

## The Rise and Fall of Argentina

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On the eve of World War I, the future of Argentina seemed bright. From the adoption of the constitution in 1853 to the onset of World War I, Argentina underwent a period of economic exceptionalism known as the Belle Époque.<sup>1</sup> By 1896, Argentina achieved per capita income parity with the United States and attained a considerably higher level of prosperity than France, Germany, Italy, and Spain.<sup>2</sup> Strong economic growth and institutional reforms positioned Argentina among the top 10 countries by 1913 in terms of per capita GDP.<sup>3</sup> Some scholars have called 19th-century Buenos Aires “Chicago on Rio de la Plata,” given the historical similarities between both cities.<sup>4</sup> Nineteenth century Buenos Aires boasted the highest literacy rates in Latin America,<sup>5</sup> unprecedented European immigration,<sup>6</sup> and rapid modernization of infrastructure.<sup>7</sup>

It seems that Argentina briskly moved the “lever of riches” in less than half a century.<sup>8</sup> In 1913, Argentina’s per capita income stood at 72 percent of the US level.<sup>9</sup> In 2010, Argentina achieved barely a third of US level. In 1860, Argentina needed about 55 years to attain the per capita income level of Switzerland. Today Argentina would need more than 90 years to achieve the Swiss level of prosperity. How could a society that achieved astonishing wealth and splendor in less than half a century move from being a developed country to being an underdeveloped one? The most obvious question to ask is, What went wrong? The answer lies in a lack of inclusive and participatory robust legal and institutional framework that would have prevented the reforms from being undermined. A counterfactual experiment for Argentina suggests that institutional breakdowns are a critical explanation in development narratives.

## **THE IMPORTANCE OF DE JURE AND DE FACTO INSTITUTIONAL FRAMEWORK FOR LONG-RUN GROWTH AND DEVELOPMENT**

Once achieved, broad-based economic development should hardly be taken for granted. The benefits of development can be easily undermined if the institutional framework fails to sustain secure property rights, low transaction costs, and a robust rule of law.<sup>10</sup> The absence of such de jure institutional framework and its de facto enforcement can easily slow economic growth and result in stagnation.<sup>11</sup>

In the broadest form, a de jure institutional framework captures the set of rules that allocates political power via electoral law, the constitution, and legislation.<sup>12</sup> On the other hand, de facto institutional framework largely determines the distribution of economic resources. It also sets constraints on powerful social groups and determines the balance of political power and economic payoffs from productive and unproductive economic activities.<sup>13</sup> Once the rules and the degree of their enforcement are established, de jure and de facto political power tend to persist. When the powerful elites lose political power following institutional changes, they may still exert a strong influence on politics and collective action through various methods such as greater lobbying, pressure, intimidation, or brute force to ensure that the new set of economic institutions does not undermine their payoff.<sup>14</sup> What delineates successful institutional changes from unsuccessful ones is the existence of a critical mass of pressure groups demanding institutional changes and ensuring that the institutional reforms are not undermined.<sup>15</sup> Societies with a broad-based, pluralistic, inclusive, and participatory de jure and de facto institutional framework, such as a level of judicial independence,<sup>16</sup> are significantly more prosperous in the long run than societies where the de jure and de facto economic and political power are concentrated in the hands of a narrow few elites.<sup>17</sup>

