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Rules and Enforcement - 2

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“Rules and enforcement”

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Abstract

This note is a new version of the one already released this year making a conceptual analysis of what the author developed in detail in his 2012 paper dealing with crises and economic models. It re-emphasizes the need to introduce into the discussion the question of the moral behavior of economic agents and the institutional designs that define the scenario of their actions. It attempts an explanation why ergodic theory poses limitations to possible predictions, while insisting on the need for the introduction of formal regulation rules in financial markets and fiscal and monetary rules for governments. Finally suggests that the trade off between free market and regulation, faces a serious dilemma, due to existing of an incomplete financial market with strong managing information asymmetries between those who manage funds in financial entities and citizens who deposited these funds in those entities, but at the same time, regulation will also faces an imperfect market, perhaps the most imperfect of all markets, which is the agency contract between representatives and citizens.

Keywords: Economic models, crises, institutions, policies, regulations.

JEL classification: G2 - Financial Institutions and Services - G38 - Government Policy and Regulation; K2 - Law and Economics - Regulation and Business Law.

1. Introduction

During the 11th Seminary on Monetary and International Economics, developed at the Faculty of Economics of the UNLP in August 2013, we had got a very valuable contribution of several economists - some of them not very young but also an important number of young economists - that certainly enriched the knowledge on crises' dilemma and, moreover, reinforced the interest for exploring this delicate subject.

One of the contributions that I would like in this moment to cite is the one of our renowned economist Guillermo Calvo, who was in charge of the inaugural conference event. Calvo, who anticipated the arrival of the Mexican "tequila" crisis, cited the phenomenon observed in recent crises in the developed world, which according to him until many years only seemed to exist in emerging countries. He talked about the importance of liquidity policy - its absolute magnitude, not only its growth rate - the phenomenon of the two variables: inflows and outflows of capital, the “herd behavior” and credit misdirection.

¹ I appreciate comments and references received from Ricardo Bara and Edgardo Zablotsky. The responsibility for what is expressed in this paper should be attributed only to the author.

These dimensions of Professor Calvo generated on me some satisfaction, because I understood that ratified at least partially some concepts advanced in our paper of 2012.²

In discussions about crises and the obvious weakness of the policy recommendations derived from the models and economic theories underlying them, little progress has been made in recent decades, beyond the well-known Keynesian recommendations and the more sophisticated developments on this feel through dynamic and stochastic models.

In our paper we emphasize an attribute almost absent in these discussions: morals and institutions, and their evolution over time, aspects that somehow give rise to confirm the very relative capacity of ergodic theories to reach good destiny.

However, at the same time we affirm that models based on rational expectations, accompanied by contributions from institutional economics and in general all the literature of public choice school, would give rise to reasonable recommendations that will lead to relatively good results on forecasts, at least for the short and medium term.

In the field of macroeconomics, the modern techniques of dynamic and stochastic models, especially Bayesian ones, and models with time series using "neural networks" are especially useful precisely for financial time series analysis. As it was pointed out by Balacco and Maradona in his article in "Revista Económica",³ in time series of financial markets, in which asymmetries behavior, volatilities, etc. are observed, linear regression models or autoregressive models, are not suitable, and requires the use of a nonlinear approach for the analysis of such series. This is the case of "bubbles" where mild upward movements in asset prices are followed by unexpected breakdowns. Thus, the linear model can not capture or predict satisfactorily in the presence of these accented inflection points, hence the need for nonlinear prediction models.

So, apparently, there is some progress on to understand and predict future, but it seems that recommendations that often arise from these models and their predictions do not have much reception of policy makers. There is an obvious disconnection between the "technical" recommendations on economic matters and policy decisions taken by many governments.

2. Rules and enforcement

In our paper already cited, we remember the events of financial and fiscal crisis, both of which have global impact (1930 and 2008), as the ones that took place in Argentina, and we extrapolate these argentinian past experiences to the ones that has been happening in the "developed world" more recently.

Our diagnosis of these phenomena is that the economy has few basic "anchors" on the basis of which, policy decisions should be subject. Actually, also the lacking of others relevant anchor parameters, additional or collateral ones consistent with them, leading

² **Piffano (2012a)**. Paper presented at the XLVII Annual Meeting of the AAEP (Trelew, 2012); also a compressed version of it in **Piffano (2012b)**, both available at the Department of Economics (UNLP) web page. See references at the end.

³ Cited in **Piffano (2012a)**.

to the design of a set of "rules", which literature developed during the 90's call "macro-fiscal rules".

The establishment of these rules has been broadly discussed in our discipline. My personal animus is "friendly" with them. They are simply the establishment of "limits" to a set of macro-fiscal parameters that governments should respect.

These rules were the ones European countries settled while signing Maastricht agreement and later imitated by countries like Brazil and Argentina, with their laws on "fiscal responsibility". In Europe these rules were broken and so were in Argentina in at least two attempts finally frustrated. Brazil is taking care about it, but I have not diagnosed about its strict compliance. In simpler words, the rules in many countries obviously have not had the necessary "enforcement", that is, were not strong enough to be observed by governments.

