

## **COLOMBIA: A COUNTRY TRAPPED UNDER ITS INSTITUTIONS.**

### *Colombian constitution as an obstacle for development*

***Andrés Mejía-Vergnaud***

Director General

Fundación DL

Development through Liberty

Colombia

[fdl@fundaciondl.org](mailto:fdl@fundaciondl.org)

On behalf of my institution, I thank all the members of the Economic Freedom Network, for allowing me to present this paper without actually attending the meeting. I thank Amela Karabegovic for her constant and valuable cooperation, and I thank WHOEVER IS READING for reading the paper on my behalf. I beg the audience to please excuse any errors in my English writing. We will gladly provide copies of this paper and deeper information on the subject upon your request at anytime. We will also provide the original Spanish version to those who prefer to read in that language. Please send your request to [fdl@fundaciondl.org](mailto:fdl@fundaciondl.org).

## **I. PRESENTATION**

### **1. Our institutions as a heavy burden**

The purpose of this paper is to describe the main elements of the institutional framework that prevents Colombia from enjoying the benefits of an open economy and a clear legal structure. By understanding these basic principles and their implications, the reader will be able to understand why, despite the fact that many well-oriented policies and economic reforms have been carried out in recent decades, their effect has not been felt in terms of the welfare of our society. The reader will be able to see that these measures and reforms, however well-conceived and oriented, are only a positive partial aspect of a legal and cultural framework that is hostile to the principles of capitalism and the open society. In the same way, the reader will be able to understand why in Colombia institutional change is such a difficult task. On one side, throughout decades, important sectors of our public life have learnt to obtain benefits

from our institutional framework, and logically they oppose reform. On the other hand, as a result of a paradoxical opinion process that has taken place in Latin America, economic liberalism<sup>1</sup> is blamed for producing our current state of stagnation and poverty, reflected in high unemployment rates and poor growth figures.

The reader must be aware that, in addition to the problems described in this article, Colombia faces another major obstacle for the development of capitalism and free markets: the increase of violence has brought about a severe crisis in personal and economic safety. The activities of several terrorist groups, the inefficacy of criminal justice, the impact of drug producing and trafficking (the impact of the war on drugs), and a high rate of ordinary crime, make investment costly and difficult. But this particular problem, important as it is, is not the only cause of the current economic situation of Colombia.

## **2. Economic opening vs. The Constitution of 1991**

In 1990, with the background of the fall of the Berlin Wall and the collapse of communism, President Gaviria conceived a reform plan for Colombia, aimed at two targets: constitutional change and economic liberalization.

In 1990, a constitutional assembly was elected by popular vote, and was given the commandment of writing a new constitution for Colombia. The product of this assembly was the Constitution of 1991, the main target of this article's criticism. We will argue that this document is not really a constitution; we will show how its fundamental principles favor the growth of a rent-seeking society and the progressive plunder of the State; its principles favor the growth of public spending and the creation of obstacles for the functioning of markets. We will also argue that the principles of this constitution are hostile to the concept of the Rule of Law.

The plan of economic reform undertaken by the Gaviria administration was, in principle, well-oriented from an economic point of view: privatization, trade opening, financial and capital markets liberalization, etc. These reforms had the purpose of leaving behind several decades of rigid governmental control of the economy, and thus preparing Colombia to enter the new era of global integration. There can be no doubt about the positive results yielded by most of these measures. In spite of the frequent

<sup>1</sup> In this paper, the word "liberalism" will be used in its classical sense.

claims of several interest groups, Colombian consumers have highly benefited from a larger supply of all kinds of products, thanks to the elimination or reduction of tariffs and other barriers. The years when we, as consumers, were inevitably submitted to the poor quality and high monopolistic prices of local producers are fortunately in the past. A flexible and market-fixed exchange rate has allowed Colombians to listen clearly to the signals of international markets. Financial liberalization has greatly improved the supply and quality of financial services in Colombia. A very orthodox monetary policy has kept inflation under control.

