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Incomplete Democracy: Why Democracy Cannot Survive Without the Market

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1. Introduction.

Imagine a hypothetical country in which three constitutional reforms are made. The first is to change the economic system so that decisions concerning the production of private goods are made democratically. The second is to change the political system so that decisions concerning the production of public goods are made by the market. The third is to subject the existence of individual rights to majority approval. Analyzing these reforms helps us understand the limits that the economy imposes on democracy, and those that democracy imposes on the market.

1.1. Voting for Refrigerators.

Suppose (as is often the case) that the supply of and demand for refrigerators is left to the market. The interaction between producers and consumers determines how many refrigerators will be produced and at what price. Consumers choose a refrigerator for their home among the various options offered by the market.

The first reform abandons the market system as the means of determining which refrigerators will be produced in favor of the democratic system (the political system).

Under this reform, decisions concerning the production of goods and services (consumer electronic, foodstuffs, tourism, clothing, etc.) are left to democratically elected authorities. The government, as the representative of the public will, decides what refrigerators are best for citizens, orders an adequate number of these produced, and distributes vouchers to consumers that they can then exchange for the refrigerator model chosen by officials.

This system replaces the market with a democratic system. A system with these characteristics seriously affects the production of goods normally considered private. Consumers may want smaller or larger refrigerators, or refrigerators with different features. If the government cannot clearly identify consumer preferences, there will be consumers with unwanted refrigerators.

Moreover, because the system will have problems identifying how many refrigerators are needed, it may generate tremendous scarcity or an extreme surplus. The usual outcome will be scarcity because the state will lack the necessary resources to produce a sufficient number of refrigerators. In addition, because the refrigerators will be free, everyone—including those who do not care for one—will ask for one. We will be faced with lines and long waits. The lack of competition will mean that refrigerator quality will leave much to be desired. Finally, corruption will be inevitable: those who can bribe officials will obtain more refrigerators and those who cannot will be left without one.

The system described is not a product of science fiction. It is a simplified description of the planned economy model best exemplified by the Soviet system (and socialist economies generally). In that system, the state attempted through economic calculations to determine the demand for each good and service, and then produced and delivered adequate amounts of each good and service to consumers. The results were the ones just described: misallocation of resources, poor quality, well-known scarcity, and a high level of corruption. Today, few would suggest returning to that system.

This reform illustrates a first limit to democracy that will be developed further later on: there are intrinsic operational limits on democracy's capacity to produce an adequate supply of private goods.

1.2. Buying Legislators.

The second suggested reform would be to do away with voting for legislators (or for the President) and instead allow for the buying of political office. An initial auction would be held and those who present the highest bids would assume legislative office. Legislators would then be free to sell their office whenever they desired, and legislative turnover would not be the product of periodic election but, rather, of continuous sales of offices in the market. Legislative composition would reflect the preferences (expressed in "monetary votes") of those who want to participate in politics.

The result would be disastrous. The legislature's public policy would not necessarily be responsive to the public interest and instead would be responsive to its members' interests. It would be composed of wealthy individuals with an interest in participating in politics. But it would be a different sort of politics in which the norm would be to produce "public goods" on a foundation of private interests. For example, if firms were to obtain enough seats, the legislature would pass environmental laws that would not necessarily promote the best use of natural resources (the best use being that which benefits all citizens) but, rather, favor the private use of the environment at the expense of others.

Thus, the market would be used to produce public goods and, in the process, the public's right to necessary public goods would be affected. The political system would be a distribution mechanism of privileges for private individuals.

This system is also not a product of science fiction and is very similar to the one we now experience in Latin America. Its results are those of mercantilist systems in which private individuals buy political decisions through influence or money in order to ensure that the public goods that they need—not those that society requires—are produced. Videotapes of Montesinos buying Peruvian officials and even businessmen with public resources are examples of this political marketplace in action.

This second reform illustrates the opposite problem that the first does; namely, the limited capacity of the market to produce public goods.

1.3. "Your Home Belongs to Everyone."

The third reform is related to the first two and involves the relationship between individual rights and the decisions of a democratic majority. Both democracy and the market require a bundle of basic individual rights in order to function. These rights are, without argument, considered fundamental to a democracy. They include, for instance, the right to bodily integrity, freedom of expression, freedom of conscience, and freedom of association, among others. The effective existence of these rights distinguishes an authentic democracy from a simple democratic electoral system.