This world's experiences would lead to many colleagues to predict that rules do not work, not by institutional weaknesses but because when unforeseen events emerge or unpredictable situations appear (shocks), rules "must" be violated.

And now, the basic conceptual message of this note. When talking about "rules" we will refer from now on as "patterns of behavior" that motivate and affect the actions of policy makers and citizens acting in markets; and let's denominate all them as "economic agents". So rules are patterns of behavior of economic agents that are either formally mandated by law, or simply by "mores" of economic agents.

Actually, rules can be "written rules", i.e. with "legal coercion", or can also be "unwritten rules" or simple "moral behavior" on which economic agents operate. Economic theories since its beginning have been based precisely on observing the moral behavior of economic agents. When Adam Smith anticipated that people pursue to improve their well-being regardless of what other people think and accordingly decide, was basing his theory on a "utilitarian moral behavior" - the homo economicus - though not necessarily that behavior where "morally perfect" from Adam Smith's "point of view as moralist". It is likely that if we could resurrect Smith, we would discover that their wishes were perhaps a hope of observing at some point an "altruistic" utility function, for example, and not so selfish as were observed at the time.⁴

As years went by, classical theory was modified and forecasting models were adapted to a changing reality. But in truth honor, the accent of observed evolution of that reality - the way that economic agents operate in their market actions - was not referred to the modifications of both assumptions (those of the rational expectation in the pursuit of people's individual welfare and the benevolent government assumption in public regulating action) but rather the instruments used by agents, that is, not with respect to

⁴ It should be reminded that the book of Adam Smith "An Inquiry into the Nature and Causes of the Wealth of Nations" was published in 1776, i.e., after his first book "The Theory of Moral sentiments" published in 1759. In this book Adam Smith explores human behavior in which selfishness seems to play a role, as Thomas Hobbes claimed. What is then exposed is the process of sympathy (or empathy), through which a person is able to take the place of another, even when he does not benefit from it. This seeks to criticize the conception of utilitarianism as it appears in Hume. The result is a dynamic and historical conception of moral systems, as opposed to more static visions as determined by religions. In philosophical terms, human nature would be designed to advance toward purposes or final causes that are not necessarily similar to persons that are guided by "efficient causes".

the "moral conduct" underlying the use or employment of these new instruments. It was so recent developments after the appearance of "securitized assets" and "structured loans" in the field of finance, theories on "moral development" of economic agents operating these new financial instruments, seems to be old fashioned. I refer to what extent the "*homo economicus*" behavior may have been changed? for example, from agents to be more altruistic or more contemplative regarding the status of their neighbors, or, on the contrary, to be an individual moral behavior that exacerbate the extreme ambition, despite its extremely negative implications for the welfare of their fellow citizens.

The example quoted in our paper, is to compare the attitude of some operators in the crisis of the years 29/30, taking the decision to commit suicide facing the disaster, and the attitude of the agents of similar rank in the 2008 crisis, apparently not only having fewer headaches for the drama which they were an active part, but rather feeling comforted with bail-out provisions of the U.S. Government, as a first reaction, that would allow them to increase their salaries.

3. Written (formal) laws and economic laws

When analyzing the most elementary economic theory, is usually mentioned the existence of "economic laws". Some of these laws arose simply from a theoretical model on economic agents' behavior in their usual exchanges of property rights. I am referring to the example of the trade equilibrium and the "law of supply and demand". A model tested, or corroborated, by what happens in the markets that prove the result of that action predicted by the model. There are other economic laws arising from the observation of reality itself, without having originally imagined a theoretical model predicting their eventual occurrence. A famous example is the old "Wagner's Law". It could also imagine the example of the "Laffer's Curve" as another empirical law, although in this case is very easy to develop a theoretical model to anticipate the likely outcome of tax policy as indicated by the curve.

The terms "law" does not necessary imply that it is a formal arrangement issued by a Congress, but finally behaves as a law, i.e. to "secure its compliance". May even be laws with more "compliance" than the ones dictated by the legislature, so have different level of "enforcement". That is, governments can violate the formal laws and, in turn, may be unable to prevent private actors to also violate them, but no one can avoid non-formal rigor of economic laws. When a majority of citizens voted for the current government of Argentina, winning elections in 2011, immediately after the event, "a herd behavior" of citizens "voted in the market", triggering the start of a stream of huge capital outflows, etc.

But let's back to the issue of laws and their economic characteristics. Probably many of these laws may not change as time goes by, but economic agents may experience others laws as a consequence of changing in human behavior. Here comes up the issue of "moral" and the incentives and constraints faced by economic agents in their actions. Incomplete markets, identifiable as situations with deficient information or information asymmetries between agents appear, will lead to behaviors not necessarily coincident with those of previous years. In this changing scenario, actions are subject to the so-called "moral hazard", so incentives and constraints faced by economic agents really "matter". If the constraints faced were legal, i.e. subject to restrictions that limit their

actions in some of its features (read: size or magnitude that a variable may take, prohibition of the use of another variable, etc.) will likely alter moral behavior, assuming they are effective (enforcement). Otherwise, another "law in fact" will arise, i.e., a new "economic law" will emerge. Then, this new "economic law" that will arise will have a different underlying moral behavior.

