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# **The Political Economy of Fiscal Reform in Latin America:**

## **The Case of Argentina**

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## Abstract<sup>1</sup>

This paper investigates the political economy of fiscal reform activism in Argentina since the late 1980s. Between 1988 and 2008, tax legislation was changed 83 times, fiscal federal rules 14 times, and budgetary institutions sixteen times. Tax and budgetary reforms moved from centralizing revenue sources and spending authority in the federal government to mild decentralization lately. Fiscal federal rules combined centralization of revenues and management in the federal government with short-term compensations for the provinces. This paper contends that reform activism can be explained by the recurrence of economic and policy shocks while reform patterns may be accounted for as consequences of the decreasing political integration of national parties in a polity whose decision-making rules encourage the formation of oversized coalitions. The decrease in political integration weakened the national party leaderships' ability to coordinate intergovernmental bargaining, and strengthened the local bosses and factions needed to form oversized coalitions.

**JEL classifications:** H77, H61, H20

**Keywords:** Public finance, Budget, Taxes, Federalism, Intergovernmental relations

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## 1. Introduction

The reform of fiscal institutions and fiscal policies has been everyday business in Argentina for the past 20 years. Tax legislation has been enacted or modified over 80 times since 1988. Fiscal federal rules have been changed 14 times in the same period, and budgetary rules have been altered 16 times between 1992 and 2008. However, the patterns of reforms across areas have presented significant variations. Tax policies and institutions have oscillated between the expansion and centralization of revenue sources and authority, and recently, their decentralization and reduction. Institutional reforms in the budget area have tended towards the centralization and hierarchization of the budget process, but lately policy reforms have somewhat reversed that hierarchization. In contrast, fiscal federal institutions and policies have invariably combined the introduction of rules that centralized revenues and financial management authority in the federal government with the distribution of short-term compensation that enabled the provinces to maintain their spending abilities and offset prospective revenue losses, at least in the short term.

What explains this veritable fiscal reform activism? How can these patterns of fiscal reform be accounted for? This paper contends that the frequency of reforms can be explained by the recurrence of economic and policy shocks experienced by the country and the patterns of fiscal reforms can be accounted for as consequences of the decreasing political integration of national parties in a polity whose decision-making rules encourage the formation of oversized coalitions. Economic shocks, such as the 1989-91 hyperinflation and the 1998-2002 recession, and stabilization policy shocks, such as the Convertibility Law and the 2002 devaluation and *pesoification* of contracts, have triggered the initiation of reform processes in all fiscal areas and encouraged the introduction of reforms aimed at the consolidation, hierarchization, and centralization of resources and their management at the national level. But the passage of these reforms has not prevented the continuous extraction of compensation from the federal government by the provinces.

The key to this outcome has been the combination of stable rules of fiscal decision-making and a gradual but steady decrease in the level of political integration of the main political parties. The rules stimulate the formation of oversized coalitions, and therefore the need to accommodate the interests and demands of the largest possible number of party factions and provinces in order to form those coalitions. The decrease in political integration, particularly

through the de-nationalization of the main political parties, has weakened the national party leadership's ability to coordinate intergovernmental bargaining. Correspondingly, it has strengthened local bosses and factions willing and able to maximize the opportunities provided by those rules to extract compensation for the fiscal losses that the reforms typically imposed on subnational government accounts.

This combination of shocks, rules, and decreasing political integration of parties explains both the increasing centralization and hierarchization of fiscal rules and policies, and the continuous extraction by the provinces of compensation for those centralizing reforms. When parties were highly integrated and nationalized, and thus able to internalize bargaining costs as they were up until the mid-1990s, the degree of centralization of fiscal reforms was limited, and coalitions were paid for via compensation schemes that provided benefits to all provinces. Party leaders were interested in crafting institutions and policies that maintained balanced, non-disruptive intra-party relations. As parties de-nationalized thereafter, particularly since the early 2000s, the weakened national party leaders became less able to enforce general bargains, and subnational party leaders became more interested in and capable of maximizing benefits to their districts. To achieve the necessary coalition sizes to pass reforms in a highly factionalized party environment, authority was transferred to the federal government so that it could implement compensation schemes limited to the provinces that supported reforms. Consequently, fiscal reforms became more centralizing as the level of political integration of parties decreased.

The Argentine fiscal policymaking game thus emerges as one of continuous bargaining about how to distribute the costs of economic and/or policy shocks by creating and/or reallocating funds from a common pool. In this bargaining, the federal government has typically obtained consent from the provinces for rules that centralized both resources and their management in the presidency by granting, in exchange, short-term compensation for any potential losses that those rules may have entailed for provincial or economic actors. Due either to new shocks that rendered them ineffective or inconvenient, or to pressure from the provinces to ease the costs of their implementation, many of these rules were eventually ignored, partially reversed—particularly in the taxation area—or simply replaced with new ones. The trend toward centralization and hierarchization in favor of the federal government has nevertheless persisted, but so has the short-term compensation with which provincial consent has generally been obtained.

These patterns suggest at least three lessons from recent Argentine experience with fiscal reforms. First, the main actors of fiscal decision-making in Argentina conceive of and decide upon reforms in all fiscal areas as if they were moves in one arena: the distribution of resources from a common pool. Thus, for instance, actors seek to recover through budgetary allocations or other intergovernmental transfers what they may lose from a given tax rule. Second, intergovernmental transfers to compensate for provincial support for reforms appear to be an efficient mechanism to bring about fiscal change. Although they do not resolve the competition for resources between the federal government and the provinces and among the provinces themselves, these transfers are useful for channeling that competition in the short term, and thus serve as currencies to build reform coalitions. Third, the nature of fiscal reforms depends upon the combination of the type of shocks with the level of political integration of the parties at the time of decision-making. Shocks typically trigger centralizing reforms, but the degree of centralization is generally higher if shocks are negative rather than positive. Highly integrated, nationalized parties typically produce reforms of limited centralization, but not if they are forced to operate under negative shocks. Poorly integrated, de-nationalized parties typically enact reforms that generate greater centralization, but operating in a positive economic environment and subjected to a de-nationalizing political shock, they may yield decentralizing rather than centralizing reforms.

