

THE INSTITUTIONAL FOUNDATIONS OF PUBLIC POLICY: A TRANSACTIONS APPROACH WITH APPLICATION TO ARGENTINA*

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ABSTRACT

Public policies are the outcomes of complex intertemporal exchanges among politicians. The basic institutional characteristics of a country constitute the framework within which those transactions are accomplished. We develop a transactions theory to understand the ways in which political institutions affect the transactions that political actors are able to undertake, and hence the policies that emerge.

We argue that Argentina is a case in which the functioning of political institutions has been such that it prevented the capacity to undertake efficient intertemporal political exchanges. We use positive political theory and transaction cost economics to explain the workings of Argentine political institutions, and to show how that maps into low-quality policies.

1. INTRODUCTION

Political institutions are the rules of the political game and, thus, are crucial in the determination of public policies. Expectations about future policies are key determinants of economic behavior and outcomes. Thus, to understand a society's economic performance, it is necessary to develop an understanding of its policymaking process. In this paper we present a transactions approach to study the impact of political institutions on public policy determination. We use this approach to explain key features of policymaking and policies in Argentina.¹

The main thrust of (of what we might call) a “transaction approach to public policy” is that public policy is the result of a series of intertemporal political transactions. As such, understanding public policy requires understanding the determinants of the underlying political transactions. We borrow from Transaction Cost Economics the dual emphasis on the importance of intertemporal considerations in (political) exchanges, and a micro-analytic approach to the study of transactions. Efficient intertemporal transactions require the appropriate alignment of the political actors' temporal incentives. These incentives, in turn, are determined by the nature of the country's institutions. In analyzing the workings of political institutions, we adopt a “general equilibrium” approach, looking at *the overall* set of incentives and constraints faced by key political actors.

Since the way these transactions are implemented is affected by the need to safeguard the interests at stake, a country's institutional characteristics impact on the substance, nature and feasibility of political transactions. The realized transactions and their nature characterize, in turn, the emerging public policies. Environments that do not provide for the adequate enforcement of political exchanges, will generate high transaction costs, as political actors will have to design complex mechanisms to protect their rent allocation. The associated high implementation costs imply that many political transactions will not be implemented, and those that may be implemented will tend to generate relatively high-cost (inefficient) public policies. These may turn out to be too rigid (i.e., not capable of adjusting to changing economic circumstances) and also too unstable (i.e., too dependent on political outcomes). Societies with such environments will tend to generate poor-quality public policies, with the consequent impact on economic and societal performance.

Our framework draws from insights in the literature on transaction cost economics, in particular the work of Oliver Williamson and followers, and on its applications to politics, suggested by North (1990) and Dixit (1996). While North and Dixit emphasize transactions among citizens (or pressure groups) and politicians, we emphasize

¹ Given its well known economic, political and social underperformance, Argentina is an interesting case study for this type of exercise. It is also a case where it is almost universally agreed that it would be very hard to explain performance without reference to its political economy and to some particular features of its policymaking process. See for instance Dominguez (1998), Erro (1993), and Waisman (1987).

transactions among politicians.² In that sense, our work is closer to the pioneering papers by Weingast and Marshall (1988) and Moe (1990b), and Moe and Caldwell (1994).³

Transaction cost economics, as developed by Williamson (1979, 1985 and 1991) and others, attempts to understand economic organization, taking *economic* transactions as the unit of analysis. In most of that work, characteristics of the institutional environment are taken as given (such as the workings of the Judiciary), and a deep analysis of the features of different economic transactions is undertaken. This micro-analytical approach to transactions, endogenizes (explains) the governance structures that support those transactions (distribution of ownership, contracts, etc.).⁴

In our transactions approach to public policy, the focus is on the institutional characteristics of a given country. This requires a micro-analytic approach to political institutions, and for that we draw from, and contribute to, the literature on positive political theory.⁵ The features of particular political transactions are very different from one to the other (it is not the same to grant a one-time cash transfer to victims of some natural disaster, than to privatize a complex network industry plagued by cross subsidies). In this framework, the governance structure for each *political* transaction, is endogenized, and it depends on its characteristics and on the characteristics of the institutional environment. These endogenously derived features of political transactions are, indeed, the features or characteristics of public policies.

Along the way, we suggest a way to characterize *features* of public policies, that although shares a resemblance with those emphasized by political scientists (for instance, Cox and McCubbins 1999), and by some economists (Rodrik 1989, 1995 and 1997), it is different from the standard focus on the *content* of economic policies in economics. Normally the political economy literature concerns itself with the substance – namely, the *inner features* of policies (i.e. will agriculture be subsidized or taxed, will exports be subsidized or taxed, which sectors will get protection from international competition, etc.).⁶ In this paper we focus on the *outer features* of policies, like their predictability, their adaptability to changing circumstances, their consistency across policy areas, and some

² Roughly, we are assuming that agency problems among citizens (or groups) and politicians are “orthogonal” to the analysis. Although clearly not the case, this issue is left for future work. See Persson, Roland and Tabellini (1997) and Careaga and Weingast (2000) for some interesting interactions with that dimension.

³ See also Epstein and O’Halloran (1999) for a recent application and generalization.

⁴ In Levy and Spiller (1996), the institutional characteristics of countries vary, and the features of the (now *political*) transaction, the regulation of utilities, are held constant. In those cases, the governance structure of that particular political transaction is endogenized to the features of each institutional environment.

⁵ See for instance Cohwey and McCubbins (1995), Moe and Caldwell (1994), Palmer (1995), Shugart and Carey (1992), McCubbins, Noll and Weingast (1987), Weingast and Marshall (1988).

⁶ For an exception, see Rodrik (1995), who analyzes six countries that implemented “the same policy,” export subsidization, but with widely varying degrees of success. Rodrik relates success to features such as the consistency with which the policy was implemented, which office was in charge, how this was bundled or not with other policy objectives, and how predictable the future of the policy was.

related “qualities.” Some of these policy features can, at least for analytical purposes, be discussed independently of their substance.⁷

We close the introduction with a caveat. We do not attempt a formal empirical test of our theory here. In this study, we provide some evidence of general properties of policies in Argentina and a few more detailed examples of specific policies. Much more structured comparisons of properties of policies across issues and polities is, though, badly needed. Some work in this direction has been done by students of “State Capacity” (most notably Evans, 1995). We hope this paper will help in providing some additional theoretical focus for such studies.

2. THE THEORY: POLICY DETERMINATION AS A TRANSACTION GAME

A. Generalities

< Figure 1: The Framework >

Figure 1 presents our analytical framework in a schematic form. We take as exogenous, for the purposes of this analysis some basic institutional features of a constitutional nature (including the electoral regime), as well as their (past) temporal stability or instability.⁸ Taking those features as given, we use elements of positive political theory to describe and understand the actual functioning of political institutions (legislatures, executives, judiciaries, bureaucracies, intergovernmental relations). The transactions approach calls attention to the incentives that those basic institutional features generate for the key actors in each of these “institutions.”⁹

The institutional performance and the organization resulting from those “exogenous” characteristics of the institutional environment, in turn provide the governance structure for political exchanges, that is the political set of rules that condition and enforce them, if

⁷ Recently, Cox and McCubbins (1999) have presented a related approach to public policy. Drastically simplifying their argument, they suggest that the determinants of public policy come to a trade-off between the ability to change policy (“decisiveness” -D) and the ability to commit to policy (“resoluteness” -R). Adding an intertemporal perspective, however, could substantially change the analysis. At a given point in time, an extra player with the institutional capacity to block moves, and possibly different preferences, *increases* R. But, when seen from an intertemporal perspective, the appearance of such a player might *increase* rather than decrease D. The very fact that the other political actors know that there is a long term player who will be likely to enforce current transactions, increases the capacity to enter into agreements (i.e., produce necessary policy changes) today, hence also increasing, rather than decreasing, D.