The explanation of the Laffer's curve, for example, is not only the elasticity of the tax-base due to the tax-rate change, but also by a change in the tax-compliance attitude. Another example: if the Central Bank is not constrained in monetary expansion, linking it to some extent of its reserves, for example, and an expansionist policy becomes habitual and of significant magnitude, can be predicted as an economic law "a depreciation of domestic currency" and a deterioration process in the financial account or capital account of the balance of payments", and probably also in the trade balance due to currency appreciation.

The phenomenon described is a phenomenon repeated in all governments of Argentina, or in most governments. The question is how one can argue that in these cases ergodic models can not predict this outcome?

By the way, setting the monetary emission limit can not necessarily mean a fixed percentage. But there are reasonable ranges within which the phenomenon of inflation is diluted and a run against the domestic currency would not appear. Actually when Argentina introduced the "convertibility" in the 90s had a good reason: the total lack of credibility in government and the loss of "*seigneurage*" of domestic currency. The currency board appeared as an inevitable solution, not as an invention of an illuminated economist at the time. The domestic currency had been destroyed, and it had to be replaced by another (the dollar) not subject to the direct control of national monetary entity.

But then the new monetary policy lacked the design of others "formal rules", such as ensure the consistency of fiscal and credit policy and management, especially in local currency versus the benchmark currency conversion (dollar). The fiscal-financial meltdown led to disaster. It was obvious then the lack of other formal rules with "enforcement" to prevent this disaster. Precisely one had to do with the financial sector and the manner in which loans were granted.

The same happened in the USA, and in the EU with the creation of the ECB and the monetary control, but the loss of credit and fiscal control; where rules or boundaries of the Maastricht agreement were not fulfilled, and credit (public or private sector) were not adequately regulated and/or sufficiently audited by Basel rules.

Failure to comply the "formal law", on the one hand, and the absence of other "formal rules" from regulatory state action, involves the "consolidation of a new culture or new morality". That moral which grew over time has condiments of exacerbation of spirit the "homo economicus". The absence of rules, the violation of existing ones and, finally, as icing on the cake: "the bail-out".

The reiteration of financial and fiscal blunders and finally the bail-out for those who were responsible of them, have created in society a destructive "moral hazard" and a difficulty to return to normality soon.

Unfortunately, the capitalist system in this cultural and moral process tends to its own destruction. Perhaps Marx would be pleased if in this case also could resurrect and see the current international situation, not necessarily because their predictions were well supported. Actually the "aisle comment" is that Marx only decided to publish his first volume - the other two were edited by their ideological followers – and that finally the political scientist-philosopher would come into doubt about their ideas and/or forecasts.

The capitalist system has two basic premises for success: the respect for property rights and respect to not feel sorry for the failures of investors, which characterize the market dynamics. This incentive climate favors decisions investors that should try to calibrate very well the possible successes or failures. This scenario is called "risk". Therefore, the system requires the fulfillment of two conditions: that the capitalist risks his/her own capital - and the state guaranteeing the investor the appropriation of the capital benefits - and not to translate or move-forward or backward their failures to third agents. That is, providing a bail-out in case of failures is not into the heart of capitalism. If the bail-out is permanently generalizes the moral behavior of economic agents will be necessarily different.....unfortunately for worse.

The risk of bankruptcy is the "disciplining" of capitalism (capitalism without bankruptcy is like religion without hell). But what if there is no possibility of failure - because it is a government or a significant player in the economy ("too big to fail") - that poses side effects of such magnitude that it is preferable to avoid them. Milton Friedman and Anna Jacobson Schwartz in 1971 presented the thesis that the crisis of the 30's was extremely serious because bank failures destroyed a lot of money, and Bernanke policy in the crisis of 2008 would had based on this. Therefore, if there is no possibility of bankruptcy, there must be a "substitute disciplinarian" because otherwise no "institution" would put in-line individual rationality with the general interest (social rationality). How to find the substitute disciplinarian? The big question that financial experts in particular should respond.

On the other hand, the claim holding that a crisis of magnitude require a bail-out, not implies a certain specific way as the bail-out is implemented. Not many days ago circulated in EU discussions on the possibility of modifying the rules of Basel (Basel III June 2011) by introducing the possibility of capital loss of financial entities that are part of the collapse. A novelty which obviously has very restless the financial sector. The problem is not less, by the way, due to the complexity of financial transactions have taken in the globalize world.

In our paper on the subject we mentioned the existence of new financial derivatives and structured loans, which have led to a situation of total lack of ability to estimate the underlying risk of the system or of the institutions taken in isolation. At times the Central Bank does not know for sure if it is appropriate to extend or reduce liquidity because has not perfect information on whether the market interest rate is modified by changes in genuine demand (i.e., higher or lower demand due to GDP growth, changes in technological development and the emergence of new highly profitable projects, or variation of the precautionary demand for money) or if it is due to changes in the risk-rate of derivatives.