The political economy of fiscal reform in Argentina has received significant attention before, albeit not with the aim of providing an integrated account of why and how institutions and policies varied across the three fiscal areas. The fiscal federal area has been the most frequent focus of study, particularly from the neo-institutional perspective. Important works by Saiegh and Tommasi (1998), Tommasi, Saiegh and Sanguinetti (2001), and Tommasi (2002) have described Argentina's fiscal federal institutions as incomplete contracts prone to instability and renegotiation, but their approach, although mostly formal and analytical, has been restricted to the fiscal federal rulemaking process. Other works by Gibson and Calvo (1997), Remmer and Wibbels (2000), Wibbels (2005), Eaton (2002a, 2004) and others have tried to account for policy outcomes and their determinants, with particular weight given to the over-representation of small provinces in Congress as an explanatory variable of both fiscal federal rules and policies. In the budgetary area, the works of Jones (2001) and Abuelafia, Braun et al. (2006) have provided a

detailed description of how the policy process operates. In turn, Rodríguez and Bonvecchi (2006) and Bonvecchi (2008a) have attempted to explain the timing of the budget process, the nature of the amendments typically introduced by Congress, the disposition of legislators and presidents to agree on the delegation of budgetary amendment powers to the Executive, and the extent and efficacy of congressional oversight of budgetary execution by focusing on party-system competitiveness, party discipline and cohesion, the state of the macroeconomy, and the financial situation of the Treasury. Focusing on budget rules, Gadano (2003) has shown how their reform may be prompted by economic shocks and confidence concerns, but their implementation appears to be contingent on not only the evolution of the economy but also the incentives of political actors. Finally, on taxation, the important contributions of Eaton (2001, 2002b) have underscored how legislative institutions provide incentives and opportunities for both provincial governors and national legislators to shape tax rules and policies in order to either cater to their territorial and/or economic constituencies, or adapt to the political restrictions that hinder cooperative, stable agreements.

This literature provides important insights and evidence about their particular objects of research and constitutes a series of fundamental contributions on which to build a more general understanding of the political economy of fiscal reform in Argentina. However, due either to their focus on specific topics or to their lack of an analytical approach, none of the works cited offers a framework comprehensive enough to account for the differences in actors, incentives, restrictions, and outcomes corresponding to all the fiscal areas. This paper intends to fill that gap by combining analytical insights from the new institutional literature on the policymaking process with contributions from research on intergovernmental fiscal bargaining and from actor-based accounts of fiscal policymaking.

The paper is organized as follows. The second section provides an overview of fiscal policy outcomes in Argentina over the past two decades in order to illustrate the effects of the reforms to be explained. The third section offers an inventory of reform activism in the areas of taxation, budget, and federalism during the same period. The fourth section describes the formal rules that organize the fiscal policymaking process in Argentina and the actors that participate in this process, with the particular aim of identifying the incentives and opportunities for actors to shape fiscal rules and policies. The fifth section elaborates on the nature of the fiscal policymaking game by identifying the determinants of changes in fiscal institutions and policies.



The sixth section discusses the operation of fiscal decision-making in Argentina by analyzing reform decision-making patterns and episodes in the three fiscal areas. Finally, the conclusion draws the implications of the causal mechanisms identified for both the literature on Argentine political economy and the prospects for fiscal reforms in Argentina.

## **2. Fiscal Policymaking in Argentina: The Outcomes (1988-2007)**

Fiscal policy in Argentina over the past two decades can be characterized as a winding road towards consolidation, hierarchization, and centralization of resources and their management.<sup>2</sup> In the late 1980s, the fiscal deficit, inflation and the public debt were soaring, budgetary management was decentralized and hard to control by the federal government, and the authority over revenue sources and expenditures—factually centralized at the federal level—was disputed between the national and subnational governments. In the late 2000s, fiscal surpluses and ordinary, non-inflationary taxation have apparently become the rule, the debt interest burden has been reduced (albeit through default and unilateral restructuring), budgetary management is centralized, and the vertical fiscal imbalance has grown significantly as a consequence of revenue centralization at the federal level and expenditure decentralization at the subnational level. This section offers a brief tour of these developments.

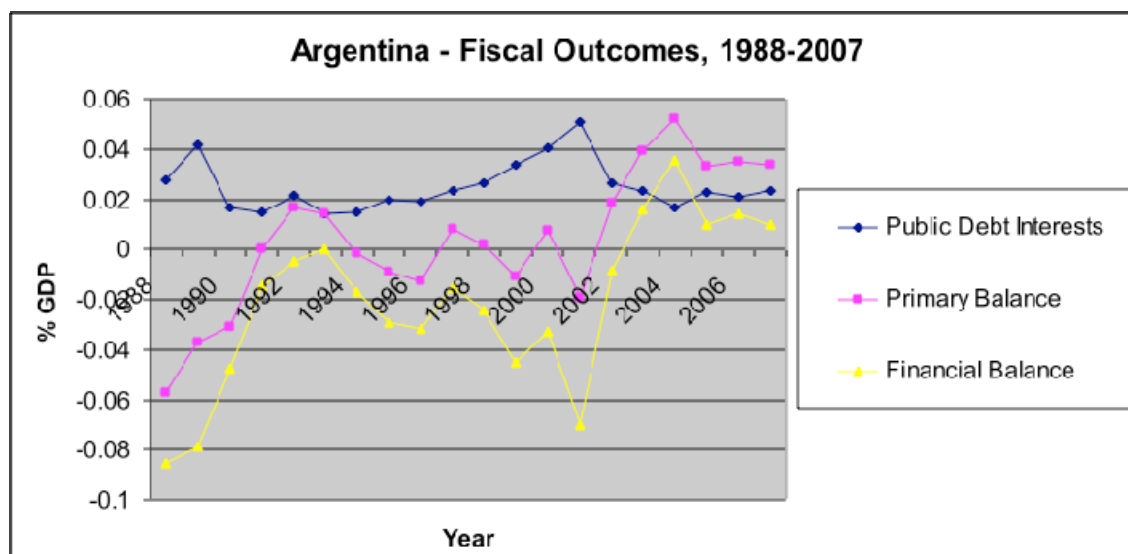
The tendency towards fiscal consolidation can be appreciated in the trajectory of the public sector financial and primary balance,<sup>3</sup> and to a lesser extent in the changes in the public debt interest burden. All three measures indicate that the deep disequilibria of the late 1980s were gradually reversed. As Figure 1 shows, the financial and primary results of the Argentine public sector, which includes the central and provincial administrations as well as public enterprises, have significantly improved in the past twenty years: from deficits over 6 percent to 8 percent of GDP to surpluses ranging from 1 percent to 3.5 percent of GDP. The interest burden, in turn, has slightly diminished of late, although there were excruciating peaks in the final years of the convertibility regime (2000-01).

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<sup>2</sup> *Hierarchization*, as it is used throughout this paper, means the introduction of rules that concentrate power at the top in the management of public accounts (Fisc and Scartascini, 2007), which is typically equivalent to concentration of decision making in the Executive or the Finance Ministry. *Centralization* means control of resources by the central (i.e., federal or national) government.