⁸ For instance, we take as exogenous the duration of democratic and dictatorial spells in any given country’s past.

⁹ For instance, we will argue that the particular incentives of the key political players in Argentina, are the combined result of its electoral rules, some features of its federal structure and federal arrangements, some “constitutional” capabilities of the presidency, as well as the history of military interruptions. The interrelation among these factors (often not considered in cross-national empirical work) is crucial to understand the performance of Argentina’s polity.

at all. This, in turn, determines the derived governance of specific political transactions and, hence, the features of the resulting policies.

The functioning of political institutions also impacts, more directly, on the qualities of public policies, via the incentives it provides for key actors (e.g. legislators, bureaucrats) to invest in the development of individual or collective capacities in substantive policy areas.

In this section we try to investigate the way in which features of the political environment determine the nature of policies. We do that in the context of a heuristic model. Some aspects of the model are formalized in Spiller and Tommasi (2000).

B. Basic Model

Imagine a group of political actors playing an infinite game, in which they have to make collective decisions, decisions that have distributive consequences. These decisions will have different characteristics, such as duration, degree of reversibility, temporality of payoffs, fungibility, and so on.¹⁰

The game contains elements of conflict of interest (different players have different payoffs as function of policies), but also some commonality of interests, which can be captured as shocks (i.e., economic uncertainty) that call for policy adjustments.¹¹ As an example, imagine that we are deciding a policy which consists of proportional income taxes to be used to finance a public good. If people have the same preferences but different incomes, richer people will want lower taxes (conflict of interest), but everybody would want for the policy to be responsive to things such as the cost of providing public goods.

There is also political uncertainty about which political actors will be particularly powerful to affect policy at any point in time. This can be captured by some form of random “recognition rule” a la Baron and Ferejohn (1989), Alesina (1988), or Dixit et al (2000). For simplicity, let us focus on an example with two players, in which every period each of the players has a probability $\frac{1}{2}$ of being the one who gets to decide (public) policy.

Define first best policies as those that would be agreed upon in a complete contract before the world starts running. It is easy to show that these optimal policies will not depend upon the realization of political uncertainty (i.e., the identity of this period’s agenda setter in the world of Baron-Ferejohn). It is also easy to show that if these actors were infinitely lived and had discount rates low enough, they would be able to (self)

¹⁰ Below we will extend to the case in which these actors not only participate in the collective decision making process, but also have the capacity to undertake some “individual” actions / investments -- as in the case of provincial governors who have policy jurisdiction at home, or of legislators who could invest in being well informed about complex technical aspects in some policy area. These actions will also have temporal properties as described in the previous paragraph.

¹¹ These shocks may come from international markets, policy decisions in other countries, technological changes, diseases, social and demographic changes, etc.

enforce first-best policies as a Nash equilibrium.¹² The highest discount rate that would sustain cooperation – i.e., the likelihood of observing cooperative outcomes -- will depend on several other features of the game. Among them, we would emphasize the number of actors, the distribution of their preferences, their ability for unilateral actions, as well as the details of the policymaking procedure.¹³

If the discount rate is high enough, cooperation will not be sustainable, and the equilibrium will be non-cooperative. In such equilibrium, policies will depend on who wins the political lottery, and welfare will be lower than in the cooperative case.

We can add to this infinite game a prior stage in which (by unanimity) players can make some agreements (sign some contracts). If complete enforceable contracts were feasible, they will contract on first best policies. Restrictions on the set of feasible (i.e. enforceable) contracts will be interpreted as determined by the institutional environment as well as by the nature of the issues in question (for instance, whether there is an independent Judiciary or not, whether the economic shocks are observable and verifiable or not, etc.). Suppose, for instance, that agreements can be enforced, but that the realization of economic shocks is not verifiable. In that case, it will not be possible to sign contracts that prescribe (economic) state – contingent actions. Thus, only simple “rules” can be agreed upon. Under some conditions, those simple rules (such as “fixing” a constant policy forever) will deliver welfare levels larger than those obtained in the discretionary non-cooperative Nash equilibrium (Spiller and Tommasi, 2000).

We can conclude from this very simple exercise that, when self-enforcement is feasible, policies will be efficient: they will be flexible enough to accommodate changing economic and social realities, but not subject to political opportunism . On the other hand, when the transactions environment does not foster cooperation, we will have excess policy volatility (in response to political shocks), as well as some policy rigidities built as protection from political opportunism.

The reasoning can be extended by enlarging both the set of explanatory variables (the Xs) as well as the space of feasible actions (i.e., policy characteristics, the Ys), which we do next.

C. Adding explanatory variables

In the discussion above we focused on variables such as the discount rate in explaining political cooperation. We can modify the description of the game in several dimensions

¹² For brevity, in what follows we concentrate on comparing one equilibrium in the Pareto frontier with the infinite repetition of the one-shot (non-cooperative) equilibrium, even though the game has many equilibria. More precisely, the statements about the likelihood of achieving one or the other equilibria should be interpreted as claims about how the set of equilibria depends on features of the game. See Spiller and Tommasi (2000).

¹³ The number of actors with veto power over a decision is a usual concern in positive political theory -- see for instance Tsebelis (1995) and Cox and McCubbins (1999). Here we embed those considerations in an intertemporal framework, in which there are things other than the number of effective veto players that matter for the nature and qualities of policy outcomes.

relevant for the mapping to institutional environments. We can group those extensions as: (1) expanding the set of possible commitment technologies, and (2) enlarging the set of “cheating opportunities”.

Regarding enforcement technologies, we already mentioned the possibility of instrumenting policy rules, via an *ex-ante* contract. An alternative mechanism which, if available, might mitigate the impact of political conflict, is “delegation”, as in the literature on central bank independence or regulatory agencies. Under some conditions, political actors can delegate the implementation of their political agreements to an “independent bureaucracy” with certain features. Of course this “technocratic panacea” is complicated by many practical problems, but if those problems are not too severe, some amount of delegation can improve upon the non-cooperative discretionary outcome. Additionally, if there was an impartial umpire capable of enforcing some agreements (i.e., and independent Court with certain characteristics), cooperation would be more likely.

The possibility of political cooperation and, hence, of efficient public policies will be increased by the availability of some such enforcement technologies. Precisely the opposite result would obtain if the game is “complicated” by introducing cheating opportunities. Those would include: asymmetric information about the economic shocks, or the possibility of some actors undertaking unobservable ex-post actions that “undo” some of the distribution agreed upon in the centralized bargain. (For instance, the national executive having discretion over the details of the geographical allocation of funds for given programs).¹⁴ The more feasible these actions are, the higher the probability of a break up in cooperation, and the higher the probability of “short-sighted” policies.