How to solve this problem without monitoring the characteristics of financial derivatives? How to solve such audit while ensuring trade secrets of each entity?

A similar dilemma has arisen in U.S.A. relative to other major issue: security and the fight against terrorism. Again auditing entities and people, but at the same time ensure confidentiality and avoid interfering too much, or divulge details of his businesses and personal life.

Given the situation in the financial sector, it is clear that a signal of possible loss of capital, beyond the measures taken by Governments to compensate the real damage: savers who must trust their money in banks and financial institutions seems necessary. It could be argued that such a risk would pose to the financial sector in an environment of uncertainty that will greatly reduce its ability to generate credit, and then the answer is simple: the Central Bank govern liquidity with the monetary issue and credit policy (rediscounts). However, it seems inevitable the audits, both in financial entities, as well as observe and monitor the reasons for the failures of risk rating entities; and, finally, fiscal and financial plans of governments, encouraging and facilitating access to credit for individuals with little power or ability to honor its debts, like in the 2008 crisis.

4. Recent developments on the literature

A few weeks after writing a first version of this note, my colleague and friend Ricardo Bara warned me about a new book written by Niall Ferguson in 2012, published just this year (2013), on the topic of crises, with the basic argument of "morality", that left me with the feeling of a very strong corroboration of what I had written in my paper that year. Subsequently, in October 2013, we take note through the media about the Nobel Prize awarded to three specialists in financial assets valuation:⁵ Eugene F. Fama, Robert J. Shiller and Lars Peter Hansen. Also in October 2013, comes up new literature on corruption in government officials, with the interesting paper by Karthik Redd, Vasiliki Skreta and Schularick Moritz.⁶ Finally, as a finishing touch, the new Argentine legislative reform of the Civil Code relative to the "immunity" of government officials, coinciding with a regrettable development of the doctrine of our Supreme Court Justice with his distinction between "individual rights" and "collective rights".

4.1. Ferguson's book

Ferguson (2013), as a good historian in economics, makes a very detailed corroboration of his interpretation about the phenomenon of crises and makes a critical review to U.S. government and EU members by introducing complex regulations that according to the author have worsened rather than improving the financial performance, and finally suggests that the solution is in the hands of "citizens' morality", that has been increasingly neglected, and broken the intergenerational contract.⁷ In Ferguson's opinion the only hope is to reactivate peacefully the "collective action" of citizens through Nonprofit Organizations (not relying too much on social networking), i.e. the idea is to incentive active group associations of people pursuing the common good, not expecting

⁵ See La Nación (Oct. 2013).

⁶ "Immunity", CESIFO, 2013).

⁷ He even disbelieves in the possibility that the American common law can achieve the enforcement of laws efficiently and effectively, when the legal system is subject to the selfish, opportunistic and often corrupt needs, of judges actions (the rule of "lawyers").

a benevolent behavior of rulers (the regulator government). Instead, to imagine a more widespread collective action, committed to the common good. But, finally, this idea forgets the pioneers' forecasts of Mancur Olson and Douglass North, and especially, the leviathan actions of governments like in Argentina, obstructing and attempting to destroy the action of these groups. The most notorious example of recent years in Argentina was the aggression towards the Catholic Church – and to who was later unexpectedly elected Pope - an institution that dares to compete with populist governments in the task of alleviating the pain and suffering of the poor.

4.2. The 2013 Nobel Prize

With regard to recent winners of the Nobel Prize, academics Fama, Shiller and Hansen, have contributed with research focused on forecasting financial asset prices in the short and long term. Their contributions can be summarized into three basic references. Fama, as a typical Chicago School economist, suggesting the assumption of perfect information in financial markets and warning that all investors actually have the same information (perfect or imperfect?)⁸, so that any particular investor can expect different results from the rest (herd behavior?) or get any special advantage -beating the market- over others. On the contrary, Hansen, formally reject the empirical implications of asset pricing models based on rational expectations and perfectly competitive markets, as recognized in that literature (Lucas). Finally, Shiller highlights the presence of "irrationality" and the importance of "psychological issues" in investors' decision, their influence on prices formation of stocks, bonds, and derivatives, and the generation of financial and real-estate "bubbles".

Apparently, it is a set of important contributions, which to be honest we must acknowledge that in some cases ratify, and others reject the assumptions of perfect information and rationality in market behavior, and a significant amount of other authors' papers that have reported the failure of traditional models.⁹

The Royal Swedish Academy of Sciences, commenting the 2013 Nobel Prize - confirming the proposition of Fama somehow - let us some doubts. It says: "There is no way to predict the price of the stocks and bonds in the coming days or weeks. But it is possible to predict the broad course of these prices for longer periods, as in the next three to five years. Such findings [...] were made and analyzed by the winners this year". In our opinion this statement generates the question of how dynamic and stochastic models would reasonably overcome the critics to ergodic models, as Paul Davison has advanced, to predict possible outcomes at three to five years, or more.