<sup>3</sup> The primary balance is Total Resources minus Total Expenditures minus Debt Interest Payments. The Financial Balance is Total Resources minus Total Expenditures including Debt Interest Payments.

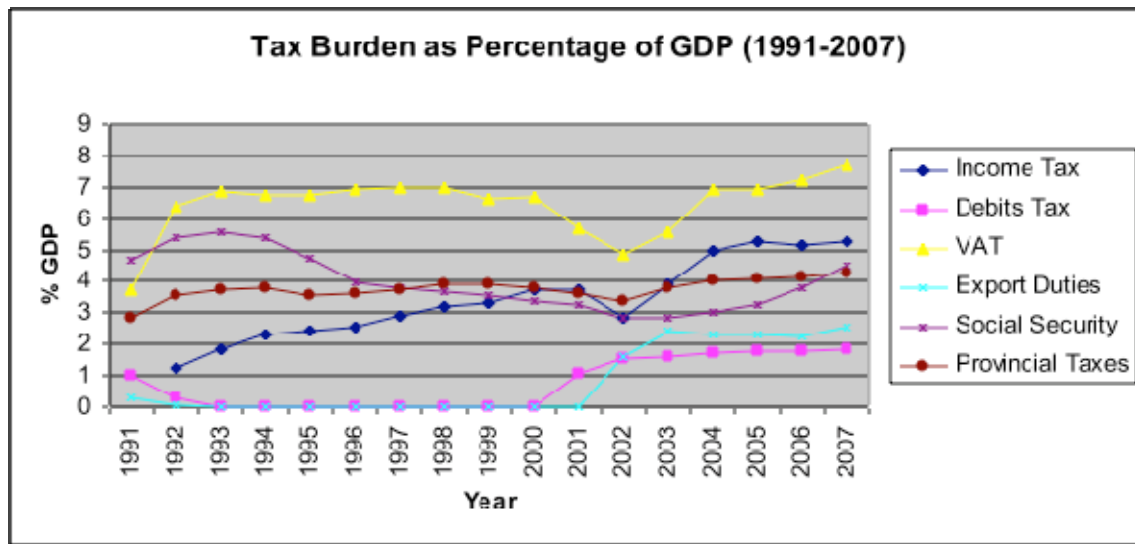
Figure 1.



Source: Information provided by the National Budget Office at the Ministry of Economy, November 2008.

However, this road to fiscal consolidation has had its bends, which may be seen in the evolution of the tax burden. As Figure 2 shows, increases in the income and value-added taxes (VAT) underpinned the reduction in the fiscal deficit between 1991 and 1993, and these taxes remained the cornerstones of the public sector revenue extraction capacity until the 1998-2002 recession. In turn, the reduction in social security contributions since 1993 was a source of fiscal deterioration and remained so until the 2006-2007 reforms expanded the coverage of the public social security system. Finally, the restoration of export duties and the reintroduction of the Bank Debts Tax made a fundamental contribution to the fiscal surpluses that accrued since 2002, despite the fact that the economic recovery generated significant increases in revenues from the income tax and the VAT. The Bank Debts Tax and the export duties jointly contributed revenues of around 4.5 percent of GDP. This suggests that if policy had otherwise remained the same, the entire public sector surplus is explained by extraordinary taxes introduced by way of emergency economic legislation.

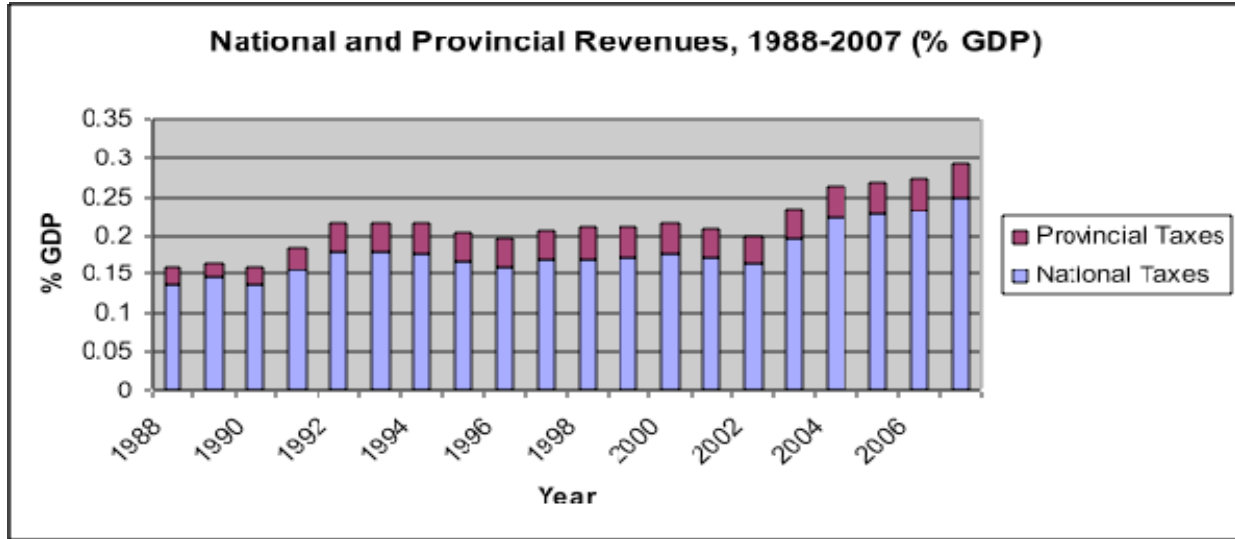
**Figure 2.**



*Source:* Information provided by the National Budget Office at the Ministry of Economy, November 2008.

Figure 2 also offers a window into the process of fiscal centralization. Throughout the entire period, the taxes raised by the provinces returned a fairly constant flow of revenues, whereas those raised by the federal government generated increasing and significantly higher receipts. This asymmetry has sharpened since the restoration of the Bank Debits Tax in 2001 and export duties in 2002, given that both taxes are almost completely appropriated by the federal government rather than shared with the provinces. Figure 3 depicts the same process and also clearly shows the extent to which the federal government has been able to maintain the centralization of tax sources. While the provinces collected an average 3.5 percent of GDP in taxes throughout the period, ranging from 2.4 percent in 1988 to 4.2 percent in 2006-07, the federal government raised an average 14 percent of GDP in taxes net of social security contributions, ranging from 9.9 percent in 1988 to 20.4 percent in 2007.

Figure 3.