Some of the reforms that were part of the initial plan could not achieve their final goals, mainly due to political causes. For example, social security reform partially introduced the system of individual accounts, but the old system was not fully eliminated, and it has become one of the greatest sources of our current fiscal time bomb. In the case of privatization, two types of difficulties kept this policy from reaching its goals. On one side, the existence of highly powerful interest groups opposed to privatization, mainly public unions and powerful professional politicians. In the first case, union members fought to keep the privileges obtained during decades of easy bargaining with bureaucratic managers. In the second case, electoral politics in Colombia is often done through the promise of bureaucratic positions to the candidate's supporters and voters. Several governmental institutions are known to be part of the electoral patrimony of local politicians, so they were logically opposed to privatization. But the policy of privatization also faced another obstacle: the absence of the Rule of Law and the lack of transparency in privatization procedures. Even today, ten years after most privatizations took place, the procedures used are being strongly questioned. The problem may not have reached the same level it did in Russia, but is in essence the same.

### **3. Colombia's crisis as evidence of institutional failure**

As we have said, despite the implementation of well-oriented economic policies and reforms, the sad reality is that Colombia's economic outlook has worsened during the last decade. Paradoxically, in times when economic liberalization is blamed for all our economic pains, our most urgent threats come from the dramatic increase in the levels of government spending. In addition, Colombia has been consistently showing very low levels of economic freedom (Gwartney and Lawson, 2002).

The ratings obtained by Colombia in the latest version of the *Economic Freedom of the World* index (Gwartney and Lawson, 2002) clearly exemplify the situation we've described. While the results Colombia shows in areas such as "Access to sound money" are remarkably good (7.1) for an emerging country, other critical areas such as "Size of government" and "Legal structure" exhibit very poor ratings (5.4 and 3.5). Added to this, we find that Colombia's ratings in the other areas that compose the index are not good, and this puts the country in a very general low ranking (92), inferior even to those of Ghana (89), Sri Lanka (77), Nicaragua (60) and Uganda (60).

The very low rating obtained by Colombia in the "legal structure" area is, in itself, evidence of how adverse to capitalism and free markets our institutions are. We find especially alarming the rating obtained by Colombia in the variable "Integrity of the legal system" (1.7), which measures the impartiality of the legal system and the degree of general observance of the law. The low degree of general observance of the law is, and has been, a severe problem during many decades, and its consequences go far beyond the economic sphere: it is also related to the high degrees of crime, corruption and violence that our society faces. We will show in this paper how Colombia's constitutional framework contains in itself incentives for the non observance of the law.

## **II. HISTORICAL BACKGROUND: THREE ANTI -LIBERAL REVOLUTIONS**

### **1. The burden of history**

The history of our constitutional institutions plays a very important role in its current condition. Colombia, like many other emerging nations, has never known free-market capitalism, and the country's constitutional structures have been only partially shaped by classical liberal ideas. In addition, Colombian institutions bear a heavy cultural and historical burden: our traditional Hispanic colonial heritage, which is adverse to capitalism and the market economy. In the context of this cultural framework, social structures were defined by land ownership and genealogies. Trade and manufacturing activities were despised, and were regarded to be proper for lower people. Eminent Colombian writer Lucas Caballero Calderón describes life in this context as follows: "Our grandfathers thought only three careers were appropriate of their dignity: arms, arts, and writing. Working and trade were regarded to be only appropriate for lower

people. They didn't even think of working. They made their living out of their lands and privileges." (Caballero Calderón, 1978)

