market to obtain loans. Under these circumstances, in 1857, the government of the province of Buenos Aires decided to commence the repayment on the defaulted loan of 1824. Repaying this English loan and, thus, establishing a degree of confidence in the investing class was a step that removed one of the major obstacles to new investments.

When Mitre came to power in 1861, the undertaking to honor the debts became the chore of the Argentine national government. In October 1862, the federal government undertook the debts of the Confederation. These were bonds issued in 1850 and 1860, when the country was not yet reunited (Cortes Conde, 1989: 23). A year later, in November 1863, a general law governing the public debt was passed. The law established a public record of all debts of the state entitled *Del Gran Libro de Rentas y Fondos Públicos*. A Caja de Amortización was set up, and all debts were declared to be a charge on all revenues of the state. Unless otherwise stated, public debts were sanctioned payable in London at the rate of 65½ shillings per ounce of gold (Ferns, 1977: 326).

Finally, the Law 206 of October 1866 declared the nation in charge of the following provincial debts: the English loan of 1824 and the "diferidos" of 1857; 20 million \$m/c in Fondos Públicos Provinciales bonds issued by the law of 5 May 1859; and 24 million \$m/c of Fondos Públicos bonds issued by the law of 8 June 1861 (Cortes Conde, 1989: 24)

The refunding of accumulated public debts had a remarkable effect on the value of Argentina's public debt, enabling the country to secure credit on unprecedented favorable terms. See for example, in Table 3, the difference between the value of the 1824 British Loan in 1840 and in 1862.

< Place Table 3 Here >

## 2.2. Monetary Policy.

The inflationary experience of the Rosas regime had a marked effect upon the development of the nation in 1861. As Ferns points out, "a national currency and a banking system were considered objects of national necessity" (1973: 37) <sup>20</sup>.

Under the government of Mitre, early efforts were made to establish a national currency based on a gold standard and managed according to what were considered orthodox European principles (Ferns, 1973: 45). The case for gold rested on two arguments: first, gold, because of its limited supply, unlike paper money that could be easily printed, was able to command a stable purchasing power over time. Second, hooking the nation's money to gold was a means to avoid the

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According to the general analytical framework presented in section I, the establishment of a national currency may be seen as an institutional device to reduce transaction costs. By being the one good for which all other goods exchange, money represents a substantial improvement over barter exchange, given that it is both a resource-saving device and a means for increasing market activities (Arnold, 1991: 229). For a discussion on the properties of monetary predictability see Buchanan (1989), pp. 129-154.

government's inducement to print money, substituting in its place a naturally stable anchor. In 1863 the national government passed a law establishing a unit of account for the whole nation, the "peso fuerte" of 17\$ the ounce of gold (25 grams of silver), and stating that it would pay its obligations in notes of the Banco de la Provincia de Buenos Aires at the gold exchange rate of the day of payment (Cortes Conde, 1989: 22).

Yet, as Ferns notes, in Argentina the only money that anyone seriously trusted was hard money: silver coins of the old Spanish Empire, which still circulated; silver minted in Bolivia; and various European coins (1973: 44). Hence, the government's efforts to establish the Banco de la Provincia de Buenos Aires and the Banco Nación as the principal institutions issuing paper money soon failed. It was now recognized that a system based on gold or silver, or a combination of both, was not feasible under such circumstances. The tendency of thought and practice, thus, turned into the direction of semi-private or private institutions. The belief was that a credible system could evolve only by separating banks from government as much as possible (Ferns, 1973: 44-45). Consequently, a system of free banking came into being. It became open to private individuals not only to create banks but also to issue paper money (bank notes) <sup>21</sup>.

The government, at this point, vehemently encouraged the development of this system as a way of "tying its hands". Leaving the emission of paper money out of its hands was another way to avoid the state's monetary manipulation and its use of currency expansion as a financial resource to renege debts and obligations (Cortes Conde, 1989: 10). Another objective pursued by the free banking law was to eventually replace the much depreciated paper money in circulation by bank notes issued by the banks (Cortes Conde, 1989: 49). As a result of this, from 1865 to 1887, the creation of money was undertaken by the issuing banks. This money, thus, was not a liability of the national government anymore, but of the private banks (Cortes Conde, 1989: 10).