Governance structures (such as the internal organization of Congress, the design of administrative agencies, or specialized decision making arenas) might evolve to minimize the transaction costs associated with political transactions, and hence to enforce the rights arising from them. But the evolution of those structures to minimize transaction costs, i.e., institutional induced enforcement, will in turn depend on the overall set of incentives and capacities of the same political actors.¹⁵ The capacity to knit the complex intertemporal exchanges necessary to decide and implement effective public policies will be affected by the “arena” or institutional umbrella for those exchanges. Legislatures are organizations specifically designed to carry out such transactions, but whether the legislature is the arena in which these transactions take place depends crucially on the legislators’ incentives. In cases like Argentina or Mexico, Presidential systems where individual legislators’ property rights have traditionally been weak, the legislature will not tend to be a crucial arena. Thus, important political exchanges either do not take place, or they take place in other less institutionalized (more uncertain, and harder to

¹⁴ This is indeed the case in Argentina, as we will describe later (see also Radics et al 1999 and Strasser 1999).

¹⁵ In the Argentine case, since Congress is not the arena where the most crucial intertemporal political exchanges are made, and since individual legislators do not have powerful policy-related incentives, such institutions designed to protect political property rights *a la* Weingast-Marshall have not emerged. See more below.

monitor, observe and enforce) settings, such as meetings of the President or of cabinet ministers with some key players (governors, interest-group representatives, and the like).

In a federal country it will also be necessary to identify the interplay between the game of national policymaking, and the game of nationally funding provincial spending. The exact nature of that interaction will depend on issues such as the degree of vertical fiscal imbalance, the provincial or national centered-ness of elections (at the national and provincial level), etc.

D. Enriching the action space

To summarize, the set of explanatory variables, the Xs could be enlarged to include many determinants of the quality of the transactions environment, beyond the discount rate. The action space (the Ys) can also be enlarged and made more complex, in order to capture other relevant features of policies and of the policymaking process. One such extension would be to enrich the intertemporal properties of policies; which rather than being chosen anew every period, could be linked intertemporally by technical reasons (building a bridge today provides utility over several periods), legal reasons (a law is in place until changed by another law), or economic reasons (present fiscal actions have future effects through intertemporal budget constraints). In such richer policy space, other implications will emerge. One that comes naturally and is of uttermost relevance in some discussions is that: welfare improving policy reforms might not be undertaken in a “bad transaction environment.”¹⁶

Another extension would be to include not only collective decisions but also individual policy actions (as in the governors example, or across ministers, etc.). Those actions could be characterized by their impact on present and future payoffs of the actor undertaking them and of other players. From there, further implications from the transaction environment to properties of public policies could be obtained. For brevity, let us summarize some of those implications as the following proposition (see Spiller and Tommasi, 2000, for details): Bad transaction environments will foster (1) non-cooperative individual actions, (2) under-investment in “good things,” and (3) inefficient actions.

3. APPLYING THE THEORY

The above model can be utilized in several types of applications. We can imagine a table which has: (1) as rows, sets of political-institutional variables characterizing a country (the X’s); (2) as columns, different policy issues characterized by a number of properties (temporality of exchanges, volatility of the underlying economic environment, observability of the shocks, nature of interests involved, etc); and (3) inside the cells, the features of the resulting equilibrium policies.

¹⁶ For a collection and review of some such results, see Sturzenegger and Tommasi (1998).

Levy and Spiller (1996) have provided one exercise in which the “issue” (privatization of telecoms”) is kept constant, and the effects of alternative political environments is analyzed. One can take the political-institutional environment as given, and look at the variety of policy features across issues (the political version of the Williamsonian exercise). In the research agenda reflected in this paper, we are concentrating on understanding in detail the set of X’s characterizing one country, Argentina, and the resulting “generic” characteristics of “all” the resulting policies.

Before we dip into the description of the Argentine case, let us provide a few hints of the variables one should be looking for in performing these exercises more generally. First, with regard to the explanatory (political) variables. The variables that arise from the model are:

- Institutional veto points
- Variables determining who holds those institutional veto points at each point in time (related to the parameters of the stochastic political shock)¹⁷
- Length of horizons and their determinants
- Institutional features (constitution, budget procedures, informal practices, etc) that permit unchecked moves by some actors
- Independence and “strength” of Supreme Court or equivalent
- Characteristics of the bureaucracy¹⁸
- Political instability

Our approach also suggests looking at the interactions, extent of substitution and complementarities, across all these determinants -- i.e., to the institutional general equilibrium --, as we will try to argue in the application to Argentina.

The institutional environment could provide better or worse protection of political property rights. In countries where institutions are organized in such a way that political actors’ property rights are well protected (as in Weingast and Marshall, 1988) many policies / political transactions can be implemented fairly efficiently, that is without need to resort to awkward safeguards.¹⁹ In countries with lesser protection of political actors’ property rights, even the possibility of implementation will depend on the features of the political transactions necessary to implement any given policy.

Public policy, as a transaction, involves multiple parties, both at the design and implementation stages. Policies normally imply a stream of benefits and costs. The potential for opportunistic behavior during the transaction induces politicians to develop “institutions” to safeguard their side to those transactions.

¹⁷ See de Figueiredo (1997) and Dixit et al (2000) for models with interesting insights in this dimension.

¹⁸ Many of these things are themselves endogenous to other more fundamental constitutional and historical factors (an extended notion of the “genetic code” in Moe and Caldwell, 1994). Part of our agenda is to understand those determinants, but, as explanation of current features of policies, some of those characteristics can be taken as exogenous.

¹⁹ This is, of course, a comparative statement (in the spirit of Williamson 1991). We are aware that political bargains in the US political system are safeguarded by a variety of “bureaucratic monstrosities” (Moe 1990 and 1997). But, we will argue, these policies may have to be implemented with even bigger monstrosities in other institutional environments, like the Argentine one.

Relevant features of the transactions that are important in determining its implementation difficulties are:

- number (and cohesiveness) of relevant political actors involved
- degree of irreversibility: can the assets associated with the transaction be withdrawn before they have any value? (for instance, it is more difficult to “control” dam building than road maintenance)
- temporality: long lasting versus repeated versus one-shot (dam building versus road maintenance versus disaster relief; those benefiting from dam building can be expected to renege on deals)
- measurability: can parties observe what’s going on? (public education vs. road maintenance)
- universality: wide vs. narrow interests (pensions/public education vs. subsidies to cotton growers)

The characteristics of the required political transactions will lead the actors to build alternative governance structures to enforce those transactions.

Transactions with low implementation costs will generate policies with few safeguards. Transactions with higher implementation costs will be implemented with costly safeguards. For instance, privatizing a malfunctioning sector with substantial cross subsidies. In this case, safeguards will have to be developed to protect the widespread rents arising from cross-subsidies.²⁰ Other instances of transactions requiring safeguards are related to federal fiscal arrangements, where to prevent ex-post opportunistic policies, programs are moved out of the annual budget discussions via earmarked taxation.

Finally, we have cases in which the implementation costs are so high, that potentially welfare-improving policies or institutional changes do not take place. The failure to implement badly needed provincial tax reforms is explained in Saiegh and Tommasi (2000) as a consequence of the incapacity of the federal government not to bail out those provinces that failed to implement those reforms. The required reforms had the nature of a long term investment, with costs up front and benefits which would only accrue gradually, creating ample room for opportunistic behavior by provincial and national authorities.

4. CHARACTERISTICS OF PUBLIC POLICIES IN ARGENTINA

Coming back to our specific application, in what follows we will argue that the political-institutional environment in Argentina has prevented the development of efficient intertemporal political transactions, and this has generated bad public policies. Let us start by summarizing some of the implications of the theory, in the following proposition.