Despite all the changes and evolution processes our society has gone through, the anti-capitalistic seed had already been planted in our culture since the times when our country was a Spanish colony. In terms of social ethics, the traditional hostility against capitalism paved the way for a more contemporary form of anti-capitalism: the view according to which the market economy is based on the exploitation of the workers: capitalism is thus viewed as a system where gains are always obtained at the expense of someone else, or some other group of society (workers, farmers harmed by trade openness, etc.). Such a vision is not exclusive to the radical sectors that are traditionally enemies of capitalism (leftist parties, labor unions, liberation theology followers); amazingly, it has reached even the mentality of many Colombian business people. According to Mr. Hernán Echavarría-Olózaga, economist and respected business man, Colombian business people don't understand how capitalism work: their mentality has been framed by a series of anti-capitalistic trends, and this has prevented them from understanding the process of wealth generation (Echavarría Olózaga, 2001). Hayek identified very well the idea that underlies all these trends of thinking (Hayek, 1988): they're all affected by a fundamental economic mistake, consisting in not understanding how, from a material transaction, the amount of wealth can be higher than it was before the transaction. It's the mercantilist vision of wealth as a fixed and limited quantity: necessarily, when there are gains, there must be losses somewhere else. In Colombia, this vision has helped to progressively shape the rent-seeking character of our society. No wonder the public sector and its treasure are seen by many as the best way to make economic gains.

## **2. The high cost of the first anti-liberal revolution**

Unfortunately, none of the many constitutional changes that our country has gone through in the last 130 years has been inspired by classical liberal ideas. Moreover, it would not be wrong to say that their foundations have been, precisely, anti-liberal (Kalmanovitz, 2001). In 1886, a new constitution was promulgated after a period of several civil wars; this constitution aimed to establish a highly centralized political structure, unified around a national project that was easily imposed on a society tired of war and division. The main features of this project were the primacy of an agricultural and domestic economy based on land ownership, the orientation towards the inherited Hispanic colonial traditions, and cultural unification around the catholic

church. The latter element brought, as an unfortunate consequence, a large degree of isolation from late 19<sup>th</sup> century economic and cultural trends. According to economist Salomón Kalmanovitz, the very high price paid by Colombia for this anti-liberal revolution was Colombia's isolation from the first globalization (Kalmanovitz, 2001).

### **3. Missed opportunities**

During the early 30's, Colombia's liberal party, no longer liberal in ideas, promoted a series of constitutional reforms that sought to correct the severe deficiencies of the 1886 model. Unfortunately, these reforms followed the wrong direction, bringing with them a new anti-liberal revolution. The 1930's reforms were oriented by a socialist political platform, and were mainly directed towards creating a constitutional basis for a larger governmental intervention on the economy. Philosophically, these reforms were based on the principle according to which individual rights must yield before the "common good", which is protected actively by the government. For such protection, the government had to be given higher intervention powers. By orienting the reforms towards these socialist ideals, Colombia missed the opportunity of introducing the Rule of Law and Limited government in the institutional framework, ending privileges and prompting our economy towards global integration.

The constitution now in effect, approved in 1991, was the product of a process whose anti-liberal features are even more dramatic. This constitution established in Colombia an institutional model whose consequences Colombians are not yet fully aware of.

## **III. THE FOUNDATION'S OF COLOMBIA'S CURRENT CONSTITUTIONAL FRAMEWORK**

### **1. Constitutions and development**

For a country, the political constitution can act as a ramp towards peace and progress, but it can also lead to misery and disorder. A constitution, in order to act as a vehicle of progress, must have a simple and clear structure, establishing the following fundamental clauses: first of all, it must establish and guarantee the Rule of Law, closing the door to privileges and legal exceptions. Second, the political constitution must clearly define the structure of the state, enumerating the powers given to each agency or branch; and this means governmental agencies will have only the powers expressly given to them by the constitution and the law. Third, a constitution must define the terms of the relationship between individuals and the state, that is, it must

establish a bill of individual rights. The institutional frameworks modeled upon these foundations guarantee legal security and the primacy of individual rights, which are the strongest foundations of economic progress. There is much empirical evidence about the relation between such institutional frameworks and good economic performance (Gwartney and Lawson, 2002).