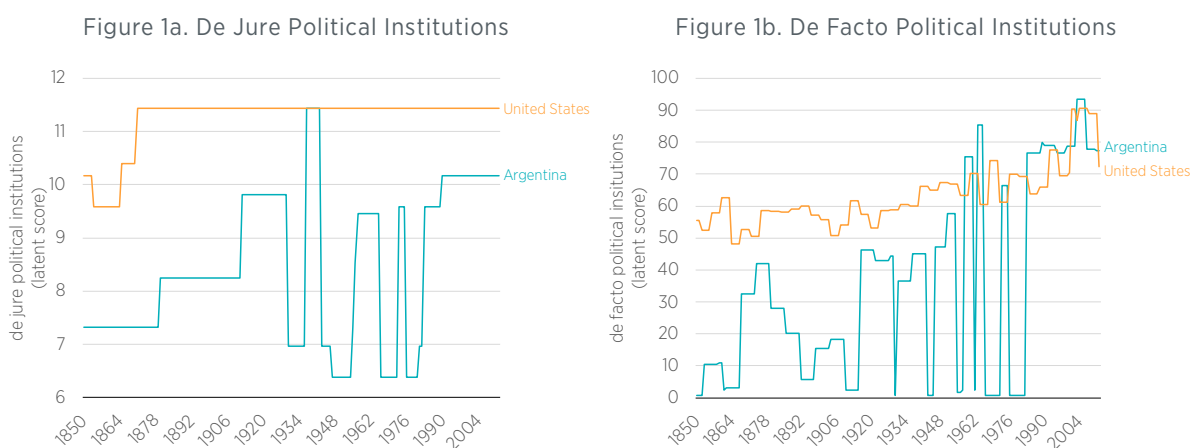
## **INSTITUTIONAL BREAKDOWNS AND THE ARGENTINE DETOUR**

Many theories have been proposed to explain Argentina's unique departure from being a rich country on the eve of World War I to being an underdeveloped one by the early 21st century. These theories emphasize institutional and noninstitutional explanations of long-run development, such as different political traditions brought over by the European immigrants, the closing of the expansion frontier in the Pampas with no meaningful alternatives,<sup>18</sup> uncontrolled immigration policy, which failed to encourage labor scarcity,<sup>19</sup> and a high demographic dependence rate and the associated low rate of national savings.<sup>20</sup> A different strand of literature argues that, compared to the United States, Argentina lacked the stock of human capital necessary to encourage broad-based, innovation-driven technological progress as a vehicle of sustainable development.<sup>21</sup> Unprecedented differences in human capital investment between Argentina and the United States could thus explain why Buenos Aires and Chicago diverged by the late 20th century, despite sharing similar historical circumstances, climatic conditions, and factor endowments. If anything, Argentina's decline has been a mere reflection of wealth implied by its core assets and fundamentals.

A large and growing strand of literature suggests that Argentina’s institutional environment contributed most to its startling 20th century decline. Some scholars believe the institutional arrangements and the old traits inherited from Spanish colonialism began to reappear and helped end Argentina’s economic exceptionalism after the Belle Époque.<sup>22</sup> Others believe the root of the decline lies in a peculiar land allocation scheme in the mid-19th century favoring a small number of large landowners, as opposed to schemes in in Canada and New England that favored a large number of small landowners.<sup>23</sup> Many scholars believe that the turning point, which led to the divergence between Argentina and four former British colonies (the Australia, Canada, New Zealand, and the United States), was the erosion of the rule of law in the 1930s.<sup>24</sup> The coup d’etat in 1930 is believed to have undermined Supreme Court independence and led to the populist takeover by Juan Perón in 1943 with long-lasting implications.<sup>25</sup>

Using a factor analytical approach, I compute the latent dimensions of de jure and de facto political institutions by exploiting the six different components of political institutions (as stated by economist Péter Földvári). The four most important of those components are the characteristics of formal electoral law, political competition and openness, executive constraints on the powerholders, and the ability of non-elites to challenge the powerholders.<sup>26</sup> The sample comprises a strongly balanced panel of 28 countries in the period 1850–2012. The resulting two latent indicators obtained from the rotated factors with the most powerful common variation reflect the distribution of de jure and de facto political power. Higher values indicate less concentrated political power in the hands of the most powerful groups and more broad-based, pluralist, participatory, and inclusive de jure and de facto political institutions. Figure 1 presents the de jure and de facto latent scores for the period 1850–2012 for Argentina in comparison with the United States.