Understood in that sense, it is impossible for these rights to be repealed democratically. If the majority were to decide that these rights were inconvenient because, for instance, they did not allow for an effective fight against terrorism (or because they affected governance), we would accept that such a curtailment could occur. To avoid it, we subject democracy to a judicial check so that majorities cannot infringe upon individual rights; we assign the task of protecting these rights to a more technocratic system (or aristocratic system, depending on how one views the matter) like the judicial branch or constitutional tribunals. While these tribunals are subject to a series of democratic controls, the truth is that appointment and removal systems attempt to shield the process of appointment of tribunal members from pressures deemed "excessively democratic" and are geared towards finding legal technocrats rather than politicians. A clear example is the United States Supreme Court, whose members are appointed for life and are free from democratic checks that permit their removal. As the Peruvian lawyer Enrique Chirinos Soto used to rightly say, the members of the United States Supreme Court "are never removed, and they rarely die."

Matters are not that different from the market's point of view. In order to function, the market requires, in addition to freedom of commerce, a basic bundle of fundamental rights without which the system is not viable. These rights are the right to property and the freedom of contract, among others. Without these rights, the market cannot function.

Like rights that allow for the proper functioning of democracy, those that allow for the property functioning of the market cannot be democratically repealed. It is not acceptable for neighbors to organize a meeting to decide whether my house will be demolished and made a park. Clearly, all (with the exception of oneself) would support confiscation of my property and vote to leave me without a home. Under such rules, the incentives for majorities to exercise "democratic takings" would have no limits. This explains the constitutional recognition of fundamental rights and of instances in which these rights cannot be stripped from individuals by a majority vote. For this recognition, we turn to the same "aristocracies" mentioned—that is, the courts or constitutional courts—and, on occasion, administrative agencies that place limits on the government's ability to use its democratic legitimacy as a means of curtailing individual rights. In short, democracy is subject to limits that prevent it from seeming like a tyranny of the majority. Majorities themselves use this system, created to shield courts from political pressure, to protect individual rights. This is why courts and constitutional tribunals are called upon to protect rights like property, the right to free trade, and the right to contract.

Now imagine a constitution that does not recognize individual rights but instead limits itself to defining the organization and decision-making structures of government entities that, due to their democratic legitimacy, decide which rights shall exist. This constitution allows rights to be created or abolished according to the whim of majorities. The result would be the destruction of many individual rights. If the majority considered torture necessary to combat crime, then the right to bodily integrity would be done away with or severely limited. By the same token, if I allow people the right to vote to take their neighbor's home, all of us would vote in favor of doing so and would thereby enrich ourselves through governmental action.

A system like this one would do away with the principle of individual civil and economic rights. By way of example, majorities could easily establish their right to discriminate against minorities simply by electing officials that favor discrimination. And if majorities wanted to enrich themselves by confiscating the property of the rich, nothing would prevent them from doing so. Under such a regime, both democracy and the market would, paradoxically, disappear due to majority will.

This reform would relax a condition that is one of the more important for democracy and that, curiously, is its foundation as well as its limit: individual rights. These rights should not only not be conditioned on majority will, but also require that the system create a means for someone to place limits on majorities should these majorities attempt to interfere or eliminate them.

These three reforms illustrate that democracy is not an absolute good and that it has the capacity to displace systems or rights simply because a majority wishes it. Democracy has various limits of which it should be mindful. Here we concern ourselves with the limits that the economy can place on it. In particular, we shall see why democracy, on its own, may be inefficient at determining the adequate supply of private goods. As a point of contrast, we shall see how the market often demonstrates a similar incapacity to produce public goods. This suggests that a good system should clearly delineate which goods should be produced by each system.

Even without the detriment of its operational limits, democracy is still limited by the principles on which it is based. If democracy could question individual rights, it would enter into a self-destructive spiral that would result in its disappearance. And if democracy could eliminate the individual rights necessary for the market to function, it would also destroy the system essential to the production of private goods—goods without which the production of public goods loses its purpose.

2. Systems that Aggregate Preferences.

Some of our needs must be met with private goods. Food, clothing, shelter, entertainment, services, and other necessities are met with resources that are ordinarily assigned to private individuals.

Other needs are ordinarily met with public goods used by all, like streets, public order, public safety, the government, the judicial system, etc.