In 1867, the government of the province of Buenos Aires decided to establish an Oficina de Cambios, where gold and paper were freely given at 25 "pesos" to the hard dollar (Mulhall, 1869: 71; Cortes Conde, 1989: 50). This mechanism instituting the free convertibility of the peso, proved to be extremely successful in keeping a stable currency. It also played a very important role in

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In fact, technically the banks were not allowed to issue currency, but the bank notes were declared a legal tender throughout the whole Republic.

creating confidence in the Argentine economy. As Table 4 shows, this was reflected in the evolution of the 6 per cent Fondos Públicos National bonds on the London money market. They were very sensitive to the changes in monetary policy. By 1872, their price climbed, while their yield fell to almost half of that of 1864. In fact, when the government decreed the suspension of convertibility of the Banco de la Provincia de Buenos Aires's notes in May 1876, their price notably fell, only to climb back in 1880/81.

< Place Table 4 Here >

In 1881, President Roca endeavored to establish a bimetallic system with a fixed ratio of 25:1.6129 between silver and gold (Ferns, 1973: 58). The law No. 1130 of 5th. November 1881, created the "peso oro", divided into 100 "centavos", and established that only 5 and 2½ pesos oro coins, denominated "Argentino", and "half Argentino" respectively, could be coined (Ford, 1966: 162). Yet, fluctuations in the value of the money in circulation continued until 1899, when convertibility was restored with the creation of the "Caja de Conversión". The law No. 3871 of 1899, established that the nation should convert the whole of the then existing fiduciary issue of \$ 293,018,258.44 legal tender into national gold currency at the fixed rate of one legal tender peso for 44 cents gold (Tornquist, 1919: 313). This institutional mechanism proved itself successful one more time, putting Argentina effectively on the gold standard after nearly ninety years of failed attempts to achieve stability of the currency.

### C. Six Decades of Economic Development.

Bartolomé Mitre's presidential inauguration marked the beginning of a new era in Argentina. During the three following constitutional periods (1862-1880), under the presidencies of Mitre, Domingo F. Sarmiento, and Nicolas Avellaneda, a firm process of creating institutions paved the way for the economic success of the subsequent 60 years. These years saw the establishment of a national legal system, an integrated judicial system, a professional army, a bureaucracy, a national bank, a taxation system, a national treasury, a national customs office, a national voting law, a system of public schooling, public libraries, an academy of science, and other technical institutions. An astonishing

rate of growth -- supported by heavy flows of capital and labor from Europe -- with an annual average of at least 5 per cent, made Argentina one of the richest nations in the world by the beginning of the twentieth century.

### 1. Immigration.

When Mitre took office in October 1862, the country was finally united as a single state and market area. National unification and the constitutionally adopted institutions of limited government provided Argentina with the appropriate conditions to attract the large-scale immigration and foreign capital needed to develop the Republic's unrealized economic potential. A program of economic expansion and integration into the international commodity and capital markets was now possible.

Thus, Mitre, like his successors, Sarmiento and Avellaneda, sought to accelerate the modernization of Argentina through foreign capital and immigration. The reply to his policies encouraging immigration and foreign investment was almost immediate. In the following years, as Ferns notes, men and women came to Argentina and moved within Argentina, in response to opportunities to earn wages, as never before. While flows of capital to the country and within the country, looking for profits, were registered at unprecedented levels (1973: 53). As indicated in Table 5, immigration began slowly in the 1850's, but it increased at an astonishing rate during the next forty years: between 1861 and 1870, 159,570 immigrants arrived; between 1871 and 1880, 260,885; between 1881 and 1890, 841,122; and between 1891 and 1900, 648,326 (Cortes Conde, 1974: 169). Hence, from 1869 to 1929, immigration was responsible for 60 per cent of the nation's population growth (Snow and Manzetti, 1993: 12).

< Place Table 5 Here >

### 2. Foreign investment.

A substantial share of the economic expansion of these years also came from foreign investment. Foreign capitals, specially British investment, also responded to Argentina's stimuli. By 1865, British business men and engineers had established banks and railway and trainway companies

operating in Argentina, followed shortly by public utilities like gas-works, water-works, and sewage systems (Ferns, 1977: 327).

A more detailed examination of the British investment shows some evidence of enormous importance. In addition to these direct investments, a substantial amount of British funds came from small individual English investors who bought Argentine bonds. In this way, with the underwriting of such banking firms like Baring Brothers or Murietta & Company as a certificate of reliability, a lot of Englishmen decided to invest in Argentina even when they had little knowledge, and no initiative nor enterprise to do it directly. From a total estimate of £23,060,000 of British capital investment in Argentina in 1875, £12,970,000 went to government loans. Thus, a proportion of 56.2 per cent of the funds invested by British capitalist or through the agency of the London money market was given to the Argentine government (Ferns, 1977: 327). As Ferns indicates, "the decision to lend having made in Britain by investment houses and possessors of capital, decisions concerning use were left entirely to the Argentine public authorities" (1977: 331).