**Figure 1.** De Jure and De Facto Institutional Development of the United States and Argentina, 1850–2012



Source: Author’s calculations based on Monty G. Marshall, Ted Robert Gurr, and Keith Jaggers, “Polity IV Project: Political Regime Characteristics and Transitions, 1800-2016” (dataset, Center for Systemic Peace, Vienna, VA, 2017).

The patterns of institutional development between the United States and Argentina indicate a wide gap between the countries that persisted over time. The most striking feature of Argentina's long-run institutional development is the persistence of breakdowns such as frequent and often violent oscillations between democracy and dictatorship. Compared to the United States, Argentina's institutional framework in the 1850s was constrained by the adverse legacy of decades of civil war between Unitarians and Federalists, and by the long shadow of Spanish colonialism. In a stark contrast to the United States, wealth and literacy restrictions on political participation inherited from the Spanish colonial period persisted much longer.<sup>27</sup> While literacy tests and other arbitrary voting qualifications nearly disappeared in New England and northern states by the late 19th century,<sup>28</sup> Argentina did not introduce secret and compulsory voting for the adult population until 1912.

Following the introduction of the Sáenz Peña Law in 1912, Argentina had its first experience of liberal representative government.<sup>29</sup> The Sáenz Peña Law provided for secret ballot and minority party representation in Congress and established universal, secret, and compulsory male suffrage through the creation of the electoral roll calls (*Padrón Electoral*). In spite of the conservative opposition, the law fundamentally altered the political process and radically changed the nature of Argentine politics by outlawing electoral fraud and voter intimidation.<sup>30</sup> It can be viewed as a breakaway from the traditional conservative ruling class in the period 1853–1912, as well as an attempt of the transition to de jure and de facto political checks and balances. The transition to an open and compulsory ballot led to the rapid increase in electoral roll calls and facilitated electoral transparency, which led to an unprecedented increase in the voting rate.<sup>31</sup> The reemergence of old colonial traits and the influence of authoritarian regimes in Europe made Argentina's transition to de jure and de facto checks and balances short-lived. While the 1853 constitution itself represents a structural break from a long history of anarchy and disorder,<sup>32</sup> Argentina on the eve of independence from Spain lacked participatory de jure and de facto political institutions—and their informal underpinnings—which failed to uphold the subsequent institutional framework to support sustained economic growth.<sup>33</sup> The institutional reforms promulgated after the 1853 constitution, such as the modernization of the civil code and commercial code to be more like those of the United States and Europe,<sup>34</sup> were short-lived because the old colonial traits began to reappear at the critical junction when Argentina initiated the transition to checks and balances in 1912.

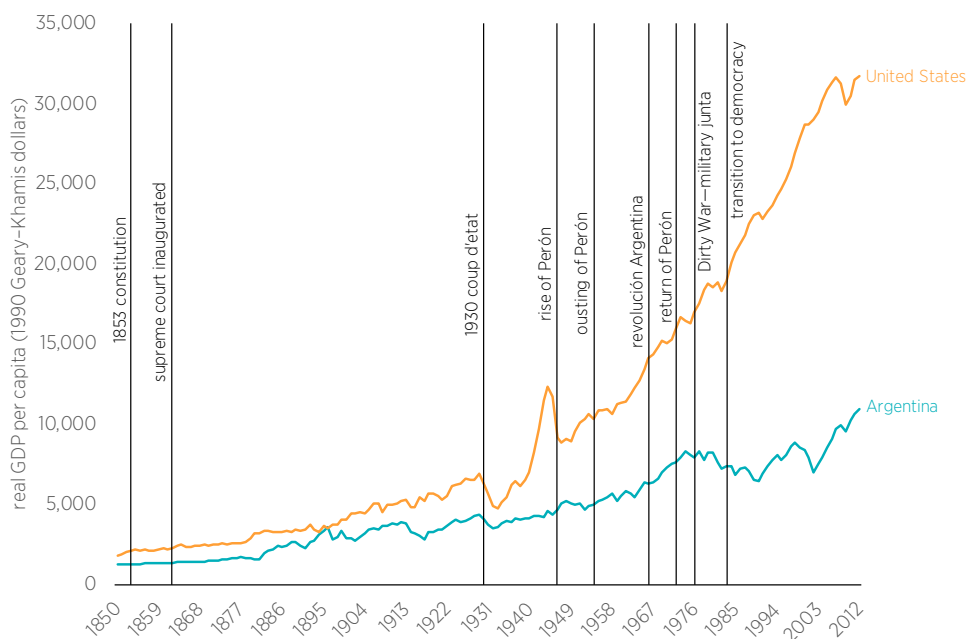
The short-lived transition to democracy in 1912 after the Sáenz Peña Law contributed little to Argentina's long-run growth. Although the secret and compulsory ballot led to greater accountability and fostered the rule of law,<sup>35</sup> several scholars suggest that democratic transitions may encourage the redistribution of income and wealth and the erosion of property rights, especially if they are introduced in the context of widespread poverty, low levels of education, and the near absence of middle class.<sup>36</sup> Hence, democracy in such circumstances may have a suppressive effect on economic growth.<sup>37</sup> In 1914, one of the first policy measures introduced by the government of Hipólito Yrigoyen was the freezing of real estate rents for tenants and a series of wage increases