Source: Information provided by the National Budget Office at the Ministry of Economy, November 2008.

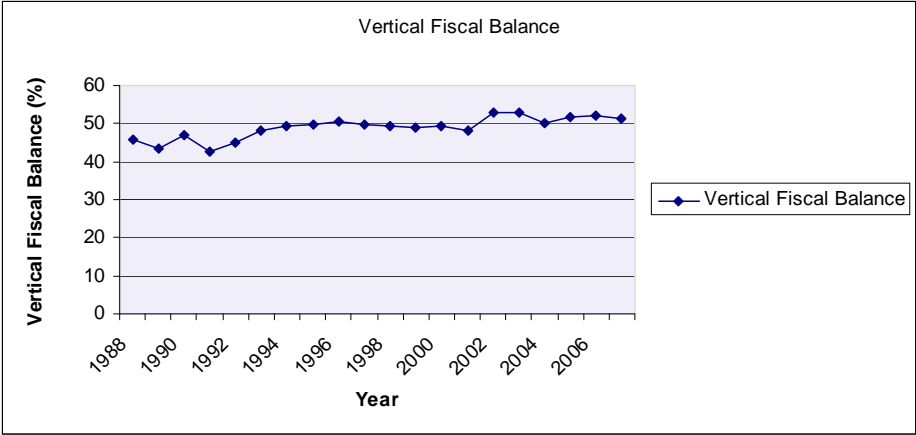
This growth in tax revenue centralization coincided with a hierarchization in the management of fiscal resources. In the fiscal federal area, this hierarchization was the result of combining a steady increase in provincial expenditures with the relative stagnation of provincial tax revenues and the marked growth and gradual centralization of revenues at the federal level. The increase in provincial expenditures was fostered by the administrative reforms in the 1990s that decentralized social expenditures—mainly in health and education—and by the concomitant growth in shared tax revenues collected by the federal government (Cetrangolo and Jiménez, 2003). The provinces had more resources available, but also more spending commitments, and revenues were moving increasingly beyond their control. Although the 1988 Co-participation Law put an end to three years of discretionary management of the revenue-sharing system by the federal government,<sup>4</sup> first the hyperinflation of 1989-91 and then the fiscal pacts of the 1990s enabled the federal government to withdraw increasing amounts from the provincial share of revenues (Cetrangolo and Jiménez, 2003). Subnational governments tried to meet this challenge to their finances by contracting public debt, but by the end of the 1990s this strategy had been exhausted as interest payments absorbed most if not all receipts from shared taxes (Sanguinetti,

<sup>4</sup> The 1973 Co-participation Law had expired in December 1984 without the federal government and the provinces reaching an agreement for its continuation or replacement by new revenue-sharing rules. Consequently, the distribution of all federal tax revenues fell under the control of the federal government, which managed it discretely until the new Co-participation Law was enacted in January 1988.

2001). In the wake of the 2001 debt default, the federal government bailed out the provinces by taking over their debts to private and multilateral creditors, and thus took advantage of the crisis in order to secure its financial dominance over them. As their main creditor, the federal government holds the key to provincial public sector balances: should the Executive decide not to re-finance provincial debts, subnational administrations would automatically fall into deficit or deepen their disequilibria.

The evolution of the vertical fiscal balance shown in Figure 4 provides insight into the unchallenged dominant position of the federal government vis-à-vis the provincial governments in fiscal affairs. The vertical fiscal balance, defined here as the ratio of provincial resources—both current and capital income—to total resources, including inter-government transfers received by all provinces, has consistently shown over the past 20 years a high degree of dependence of the provinces on the federal government to foot their bills.<sup>5</sup> Though the overall balance improved over the period—from 45 percent in 1988 to 53 percent in 2002—provincial dependence actually increased when social expenditures were decentralized in the early 1990s, when recession hit the economy in 1995 and 1998-2002, and when in the late 2000s the weighting of shared taxes in the tax mix declined in favor of non-shared taxes such as export duties and the Bank Debits Tax.

**Figure 4.**



*Source:* Ministry of Economy, on the basis of data provided by the National Directorate of Fiscal Coordination with the Provinces, November 2008.

<sup>5</sup> The extent of this dependence is, predictably, highly heterogeneous: while the province of Buenos Aires finances around 50 percent of its budget with its own resources, over 74 percent of the income of Formosa is provided by intergovernmental transfers (Cetrángolo and Jiménez, 2003).

Hierarchization in the management of fiscal resources also took place in the budgetary area. Until the 1992 fiscal year, the budget of the national administration was effectively decentralized to several “windows” (Heymann and Navajas, 1989): the public enterprises, the military industries, the Social Security system, and a panoply of public entities dealing with sectoral interests, such as the universities and the Agrarian and Industrial Technology Institutes. This meant that the National Treasury had little control over the composition or the execution of expenditures (Heymann and Navajas, 1989; Carciofi, 1990). Between 1992 and 2006, several pieces of legislation were passed that centralized budgetary management in the Finance Ministry, imposed numerical rules for the formulation of the annual budget, established the principle of single accounting, and instituted fiscal responsibility rules such as a countercyclical fund, a multiyear budget framework, transparency in information, and restrictions to subnational debt policies (File and Scartascini, 2007). Some of these rules were recently relaxed or abandoned. But while this has partly reversed the hierarchization achieved in the 1990s by undermining the Finance Ministry’s dominance over the budget process, the president’s control over budgetary transfers via congressional delegation of amendment powers and his direct jurisdiction over specific expenditures have enabled the federal government to exercise significant control over budgetary composition and spending.