Proposition 1:

²⁰ This type of safeguards is behind the difficult regulatory problems in both the telecommunications and water sectors in Argentina. See Abdala and Spiller (2000).

If the institutional environment (the features of the game) is such that conditions are not given for the agreement and enforcement of efficient intertemporal political exchanges, then inefficient, awkward and opportunistic policies would be prevalent. To prevent opportunistic behavior it is likely that a large portion of the rents would be distributed ahead of time, making them insensitive to shocks (i.e., these will be inefficient, rigid policies). The part that is left to be sensitive to shocks will tend to be manipulated by the player with the ability to move “ex-post” (opportunistic policies). Thus, policies will be characterized by:

1. *Pursuance of short term benefits for the enacting coalitions, as well as non-cooperative individual actions (“Short termism”)*
2. *Inflexible rules, procedures and structures for “long term” policies. (Straight-jackets to prevent opportunism)*
3. *Some desirable policy reforms never take place. (Some trades are not made at all; leading to “indecisiveness” in the language of Cox and McCubbins, 1999)*
4. *Underinvestment in capacities, leading to lower quality policies.²¹*

Point 2 could be interpreted as excessive *defensive investment*, while points 3 and 4 refer to insufficient *productive investment*.

In the rest of the paper we argue that Argentina is a case in which a generalized incapacity to strike efficient intertemporal political exchanges has induced very defective public policies, and we explain the reasons behind that incapacity to instrument intertemporal agreements. In this section we briefly describe the dependent variable, the characteristics of public policies.

As stated in the introduction, we are focusing on *outer properties* of policies. Those include their flexibility to adjust to changing underlying circumstances, their volatility in response to political changes, as well as other features such as “coherence” and other dimensions of “quality.” Coherence relates to the degree of consistency with other related policies, that is, the degree that different policies operating over the same realities have a logic and operational consistency.²² Quality is, of course, a fuzzy concept, but area specialists can often judge and agree on some qualities of policies.

There is enough circumstantial evidence to characterize Argentina’s public policies as being of low and heterogeneous quality, incoherent, sometimes unstable, and other times too rigid. The sudden policy changes and erratic application of statutes, has generated a widespread feeling of judicial insecurity (the opposite of the rule of law, Weingast 1993),

²¹ Legislators and their staff with little or no policy expertise would be one example. Governors that do not invest in building up their local tax administrations would be another.

²² This dimension is related to the notion of “Balkanization” in Cox and McCubbins (1999).

with important disincentives for investment, and thus damaging the economic performance of the country.

These properties of policies are difficult to measure, and even more difficult to compare across countries. In this section we attempt to provide some suggestive evidence. Figure 2 presents a very rough measure of volatility of economic policy from Freedom House, where Argentina is the 7th most volatile case in a sample of 106 countries.

< Figure 2: Volatility of Policies >

More generally, few observers will disagree that Argentina produces public policies of lower quality than many other countries. Consider monetary policy. During the high-inflation times of the late 1980s, it was obviously of lower quality than that of the Bundesbank or the US Federal Reserve, as well as many other countries. Current monetary policy in Argentina (the convertibility policy, a straitjacket introduced in 1991 that prevents the undertaking of monetary or exchange-rate action) is also a low quality policy, although probably the best feasible policy given history and other characteristics of the institutional environment.

Argentina's macro policy instability is a well-known fact. But policy instability has also operated at the micro level. Acuña (1991), for example, has documented the unwillingness of industrialists to invest in building export capacity, at times in which they were offered rather generous export promotion policies. That unwillingness seems to have been due to their uncertainty about the stability of those policies.

Public policy is also incoherent. Rodriguez Larreta and Robredo (1999) and Abdala and Spiller (2000) describe in detail the incoherences in anti-poverty and regulatory policies. Both show substantial "balkanization." Regulatory policy is made in an ad-hoc, and decentralized, fashion. The regulatory process is conducted by a bureaucracy with substantial executive interference, and with only partial congressional involvement.²³ Contrasting to the commonalties across sectors in regulatory policies in the UK or Chile, in Argentina each sector has had its own way of being regulated, reflecting the discretion of, and lack of coordination among, the sectoral secretaries. Policies also show large changes without changes in congressional mandates.²⁴ Saiegh and Tommasi (1999) show that Argentina's version of fiscal federalism shows excess rigidity (more on this below). Public policy, while being incoherent, shows both instability in some dimensions and excess rigidity in others. To understand the reason for this seemingly contradictory set of policy features, an understanding of political institutions is in order.

²³ That is not to say that Congress was not relevant for the privatization process. Contrary to some simplistic accounts of the Argentine process of market oriented reforms, Congress was substantially involved (Llanos, 1998; Bambaci et al, 1999; Abdala and Spiller, 2000). Although Congress may try, and even succeed, in blocking privatizations, it cannot control them once they are under way.

²⁴ It is not uncommon to observe that the political appointees (Minister or Secretary) make use of this discretion orienting the resources to their provinces of origin. This is especially pervasive (in terms of stability) when the rotation of the political appointees is high, as it can be seen in the National Secretariat for Social Development, where in the last 6 years four different Secretaries have been appointed.

5. A BRIEF INTRODUCTION TO ARGENTINA'S POLITICAL INSTITUTIONS

We will argue that some institutional characteristics of Argentina, as well as its history of political instability, have been important determinants of the actual workings of government, and hence of the nature of public policies. In this section we provide a very brief introduction to Argentina's constitutional structure, electoral system and political history.

As the US, Argentina's political system tends to generate a relatively fragmented polity. It is a federal republic, with a presidential form of government and a bicameral legislature.²⁵ A main difference with the US, and indeed a crucial one, is the way legislators are elected. Differing from the US, the members of the Chamber of Deputies (currently 257) are elected from multi-member districts (the 23 provinces and the federal capital) for four year terms. The deputies are elected from closed party lists using the d'Hondt divisor form of proportional representation. One-half of the Chamber is renewed every two years, with every district renewing one-half of its legislators (or the closest equivalent).

As in the US, the 24 "provinces" receive a number of deputies in proportion to their respective populations. The Argentine system, however, tends to over-represent the smaller provinces much more than in the US. There are two restrictions to proportional representation: (1) no district (province) can receive fewer than five deputies, and (2) no district can receive fewer deputies than it possessed during the 1973-76 democratic period. As a result of these rules the least populous provinces are highly over-represented in the Chamber.

Senators have also been elected in a very different way than in the US. As in the US, prior to the 1994 constitutional reform, all of the country's provinces, and its federal capital, were represented by two senators.²⁶ Differing from the US, however, senators were elected indirectly for nine year terms by the provincial legislatures using the plurality formula, except in the Federal Capital where they were selected via an electoral college.

A major difference with the US is that (intra-party and general) electoral rules have made provincial governors (as party leaders) individually and collectively, very powerful actors. They control large budgets, and exercise influence on important public policy areas, like education, health and public safety. (Jones, 2000, pp. 3-4). Furthermore, as we

²⁵ Argentina's original constitution dates from 1853 and it became fully "operational" (being ratified by all the provinces of the time) in 1862. Argentina consists today of 23 provinces and the federal capital city of Buenos Aires – which after the Constitutional reform of 1994 became autonomous.