The division and specialization of labor have made it impossible for each individual to obtain these goods independently, regardless of their nature. We human beings must resort to exchange in order obtain what we need. This suggests the challenge of organizing systems that supply private and public goods that satisfy the needs of millions of human beings, and that free each individual from having to provide himself with the goods and services he needs.

The design of these systems begins at two possible starting points that run counter to one another. The first is to design the system in a way that allows an autonomous third party, independent of those who consume goods, to decide how needs will be met. This third party's decision-making capacity would be derived from a hierarchical structure without a basis other than the use of its power. This institution would decide how to satisfy the demand for public and private goods. It would decide what streets would be constructed, how safety would be distributed or generated, what methods of conflict resolution would exist, how much food and clothing would be produced, how homes would be built and who would live in them, etc. All the while it would be subject not to the control of human beings who consume these goods or services, but to the control of public officials.

The second starting point is radically different and begins by acknowledging that the needs of human beings are normally tied to individual preferences; that is, to a desire concerning how each need should be met. Consequently, third party decisions regarding what human beings should and should not consume carry a high likelihood of error with respect to how individual preferences should be satisfied. In order to achieve the highest level of precision, decisions concerning what public and private goods to produce, how to produce to them, and how to distribute them should be made by those who consume the goods. But given that society is composed of millions of individuals, the adequate production of these goods should abide by some form of an aggregation of individual preferences that determines what shall be produced and in what manner.

This last approach is based on a rather clear value: man should be free to decide. It suggests free decision-making with respect to the production of goods, even if the need to aggregate individuals' preferences imposes limits on this liberty. One does not find all that one wants in a democracy, and nothing ensures that I will acquire the public goods that I want; in principle, one gets what the majority wants. But the market does not necessarily give me what I want either. Even though I would like a Coca-Cola that is less sweet than usual, I would not be able to find it if there are not a sufficient number of consumers that make producing it profitable.

Under this second approach, democracy and the market are two systems of preference aggregation designed by society to make individual liberty compatible with the need to simultaneously satisfy the needs of millions of distinct individuals. They are systems of preference aggregation that share an ethic of individual freedom to make decisions. In the case of democracy, these decisions are made through the electoral system. In the marketplace, they are made through the system of prices.

3. Why Have Different Systems of Preference Aggregation?

Without detracting from their ethical foundations in liberty, let us not forget that we are talking about operative systems that must resolve practical problems. That said, given that the problem democracy faces is different than that which the market faces, the systems' designs will be different.

For a reason that will be explained later, democracy aggregates preferences through votes, whereas the market does so by discrete decisions about consumption and production expressed through "monetary votes": the amount of money that each consumer chooses to assign to the satisfaction of each of his needs.

The reason for the difference between the two is the nature of the goods around whose production individual preferences aggregate. Democracy is a system meant to supply public goods whose production, use, and enjoyment can only be carried out with a common system (a public system). Here we are speaking of goods whose production has been assigned to the state.

In contrast, the market is a system meant to supply private goods whose production, use, and enjoyment are carried out through private transactions and exchanges, and that are assigned through property rights and contracts between private individuals.

The distinctive nature of the goods supplied is what justifies a different design and not, as is often asserted, a different foundational ethic. Through the democratic system, we aggregate individual preferences in order to supply public goods like government, public safety, basic infrastructure, streets, highways, judicial systems, etc.

In contrast, using the market, we aggregate preferences in order to produce private goods (through private property rights) like food, health, shelter, entertainment, clothing, etc.

4. One Person, One Vote vs. Monetary Votes.

Perhaps the most glaring difference between democracy and the market is the unit of measurement used to aggregate individual preferences and make decisions. Democracy is based on the "one person, one vote" ideal, while the market uses the capacity of acquiring goods and services as its unit (usually measured in units of money, or "monetary votes").

This distinction is perhaps the root of the erroneous assumption that democracy is sustained by a set of values superior to those that sustain the market. While democracy deems all human beings equal the market, it is said, distinguishes according to individual wealth. Individuals' participation in the market, it is argued, is determined by their purchasing power. This leads some to believe that the market lacks the equality ideal that inspires democracy.

It is not the purpose of this piece to analyze the error that lies in believing that egalitarian ideals have no place in the market. Nonetheless, I think it important to emphasize that the market does value an abstract equality that allows individuals to recognize the possibility of competing with one another. The fact that some may be in a better position to compete with others is another matter altogether. The most able at conducting business perhaps might make more money, and those with more resources will enjoy more opportunities to succeed. But this same phenomenon manifests itself in democracy.