With regard to the possible self-regulating markets in the longer term, Fama in fact seems to accept the inability to predict future changes in the market prices of the assets "*in a financial market highly volatile in nature*". It seems that the result of maximizing behavior of investors in their search for information and "*on the basis of their knowledge and beliefs about what will happen in the future*", generate market operations

⁸ The two questions in this paragraph are mine not from Fama.

⁹ An interesting note by Enrique Kawamura commenting the Nobel Prize, published in the newspaper La Nación (15 Oct-2013), quotes to statistician Nassim Tale, author of the bestselling "The black swan" ("El cisne negro"), who strongly criticized the predictions of "the asset pricing models", generated by academics and were used to value financial derivatives from the "subprime" mortgages whose repayment problem involved precisely the 2008 crisis.

in which "asset prices are move up to the risk-adjusted expected returns that are the same for all assets",¹⁰ but which we believe does not means that "the risk-adjusted expected prices" will solve the dilemma of a possible bubble, just because they could be wrong.

My interpretation about Fama's assertions, is that he simply forecast the "convergence of investment decisions", but not the "correction" or "certainty" of how the market is evaluating the evolution of risk in this trend towards convergence, that is in the "sizing or level of risk" where private sector actions converge ("*according to their knowledge and beliefs*") and what also government ('the regulator') believes or understand about that risk level, in this case, for example, encouraging credit growth with reductions in the interest rate and thereby promoting credit accessible to individuals with low capacity and consequent probability of failing to honor its debts, such as happened in the 2008 crisis. The problem is how to separate the "genuine or real economic" interest rate from the "real risk" interest rate out of control or not sufficiently observed with clarity by investors and government.

4.3. A recent paper on "immunity" of rulers

CEsifo GmbH is a Munich's society whose objective is the promotion of Economic Research that links the Department of Economics at the University of Munich and Ifo Institute with international economic research community. Recently in its series Working Papers published the document "Immunity", by Moritz Schularick, Karthik Reddy and Vasiliki Skreta, analyzing the effect of governmental immunity on corruption of politicians. A historical and conceptual review of the reasons which justified the adoption of laws or regulations that "protect" rulers through the expedient of 'immunity' to the possible consequences that might arise from their decisions, making an analysis of empirical legislation in a sample of 73 countries. The hypothesis to corroborate was if immunity encourages corruption in rulers' behavior.

Reproduced by a synthesis according to the authors, the analysis leads to verify a doubt originally advanced by Platon, who formulated the question of what would happen if a person recipes a ring that make him invisibly and if he/she could resist the temptation to appropriate of "what is not theirs". Therefore, it is to investigate the moral behavior of people before different circumstances they may face. The point is to confirm the level of corruption that could emerge from an eventual establishment of formal rules that generate an scenario of impunity for the rulers, regarding the consequences - not good or harmful - that could decisions generate for many of its citizens.

Granting immunity to those who govern has an old history. The authors cite ancient Rome, when the decisions of the members of the Senate were considered inviolable, in order to protect them from interference by the nobility of *tribuni plebis*. The authors also cite the case of England, when in Parliament of 1397; parliamentary Sir Thomas Haxey rebuked prodigal habits of King Richard II. At that time the king had the conviction that Haxey was orchestrating a betrayal and had already issued a death sentence against him. Only due to intercession of the Archbishop of Canterbury, parliamentary life was saved. Then Richard II was overthrown in 1399 and the Parliament concerned about the legislative independence in England codified the

¹⁰ Cabieses (2013).

immunity by the "English Privilege of Parliament Act" in 1603. In France, since the legal and police systems were maintained for more than two decades under the command of the old regime after the French Revolution, immunity was imperative to protect members of the National Assembly for politically motivated charges.

Now, if those provisions survive the transition to modern democracy - in rigor force in more than 70 countries – Platon's democratic concerns unfortunately have been confirmed. In reviewing historical data on diplomatic immunity the paper cited the parking violations in the city of New York, which took a long time of a flagrant abuse. In Greece, mismanagement of public funds has recently been attributed to the protection of immunity. In Mexico, an elected but not yet sworn in parliament, with links to the drug mafia, was investigated by the justice. However, this politician, neglecting the police guarding the access to the House, came in to swear. Fortunately, sanity returned and his colleagues in the House voted to strip him of his immunity. Parliamentary quickly disappeared and he is still on the run. Finally, the case of Silvio Berlusconi in Italy, who made full use of the laws of immunity to avoid prosecution for ages, until his colleagues voted to expel him from the Senate.

The researchers systematically coded document immunity protection in 73 democratic countries by consulting written constitutions, founding documents, statutes, legislative procedural rules and jurisprudence of each country. The spectrum of immunity provisions investigated ranging from the UK, where parliamentary are protected by what they say in Parliament, but not criminal prosecution if they commit a crime. Or in cases like Paraguay instead, where immunity is so strong that even former presidents enjoy a procedural protection for life. France is somewhere in between.