²⁶ Since the constitutional reform of 1994, the Senate is composed of 72 members, with every province (and the federal capital) represented by three senators which will be elected directly, with the stipulation that no one party can occupy more than two of a province's seats in the Senate. Until 2001 these senators will continue to be elected indirectly by the provincial legislatures

explain below, federal fiscal finances are characterized by large fiscal imbalances: provinces have large spending responsibilities, but most of their funding comes from a common pool of resources collected by the National government on behalf of itself and the provinces. These two features together – (1) governors are important actors in national policy, and (2) the national government is an important actor in provincial public finances – are the backbone of a very particular policymaking game, which we describe later.

For many years (except during military dictatorships and proscriptions) the two dominant political parties in Argentina have been the Partido Justicialista (PJ, also known as the Peronist Party) and the Union Civica Radical (UCR). In addition to the PJ and UCR, other important actors in the Chamber are small center-right provincial parties that tend to compete in only one province (where they are often the dominant, or main opposition, party).

Argentina's first constitutional president took office in 1862. The formal machinery of democracy, elections and checks and balances operated in Argentina until 1930, the first time that a military coup succeeded in removing a constitutionally elected president. Between 1930 and 1982 twelve presidents (both *de jure* and *de facto*) were taken out of office by force, with no two different democratically elected presidents following each other in a normal manner until the accession of President de la Rúa in December 1999. The sources of Argentina's institutional instability have been explored by numerous scholars with different interpretations (see Waisman (1987) and (1999)). We treat institutional instability as exogenous for the purposes of this paper, in which we attempt to explain the current (i.e., since the return to democracy in 1983) features of public policies.

6. THE WORKINGS OF POLITICAL INSTITUTIONS AND THE POLICY PROCESS IN ARGENTINA

A. General Picture

The purpose of this section is to provide a concise presentation of our theory of Argentina's polity. The main thrust of the transactions approach is that public policies are the outcomes of complex intertemporal exchanges among politicians. The framework presented in section 2 suggests that efficient intertemporal political transactions require either self enforcement or institutional arrangements that facilitate enforcement. In the absence of either type of enforcement, intertemporal political exchanges will be characterized by short-termism, inflexible rules, indecisiveness, and underinvestment in capacities, leading to low quality policies. We claim that Argentina is such a case, and that its historical political instability, basic constitutional features, electoral rules and federal fiscal features, are key determinants of such inability to develop efficient long-term public policies.

In the theoretical discussion we identified a series of elements which affect the capacity to knit efficient intertemporal political exchanges. They include: the number of political

actors with power over a given decision; their intertemporal linkages, including the length of their horizon (conversely, their impatience); the characteristics of the arenas in which they undertake key political exchanges; the availability of enforcement technologies such as the possibility of delegating the intertemporal implementation of political decisions to independent and capable bureaucracies, or the presence of an independent enforcer such as a strong and unbiased Supreme Court; and other features such as whether some key actors can undertake unobservable moves which affect the payoffs of other players.

We argue below that many of those features “took the wrong values” in the Argentine case. Key political actors have tended to act with short horizons. Historically, this was a consequence of political instability. But the past instability left an imprint through path dependent behavior in Congress, Courts, the Bureaucracy, as well as the actions and expectations of non-governmental actors. On top of that, features of the electoral regime conspire against a strong, long-lived and powerful national Congress, weakening what could constitute a crucial arena for intertemporal political exchanges.

Electoral rules that transfer political power away from legislators and national parties towards provincial party organizations, generate short horizons for legislators. Weak (constitutional, judicial, and budgetary) restraints to unilateral actions by the executive tend also to undermine political players’ ability to enter into efficient intertemporal political exchanges. Weak restraints on moves by the National government on issues that affect the provinces had the same effect in intergovernmental relations; the importance of this was magnified by the fact that provinces have a heavy financial dependence from the center.

The historically extreme political instability of the nation contributed to the lack of judicial, and thus constitutional, restraints to executive action. A professional bureaucracy, well supervised by Congress, could be an alternative channel for the intertemporal enforcement of political agreements, but Argentina does not have such a bureaucracy either.

The combination of lack of legislative incentives, the ability for unilateral moves by the executive, and the power of provincial leaders, all have moved crucial political bargains away from the national legislature and into other arenas.²⁷ Often these bargains take place in Executive quarters, in meetings of the President with governors, or occasionally in meetings of national political party leaders. Since those arenas do not have particular institutional stickiness, they do not allow key political actors to enforce bargains intertemporally.

²⁷ This problem relates to the intermixing of national and provincial policies. Paradoxically, the President depends “too much” on provincial political leaders, at the same time that the provinces are heavily dependent financially from the central government. There are some general-equilibrium interactions at play here, since some awkward features of the federal fiscal regime are maintained due to the inability to carry out reforms, which in turn is due to the political transaction costs we are emphasizing.

In the following subsections we bring the focus to some of the “components” of the general picture briefly sketched above.

B. Congress: Professional Politicians, Amateur Legislators

A crucial component for self enforcement is missing in Argentina. Legislators, key administration officials, bureaucrats, and justices all have short term horizons. The short horizons of legislators can be seen by the very high rate of turnover in the legislature. Figure 3 shows that tenure in Congress for the average legislator is very short.²⁸ The figure shows that legislative tenure was increasing until the first Perón administration. Since then tenure has been very short. Table 1 shows that the probability of reelection for the average deputy is less than 20%.²⁹ Table 1, shows, also, the workings of electoral mechanisms. The Table shows that legislators’ turnover is not the result of voters’ rejection, but rather of the fact that most legislators simply do not show up in the provincial party list.³⁰ Indeed, those who show up have a reasonable chance of being reelected. It is the fact that so few of them seek reelection that brings about such a low probability of reelection.

<Figure 3: Tenure of legislators>

<Table 1: Reelection probability in Argentina and elsewhere>

Thus Table 1 shows that legislators’ career objectives cannot be based on maintaining and improving their position in Congress. Instead Table 2 shows that legislators find Congress only a stepping stone in their political careers, where they spend at most one or two terms, moving then to more politically lucrative activities in the provinces, party or at the federal government.³¹ While they may be professional politicians, as legislators they are *amateurs*. As professional politicians in an environment in which their future is disconnected from direct electoral success, Argentine legislators’ incentives are aligned with the interests of their provincial party, unless they have gained substantial provincial visibility at which time they actually can challenge the provincial party boss as well. Thus, the incentives of provincial party bosses are to manage the careers of their back-benchers so as to promote them while maintaining their own control over the provincial party. Thus, their incentives to move them from political job to political job.

<Table 2: Career path of legislators>

The mobility generated by the electoral rules limits legislators’ incentives to invest in policy making expertise and, in general, to undertake actions with long term implications.

²⁸ This is also the case for legislative leaders, defined as the 15 legislators in the Chamber of Deputies with the longest tenure at each point in time. While until the Perón Administration, their average tenure has been 13 years, since then it has fallen to just about 7 years.

²⁹ A similar figure can be obtained for senators. See Jones, Saiegh, Spiller and Tommasi (2000).

³⁰ Since provincial parties do not normally hold primaries to decide on their roster for the national congressional elections, it is not voters who reject the legislators.

³¹ The Table shows that Peronist deputies tend to return to provincial administrations more than Radical deputies, who tend to return to the National Party. The reason is that during the time, the Radicals held very few governorships, limiting the potential for career development at the provincial administrations.

Legislators in general have little incentive to undertake any type of legislative action, unless the legislative action is motivated by direct provincial interests. The lack of direct voters' scrutiny implies that legislators have very little incentive to specialize. Table 3 shows that legislators tend to belong to a large number of committees, thus specialization is not taking place. Table 4 shows that legislators tend to last less than a whole legislative period in each committee, even in as important committees as Labor, Regional Economies, and Budget and Finance.