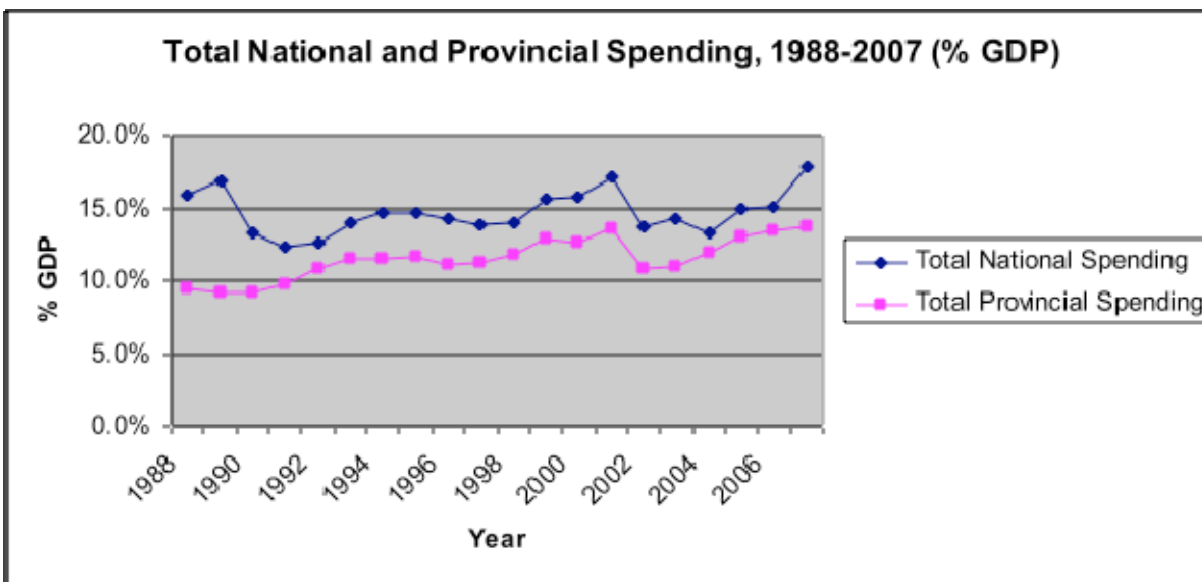
However, these trends towards the centralization of tax revenues and the hierarchization of fiscal and budgetary management have not prevented provincial expenditures from rising almost uninterruptedly since 1991.<sup>6</sup> As Figure 5 points out, provincial expenditures only decreased in the adjustment years of 1996, 2000, and 2002, and then only slightly, while total central government expenditures followed a more winding trajectory. In all, provincial public sector spending in the past 20 years grew over 4 percentage points of GDP, from 9.5 percent to 13.6 percent, compared to the 2 percentage point increase in national expenditures.<sup>7</sup>

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<sup>6</sup> Abuelafia et al. (2006: 207) illustrate the mechanics underpinning this pattern of provincial spending by pointing out that in 2003 the federal government raised 81 percent of all tax resources but spent only 53 percent - because it channeled 5.85 percent of GDP to the provinces via revenue sharing and other transfers.

<sup>7</sup> Cetrángolo and Jiménez (2003) cite various causes for the marked increase in provincial spending: the transfer of education and health services from the national level in the early 1990s; the rise in provincial indebtedness between 1996 and 1999; the steady growth in personnel expenditures since 1983; and the “flypaper effect” since 2002.

Figure 5.



Source: Ministry of Economy, on the basis of data provided by the National Directorate of Fiscal Coordination with the Provinces, November 2008.

The trends towards consolidation, hierarchization, and centralization of resources at the federal level are clear enough, but the path to their realization does not appear as steady or straightforward. By raising non-shared taxes, bailing out subnational governments' debts, and concentrating the power to manage budgetary expenditures, the federal government has strengthened its hold on provincial accounts over the past two decades. Still, the fact that subnational spending has increased almost unceasingly despite the growth in revenue centralization and hierarchical fiscal and financial management suggests that neither centralization nor hierarchization have been established without paying some sort of a price to the provinces. How this price was fixed is the crux to understanding the political dynamics of fiscal reform in Argentina.

### 3. Fiscal Policymaking in Argentina: the Reforms (1988-2007)

The winding road towards the consolidation, centralization, and hierarchization of fiscal resources and their management in Argentina over the past 20 years was paved with a striking number of reforms that swept across all areas. Reform activism was especially evident in taxation, but significant changes also took place in budgetary and fiscal federal institutions.

Taking into consideration only those initiatives enacted by Congress, there were 113 reforms in this period—an average of 5.38 reforms per year. Considering only the bills passed as legislation, as Table 1 shows, about four tax reforms were introduced per year, about one and a half budget reforms every two years, and more than one reform of fiscal federal institutions or policies every two years.

**Table 1. Fiscal Reforms in Argentina, 1988-2008**  
Congressional Acts per Area and Year

Year	Federalism	Budget	Taxation	Total
1988	3		1	4
1989			5	5
1990			2	2
1991			2	2
1992	1	1	2	4
1993		1	1	2
1994			3	3
1995	1	1	7	9
1996	3	2	3	8
1997			4	4
1998	1		6	7
1999	1	2	1	4
2000	1	1	3	5
2001		1	5	6
2002	1	1	5	7
2003			7	7
2004	1	1	5	7
2005	1	1	5	7
2006		2	10	12
2007		1	5	6
2008		1	1	2
<b>Total</b>	14	16	83	113
<b>Annual Average</b>	0.66	0.76	3.95	5.38

*Source:* Author's compilation based on Chamber of Deputies' Parliamentary Information Database.

The exact number of reforms would increase if it were possible to include the complete figures for those enacted by Decrees of Necessity and Urgency.<sup>8</sup> Of this set of reforms by presidential decree, three stand out: the reductions of employer contributions to the social security system, the 1993 Fiscal Pact, and the 2001 Agreement for Independence and

<sup>8</sup> A preliminary estimation by Ferreira Rubio and Goretti (1996) indicates, for instance, that President Menem signed 72 such decrees between 1989 and 1994. But since the authors count in not only those decrees that the president declared as bearing "Necessity and Urgency" but also those the authors themselves consider to be so, the actual figure is arguable.



Institutional Support for Governability.<sup>9</sup> None of these decrees actually constituted a unilateral decision by the president; rather, they crystallized the outcome of negotiations between the finance minister and the governors. Thus, they were functionally equivalent, at least at their inception, to fiscal federal legislation.

Institutional reforms in the budget area were generally oriented towards the centralization and hierarchization of the budget process. The main reforms introduced numerical rules for amendments, a single account for administration, transparency rules for all levels of government, a countercyclical fund for the federal budget, and even nominal caps on and reductions of expenditures. However, some of these institutional reforms have been reversed, or their implementation deferred, via budgetary policy reforms. The integration of the countercyclical fund has been continuously suspended since 2000; transparency rules have been only partially enforced; and the single accounting principle has been weakened by the inception of fiduciary funds, the re-creation of public enterprises, and the budgetary autarky granted to specific administrative units.<sup>10</sup> The tendency to constrain spending by Congress and the provincial governments through numerical rules and nominal expenditure caps has also been partially reversed through the deferral of the incorporation of all administrative units into the budget mandated by the two Fiscal Responsibility Laws. In contrast, the trend towards the concentration of budgetary amendment powers in the federal Executive has persisted, thus granting the president almost unlimited capacity to change the budget negotiated in Congress. All in all, then, institutional reforms have attempted to establish the centralization and hierarchization of the budgetary process, but while hierarchization in the Finance Ministry has been lately weakened

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<sup>9</sup> The reduction of employer contributions to the social security system was initiated in 1993, then reversed in March 1995, resumed in September 1995, and deepened in 1998, only to be partially reversed in 1999, 2001, and 2002. The 1993 Fiscal Pact between the federal government and the provinces increased the monthly fixed sum of Co-participation revenues guaranteed to subnational governments in exchange for the reduction or elimination of the main provincial taxes—a commitment never fully met by the governors and continuously deferred by subsequent legislation. In the Agreement for Independence and Institutional Support for Governability signed by the national and subnational governments in 2001 the provinces consented to receive their Co-participation payments in Treasury bonds rather than pesos in exchange for debt rescheduling programs and emergency aid for fiscal adjustment.