in the public-sector bureaucracy, which led to a large-scale redistribution of income and wealth. The 1912 Sáenz Peña Law was thus a manifestation of greater political freedom at the expense of lower economic freedom. The law also accompanied the practice of appointing administrative employees for nonexistent jobs by the Unión Cívica Radical (UCR) government. Such policies laid the foundations of populist redistribution and rent-seeking by privileged groups, both of which increase transaction costs,<sup>38</sup> render property rights insecure, and constrain economic growth.<sup>39</sup>

By 1930, Argentina's infant democracy fell to the military coup d'état, which marked the onset of the Infamous Decade. The old colonial traits of militarism, inexperience with self-government, traditional disrespect for law and order, and power abuses again became a norm. Along with the almost complete erosion of the rule of law, the conservative elite behind the coup (*concordancia*) forbade political parties, banned the 1853 constitution, suspended congressional elections, and deemed the presidential elections in 1938 and 1942 fraudulent. Some scholars believe the 1930 coup and the Peronist rule in the years 1946–1955 was an Argentine version of Italian fascism.<sup>40</sup> Economic policy leaned heavily toward government favoritism of key interest groups, corporatist principles, and active dirigiste state intervention in many economic areas. The 1930 institutional breakdown set the precedent for subsequent de jure and de facto institutional development. A series of institutional breakdowns was instigated when Juan Perón rose to power. The prosecution, repression, and harassment of political opponents became the norm, together with widespread government favoritism of loyal interest groups and forced resignation of Supreme Court justices, which largely represents Argentina's abandonment of the rule of law and the end of judicial independence. In spite of the military coup d'état in 1955, a series of fragile UCR governments after Perón's exile to Spain failed to curb widespread government favoritism and continually used the executive power to declare states of economic emergency, which further weakened the de jure and de facto political institutions as a check on the executive power abuses. When Perón returned from exile and was elected president in 1973, Argentina underwent a series of de jure and de facto institutional breakdowns such as the expropriation of foreign bondholders, nationalization of key banks, prohibition of foreign media service, and the abrogation of university autonomy with political favoritism. The ultimate breakdown came with the onset of military dictatorship in 1976 when guerrilla violence in various parts of civil society, brutal violence against political opponents, arrests without trial, and massive violations of human rights became a norm.