It is evident that people better skilled at forming ideas and expressing them (the most intelligent, the most well-spoken, charismatic individuals, etc.) can exercise their freedom of expression in a way superior to others and, by doing so, create more opportunities for political success. In addition, those who own the media would seem to have a much greater capacity than other citizens to exercise that freedom due to the simple fact that they own the means of disseminating ideas.

Evidently, freedom of expression is not a right distributed equally among citizens, even though all citizens are deemed equal in the abstract. This freedom is exercised through a principle very different from the "one man, one vote" principle. The reason is evident. If it were not the case, freedom of expression, as an expression of freedom itself, would be subject to a series of limitations. One would have to revoke the right of the media to publish what is pleases or, if not, distribute this right in equal parts to all citizens. Thus, taking equality to its logical extreme serves to restrict freedom of expression to the point of eliminating it. It is therefore not possible for all opinions, without exception, to manifest themselves with equal force without eliminating freedom of expression itself. But democracy needs this freedom because without it, democracy loses its virtue and ceases to function properly.

Democracy—without doing harm to itself—normally does not allow for the aggregation of individual preferences for the purpose of obtaining specific results or measures like a refrigerator. With the exception of the referendum or other methods of direct democracy (like open municipal councils), voters elect representatives that will vote their interests, whereas in the market the consumer himself goes to the store and selects a refrigerator for his kitchen. Voters tend not to decide, unless through direct means, how the national defense system will be organized, how courts will function or provide services, where bridges and streets will be built, or what level of resources will be allocated to social programs. Those are decisions delegated to persons that the electoral system deems authoritative (the President, Congressmen, mayors, etc.). The reason is evident. It is not possible for the allocation of public goods to reflect the discrete preferences of all individuals. Only the preferences of a few may be reflected.

Thus, the system of preference aggregation tends to limit itself to delegating the authority to make decisions to representatives who, as candidates, make promises and offer programs and whose fulfillment of these promises and offers is monitored through subsequent elections. Consequently, many will not have what they want, and the system will be deemed democratic if, in the aggregate, the public goods produced reflect the preferences of as many citizens as possible given the circumstances—all the while protecting the basic rights of minorities through the recognition of fundamental rights.

The market, by contrast, is in the position to address specific preferences by directly supplying specific goods for each citizen. Consumers can have different cars, different homes, and various forms of entertainment that suit their particular tastes. Each consumer can enter the market and identify, with utmost precision, what he needs and then obtain it (subject to his budgetary constraints). The aggregation of preferences allows providers of goods and services to determine what to produce, how to produce it, and at what price to produce an aggregate amount. This aggregate does not exhaust itself according to the majority's wants but, rather, according to the wants of each individual consumer.

Let us return to the problem of "one person, one vote" vs. "monetary votes." As we said, the problem seems to be the theoretical basis for the alleged superiority of democratic values over market values. But the difference between the two principles is not rooted in a different foundational ethic, but instead in the need to solve different factual problems.

If what one desires is to aggregate preferences for the purpose of generating public goods, it is possible (and convenient) to develop an egalitarian system of units of preference aggregation. In the final analysis, if some are to benefit and others are to be harmed by governmental decisions, an adequate solution is to give everyone an equal vote. Only by doing so do we ensure that the decisions made will be, at least indirectly, representative of the majority's will (in spite of the fact that, inevitably, part of the majority will perhaps not agree). Voting has a series of free rider problems, or externalities. It is possible to affect the destiny and well-being of others with my vote.

Imagine that a candidate wishes to pass a law prohibiting parties after 11 p.m. This proposal might bother citizens who like late night entertainment. Citizens who enjoy silence and who like to go to bed early think the proposal is good and support it. “Silence” and “noise” are public goods. If the city is a quiet one, those who like silence win. If it is a noisy city, those who like parties win. But the city cannot be noisy and quiet at the same time, because the public space affected by the noise is a public good through which, in way or another, the costs and benefits of activities are externalized.

If the majority who voted for the candidate who proposed the ban on parties likes silence, it has achieved its objective through democratic means. But by doing so it has externalized the effects of its decision on the minority who likes parties and who do not like the measure. This is an inevitable outcome because the goods that this system produces are public goods that by their very nature generate externalities.