<sup>10</sup> Fifteen fiduciary funds were created between 1994 and 2004: 50 percent of them by Executive decisions, and all of them under administrative control of the president via specific ministries (Abuelafia et al., 2006: 237-239). In addition, 27 public enterprises, 12 administrative units, including the Federal Administration of Public Income,— and all public financial institutions except the Central Bank operate beyond the budgetary system but under Executive control via ministries (Uña, 2006).

by the delegation of budgetary amendment powers to the Cabinet chief, centralization of budgetary control in the hands of the president has remained intact.

**Table 2. Budget Reforms in Argentina, 1988-2008**

<b>Law Number</b>	<b>Description</b>	<b>Year</b>
24156	Financial Administration Law: hierarchical organization of budget process, numerical restrictions on budgetary amendments, creation of oversight agencies	1992
24307	1994 Budget: Authorization to Increase Spending using Public Debt and Freely Available Treasury Funds, Ratification of 1993 Fiscal Pact	1993
24624	1996 Budget: Delegation of Budgetary Amendment Powers	1995
24629	Second State Reform: Multi-annual Budgetary Framework, Delegation of Budgetary Amendment Powers	1996
24764	1997 Budget: Delegation of Budgetary Amendment Powers, Prohibition of Increasing Expenditures using Treasury Obligations Fund	1996
25152	Fiscal Solvency Act: Deficit Reduction Targets, Countercyclical Fund, Budget Transparency Rules, Limits on Spending Growth	1999
25237	2000 Budget: Delegation of Budgetary Amendment Powers, Suspension of Countercyclical Fund	1999
25401	2001 Budget: Delegation of Budgetary Amendment Powers, Suspension of Countercyclical Fund	2000
25453	Zero Deficit Act: cash-basis rule for public sector payments with priority for debt payments	2001
25725	2003 Budget: Delegation of Budgetary Amendment Powers, Suspension of Countercyclical Fund	2002
25967	2005 Budget: Exemption from Fiscal Responsibility Law Spending Limits for Provinces, Deferral of Provincial Obligation to Incorporate all Administrative Units into Budget, Elimination of Prohibition to Finance Expenditure Increases with Treasury Obligations Fund, Suspension of Countercyclical Fund	2004
26078	2006 Budget: Exemption from Fiscal Responsibility Law Spending Limits for Provinces, Deferral of Provincial Obligation to Incorporate all Administrative Units into Budget	2005
26124	Reform of Financial Administration Law: Permanent Delegation of Budgetary Amendment Powers to the Executive	2006
26198	2007 Budget: Exemption from Fiscal Responsibility Law Spending Limits for Provinces, Deferral of Provincial Obligation to Incorporate all Administrative Units into Budget	2006
26337	2008 Budget: Exemption from Fiscal Responsibility Law Spending Limits for Provinces, Deferral of Provincial Obligation to Incorporate all Administrative Units into Budget	2007
26422	2009 Budget: Exemption from Fiscal Responsibility Law Spending Limits for Provinces, Elimination of Provincial Obligation to Incorporate all Administrative Units into Budget	2008

*Source:* Author's compilation based on information from the Ministry of Economy's Legal Service Database (Infoleg) and the Chamber of Deputies' Parliamentary Information Database.

Of these 16 reforms in the budget area, six have aimed at introducing structural changes in the rules of the game: the 1992 Financial Administration Law; the 1996 Second State Reform; the 1997 budget's prohibition to finance increased expenditures through the Treasury Obligations Fund; the 1999 Fiscal Solvency Act; the 2005 budget's reversal of the prohibition introduced in the 1997 budget; and the 2006 Reform of the Financial Administration Law. The rest of the reforms were piecemeal. They either paved the way for subsequent structural changes, such as the delegation of amendment powers to the Executive, or introduced exemptions from general rules, such as transparency requirements included in the Fiscal Solvency and Fiscal Responsibility Laws.

Fiscal federal reforms in Argentina have generally consisted of adapting revenue-sharing rules to the restrictions imposed on the federal and provincial treasuries by either economic shocks or stabilization policies. During the convertibility years, the instruments for adaptation were the fixed sum guarantees and the deferral of provincial tax reductions. Before and after the convertibility regime, the instruments were various forms of bailout—budgetary or financial. These instruments generally enabled the provinces to maintain their spending ability: had they not been incorporated in the reform packages or traded in exchange for the restrictive and centralizing reforms promoted by the federal government, the provinces would have immediately experienced a net loss in either their availability of resources or their capacity to spend them. Fixed sums, tax-reduction deferrals, and bailouts allowed the provinces to maintain their status quo spending abilities at least until the following negotiation (Bonvecchi, 2003, 2005).