A near absence of de jure and de facto institutional checks and balances, coupled with high transaction costs and weak property rights, greatly constrained Argentina's postwar economic development.<sup>41</sup> The weakness of de jure and de facto political institutions in absorbing political conflicts into peaceful resolution was one of the major barriers to sustained growth and development. A series of de jure and de facto breakdowns, along with the return to the old cultural norms of disregard for law and order and absolutist practices, undermined the security of property rights and increased transaction costs. Without a de jure and de facto institutional framework to support economic freedom, limited government, and the rule of law, investment rates plummeted,<sup>42</sup> total

Figure 2. Long-Run Development Paths of Argentina and the United States, 1850–2012



Source: Jutta Bolt and Jan Luiten Van Zanden, “The Maddison Project: Collaborative Research on Historical National Accounts,” *Economic History Review* 67, no. 3 (2014): 627–51.

factor productivity stagnated,<sup>43</sup> and returns from human capital investment lagged behind other countries.<sup>44</sup> In less than half a century, Argentina declined from being a rich country in the ultimate year of its Belle Époque to being an underdeveloped one by the late 20th century. Figure 2 presents long-term development trajectories of Argentina and the United States along with the dates of institutional breakdowns.

## COUNTERFACTUAL ANALYSIS

I deploy a structural model of long-run development to examine how much de jure and de facto political institutions contribute to long-run development. For a panel of 28 countries in the period 1850–2012, the effects of de jure and de facto political institutions on long-run development are both strong and robust across a number of specification checks and control variables. A country where de jure political institutions improve by one basis point (on the latent scale from figure 1) can expect its per capita income to increase by 2.6 percent in the long run. In a similar vein, a country where de facto political institutions improve by one basis point can expect its per capita income to increase by 2.2 percent in the long run. The beneficial effects of de jure and de facto political institutions are the most powerful counteracting mechanism against institutional breakdowns such as those that plagued Argentina in the 20th century. The effects of de jure and de facto political institutions do not disappear once previously acknowl-

edged development factors are taken into account, such as physical geography,<sup>45</sup> legal history,<sup>46</sup> legal system,<sup>47</sup> and culture.<sup>48</sup>

How would Argentina have developed in the absence of institutional breakdowns? I tackle the effects of institutional breakdowns using a synthetic control method for comparative case studies.<sup>49</sup> I exploit the precise timing of institutional breakdowns and construct the counterfactual scenario. The scenario is built by constructing the long-run development of a synthetic Argentina as a weighted average of other countries sharing similar growth and development characteristics and parallel trends before the breakdown. I rely on constrained quadratic programming optimization to find the best-fitting weights for the synthetic Argentina and reduce the predictive discrepancy between the real and synthetic Argentina to the highest possible degree.

Figure 3 presents the counterfactual scenario of Argentina’s long-run development in the absence of four major institutional breakdowns. The evidence clearly suggests that the institutional breakdowns were a major constraint on Argentina’s long-run development. Surprisingly, the 1912 Sáenz Peña Law and the 1930 military coup d’état exhibit a similar counterfactual growth and development pattern even though the former represented a transition to checks and balances while the latter embodied the demise of the rule of law. Argentina before the Sáenz Peña Law shares the growth and development characteristics of Chile (50 percent), Germany (22 percent), the United States (21 percent), and Uruguay (6 percent). In a similar fashion, in the absence of Perón’s rise to power, postwar Argentina would have followed the growth and development pattern of other Latin American countries in the temperate zone (Chile and Uruguay), Western European countries such as Switzerland and Sweden, and the United States. The absence of military dictatorship and the reliance on predictorship trends is associated with the most pervasive long-run development cost of breakdowns. In 2010, Argentina’s real per capita GDP stood at 10,990 Geary-Khamis (G-K) international dollars. In the absence of the 1930 coup d’état, per capita GDP would have increased up to

Figure 3. Counterfactual Scenario of Institutional Breakdowns in Argentina, 1850–2012