Thus, in democratic processes majorities externalize part of the costs of their decisions on minorities (if the candidate fulfills his promises). This is true in all areas: voters indifferent to protecting the environment affect environmentalists; those who can bribe judges affect those who believe in impartial justice; those who want special privileges affect those who cannot obtain them; those who want free education affect those who pay their taxes but who can afford private education; and so on.

It is not possible to construct highways that affect only those who voted for the mayor that decided to construct them; or to design systems of administration of justice that are biased only against those who voted for persons opposed to judicial reform; or to allow that the environment deteriorate only in areas in which the majority who elected an environmentally unconscious president lives. Bad government tends to affect everyone, not simply the majority that put it in power. And good government can benefit everyone, even those who were opposed to its election.

Given these circumstances it is understandable why we have a “one person, one vote” system. That system is the best way of mediating the effects of these externalities because it fragments the power of the majority to the furthest extent possible by turning the production system for public goods into the most public system possible. If externalities persist they will be mediated by the fragmentation of political authority, thereby reducing their harmful effects to the furthest extent possible.

To understand this aspect of the system imagine a city in which there are only five citizens with the right to vote. These citizens have markedly different income levels. One is very rich and the other four are poor. The wealthiest one loves to listen to loud music into the late night hours. The other four like to go to bed early. If monetary votes are used to elect the city's mayor and the wealthiest citizen has enough money, he will have a mayor favorable to late night loud music. The other four will suffer the externalities distributed to them through the public space. If we used a "one person, one vote" system, however, the mayor will favor silence and the wealthiest citizen would suffer the externality of having to remain silent when he wants to listen to music. A more democratic system, then, reduces the externality associated with using the public space. The system of monetary votes would make the public space the wealthiest citizen's living room; in other words, it would make a public good something like a private good.

If candidates for office were elected using "monetary votes" the externality effect would be exacerbated. Public goods would cease to be generated by a public system, and they would be responsive to private interests (in particular, to those interests that can afford to pay them the most). We would then have an institutionalized mercantilist system that leads to inefficient decisions and that harms large groups of people who are excluded from enjoying the privileges that the state bestows to some by using resources that belong to everyone. Similar explanations can be made to understand how corruption distorts the system. If an official is given a bribe in exchange for a benefit others are affected, thereby externalizing the cost through the production of a public good. Corruption is nothing more but the lack of well-defined property rights because the bribed official is in the position to dispose of property that does not belong to him.

By contrast, the incentive structure of the market is different. The market is a system of preference aggregation for the production of private goods. Consequently, the results of these decisions have direct and exclusive repercussions on those who take each individual consumption and production decision. If I buy the wrong refrigerator, I alone bear the costs of the error (just as I enjoy the benefits of buying a car of excellent quality). Markets with low transaction costs, without serious externality problems, and with well-defined property rights lead to greater individual well-being without harm to the public interest.

But in a world with scarce resources, not all of us can have what we want. It is therefore necessary to have a mechanism that rations the use of scarce resources and makes us conscious of this scarcity. Every need is thereby matched with a preference, but all preferences are subject to a budgetary limitation that permits aggregated preferences to be limited by the amount of resources available to satisfy them. It is not possible to distribute more than what exists, and the market is a system thought up with that limitation in mind. The market does not allow for dreaming, but rather brings our dreams to firm ground when we take concrete decisions.

This is not to say that the production of public goods through the political system is not subject to budgetary constraints. In fact it is, and oftentimes these constraints are greater than those faced when satisfying the need for private goods. The structuring of a national budget is an attempt by the political system to produce public goods that correspond to the scarcity levels of available goods. The concept of fiscal equilibrium is an imperfect substitute for the price system's role of rationing the use of public goods. Here we can see one of the largest externalities that democracy produces over private individuals. The deficit generated by excessive public spending (a practice that tends to benefit only a portion of the citizenry) has repercussions for the entire population because it generates inflation. In the final analysis, inflation is generated by those who voted for a government that is populist or poorly disciplined, or by those who are in the position to influence government decisions for their own benefit.