To avoid the danger of backsliding in the instance of causation - for example, that corrupt politicians can choose the design of better protection of immunity in order to protect themselves from prosecution - the code of the authors was to observe the strength of immunity protection at the time of the first democratic constitution of the country. And they found that the immunity provisions are highly persistent over time and reflect the decisions taken at the time of drafting the original constitution, so it is not just the political machinations that account for the current strength of immunity protection in different countries.¹¹

However, after presenting a large amount of data and application test of rigorous robustness, authors find safeguards immunity of democratic institutions when democracy is in its infancy, particularly when the judiciary is still controlled by the old elite. But in mature democracies immunity encourages corruption: better protection of immunity is associated with greater corruption and weak governance, even after controlling for standard estimates of corruption determinants, such as per capita income, electoral rules and other factors.¹²

No surprise there. What at first seems not surprising is that this relationship is more pronounced in countries with strong legal systems (i.e., systems with high levels of judicial independence). In other words, the more independent is the judiciary, corruption is greater among those who enjoy strong immunity. In countries with weak legal

¹¹ The authors develop a score of immunity, which includes eighteen variables to represent the strength of the immune system of a country. Ensures that it is the first score, or measurement, of this type..

¹² For the story that we will explain later, this is occurring very rapidly at present in the case of Argentina.

systems, on the other hand, the effects of protective immunity are ambiguous: i.e., there is no evidence that immunity harm in countries with poorly developed legal institutions.

How do you explain this? In a country where the judicial and police systems are independent and effective, authors affirm that is the weaker protection of immunity that leaves corrupt politicians exposed to swift punishment. In this country, politicians tend to avoid offense. However, if the protection of immunity is strong, corruption is costless, which induces governance decisions and bad policies that serve the interest groups, more than most voters.

The final comment on the paper concludes that the trick to keep Platon's justice on the good road after government's rulers find the ring of invisibility, is to provide Justice with a kind of antidote to invisibility, so judges can get their hands on the official ruler in question, on which they would turn his justice, and particularly when democracy is in its infancy, induce him/her to choose accordingly to get away .

4.4. The new "immunity" of rulers in Argentina, the evolution of recent doctrine of the Supreme Court, and the consequences

The House of Representatives (Cámara de Diputados) recently approved the draft law raised by the Executive (Poder Ejecutivo) on the reform and unification of the Civil and Commercial Code. It consists over 2700 items, which once sanctioned by the Senate next year, will govern future civil and commercial relationships of natural and legal persons, private or public. The new code will take effect the first day of 2016.

One of the important sections that we discuss here is that of the provisions on **"Property individual rights" and "collective advocacy" or "collective rights"**; and the other on **"State Responsibility" or "Accountability"**. Article 15 states that while people are holders of individual rights over their property, but the next line states that property also **"has a social function and therefore is subject to the obligations established by law for the common good"**. Previously, Article 14, the new code recognizes the collective rights and states that **"the law does not protect abuse of individual rights when it can affect the environment and collective rights in general"**. According to many analysts, I included, the reform introduced by this article opens the door for the State to interfere arbitrarily in individual rights. The underlying principle of the philosophy that arises from this new legal reform is the replacement of individuals as the center of Argentina's social organization, by the State.

Dealing with **State Responsibility**, it provides that it must abide by the rules and principles of national administrative law, not by civil law. The same for non-compliance in public officials' duties. So a very important step towards "immunity". Indeed, one of the most controversial aspects of the new rules is the one that disclaims all liability to the State and its public officials before a lawful act or unlawful harm to a citizen or an enterprise. So far, the affected person can go to civil court to claim a compensation for the damage done: from the new law should settle these cases on administrative law, which is not only more contemplative with the interests of the State, but legislation will be not homogeneous, because it will vary by province.

In an article published by the newspaper La Nación by Laura Serra, after collecting opinions of lawyers and political opposition, mention that the reform states that the

deterrent financial penalty (e.g., fines) is considered "inadmissible against the State and its official agents". It further provides that "the State should not respond, even as subsidiary, for damages caused by dealers or contractors of public services" and, to top off, the state should not "under any circumstances" repair any lost profits in the event of a legitimate activity, damaging by a third person. That is, "the complete irresponsibility of the State" is sanctioned in all its interventions.

This restriction applies, for example, when the state expropriates land for the completion of a public work. Or, in the case of the media law, to eventual claims for lost profits formulate businesses affected by having to give up their current licenses before the end of the concession period.

All opposition representatives and a large portion of legal experts in the field describe the reform as a "huge legal setback"; by this decision of Government to eradicate the Civil Code State responsibility. While today the Code does not explicitly contemplates this regulation, there is a vast jurisprudence endorsed by the Supreme Court that allows citizens to go to civil court to sue the state or a public official in the event of injury. But now the law promoted by the government, bans this possibility exhaustively, by providing in the first article that "the provisions of the Civil Code do not apply to State liability directly or secondarily".