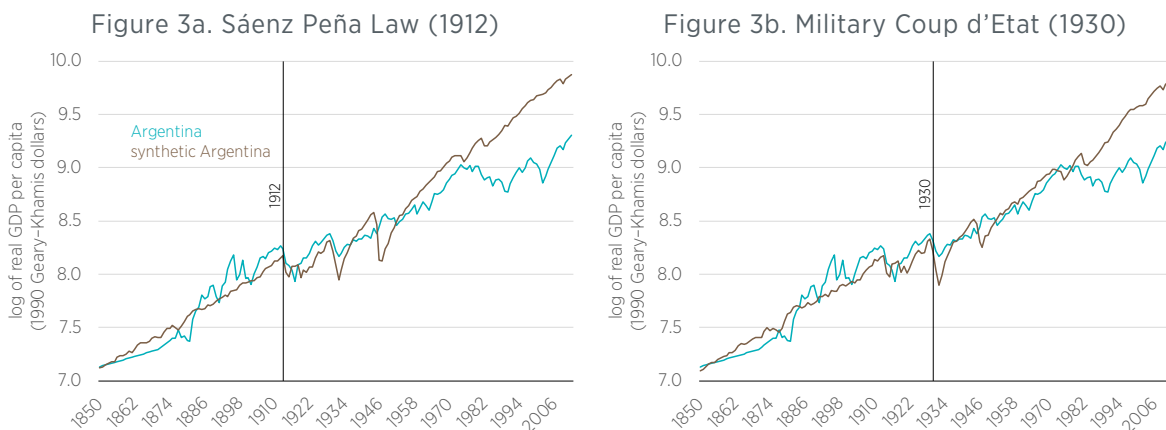
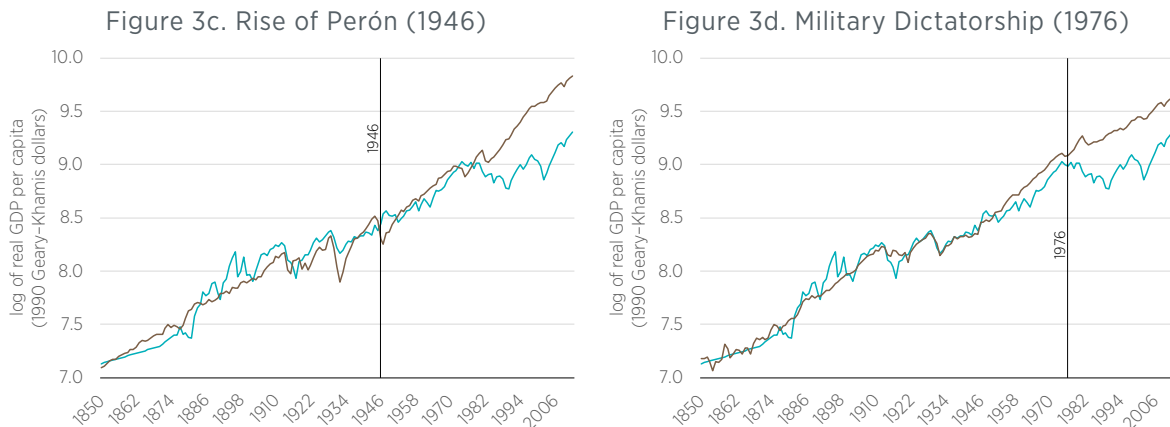


Figure 3 (continued)



Source: Author's calculation based on Bolt and Van Zanden, "The Maddison Project."

18,564 G-K international dollars while a similar level would be reached in the absence of the Sáenz Peña Law, assuming Argentina would follow its preexisting trends. In per capita terms, the 1930 coup d'état is associated with a 68 percent difference between the counterfactual and real Argentina in 2012, which indicates a substantial and sizable long-run cost of institutional breakdowns.