The market system uses "monetary votes" precisely to keep preferences within the limits imposed by the scarcity of existing resources, thereby permitting a reasonable use of these resources according to their level of relative scarcity. No more effective mechanism exists to achieve this than the market, through a pricing system. Thus it is not possible to distribute all existing resources among all citizens and satisfy all needs like it is to infinitely divide the number of votes necessary to elect a President. No limits exist to establishing the votes necessary to elect officials in an electoral system. Theoretically this number could climb infinitely and we would continue electing only one President. But it is not possible to assign an infinite number of "monetary votes" because by doing so we would create a unbalance between what people want and what they can be actually be given. The most well-known result of attempting to transfer the "one person, one vote" principle to the market is the inflation generated by artificially oversupplying money. Distributing more votes does not cost anything. Attempting to distribute more resources than exist, on the other hand, does have a clear social cost. This is why populist pressures tend to generate inflation: they create incentives to spend more than what is available.

But there is more to the system. The market is in the position to define the proper individuality of human beings in a more precise way than democracy because, as we have already seen, democracy does not have the capacity to make specific responses to specific preferences. For this to be possible it is necessary that we be able to express our preferences in a distinctive way. It is therefore not possible to use a "one person, one vote" system because, in contrast to public goods, the private nature of the goods when acquired requires a system of preference aggregation with differentiated units that are amassable and therefore individualized for each person.

Using the political system to produce private goods would put violins in the hands of people that hate music, Spanish *chorizo* in the hands of vegetarians, and law books in the hands of engineers. The principles of consumer sovereignty and private autonomy would not exist and individual economic liberty would be swept away. It could also be said that democracy suffers from precisely from this type of problem: its incapacity to produce distinctive public goods that reflect distinctive individualities. But that is a problem that is impossible to solve, not because democracy is not a good system, but because it is an implicit cost of the public goods it produces—a cost that prevents it from reaching that level of individualization.

For the market system to reach an adequate assignment of resources based on individualized preferences, it is necessary to use a unit that measures these preferences in a way that reflects distinct valuations. In order for the system to work exchange is required, and for exchange to work the common measure must be suitable in order to reduce transaction costs. To reach this goal man invented money. Money is not only a measure of valuation but also a means of exchange that generates, in an incredibly efficient way, a complex, dynamic, and tremendously effective exchange system. It also reduces transaction costs by establishing a "common exchange language" that makes possible transactions that would otherwise be tremendously complex.

For those practical reasons the market uses money as a unit of measurement to aggregate individual preferences, giving citizens "monetary votes" so as to function in a way that maximizes the general welfare.

One could argue that the system is not egalitarian on the ground that it differentiates people according to what they have and not according to what they are. This is an inexact assertion. The market does not establish limits on what people may accumulate. In principle, the accumulation of resources is determined by the individual's capacity to use them. This system of assignment itself generates adequate incentives for better use of resources. If a law were passed mandating that all lawyers earn exactly one thousand dollars, the consequences for the effectiveness of the legal services markets would be disastrous. If everyone earned the same amount ability, effort, education, and preparation would not establish differences in income levels. Lazy lawyers and poorly prepared ones would make as much as hardworking and studious ones. The result would be incentives for lawyers to be lazy and ignorant. This would reduce the capacity of the economic system to generate well-being.

The root of the problem has to do with the difference between the transaction costs involved in producing public goods and those involved in producing private goods. Markets operate under low transaction costs. But it is unimaginable that all citizens could agree on the type of justice that they want or what environmental standards to use.

According to Coase, it is possible to understand why firms structure themselves internally according to the margin (through hierarchical structures) when transaction costs are significant, and why markets develop when such costs are reasonably low. Going one step further (or, from another perspective, one step back), it is also possible to understand why society would select decision-making systems through democratic means when transaction costs associated with producing certain goods are too high and why, on the other hand, it would use the market system when the costs of supplying these same goods are reasonable.

As Adam Przewoski correctly notes, "Democracy is necessary precisely because we **cannot** agree." To complement Przewoski, we could say that the market is necessary precisely because we **can** agree.

5. Democratic "Aristocracies."

I once heard someone say that the market should be subordinated to democracy because citizens could vote democratically to have a different economic system. I would ask myself whether those who think along these lines would agree that democracy could itself be abolished democratically and the government made a lifelong dictator.

Likewise, we could not passively accept that the democratic system eliminate, even with great popular support, the so-called fundamental rights. And we should also not passively accept that the democratic system "expropriate" private property or the right to contract.

But the "democratic temptation" to seize rights is strong. To protect ourselves we have created mechanisms that prevent democratic power from becoming antidemocratic. The most common of these mechanisms are the courts. One of judges' principal roles is to place limits on institutions of democratic origin, like the executive or the legislature.