<Table 3: Number of committees by deputy>

<Table 4: Length of service by committee>

C. Federalism: A Fiscal Pact With The Devil

The history of Argentina, as that of the US, is inextricably intertwined with the issue of Federalism.³² In spite of the fact that modern Argentina is a large fraction of a Spanish viceroyalty, at the time of independence in 1810, military and fiscal technologies were such that fairly strong independent provinces were what was left after the Spaniards were gone. After several decades of violent struggle and powerful ideological debates, the "United Provinces of the South" became one federal nation and adopted a Constitution similar to the American one.

Unlike the US, though, over time the federal fiscal regime adopted some characteristics that we could describe (following Careaga and Weingast 2000) as a "Fiscal Pact with the Devil."³³ Argentine fiscal federalism over the last several decades has been characterized by a very high degree of fiscal imbalance, a repeated tendency of the federal government to bailout provinces that run into financial problems, and a tax-sharing agreement full of rigidities and loopholes which is the source of poor incentives for provincial and national governments.³⁴

In the last decade, the Federal Tax Sharing Agreement (FTSA) and other transfer mechanisms financed more than 75% of total spending for the average province.³⁵ There are large variations around that average, with 11 out of 23 provinces financing less than 20% of their spending with their own taxes, while three provinces financed more than 45% of their spending with own revenues (see Figure 4). These shares have evolved over

³² For a more detailed discussion of Federalism in Argentina, see Iaryczower, Saiegh and Tommasi (1999).

³³ Iaryczower, Saiegh and Tommasi (1999) attempt to endogeneize that evolution. The 1853 Constitution established that the federal government would use taxes on foreign trade to finance its expenditure, while provinces will have property, income and sales taxes. Over time, for both economic and political reasons, the national government increased its role in the tax collection process, and currently collects taxes on foreign trade, personal and corporate income, sales, property, etc. The process by which these taxes are subsequently "devolved" to the provinces has been regulated by the FTSA.

³⁴ See Saiegh and Tommasi (2000), Nicolini et al (1999), Jones et al (2000), World Bank (1996), Schwartz and Liuksila (1997).

³⁵ Total subnational spending oscillates around 2/3 of consolidated government spending (excluding pensions), i.e., it is twice as large as spending by the national government.

time in a distributive fashion, from the earlier times of hard budget constraints and richer provinces spending more, to a current situation where public spending in the poorer and small provinces being twice as large as in the most advanced ones. This, in turn, has been the result of the “centralization” of federal fiscal decision making, and of the overrepresentation of small provinces in the national Congress.

<Figure 4: Vertical Fiscal Imbalances >

This fiscal situation implies that although, as described earlier, the President has to get together with provincial governors to negotiate national policies, most provinces are heavily dependent upon decisions made in the Capital city, increasing the political bargaining power of the President in what constitutes a perverse fiscal-political game.

The discretionary budget powers of the President and, even, of lower level national officials, have contributed to generate irresponsible fiscal behavior at the provincial level, which is even today considered to be one of the main threats to the macroeconomic stability painfully gained over the last few years.³⁶ Those problems were heavily compound during the times of high inflation, when it was virtually impossible to track down the real value of any nominal flow.³⁷

Even though individual provinces have at times been beneficiaries of the discretion of the national government, it is clear to everyone that the net game is highly inefficient.³⁸ In an attempt to curtail that discretion, they have tended to increase the rigidity of the FTSA, and hence its incapacity to adjust to changed economic circumstances.

These features, as well as the practice of earmarking some taxes for specific programs with clear regional distributional effects (subsidies to special activities), has lead to a very rigid, yet very convoluted system of federal tax collection and distribution, which has been christened the “Argentine fiscal labyrinth,” illustrated in figure 5.

<Insert Figure 5: Fiscal Labyrinth >

It is important to emphasize again the reinforcing (or *general equilibrium*) interactions between the features of Argentina’s fiscal federalism, and the overall incapacity to implement efficient intertemporal political exchanges. On the one hand, as emphasized in this section, the peculiar features of the federal fiscal system (such as the high degree of vertical fiscal imbalance) are a factor that impinges upon the capacities to instrument effective policies in the national arena. At the same time, the high transaction-costs that

³⁶ See Jones, Sanguinetti and Tommasi (2000), World Bank (1996), First Boston Report (May 2000).

³⁷ The provinces insisted and eventually succeeded in claiming to receive daily transfers from the nationally collected taxes.

³⁸ Saiegh and Tommasi (1998) report evidence of provincial governors explicitly recognizing this situation in discussions about possible reforms to the FTSA.

have characterized the Argentine political economy, have contributed to the evolution and maintenance of this peculiar system of fiscal federalism.³⁹

D. A Bureaucracy without a Long-Term Principal

One possible mechanism for the intertemporal enforcement of political agreements is through delegation to a relatively independent, yet accountable, bureaucracy. Argentina, however, has not developed such a bureaucracy. The lack of any long term principal, can be seen, following Spiller and Urbiztondo (1994), as a key factor behind the lack of a professional bureaucracy. By definition, Executives are transient in (almost) all presidential systems; and as already explained, Congress is not a long-term principal in Argentina since legislators are not that interested in controlling the Administration.⁴⁰

The bureaucracy, as a consequence, faces no long term incentives, facilitating shirking and requiring intrusive administrative controls to avoid corruption, further reducing its ability to generate timely and effective policies. Each new Executive, unable to motivate the permanent bureaucracy, has nominated large numbers of political appointees, often under much more flexible labor agreements (creating indeed a parallel albeit transient bureaucracy). This has increased bureaucratic rotation, multiplying the effect of the historically high rotation of Presidents, and impeding the development of norms of cooperation among different branches of the bureaucracy. This has, in turn, decreased the quality and coherence of the bureaucracy and of the resulting policies. See Figure 6.

<Figure 6: Bureaucratic quality>

The incapacity to motivate the permanent bureaucracy has been reinforced by the presence of a constitutional clause (art. 14 bis) that establishes “stability of public employment”, which imposes large difficulties to fire public employees. This has been circumvented by the development of a “parallel bureaucracy.” The parallel bureaucracy undertakes the same actions as the normal bureaucracy is designed to, but unable to, undertake. The rotation at the ministerial and secretarial levels implies rotation at the “parallel bureaucracy” as well, limiting the extent of institutional knowledge, and the development of cooperation across ministries and secretariats, deepening the heterogeneity in policy quality, and the lack of policy coherence.⁴¹

E. A Friendly Supreme Court

³⁹ This point is illustrated in Saiegh and Tommasi (2000), where transaction-cost reasoning is used to explain the failure of the attempts to substitute highly distorting taxes, and of the attempts to “decentralize” taxation power to the provinces.

⁴⁰ As Krehbiel (1991) argues, legislators tend to undersupply that kind of public good, an effect that is magnified in Argentina since legislators only tend to provincial party leaders who, in turn, are not interested in this.

⁴¹ The parallel bureaucracy is widespread, but difficult to measure. Bambaci, Spiller and Tommasi (2000) report information for a single agency. In that case, the parallel bureaucracy, which consists of all those under special “contracts” represent well above 50% of total employment, and a larger fraction of the wage bill, as these tend to be better paid (but shorter lived) employees. .