### 3. The Evidence.

This has strong implications for the model discussed in this paper. Compared to the financial scenario of the previous years, this acute change in the willingness of the lenders to supply funds to Argentina reflects a substantial increase in the perceived commitment by the government to honor its agreements. What came of the investment depended, therefore, on the capacity of the Argentine government to credibly commit to honor the incurred debts.

The evidence shows that once the institutions of limited government were in place, Argentina's financial capacity was almost unlimited, allowing its access to more and more credit at cheap rates. Table 6 has information on governmental expenditures and debt, showing the profound changes in government borrowing. In 1864, Mitre's second year in office, government expenditures were about 7,119,931 pesos and debt was extremely limited. As Table 6 shows, in 1884, just twenty years later, government expenditures had grown by eight times to 56,440,137 pesos, and the public debt to 122,503,000 pesos. This level of debt was previously unachievable. Between 1880 and 1890 the external public debt grew 828 per cent, while the aggregate public debt (domestic and external)



increased by 312 per cent (Cortes Conde, 1974: 188). By 1890 the debt service was absorbing 38 per cent of the total national budget.

< Place Table 6 Here >

At a first sight such an abrupt expansion of financial obligations might seem hazardous. However, the decisions of the national government concerning the use of the borrowed funds, unlike the public expenditures of the 1820s, were largely constrained by the adopted institutions of accountable and limited government. As Ferns notes, Argentine public investment at this time was used to strengthen the economy as a whole by contributing to social peace, by making continuous productive work possible, and, beyond all, by opening ways of communication with remote areas where transport costs in the pre-railway era were a large barrier to participation in the international division of labor (Ferns, 1977: 332) (See Table 7, below). Hence, despite the sustained deficits and the immense increase in the size and burden of the public debt, the expansion of the economy that accompanied this macroeconomic stimulation helped to maintain such levels of indebtedness<sup>22</sup>.

< Place Table 7 Here >

It is also worth noting that at the same time that the scope of governmental borrowing increased, the rate the market charged the government fell. The initial yield of the 1863 6 per cent Fondo Público National bond was around 14.96 per cent in 1864 (see Table 4). By the beginning of the 1880s the rate was about half, between 7.05 and 6.92 per cent. This rate only went up again in 1876 when the free convertibility of the peso was suspended, but continued to fall over the next years, such that, by 1884 the yield was 6.73 per cent.

#### 4. The Argument.

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The exports grew from 57,000,000 pesos in 1881 to 100,000,000 pesos in 1888; International trade went from 113,000,000 pesos in 1881, to 254,000,000 in 1889; The railroads changed from a 852 kilometres extention and a capital investment of 20,983,000 pesos in 1871, to 12,475 kilometres and 379,000,000 pesos in capital invested (Cornblit, Gallo, and O'Connell, 1965: 51).

This evidence show, first, that the amount in capital available to the Argentine government expanded enormously by this time. Second, that at the same time that the government borrowing increased, the rate the market charged fell. As North and Weingast observe, for the case of seventeenth-century England, "Sharp increases in demand accompanied by decline rates indicate that the overall risk associated with government behavior decreased considerably despite the enormous increase in the size of the debt" (1989: 823).

In sharp contrast to the pre-constitutional period, the adopted liberal institutions provided the way out of restricted credit and high interest rates. Therefore, as in the case of the gains that followed the Glorious Revolution in England described by North and Weingast (1989), the improved economic efficiency that ushered by the constitutional limitations on state power in the late nineteenth-century Argentina was spectacular.

## **V. Conclusions.**

### **A. Argentina's economic prosperity: an institutional analysis.**

As it is stated in the introduction of this essay, an important lesson to understand the factors that lead to Argentina's economic decline can be drawn from the very factors that promoted its economic prosperity.

The question, thus, is what accounted for Argentina's prosperity in the late nineteenth century. The main argument of this paper, is that the country's economic growth depended on legal and stable institutions that provided low costs of transacting in impersonal political and economic markets. As in the case of seventeenth century England studied by North and Weingast (1989) the answer to Argentina's economic success lies in the rise of liberal, representative institutions, and their effects: the creation of a credible, limited government under the rule of law.