**Table 3. Fiscal Federal Reforms in Argentina, 1988-2008<sup>11</sup>**

Law Number	Description	Year
23548	Co-participation Regime: 54.66 percent of revenues to the provinces, 42.34 percent for the federal government, 1 percent for Treasury Contributions Fund	1988
23562	Temporary Provincial Fiscal Disequilibrium Fund	1988
23658	Provincial Financial Overhaul Bond, Fiscal Credit for Private Firms, Tax on Interests from Time Deposits	1988
24130	Ratification of Fiscal Pact: Fixed Monthly Co-participation Sum, Provincial Fiscal Disequilibrium Fund, Transfer of Management of Special Funds to Provinces, Appropriation of 15 percent of Co-participation for Social Security	1992
24463	Freeze of Pensions and Social Security Lawsuits, Change of Income Tax Revenue-Sharing Rule	1995
24671	Deferral of Provincial Compliance with Fiscal Pact Obligations	1996
24699	Deferral of Provincial Compliance with Fiscal Pact Obligations	1996
24762	Deferral of Provincial Compliance with Fiscal Pact Obligations	1996
25082	Revenue-Sharing Rules for Taxes on Presumptive Income, Entrepreneurial Indebtedness, and Interest Payments: Appropriation for Social Security and Increase of Co-participation Fixed Sum for Provinces	1998
25235	Ratification of 1999 Federal Agreement: Appropriation of Extra Revenues by Federal Government, Increase in Co-participation Fixed Sum for Provinces, Debt Rescheduling Program for Provinces, Bailout of Some Provincial Pension Regimes	1999
25400	Ratification of 2000 Federal Agreement: Maintenance of Revenue Appropriation for the Federal Government, Increase of Co-participation Fixed Sum for Provinces, Extra Funds for Social Programs in Provinces	2000
25570	Ratification of 2002 Fiscal Pact: elimination of Co-participation Fixed Sums, Bailout for Provincial Debts, Co-participation of 30 percent of Bank Debits Tax	2002
25917	Fiscal Responsibility Law: limits on national and subnational spending and debt, exemptions for provinces, penalties for infractions, unification and consolidation in budgets of all public spending	2004
26075	Education Finance Act: change of Revenue-Sharing Rules for Co-participation Receipts above 2005 Level	2005

*Source:* Author's compilation based on information from the Ministry of Economy's Legal Service Database (Infoleg) and the Chamber of Deputies' Parliamentary Information Database.

<sup>11</sup> The table excludes the 1994 constitutional amendment that incorporated the co-participation regime to the Constitution because it was not an act of Congress. This reform is not analyzed here because it did not strictly constitute an attempt to change the status quo rules, but rather to confirm them (Bonvecchi, 2003).

Only five out of these 14 fiscal federal reforms introduced structural changes in the rules of the game. The 1988 Co-participation Law, the 1992 and 2002 Fiscal Pacts, the 2004 Fiscal Responsibility Law, and the Education Finance Act all altered either the distribution of revenues between the federal government and the provinces or the sharing rules among the provinces themselves. Most of these changes have entailed centralizing revenues and their management in the federal government, but also distributing compensation to the provinces for the losses potentially arising from that centralization. The rest of the reforms were piecemeal: minor changes in revenue-sharing rules for specific taxes, marginal increases in co-participation fixed sums, etc.

Reforms in taxation have been mostly pro-cyclical: they increased taxes and bases during the positive phase of the economic cycle, and decreased them during the negative phase. However, this pattern has been inverted in recent years, when the rates and bases of income, value-added and some minor direct taxes have been reduced in the midst of good economic times. Delegation of authority to the Executive for manipulating tax rates and bases has also been a recurrent feature, although the extent of delegation has varied through time and conjunctures: they have been explicitly constrained during positive phases, and generally unconstrained in hard times.

**Table 4. Tax Reforms in Argentina, 1988-2008**

<b>Law Number</b>	<b>Description</b>	<b>Year</b>
23549	Forced Savings, Bank Debits Tax, Agrarian Emergency Fund	1988
23666	Reduction of VAT Rates	1989
23667	Taxes on Agricultural Products, Agricultural Emergency Fund	1989
23669	Suspension of Regional and Sectoral Fiscal Promotion Regimes	1989
23760	Changes in Rates and Revenue-Sharing Criteria of Taxes on Firms' Assets, Bank Debits, Income, Excise, and VAT	1989
23765	Generalization of VAT	1989
23871	Tax on Trade of Financial Assets	1990
23872	Exemption to VAT	1990
23905	Increase Rates of Income, Bank Debits, Assets, and Value-Added Taxes	1991
23966	Increase VAT and Social Security Contribution Rates and Change VAT Revenue-Sharing Rules to Finance Social Security	1991
24073	Increase Rates of Income, Value-Added, and Liquid Fuel Taxes, Change Revenue-Sharing Criteria of Income and VA Taxes	1992
24181	Exemption of Liquid Fuel Taxes for the Patagonia Region	1992
24367	Exemptions to VAT for Transport	1994
24391	VAT Reform: Authorization for the Executive to Establish a Special Regime for Purchases from Exporting Firms	1994
24415	Reform of Customs Duties	1994
24468	Increase of VAT Rate and Appropriation of Proceeds by the federal government for one year, compensatory fixed sum for provinces, deferral of provincial due compliance with Fiscal Pact obligations, Expansion of Personal Tax bases	1995
24475	Increase of Income Tax Bases	1995
24514	Tax Exemption for Rural Mortgages	1995
24587	Tax on Private Equity, Increase of Income Tax base, general deferral for compliance with tax rules	1995
24590	Personal Tax Exemptions	1995
24621	Extension of Income Tax and its Revenue-Sharing Rules	1995
24625	Emergency Tax on Cigarettes, Earmark for Social Programs	1995
24631	Elimination of Exemptions from VAT and Income Tax, Limited Delegation to the Executive for Eliminating Exemptions	1996
24689	Exemptions from VAT for Imports of Consumer Goods	1996
24698	Exemptions from VAT for Airplanes	1996
24829	Exemptions from VAT for Medical Equipment	1997
24885	Limits to Income Tax Deductions, Exemptions from VAT	1997
24917	Amendment of Law 24885	1997
24920	Exemption from VAT for Bank Transactions by Provinces and Municipalities	1997
24977	Simplified Tax Regime for Small Contributors	1998
25037	Blanket Tax Exemption for Theatrical Activities	1998
25053	Teachers Incentive Fund	1998
25055	Expansion of Liquid Fuel Tax Base	1998
25057	Income Tax Exemption for Fiduciary Funds	1998
25063	Expansion of Income, Excise, and Value-Added Tax Bases, Taxes on Presumptive Income and Cost of Entrepreneurial Indebtedness	1998
25123	Expansion of Presumptive Income Tax Base	1998