Judges are selected (at least in theory) before their political sympathies or capacity to win votes from the public are determined. They are selected for their legal and technical expertise, and their tenure tends to be protected by various methods from excessive democratic pressure. They are rarely elected directly by the people and the legal community tends to require additional qualifications of them (age, experience, interviews and hearings, etc.) other than being popular. It is not desirable for judges to be responsive to political power and we appreciate their autonomy and independence, including autonomy and independence from majorities' desires. This implies that judges should play the role of preventing the system from falling prey to "waves" of democratic fads that sweep away the bundle of basic rights that the democratic system itself needs. The courts are called upon to prevent democracy from becoming a tyranny of the majority.

The role of these "aristocratic" bodies is also to place limits and draw the line between those who take decisions concerning the production of public goods and those who take decisions concerning the production of private goods. When the courts protect the public interest from, say, the excesses of commercial freedom, they are actually preventing the market from producing or affecting public goods. On other front, judges also protect private property and the right to contract from excessive regulation, and ensure that property is not confiscated without just compensation. By doing so they prevent the public system from shaping the production of private goods. Courts themselves place limits on democracy.

The law may dictate who is the owner of what, but it is the courts that set the standards that define the limits on the exercise of my rights. In countries where both democracy and the market function reasonably, we have courts that have established reasonably clear distinctions between what is public and private, including the protection of private property from the democratic pressure to take it for the public welfare.

This last definition is crucial to the proper functioning of the system of private good production. The uncertainty of political risk raises transaction costs and thereby reduces exchange and investment levels. This is why one should call attention to the growing interest that businessmen demonstrate in seeing improvements in the administration of justice.

These “aristocracies” charged with overseeing the balance between democracy and individual rights are unfortunately not very prestigious in Latin America. The lack of reliable judicial power makes the balance between democracy and individual rights, paradoxically, an unbalance. The line between public and private property becomes tenuous, or ceases to exist altogether. And an individual communal right is a contradiction. The result is a bad division between the system of public good production and the system of private good production. This situation generates, on the one hand, disincentives for investment and economic development and, on the other, the assumption of power by economic interests (mercantilism and corruption).

6. Privatizations without “Aristocracies.”

Matters worsened during the Latin American privatizations of the 1990s. These processes formally marked a radical change in the ownership rights to the means of production, which passed en masse from state hands to private hands. Privatization attempted to place the production of private goods in the market and leave the state with the sole task of producing public goods (although the final results were very unsatisfactory as far as these goals was concerned).

Nevertheless, is it useless to convert ill-defined public property to ill-defined private property. The result is an inconsistent and unstable system that is not a good system for producing neither public nor private goods. To privatize without drawing the line between private and public is not privatization in the true sense of the word.

In many Latin American countries weak courts did not ensure potential investors that their rights would be respected. Investor doubts were especially strong in politically sensitive areas like public services (telecommunications, energy, water, and sanitation) whose privatization was urgent and necessary but where the democratic temptation to interfere with investors' rights was much stronger. It is no secret that Latin American politicians, and especially legislators, believe that their role is to directly fix the rates for such services, or to regulate through law these sectors' utterly complicated technicalities. Thus, the rights of investors were left subject to politicians' interest in increasing their popularity by taking on the rights of business. No judicial power capable of stopping the possible excesses was visible.

These circumstances gave rise to the creation of a series of "substitutes" for reliable judicial power. Given that reforming the judicial system seemed rather difficult and lengthy, privatizations could not wait. There had to be alternative mechanisms to generate greater confidence. This is how judicial reform was renounced or delayed, and the emphasis instead placed on the creation of various mechanisms aimed at limiting the political system's pressure over economic actors.

These "substitutes" are usually called "antidemocratic" because those who oversee the limits either do not have a democratic origin or stand on a tenuous democratic basis. The summary of the panel topic is an example of these substitutes. Nevertheless, one should ask oneself whether their merit lies specifically in their autonomy from democratic pressure. What are these systems? Let us enumerate a few:

a. **The creation of specialized administrative agencies.**

One approach is to create an administrative agency to resolve particular economic issues, thereby replacing courts as the day-to-day arbiters of those issues. These agencies, especially "antitrust" agencies and sector regulators, have more resources, better personnel, and more capacity than the courts, therefore creating a curious paradox in which those whose who oversee these agencies' actions (the courts) earn less and have less resources at their disposal than those they oversee.