Not only the opposition and law professional associations question the government project, it even runs counter to the original initiative that had drawn the Supreme Court, Ricardo Lorenzetti and Elena Highton de Nolasco, with the collaboration of jurist Aida Kemelmajer Carlucci. Indeed, in their proposal, they included the responsibility of the State and public officials in the Civil Code, both for its lawful activity or for their wrongdoing. In the latter case indicated that the State is liable for the damage, even "without the need to identify the author". In the case of a lawful activity, "if affected the continuation of an activity" must include the "compensation for unamortized value of investments".

One example cited in the note is that today a survivor by an accident on a public transportation (as the case of Railways) can trigger civilly in jointly or independent against government's officials responsible for controlling the operation of the service and against the state, directly responsible for the acts of its agencies. With the new legislation, the affected person can only go to the administrative jurisdiction of the Capital.

However, the law that raises the government proposes some exceptions, but they are very restrictive. Indeed, in its third article provides that only anyone can civilly sue the state where there is a "true and actual damage, duly attested by those who call for it, and measurable in money"¹³ or when the "causal link between activity and inactivity, and injury is verified by the body for which compensation is sought". Furthermore, the initiative provides very meager limits of two years, to the natural or legal person may sue the State or a public official for damage that was committed.

¹³ This condition does not provide any psychological or emotional harm, not susceptible of monetary measurement through the market, such as the performance of an activity that can be assumed as the rationale for an individual - either by the vocational component, the strong influence of customs and family tradition, or other motivation - beyond the economic revenue to generate.

In short, the waiver of “civil” responsibility of the state is nothing but the exemption from liability of its officers. The bureaucrats may take any decision on the lives of citizens and will not be monetarily responsible for their consequences.

Regarding the "responsibility", by this principle of "immunity" or "no accountability of public officials", as pointed out by the analyst Carlos Mira, lawmakers have amended the original proposal of the members of the Supreme Court Lorenzetti and Highton Nolasco. They were the ones who in the judgment by the “media law” invented the esoteric category of "collective rights". In this regard, as Mira said, the question that arises is: “Since when does a "collective" have rights? The only ones who may be subjects of law are the natural or legal persons, the "collective” have no rights, individuals are the ones which have them. Actually within the "collective" there are millions of human beings who disagree. The State pretends to be the incarnation of the "collective" that only serves for the set of officials sitting in their armchairs. What type of legislation makes that of people like us, are not equal, but privileged, with rights that citizens do not have, like this one that is now being voted with unpunished people civilly for damages they cause with their decisions.

As paper finally concludes from this new philosophy of "collective rights", is that the two cited judges who have invoked that theory.... "could not be scared because the State intends to introduce legislation that declares impunity of some citizens That is their blessed "collective" over acting!” There is then a group of people that are reputed to be more important than citizens and then not want to be unpunished before them? Their new doctrine has allowed it.

The doctrine of the current Supreme Court, despite the reported prestige of many of its members, has given us samples of hazardous apartments in the historical interpretation of constitutional provisions. The case I wish to quote again this time is the judgment of "Candy v/ AFIP", commented in detail in previous papers.¹⁴ In that judgment, the Supreme Court ruled in favor of the firm Candy showing that the income tax (Impuesto a las Ganancias) on its current design caused a real tax burden of 62%, i.e., a higher percentage than the 35% set by the legal tax rate and the confiscation limit of 33% established by doctrine.

Indeed, from a legal point of view, the Constitution Argentina protects property rights by prohibiting the confiscation of property (Art. 14 and 17). The Supreme Court in turn has interpreted the seizure takes place when the tax rate is more than 33 percent of the value of the property or the income. Within this line, the supreme judges insisted that "this pattern" (the 33%) has been repeatedly recognized by the Court, so the confiscation occurs in all cases where the tax burden exceeds the indicated percentage.

However, the Supreme Court also made clear in its judgment that the permissible limit of 33% "is not absolute but variable in time and in circumstances" so that the reasonableness of taxation is thus subject at the time conditions or circumstances when courts take the case.

Although deep a discussion of the legal issue is beyond the scope of this note -

¹⁴ Piffano (2009; 2013^a; y 2013b).

acknowledging my obvious professional weakness in this area – anyway I desire to express the apparent contradiction in the jurisprudence of the Court when it also argues that Justice cannot make "politics", because according to the Court, policy is set by the Parliament. On what basis or argument the Supreme Court will measure the "reasonableness" of taxation and fix the tax burden that violates the property or not, without making "politics" in fact?

The issue will not be solve by arguing that a trial is very complicated, because it depends on how commercial trade policy is defined, the exchange rate policy, the needs of public goods, the problems of income redistribution, etc. No matter how complicated is the case, it should be resolved by judges when the case arise in that instance. It seems that the problem of Justice, at least in recent years in our country, has adopted a very careful attitude to "avoid politics" or "not make political decisions", arguing that the policy is fixed by the Congress. Hence not to prosecute, for example, the street protests or the claim of a people cutting routes with police acquiescence (in fact, "legitimizing that situation"), etc. It seems that Justice neglects to acknowledge that represents an institution whose existence responds to Republican form of government, which therefore constitutes a "power" and, consequently, will also be part of government policy decisions when the Constitution is violated. In the commented case, this is so because the justification for the existence of a tax does not depend solely on what the views of Congress, on how good, appropriate, timely and well-intentioned is the tax from the economic and social point of view - including the opinion endorsed by economists with Nobel Prize - simply by the provisions of the Article 28 of the Constitution.¹⁵