The workings of judicial institutions have direct implications for the feasibility of private contracting. Judicial institutions impact as well on the nature and feasibility of arrangements among private parties and governments, and for the issue that interests us here, for arrangements among political agents.

The ability of the judiciary to restrain political agents from undertaking opportunistic actions vis-à-vis each other depends on the relative political power of the various players. In particular, a judiciary whose reviews of the constitutionality of a legislative or administrative act can be easily dismantled, whether by legislative action, or by fiat, would seldom develop a doctrine of judicial review of such actions. Judicial review of such actions would only result in legislative or administrative reversals of their decisions and may even trigger political retaliation. In such restraining scenarios, Justices, then, will learn to follow their political masters.

On the other hand, a judiciary facing a fragmented polity, one that will face difficulties in overturning judicial decisions, will over time develop doctrines favoring judicial review of administrative and legislative acts.⁴² This theory would suggest that courts will not tend to reverse government acts in the presence of unified governments, like strong parliamentary systems, while they will tend to be more aggressive in the presence of divided government, like presidential systems.⁴³

Judicial activism, however, measured by the extent of reversal of government acts, depends not only on the opportunities faced by the court (i.e., how fragmented are its policy competitors), and hence on its doctrines, but also on its current political alignment. Political alignment, in turn, depends on the nomination process and on its turnover. Courts whose tenure are very short will naturally tend to be politically aligned, while Courts whose tenure is indefinite or very long, may alternate between political alignment and political opposition to the sitting government.

Differing from most other countries, the Argentine judiciary, at least since the mid 1940s, has exhibited a very high level of rotation. During that same period, and because of electoral results and *de-facto* administrations, governments have had an unusual level of control over the Federal legislature. As a consequence, it is possible to say that over the last half of the last century, the Argentine court was not independent. This lack of independence facilitated the ability of the executive to exceed its constitutional powers, and hence to limit the credibility needed for long term contracts, whether among private or public agents.⁴⁴ As a result, this lack of independence limited both private investments, and efficient long term policies.

Table 5 shows that the Argentine Supreme Court in the second half of the last Century was one of the courts with the shortest average tenure in the world. Indeed, since 1960

⁴² For a “Pavlovian” theory of judicial independence, see, Spiller (1996).

⁴³ For evidence on judicial restraint and promotion in strong parliamentary systems see Ramseyer and Rasmusen (1997) who provide evidence that in Japan, justices promotion depends on their support of the government, and Salzberg (forthcoming), who provides similar evidence for the United Kingdom.

⁴⁴ In the language of O’Donnell 1993: 1367, it did not provide “horizontal accountability.”

until the mid 1990s, the average Argentine justice lasted less than four years in its post. The average tenure of Argentine justices is similar to that of Pakistan, Peru, Sri Lanka, the Dominican Republic, and Zambia, countries not associated with long term stability and the predominance of the rule of law.

<Table 5: Tenure of the Court, comparative >

Figure 7, shows, however, that this is a feature of the last 50 years. The Figure shows that after WWI, the Argentine Court was on its way to become not too distinct from its US counterpart. Indeed, since its creation in 1863 and until the mid 1920s, the average tenure of the Argentine Court systematically increased, when the average tenure of its members reached the same level as that in the US. The later political instability drastically reduced the tenure of justices on the bench. Only recently has tenure started to climb back to prior levels.

<Figure 7: Judicial tenure Argentina/US >

Figure 8 shows that the impeachments brought about against the sitting Court members during the first Perón administration had a lasting impact. Since then, the norm of not manipulating the membership in Court has been lost. New military presidents had no qualms in removing civilian appointed justices, and similarly, civilian presidents had no qualms in removing justices appointed by prior military regimes. At the return to democracy, newly elected presidents picked their own Justices. The first time since 1946 in which a President might have faced an opposition Court, President Menem expanded the court from five to nine members allowing himself a “working” judicial majority. Figure 8 shows that a substantial number of Presidents since 1946 were able to name at least two thirds of the Court justices. Indeed, the control over the court was such that since Perón until the administration of De la Rúa which started in 1999, no President faced a Court with a majority appointed by a political adversary.

<Figure 8: Percentage of Justices named by friendly administration >

Thus, the lack of independence of the Court during the second half of the last century is related to its unusually close political alignment with the executive, which reflects the political instability of Argentina during the period. Indeed, as democracy sets in, justices are going to last longer, and judicial independence will reassert itself, with the potential for further limiting of executive discretion.⁴⁵

F. Interactions

The lack of legislative specialization described above, implies that Congress cannot delegate an action to the Executive and expect to supervise or monitor it closely. Thus, actions that are delegated to the executive are those that do not have drastic regional

⁴⁵ For an empirical analysis of Supreme Court decision making in Argentina, see Iaryczower, Spiller and Tommasi (2000.)

impacts, or whose delegation are unavoidable, including budget preparation and execution. The inability to monitor and control budgetary execution, implies that the administration has substantial discretion in the execution of the budget. Thus, little attention is placed in the legislature to budgetary details, and most budgets, once presented, are approved with relatively minimal amendments.⁴⁶

Indeed, since the beginning of the XXth Century, and apart from the administrations of President Perón and Menem, Congress has rarely approved in time the Budget sent by the Executive.⁴⁷ In practice, then, the Executive has operated with large amounts of budgetary discretion. Even in the post-stabilization 1990's, where *ex ante* budgets started being approved in time, *ex post* control has not been exercised. Table 6 shows this last point. The so-called *Cuenta de Inversión*, the *ex post* budget verification, has not been dealt with promptly enough to be an operational instrument for Congress to verify the fulfillment of the budget contract by the Executive.

<Table 6: Budgets executions approved in time (ex post control) 1984-1999>

We have referred already to several sources behind the Executive's ability to make unchecked unilateral moves (which can undo previous agreements): the fact that the Supreme Court has tended to be politically aligned to the president, the lack of a strong and independent bureaucracy, and budget practices. Additionally, this power has been based on some "constitutional" capacities and practices, amounting to legislative powers of the president. These practices have evolved partly out of the history of political instability, which has tended to focalize in the Executive processes that, in a more stable environment, would have naturally drifted towards the legislature.⁴⁸ They are also due, in part, to some explicit constitutional capacities and to some constitutional lacunae and their interpretation.⁴⁹ We include in this category the fact that the Constitution names the President as the Chief of the Public Administration, the fact that the President is endowed with the capacity to "regulate" the laws from Congress,⁵⁰ and more recently, the practice of issuing *Decretos de Necesidad y Urgencia* (Decrees of Need and Urgency, DNU's).⁵¹

⁴⁶ The budget preparation process is conducted mostly in the Cabinet, which is the entry point for most pressure group activity. It is not uncommon for provincial governors to visit the Minister of the Economy, his secretaries, or other ministers, trying to get favorable treatment for their provinces in National allocations and decisions. (Jones 2000b).

⁴⁷ Furthermore, there were times in which the President did not even bother to send the Budget Proposal to Congress (Molinelli et al, 1999). This was common during the high-inflation periods.

⁴⁸ Acuña (1995), De Riz (1986).

⁴⁹ These lacunae in constitutional interpretation are, of course, not independent of the relative weakness of the Supreme Court we have referred to.

⁵⁰ The expression in Spanish is "*reglamentar las leyes*," what we would call completing the legislative contract. See Carey and Shugart (1998), Ferreira Rubio and Goretti (1998) and Molinelli et al (1999).