The Colombian constitutional framework, on the contrary, is based upon very different principles, which can be identified and described as follows:

- a) The definition of our political structure as based on the so called "social rule of law." This idea is supposed to mean a contemporary correction of the classical idea of the Rule of Law (Leguizamón, 2000), based on equality of opportunities before the law. For the defenders of the new concept, the government must be active in the promotion of "effective equality", and at the same time protect individual rights as it was meant to do in the classical conception. This idea is based on noble purposes and intentions, but it was conceived in error: first, it's based on a naïve vision of the government and its effectiveness; second, the ideas that underlie the concept of "social rule of law" are incompatible with the classical idea of the Rule of Law. There can be no such combination. The "social rule of law" opens the door to privileges, legal insecurity and constraints to freedom, and erodes the principle of separation of powers.
- b) The second pillar of our constitutional framework is the enunciation of a long and comprehensive list of social welfare aspirations that are given the level of constitutional rights. Of course, it is highly desirable to live under a system where these social and economic needs are met, but the writers of our constitution chose the wrong way to achieve this goal. Social welfare is the product of the economic development of a free, open, and globally integrated society. It can not be magically created by law.

## **2. A lethal combination.**

A political constitution that combines the two ideas explained above produces fatal results, not only in the economic realm, but in every other aspect of social organization. This effect is even worse when the combination of these principles is done with the vagueness and imprecision that characterize our constitutional rules. When socio-economic promises coexist with a regime that promotes governmental intervention and the unequal application of the law, the incentives for the development

of a private economy begin to fade. In many cases, citizens will find it less costly to pursue the satisfaction of their needs through the judiciary. When the constitution itself establishes privileges, no matter how well meant they are, there will be incentives to capture these constitutional privileges and the benefits they yield; this will be more profitable than investing one's resources in competitive activities. Under the Rule of Law, economic progress is obtained through open competition in the marketplace. Under the "social rule of law", since incentives for competition are reduced in favor of rent-seeking, there will be few incentives for innovation, creativity, and research. This is how societies become intellectually poor. In addition, such a system creates growing pressures on the public finances, and since it opens the door to wage and price controls, it can cause the economy to be unable to adjust in times of crisis. Judicial activism is favored over legal certainty. And finally, integrity and general observance of the legal system are eroded, since the system itself contains incentives for the nonobservance of the law.

**The incompatibility of the Rule of Law and the "social rule of law":** The government of law is the most essential condition for the existence and development of any community. The classical and individualistic notion of the Rule of Law is the only one that can satisfy this requirement. A harmonic and clear legal system, that protects freedom, guarantees equality of opportunities and the absence of privileges: this is the classical idea of the Rule of Law. In the course of history, it's possible to verify that every society that has embraced this idea has enjoyed remarkable progress. The great Scottish philosopher David Hume saw, correctly, that the most important process in English history had been the passage from the government of men to the government of law.

Unfortunately, and perhaps inspired by the noble aim of "social justice", the writers of our constitution decided to take a different path, defining the basis of our institutions as a "social rule of law". With this formula, they attempted to combine the virtues of the classical Rule of law and the alleged advantages of a socialist (some call it "solidaristic"<sup>2</sup>) view of society. The latter is founded on the active role of government in the pursue of "effective equality." But trying to make such a combination is vain: both ideas are essentially incompatible. Either equality before the law is guaranteed, or

<sup>2</sup> Which is absurd in itself, since solidarity implies voluntary acts.

privileges exist. Either law is applied impartially, or is applied seeking to favor particular groups of society. Both ideas simply cannot live side by side.

The anti-liberal orientation of the "social rule of law" doctrine can be read in several decisions of Colombia's Constitutional Court. For example, in a 1992 decision, the Court stated that

"The social rule of law is a form of political organization that attempts to fight the economic or social pains of several groups in society, assisting and protecting them...The goal of improving the abilities of people requires the government to act effectively to preserve or improve the living standards, which includes feeding, housing, social security, and the resources needed to act in society" (Decision T-426, Junio 4, 2002).