## LESSONS FROM ARGENTINA'S DECLINE

Argentina's unique decline from being a rich country on the eve of World War I to being an underdeveloped one by the late 20th century posits several normative implications for the policymakers eager to draw lessons. One of the chief threats to long-run development is not the type of political regime per se, since successful growth and development episodes can be found among dictatorships and democracies alike.<sup>50</sup> The key threat to long-run development emanates from the populist redistribution of income and wealth.<sup>51</sup> Argentina never accomplished the transition to an open-access political system mainly because the transition to checks and balances in 1912 led to the erosion of property rights and increased transaction costs through populist redistribution. Such a decisive shift towards populism had arguably large negative implications for long-run development, as it encouraged the frequent back-and-forth shifts between democracy and dictatorship that lie at the forefront of institutional breakdowns.<sup>52</sup>

Second, institutional breakdowns that occurred during the Argentine detour from an infant democracy in 1912 to a military dictatorship in 1975 typically arose from the populist takeover of political power by well-organized interest groups. These groups pursued institutional breakdowns to relax the de jure constraints on executive power to meet the demands of their constituents. The institutional breakdowns can be avoided by nurturing strong cultural norms to prevent populist takeovers. These norms include active and robust political participation based on open dialogue



and nonexclusionary policy discussion. When a critical mass of groups demanding inclusive institutional changes exists, populist takeovers are costly for the incumbent elites. The cultural norms mimic the informal executive constraints and might help to enhance the resilience of the de jure and de facto institutional framework against the threat of populist takeover. The absence of political participation and policy discussion typically fuels the power vacuum, which well-organized interest groups exploit to their advantage to facilitate a populist takeover. Upon the failed transition to de jure and de facto checks and balances in 1912 via the Sáenz Peña Law, Argentina lacked the political culture and informal institutional underpinnings of a participatory and broad-based de jure and de facto institutional framework. The power vacuum was carefully exploited by the military in 1930, which aided the traditional ruling class by mounting a coup d'état. It also paved the way to the reemergence of old colonial traits of disrespect for law and order, subversive militarism, and persistent power abuses. The net effect was widespread populist tendencies by incumbent elites, which distorted investment incentives, undermined the security of property rights, and kept transaction costs too high for Argentina to keep pace with the growth of other advanced countries. In the end, the populist cycles undermined Argentina's long-run development potential despite the abundance of production factors needed to support sustained long-run growth.

Third, widespread government favoritism of particular interest groups most likely exacerbates conflicts in civil society,<sup>53</sup> which leads to political polarization, which in turn raises the returns from institutional breakdowns by powerful political actors. In Argentina, such government favoritism encouraged widespread rent-seeking instead of productive economic activity and laid the seeds of slow economic growth in the postwar era. When Juan Perón was deposed in a military coup in 1955, he secretly made a pact with the labor unions to make Argentina ungovernable in his absence,<sup>54</sup> which perpetuated the political instability and encouraged future breakdowns. The avoidance of government favoritism to provide a level playing field is the key to avoiding prolonged institutional breakdowns, which have high long-run growth and development costs.

And fourth, Argentina's long-run decline could have been avoided if the transition to checks and balances had not been counteracted by large-scale populist redistribution. Such inefficient redistribution is more likely to occur in societies undergoing rapid economic growth, as the interest groups have higher stakes to demand. Providing broad-based access to political and economic opportunities to the non-elite groups on equal grounds is significantly less likely to avail the powerful interest groups who would take advantage of the institutional breakdowns. When the 1930 coup d'état was deemed void, the Supreme Court ignored the issue in spite of a series of constitutional violations.<sup>55</sup> Ensuring and preserving the independence of the Supreme Court from pressure by government and interest groups is perhaps one of the single most important institutional blueprints to tackle the negative effects of privileged interest groups' pressure for greater redistribution, and preserve the institutional foundations of sustained and inclusive growth and development.<sup>56</sup>

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## ABOUT THE AUTHOR

Rok Spruk is an assistant professor of economics in the department of economics at the University of Ljubljana – Laibach. He received a PhD in quantitative economic history from Utrecht University in 2016 with the dissertation titled “Institutions, Growth and Long-Run Development Paths.” His research interests include new institutional economics, economic growth and development, applied econometrics, and economic history.

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