⁵¹ The first two attributions were assigned by former article 86 of the Constitution, while the latter was a practice of Executive legislation, whose constitutionality has been vividly debated in Argentina. The 1994 Constitution includes the first two and attempts to regulate (yet, giving to it constitutional status) the DNU's in article 94. DNU's were rare in the past, President Alfonsín (1983-1989) increased their use, while President Menem tended to abuse them, leading to the attempt at regulating them in the constitutional reform. See Ferreira Rubio and Goretti (1998), Molinelli et al (1999), Bidart Campos (1995).

As a matter of fact, one of the reasons why the Executive has tended to issue as many DNUs, is, curiously, the fact that the President does not control Congress either. Even though Congress does not have strong capacities for fine tuning policy formulation or controlling its implementation, it is still in charge of passing laws, and as such, it has the ability to act as a blunt veto player.⁵² The inability of the Argentine Congress to fine tune the control of the administration, is paralleled by the inability of the administration to manage the Congress. Electoral rules make it difficult for the administration to control the legislature, even when the government party controls one or both chambers.⁵³ Since electoral rules generate a naturally fragmented legislature (see Table 7) presidents need develop workable coalitions by adding to their own party members, legislators from independent regional parties. As Table 7 shows, since the return to democracy in 1983, all administrations had an own-party contingent of around 50%. But this support was only nominal.

<Table 7: Parties in the legislature over time>

Given the fragmented nature of party discipline, Presidents have needed to buy the support of their own congressmen through “provincial” politics.⁵⁴ Since governors control, in the chamber, normally more than one legislator,⁵⁵ popular governors from the government party are pivotal players, and garnering their support for presidential initiatives becomes not only crucial, but more important, expensive. Since legislators respond to their provincial party bosses, attempting to get support from individual party legislators against his or her governor would be very hard to achieve.⁵⁶

The combination of block-buying votes with the fact that legislative contingents have been of around 50% since the return to democracy, helps to understand the very salient role of governors in national politics (Jones, Saiegh, Spiller and Tommasi, 2000).

G. Implications

The lack of long-term horizons and of institutionally-induced enforcement (via Courts or bureaucratic implementation), implies that many political transactions are not going to be implemented, and that those that are will have higher transaction costs than in

⁵² See Jones, Saiegh, Spiller and Tommasi (2000).

⁵³ In practice, these difficulties were superseded only in exceptional political times, like the first Administration of President Perón.

⁵⁴ Bambaci, Saront and Tommasi (2000), following Gibson and Calvo (1997) and Corrales (1999), describe the exchanges that President Menem had to do with Peronist provinces in order to get his market-oriented reforms through Congress.

⁵⁵ As mentioned, the minimal number of chamber members per province is five.

⁵⁶ On the other hand, gathering support from legislators whose provincial party does not control the provincial government is easier, as the provincial party boss cannot offer as much advancement to his or her own legislators as can the President via the federal government. Provincial party bosses who are not in government have poor currency with which to compensate their legislators. They cannot offer jobs in the provincial Administration or judicial systems, and hence must rely on the national party for party or patronage appointments at the national level. The Administration, however, can offer promises of such jobs at the federal level, countering the power of the provincial party boss.

environments where politicians have longer horizons and where institutionally-induced enforcement is feasible.

Congressional protection of regional interests requires very rigid, and even awkward looking policies, like earmarking some taxes for specific programs (i.e., subsidies to special activities) or activities with clear regional distributional effects.

Public policies in Argentina are characterized by two seemingly contradictory features: they are either extremely volatile and short term, being modified with changes in the composition of the administration,⁵⁷ or they are extremely inflexible, limiting their adjustment to changing economic circumstances.⁵⁸ The first type of policies limits incentives of the private sector to undertake long term investments, while the second type assures that ineffective policies will tend to have longer than necessary shelf lives.⁵⁹

Similar reasons bring about bureaucratic decision making which is incoherent, lacking cohesiveness and not built on consensus-building. Hence, both the design and implementation of policy generate an environment which is not propitious for long term growth and stability.

7. CONCLUDING COMMENTS

Rather than re-capping the main themes of the paper, we conclude with observations on two issues: implications for comparative analysis and considerations about Argentina's present and future.

As Oliver Williamson emphasized for economic transactions, political institutions and the associated political transactions, have a complex texture. Hence, in order to uncover the real determinants of a polity's performance, it is necessary to perform detailed micro analysis of the incentives of key political players, which goes beyond the level of aggregation usually considered in cross-country comparative analysis. Argentina has, in practice, some behavioral features that are closer to what is generally perceived as arising in the block-category "parliamentary systems": weak legislators' incentives to oversee the bureaucracy, and in general to perform legislative duties; the dependence of legislators on party faction bosses; and the dominance of the cabinet in the budgetary process; among others. Laver and Shepsle (1994) emphasized developing "a richer and more systematic theoretical treatment of cabinet government *in parliamentary democracies*;" as if "cabinet government" were antithetic with presidential democracies. Our study of the Argentine case suggests otherwise. Also, Persson, Roland and Tabellini (1998) in their work on size and composition of government as a function of political

⁵⁷ This does not require a change in the President. Enough that there is a change of Minister of Secretary. Such changes may bring drastic expenditure changes, redistributing their available funds to their provinces or other "constituencies." (See box on Social Policies).

⁵⁸ As examples, consider the rigidities associated with the Tax-Sharing Agreement, or with the Trade Unions "owning" the Health System.

⁵⁹ As an example, consider the lack of reform of the provincial tax systems described in the section on Federalism.

regimes, tend to assign Argentina and other Latin American countries to the block category of “presidential systems”, while according to the budget procedure they model, Argentina should fall in the other group.

Also, it is important to understand the interactions across different inherited political characteristics, what we might call general equilibrium effects. For example, it is clear that all presidential systems (or all parliamentary systems for that matter) do not generate the same type of incentives in legislators. Electoral rules are key factors, but may not easily be generalized into two or three categories (i.e., simultaneity of elections may be important in one situation, and a second order effect in another). Presidents have vast differing powers (see Shugart and Carey, 1992), but their power depends also on legislators’ incentives and those of other political players, and even on issues such as the nature of financial arrangements in multi-layered government. As another example, a formal reading of Argentine constitution would suggest that the Argentine Courts should be quite independent, but that turns out not to have been the case. Just counting veto points does not suffice to provide insights on institutional performance.

What does our analysis suggest about possible institutional reforms that would improve the environment for policymaking in Argentina? We focus on two areas. First, we noted that Congress is the weak link in the policy determination process. Even though part of the weakness is correcting itself with the uninterrupted democratic spell, there are at least two other important factors: First, reforms to electoral rules, specially (intra-party selection process) to reduce the role of regional party bosses; and second, a regulation of the legislative instruments of Executive, construing them as narrowly as the Constitution permits. The combined effects of these two sets of institutional changes, together with the disappearance of the threat of military coups, could produce legislators with longer horizons and with stronger incentives to actively participate in National policy making.⁶⁰ Neither reform, though, is politically feasible under normal circumstances, suggesting that the current situation is indeed an equilibrium.⁶¹

⁶⁰ It is worth pointing out that the recent virtuous circle has been supported by the fact that, with the disappearance of inflation, budgets have started to have some meaning as an instrument of intertemporal compromise.

⁶¹ We are skeptical of current proposals to improve the workings of the Argentina public administration (and Judiciary), which do not take these deeper political determinants into consideration.

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