Reading the entire text of our constitution (380 articles), many other instances of this anti-liberal doctrine can be found. Chapters 2 and 3 of Title I, for example, include a long list of socio-economic and environmental "rights". The constitution orders government to intervene in the economy "in the exploitation of natural resources, the use of land, production, distribution and use of goods,...in order to rationalize the living standard of the inhabitants, the equal distribution of opportunities, the benefits of development and the preservation of a healthy environment" (Article 334). In defining freedom of enterprise, the constitution states that "it is a social role that implies obligations." Right after that, the Constitution says that cooperative associations will be benefited by governmental intervention in their favor, and the government is commanded to act in order to strengthen this form of association. In this way, no matter how noble the purposes are, the constitution creates a privilege and an incentive to exercise one sort of private activity in detriment of the others, which are not benefited with a constitutional commandment in their favor. In many countries laws establish subtle privileges. But when the privileges appear openly in the constitution, one cannot hope the legal system to be impartial and clear.

**Incentives for a rent-seeking economy:** When a constitution includes a list of social welfare "rights", and the rules for interpreting and applying these norms are not clear, the constitution establishes the basis for the growth of a rent-seeking mentality. In this framework, incentives for production, competition and innovation are few,

compared with the incentives for capturing institutional privileges. When taking wealth is more profitable than creating wealth, the road leads inevitably to poverty.

The framers of socialist-oriented constitutions would be surprised to find how their principles, all of them aimed to favor the weak and the poor, become an instrument for gaining privileges in the hands of the rich. *Dinero*, a Colombian bi-weekly business magazine, recently reported that senator Fuad Char, who is the owner of a powerful supermarket chain, managed to make the City Council of Barranquilla back a judicial action against other supermarket chain that was planning to open a store in that city, on the grounds that building such a store would hurt the environment (*Dinero* n° 166, September 20, 2002, p. 18). No wonder those typically rent-seeking groups of society, for example labor unions, are known to be the greatest defenders of the 1991 constitution and the decisions of the Constitutional Court.

A problem that rises naturally when a constitution promises social goals is deciding who will pay for the costs of such "rights". Our vague constitutional rules can be read as commanding the government to satisfy these aspirations. A consequence of fully applying this rule would be fiscal chaos, on one side, and the progressive fading of private economy, since every need must be met by the government.

Another peril of including such a catalog of "social rights", and establishing that private enterprise has a "social role that implies obligations", is that courts could read these clauses as if the cost of "social rights" should be assumed by the private sector. This is not an exotic speculation. Our Constitutional Court, in its polemic decision on the interest rates for housing loans, established a price control system on the grounds that private banks are not free when it comes to a "basic social right." Another interpretation could be that, since the Constitution elevates these aspirations to the category of rights, their satisfaction cannot be the object of private business activities. During the debates that preceded the decision mentioned above, several justices advanced the view that housing loans should not be a private business, since the constitution includes the right to have a good place to live (Clavijo, 2001). Now, if we consider that almost every human need is covered by our comprehensive constitutional rights catalog, it would follow that nothing can be a private business matter. This is equivalent to erasing the market economy and to replacing it with a naïve and romantic set of principles, where it's not clear how will these needs be met if

they cannot be so through private business. This is not a remote possibility. All it takes is an activist group of justices, and that's not a hard thing to get.

**Judicial activism and the erosion of the legal system:** A consequence of rejecting the classical idea of the Rule of Law is that the threat of judicial activism instantly appears, and with it the erosion of the principle of separation of powers. The Colombian Constitutional Court has faced often the accusation of practicing judicial activism, invading the areas of other branches of power, especially Congress and the central bank. The Court, however, considers that, since its decisions have a constitutional level, they can legally re-write the law and act in areas reserved to other branches. The first natural consequence of this is the erosion of legal certainty: individuals no longer know what rules and laws are standing, or will be standing tomorrow. Since legal certainty is an important condition for investment, judicial activism has a considerable impact in slowing economic activity. Again, as in many other cases, the Court hurts the groups it claims to protect and defend.

As many experts have pointed out, the Court justices have disregarded their own human limitations when writing their decision, especially in technical economic matters, an area that is beyond their scope of knowledge, and whose treatment should be in the hands of congress and the central bank. In addition to the fact that this violates the principle of separation of powers, from the democratic point of view it is unacceptable that nine men, who form a non-representative body, make decisions that should be made only by an elected representative corporation (Congress).