What had ratified the Court in case Candy SA c / AFIP, that the 33% limit is not a strict number because it would be subject to conditions "variables in time and in circumstances", introduces an extraordinary level of uncertainty about future, destroying the viability of many investments - particularly those of long maturation - which is incompatible with a free market system and private property to operate efficiently. Moreover, if the Court decides in future trials that due to circumstances the boundary extends for example to 66 % - doubling the famous 33% - would not only be doing politics but also co-legislating a tax retroactively, i.e. on sunk investments. This would contradict the constitutional principle that the validity of tax legislation should be in advance to chargeable event. So fixing the limit cannot be subject to future discretions in which differences with 33% are relatively important. Ultimately, the Supreme Court cannot avoid making policy and also could violate the constitution itself due to the inconsistencies in doctrine. Finally, this is one more example of how our Supreme Court has "limited the property rights", now further limiting through the differential identification of individual rights and collective rights, both to be defined by the public policy of successive governments and that will surely affect the Justice, based on parameters subject to pressure and imposition of the other two government branches, actually modifying the constitutional principles, as subject to discretionary changes in

¹⁵ The justification of a tax law cannot be based only on grounds of economic efficiency (gain / loss of welfare discouragement / encouragement of uncompensated taxable activity with improvements / deteriorations generated in the rest of the economy) and / or reasons of distributional equity (redistribution as a public or merit good). On this last point in particular see Bour, E. (2008, 2009), Chapter XV. What the design of economic policy faces is a typical problem of conditional optimization - it forces a "second best" solution from the political official point of view - and in which the operating restriction must be the "confiscatory assessment", no matter what the objective function to be optimized may be. The restriction should be solved or imposed by Justice.

power. In Argentina, the forgotten issue that governments do not have the possibility of constitutional amendments, such as in the U.S. or Brazil. Governments, or our ruling class in general, do not seem to take note of this important difference that Alberdi deliberately wanted to care about in the design of the 1853 Constitution.

In short, the non-permanence of the essential rules that guarantee basic citizenship rights, such as private property, and its effective enforcement, foreshadows a scenario of huge uncertainty and chaos, incompatible with any attempt to develop a private sector under reasonable levels of risk, particularly not subject to any corrupt behavior of "not responsible" officials of the government in turn.

5. Final remarks

In the actions of economic agents in every economy there are "laws". Some of them derived from explicitly government regulations, others by the actions, cultural and moral attitude as economic agents operate. The latter depends at the same time on the scenario of incentives and constraints faced by these agents. Change in the prevailing scenario of incentives and constraints they face in their actions involve the effect of new "economic rules or laws" that are shaping the course of history.

From my point of view I think as necessary imagine "formal rules" with sufficient enforcement in cases where the extent of possible damage faced in the absence of them - especially when the previous scenario has led to a damaging moral hazard - make necessary. A lower rate of economic growth that could generate such restrictions should be interpreted as the cost of an insurance premium to cover the damage of a possible run by an unsustainable bubbles or macroeconomic imbalances.

If anyone imagines that the rules assume the possibility of having the need to rape them due to a crisis sometime "unforeseen", I think that no-one would oppose a rule change facing an event of magnitude. For example, a natural disaster that involves having to modify the budget law. No one would object to such "violation". Now, not to anticipate future crises by a reckless "soft liquidity policy" or an uncontrolled fiscal government behavior, clearly do not admit justification. These "crises" are avoidable and a "Samuelsonian' manual" is enough to avoid them.

With regard to the financial sector - in the detail is the devil – the problem is how to monitor the expansion of liquidity of financial derivatives and how to handle the information of the entities in this regard. Well, that's the job we expect from financial management experts.

Unfortunately, as we concluded in our paper already mentioned, the problems facing in business agent regulation - due to information asymmetries between agent and principal - faces the problem of information asymmetries between Government and citizens - developing its action on a highly imperfect political market - which makes conclude in an unfortunate doubt or conflict, that is, whether the phenomenon will be feasible of resolving reasonably. As Ferguson points out in his book, the dilemma of financial-fiscal and monetary regulations is to seek answers to the question of "how to regulate to the regulator". The establishment of macro-fiscal and monetary rules, with clear sanctions for its violation; it is our humble and insisting suggestion.

Finally, in the specific case of Argentina, the trend more recently recorded in legislation and in the doctrine of the Supreme Court adds more ingredients of doubt and disappointment regarding expected of public officials behavior, in a scenario of perverse incentives, boundaries to their actions nonexistent and high discretion, without any punishment for their mistakes, whether involuntary or worse, perhaps arising from corrupt attitudes in their decisions. The persistent and aggravating evolution of the institutional weakness of Argentina leads to increasingly high risk scenarios and uncertainty, not only in terms of investment, but also in terms of basic freedoms and rights of citizens.

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