Previous studies have pointed out many structural socioeconomic factors such as factor endowments or the expansion of the international markets. Yet, while these economic factors certainly played an important role in Argentina's economic development of the second half of the nineteenth century, they cannot alone explain how the appropriate conditions that produced this economic turnaround rose.

As it was shown above, the era inaugurated by the adoption of the 1853 Constitution with the 1860 amendments saw the establishment of a national legal system, an integrated judicial system, a professional army, a bureaucracy, a national bank, a taxation system, a national treasury, a national customs office, a national voting law, a system of public schooling, public libraries, an academy of science, and other technical institutions. These institutions which are frequently associated with economic development profoundly affected transaction costs. Growth in income and welfare, thus, seemed 'automatic' for many students of Argentina once gains from exchange, hitherto prohibitively costly, were realized.

Thus, based on concepts and ideas developed by the new institutional economics, the aim of this paper is to contribute to this debate from a different perspective and lead to a better understanding of the interplay between factor endowments, institutions and economic growth.

#### B. Post Script.

Unfortunately, the story of Argentina's economic success does not have such a happy ending. After an astonishing rate of growth, averaging at least 5 per cent, that made Argentina one of the richest nations in the world by the beginning of the twentieth century, the country drop to the seventieth place by 1990. This process of decay started in the 1930s. Until then, the political institutions that were put in place by the 1853/60 Constitution remained in equilibrium. Yet, some of these institutions were not equipped to handle strong external economic shocks, nor large new groups of political participants, and in 1930, a military coup took place.

This marked the beginning of a new era in Argentina, the institutions of limited government were only intermittently restored in the following sixty years, leading to the erosion of the constitutional system that promoted Argentina's economic growth.

The implications seem to be straightforward. Understanding that counting with institutions limiting the government's arbitrary powers is not only a way to enhance individual freedom but also to achieve economic growth is crucial to make democracy and the rule of law Argentina's privileged path to achieve prosperity again.

**Table 1**

## Expenditures of the Province of Buenos Aires: 1840-1850

(Percentages of Total)

	Junta Repres.	Min. Govern.	Min. For. Aff.	Min. War	Gnl. Exp.	Min. Finance	Tr. bills	Total
1840	0.10	3.00	2.80	49.10	3.50	6.30	35.20	100.0
1841	0.11	4.95	2.40	71.11	3.75	9.01	8.67	100.0
1842	0.11	4.80	1.84	63.35	6.81	10.34	12.75	100.0
1843	0.12	6.12	2.28	53.05	9.14	10.69	18.60	100.0
1844	0.12	7.15	2.30	60.95	7.89	10.93	10.66	100.0
1845	0.12	6.16	3.81	54.72	8.50	11.08	15.61	100.0
1846	0.14	6.95	5.81	49.45	6.22	11.99	19.44	100.0
1847	0.10	7.20	4.54	57.94	5.38	9.61	15.23	100.0
1848	0.10	6.60	4.65	55.71	5.85	9.96	17.13	100.0
1849	0.08	8.42	3.25	58.27	4.70	7.76	17.52	100.0
1850	0.08	10.51	2.23	49.87	8.39	6.70	21.22	100.0

Source: Burgin (1946: 198).

**Table 2**

**Currency Issued During the Administration of Rosas**

Notes of the Banco Nacional (May 30, 1836)		15,283,540 p.
Law, March 11, 1837	4,200,000	
Law, December 8, 1838	16,575,0000	
Law, September 17, 1939 a	3,605,954	
Law, March 28, 1840	12,000,000	
Law, January 16, 1846	73,600,000	
Total		109,980,854 p.
Total issued at end of regime		125,264,294 p.

a Ten per cent of total currency in circulation officially ruled as lost.

Sources: RO-1143, L-16, no.-3; RO-1275, L-17, no.-12; RO-1340, L-18, no.-9; RO-1392, L-19, no.-3; RO-1721, L-25, no.-1. Cited in Burgin (1946: 216).