Another important consequence of our constitutional doctrines has been the erosion of legal integrity, that is, the general observance of the law. It is true that, in Colombia, the high degree of law nonobservance has been a problem for decades. But our current institutional framework is not very helpful for the solution of that problem. First, by expressly renouncing the classical doctrine of the Rule of Law, the constitution favors the establishment of privileges and exceptions to the law, which ceases to have a general and impartial *imperium*. On the other hand, the rent-seeking dynamics described before harm the integrity of the legal system too: when individuals or groups have high incentives to seek the establishment of privileges and legal exceptions in their favor, one can expect many individuals and groups to do so. In such a case, the integrity of the legal system will be harmed to a high degree. A good example of these practices is explained by Mr. Kalmanovitz, who points out that, in

Colombia, even in our Congress, very often the same congressmen who demand protectionism benefit from smuggling, an activity that becomes highly profitable in the context of high tariffs and constraints to trade.

**An alternative interpretation:** an alternative way to understand these constitutional clauses, which has been tried by some justices and scholars (Clavijo, 2001), consists in saying that the constitution does not establish an economic model, rather, social "rights" should be interpreted merely as general guidelines and welfare goals for public policy. Nevertheless, despite the fact that this interpretation could reduce the costs of judicial activism, our view is that Colombian constitution indeed establishes an economic model whose foundations are the intervention powers given to the government. The state, the government and its agencies are seen naively as perfect instances for the solution of every conceivable public problem.

It is true that our constitution claims to defend individual rights and private property too. However, the effectiveness of this defense is subject to a large number of exceptions, "social obligations" and privileges established by the constitution itself. Moreover, the doctrine of "social rule of law" is supposed to be based on a rejection of the classical notion of equality, essential to the protection of individual liberties. In the words of author William Leguizamón, individual economic freedom in our constitution is restricted by "a high level of governmental intervention in every field...through a large number of constraints, allowing us to see the precarious state of that individual freedom that the constitution claims to defend". Again, this is an evidence of the incompatibility of the notions of Rule of Law and "social rule of law."

#### **Final remarks: ¿what can we expect?**

Institutional reform is a historical imperative for the survival of our nation. Currently, we can find forces acting both for and against institutional reform:

Perhaps the biggest enemy of institutional reform is a curious social process that can be seen in several cases similar to ours: an institutional framework like the one we've described tends to increase poverty, by narrowing the room for individual economic activity. As poverty increases in a context of low opportunities (due to strict governmental control), preferences for redistribution, welfare programs and government-based satisfaction of economic needs, tend to increase, paradoxically giving the constitutional framework the support of those it has harmed. Recently, *The Economist* magazine (August 5, 2002) reported that in Venezuela, as poverty

increases mainly thanks to Chavez's policies, a large sector of the poor have come to support his promises of social redemption. There are interesting studies that show how, where there are few opportunities for private activity, preferences for redistribution grow (Alesina y LaFerrara, 2001). However such a state of affairs cannot last for very long, since in a system where the many plunder the many (to use Bastiat's words) no wealth is created, and the inevitable collapse of the public treasure can bring about the collapse of the entire economy.

In addition to this curious process, there's another obstacle for institutional reform in Colombia: the groups that obtain benefits from the current system (labor unions, political groups, special interest associations), constantly and fervently defend the constitution in the public arena, and in their rhetoric they call critics of the constitution "enemies of the people." The public impact of this defense of the constitution is considerable: in Colombia, many people still regard the most polemic justices of the Constitutional Court as "defenders of the workers". One of them recently gained a seat in Congress with a very high number of votes.

However, on the other side, there are positive trends too. Today in Colombia, a growing number of influential people are insisting on the need for institutional reform. A major effort in this direction is the work done by the *Alesina Mission* (Alesina, 2001), which produced a series of recommendations for institutional change, all of them oriented toward classical liberal principles. In fact, President Uribe and his team have submitted to Congress a few but urgent reform initiatives. Due to the existence of several other priorities for the administration, perhaps a major project of reform will have to wait while.

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