The reason for creating these agencies is to give the investor the sense that a technical and specialized “new aristocracy” exists that is charged with imposing limits on democratic pressure to reduce individuals’ and firms’ rights. In many countries these agencies enjoy a public legitimacy in terms of reliability that is greater than that of the courts.

Curiously, the abandonment of judicial reform puts us in the absurd position of making the government (these agencies tend to be part of the executive branch) the arbiter of politicians’ excesses over the structure of markets. Even if the short run results seem encouraging, in the medium and long run these agencies tend to suffer capture pressures from those they regulate (corporations) as well as from politicians, thereby blurring the distinction between the public and private spheres.

b. **Legal Stability Agreements.**

Perhaps the clearest case of a substitute for reliable judicial power is the so-called Stability Agreement (or Law-Contract) that immunizes firms from legislative or regulatory changes. Through these agreements with business, the state forfeits its right to change the law. If a change in the law harms a firm, that change will be not enforceable against that firm if it holds a Stability Agreement. To use this device is to accept that democracy cannot make untimely legal changes that affect private individuals.

Throughout the 1990s a legal regime developed that enforced agreements in which firms guaranteed investment in exchange for the government’s promise that the rules of the game would not change. This system is set forth in the Constitution of Peru, which states in the second paragraph of Article 62 that “[t]hrough Law-Contracts, the state may establish guarantees and grant assurances. These cannot be modified through legislative action, (…)”

Under this system investors enjoyed legal stability agreements that were unalterable by law, thereby guaranteeing that the tax laws would not be modified, that the free availability of currency would be not disturbed, and that the right to nondiscrimination between investors would be preserved. If any of these regimes were modified, the changes would not affect any firm that held a stability agreement.

It is interesting to see how the state, in the interest of making the system more stable, forfeits its power to modify the law.

Is this forfeiture antidemocratic simply because the state is closing the door on new lines of voter opinion that call for the modification of the rights acquired by firms? In a way, the firms' individual rights are protected by making the right not to have the law changed an individual right (derived from a contract). However, it should be asked whether a state's guarantee to not apply the death penalty that is later renounced would be antidemocratic.

c. **International investment protection systems.**

It seems that the above two measures are insufficient. Therefore, many countries sign international agreements or treaties that protect investors from untimely and unjustified legal modifications by domestic legal regimes. These systems include the submission of disputes that involve the state to international arbitration or other systems of dispute resolution. These systems take the task of differentiating between public and private good production structures out of the hands of the domestic judicial system, or else transfer these disputes to international institutions not subject to the democratic control of the country itself.

These systems are mechanisms equivalent to international human rights systems that are free from the democratic control of the country itself and protect the country from its own immaturity as far as respecting these rights are concerned. These systems are a response to the weakness the judicial system displays in drawing the line between the public and private sphere.

Are these mechanisms antidemocratic?

It could be argued that these various mechanisms (administrative agencies, stability agreements, international investment protection systems) involve a lesser degree of democratic control than the mechanisms democracy uses to defend individual rights. But at their core these mechanisms are not meant to be responsive to pure democratic controls. If they were, they would only duplicate the problem of democracy tempting itself to go beyond its proper limits.

In any case, these systems are simple substitutes (perhaps not the best ones) borne of the lack of stability of rules as well as of the lack of courts that not only set the boundary between the market and democracy, but also fix the extent to which individual rights can limit democracy itself. Undoubtedly it would be better to have stable judicial systems and courts that set forth clear limits. But as the saying goes, “in the absence of bread, *tortas* will do.”

7. Conclusion.

It is not possible to satisfy every human need solely with public goods. Nor is it possible to satisfy them solely with private goods. We need both to live well. To neglect either of them is to settle for half the symphony—for an incomplete democracy. Understanding that the problem of satisfying human needs is not only a philosophical problem, but also a practical one that involves matters apparently so banal as determining how to use scarce resources to satisfy these needs, is crucial to understanding the relationship between democracy and the market. We should not conceive of democracy and the market simply as systems subject to value scrutiny. They are also operative systems geared towards obtaining concrete results and, as such, they should be subject to practical scrutiny as well. A democracy without limits could be a dictatorship or anarchy, none of which is a true democracy.