**Table 4**  
**Fondo Público National Bond , Price and Yield**  
 (Issued in 1863, 6%)

Year	Price	Yield	Exchange Rate	Gold Yield
1864	40.12	14.96	1.15	13.00
1865	39.84	15.06	1.10	13.69
1866	40.73	14.73	0.97	15.19
1867	51.83	11.58	1.00	11.58
1868	47.79	12.55	1.00	12.55
1869	57.97	10.35	1.00	10.35
1870	64.90	9.24	1.00	9.24
1871	68.84	8.72	1.00	8.72
1872	75.17	7.98	1.00	7.98
1873	78.57	7.64	1.00	7.64
1874	76.70	7.82	1.00	7.82
1875	67.40	8.90	1.00	8.90
1876	46.94	12.78	1.14	11.21
1877	56.44	10.63	1.19	8.93
1878	56.25	10.67	1.28	8.33
1879	65.12	9.21	1.29	7.14
1880	75.64	7.93	1.22	6.50
1881	85.09	7.05	1.08	6.53
1882	86.69	6.92	1.00	6.92
1883	87.55	6.85	1.00	6.85
1884	89.10	6.73	1.00	6.73

Source: Cortes Conde (1989).

**Table 3**  
Market Value of Argentina's Public Debt 1824-1861 (Selected Years) and 1862-1881  
(Average Value per Year)

Year	External Nat. Debt (Value in London Stock Exchange)		Fondos Públicos Nat. Bonds (Value in Bs. As. Stock Exchange)			
	Emp. 1824	Diferidos	Emp. 1868	Hard Dollars	11/16/63 Law	10/01/60 Law
1824	93					
1826	60					
1831	22					
1840	17					
1845	47					
1848	22					
1850	55					
1852	71					
1854	55					
1858	82	18				
1861	88	28				
1862	92	36				
1863	94	38				
1864	93	37			40	
1865	89	36			39	
1866	81	33	73		40	
1867	80	36	73		51	
1868	87	46	75		47	
1869	90	54	80		57	
1870	94	57	89		63	
1871	96	58	93		68	87
1872	100	74	96		75	88
1873	99	73	97	83	78	90
1874	94	70	94	78	76	80
1875	86	66	92	69	67	--
1876	61	45	61	41	46	47
1877	65	56	68	43	56	71
1878	68	--	73	43	56	76
1879	74	67	80	51	64	82
1880	83	75	91	66	74	86
1881	92	--	97	73	85	89

Source: Oszlak (1982: 208).

**Table 6**  
National Budget and Public Debt 1865-1890

Year	Revenues Thou. \$ Gold	Expenditures Thou. \$ Gold	Public Debt Thou. \$ Gold	Debt Services Thou. \$ Gold	Debt Services % Tot. Budget
1865	8,295	12,517	n/d	3,383	27.0
1866	9,568	13,745	n/d	3,359	24.4
1867	12,040	14,110	n/d	2,740	23.8
1868	12,496	16,693	n/d	2,575	15.4
1869	12,676	14,953	n/d	3,449	23.0
1870	14,834	19,439	n/d	6,360	32.7
1871	12,682	21,166	n/d	8,578	40.5
1872	18,524	26,483	n/d	14,432	54.4
1873	20,698	31,025	n/d	12,675	40.8
1874	16,587	29,784	n/d	11,231	37.7
1875	17,206	28,567	82,877	8,510	38.8
1876	13,583	22,153	86,813	8,644	41.4
1877	14,824	19,924	82,230	8,211	46.7
1878	18,415	20,840	80,649	7,909	45.0
1879	20,961	22,523	77,738	8,219	46.1
1880	19,594	26,919	86,313	8,686	45.7
1881	21,345	28,381	107,075	8,766	45.2
1882	26,822	58,007	124,112	10,978	37.7
1883	30,950	44,831	128,047	11,297	36.2
1884	37,724	56,440	122,503	11,753	34.5
1885	26,581	40,515	113,381	10,312	32.5
1886	30,395	39,178	117,153	10,053	34.2
1887	38,209	48,205	141,717	11,600	33.3
1888	34,892	51,596	277,462	10,896	30.9
1889	38,169	55,770	295,159	9,278	28.9
1890	29,143	38,145	355,762	12,958	38.6

Source: Elaborated with data from Vazquez-Preledo (1971: ), and Oszlak (1982: 262).



**Table 5**  
Immigrational Balance 1857-1900

<b>Error! Reference source not found.</b> Years	Immigrants	Emigrants	Balance
1857-1860	20,000	8,900	+ 11,100
1861-1870	159,570	82,976	+ 76,594
1871-1880	260,885	175,763	+ 85,122
1881-1890	841,122	202,455	+ 637,667
1891-1900	648,326	328,444	+ 319,882

Source: Cortes Conde (1974: 169).

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