<b>Law Number</b>	<b>Description</b>	<b>Year</b>
25239	Increase in Income Tax Rates and Bases, Increase in VAT Bases, Emergency Tax on High Incomes, Increase in Excise, Liquid Fuel, and Simplified Regime Rates	1999
25300	Exemptions for Small and Medium Enterprises	2000
25360	Increase of VAT, Interest Payments, and Entrepreneurial Indebtedness Rates and Bases, Authorization for the Executive to Reduce Rates	2000
25361	Accrual of Liquid Fuel Tax Payments to Income Tax Payments	2000
25402	Expiration Date for Taxes on Interest Payments and Entrepreneurial Indebtedness	2001
25405	Limits to Exemptions from VAT	2001
25406	Accrual of VAT Payments for Exporters	2001
25413	Competitiveness Act: Bank Debits Tax, Exemptions and Revenue-Sharing Rules	2001
25414	Blanket Delegation of Tax Authority to the Executive, Administrative Delegation to Eliminate Administrative Units	2001
25525	VAT Exemption for Honey Producers	2002
25585	Increase of Personal Assets Tax Rates	2002
25710	Reduction of VAT Rates for Cattle Producers	2002
25717	Suspension of Differential VAT Rates for Agrarian Activities	2002
25723	Reduction of Social Security Contributions	2002
25731	Suspension of Exemptions from Income Tax for Exporters	2003
25732	Repeal of Competitiveness Agreements, Restoration of Former Tax Rates	2003
25745	Increase of Liquid Fuel Tax Rates and Bases	2003
25784	Increase of Income Tax Bases	2003
25865	VAT Exemptions, Tax Amnesty for Self-Employed Persons	2003
25866	VAT Exemption for Periodicals	2003
25868	Extension of Excise Taxes	2003
25920	Ratification of Previous Blanket VAT Exemptions	2004
25923	Tax Amnesty for Provinces and Municipalities for Non-Compliance with Teachers Incentive Funds	2004
25924	Fiscal Credits for Investment in Capital Goods	2004
25951	Reduction of VAT Rates for Agrarian Activities	2004
25987	Income Tax Exemption for Retirees	2004
26022	Exemptions from Gasoil and Liquid Fuel Taxes	2005
26022	Exemption from Liquid Fuel Tax for Importers and Consumers	2005
26028	Tax on Gasoil Sales, Earmark for Infrastructure Development and Compensation for Freeze of Transport Fees	2005
26050	Reduction of VAT Rates for Fertilizers	2005
26074	Exemptions from Gasoil Tax	2005
26093	Fiscal Credits for Investment in Biofuel	2006
26095	Taxes on Gas and Electricity Tariffs, Earmarks for Gas and Electricity Infrastructure Development	2006
26111	Accrual of VAT Payments for Buyers of Reactive Substances for Detection of Adulterated Fuel	2006
26112	Exemptions from VAT for Public Financial Trusts for SMEs	2006
26115	Exemptions from VAT for Public Entertainment Events	2006
26151	Exemptions and Differential VAT Rates	2006

<b>Law Number</b>	<b>Description</b>	<b>Year</b>
26154	Fiscal Credits for Fuel Drilling and Development	2006
26176	Exemption from Income Tax for Oil Workers	2006
26180	Extension of Income Tax and its Revenue-Sharing Rules	2006
26181	Tax on Sales and Imports of Petrol and Natural Gas, Earmark for Water Infrastructure Development	2006
26287	Reduction of Income Tax Bases by Increase in Deductions	2007
26317	Increase in Personal Tax Rates	2007
26325	Increase in Gasoil Tax Rate, Change in Earmark	2007
26340	Extension of Bank Debits and Excise Taxes	2007
26346	Extension of VAT Base	2007
26360	Fiscal Credits for Investment in Capital Goods for Infrastructure Development	2008

*Source:* Author's compilation based on information from the Ministry of Economy's Legal Service Database (Infoleg) and the Chamber of Deputies' Parliamentary Information Database.

The overwhelming majority of these bills instituted piecemeal reforms. Only about 30 percent of tax reforms (25 out of 83) introduced structural changes in tax rules, i.e., they created new taxes, extended tax bases, raised tax rates, or enabled the Executive to manage rates and/or bases in a discretionary manner. The rest of the bills typically instituted tax exemptions or credits to specific economic sectors or activities. These exemptions generally followed the enactment of comprehensive tax bills, so they effectively operated as tailor-made amendments to the general rules thereby established.

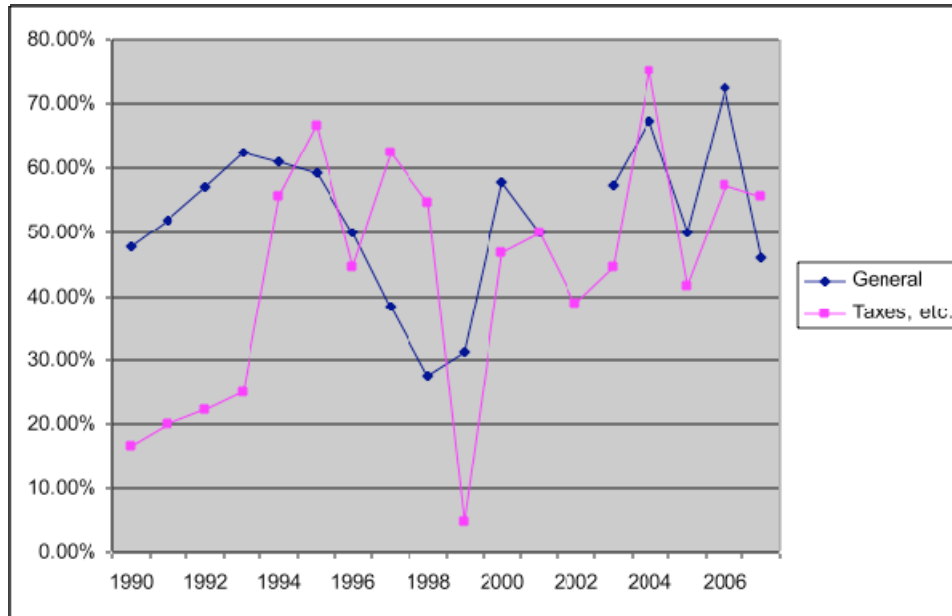
Only a handful of reforms have failed to be enacted since 1988. As Figure 6 shows, legislative success rates for fiscal reforms were high in most years and even higher than general legislative success rates on some occasions. Of all bills sent to Congress by the president, fiscal bills generally met with as much approval as the rest of the bills, and sometimes constituted the bulk of Executive initiatives approved by legislators.<sup>12</sup> Of the handful of failed reforms, two stand out: the 1992 Tax on the Primary Surplus of Firms, and the 2008 Variable Export Duties, the first of which will be analyzed below.

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<sup>12</sup> Again, data are not yet available for reforms before 1990.



**Figure 6. Legislative Success Rates of Executive Bills  
Percentage of General and Fiscal Bills Approved by Congress**



*Source:* Author's compilation based on the basis of data from the Chamber of Deputies' Parliamentary Information Database.

This overview of fiscal reform activism in Argentina in the past two decades shows that reforms have been numerous and frequent and have mixed structural with marginal changes. However, particularly in the taxation and budgetary areas, they have often been reversed in the short term by other reforms. This begs the question what factors led to the introduction and subsequent reversal of those reforms. Can this be explained by the economic and/or policy shocks experienced by the country? Or must one also take into account the nature of the fiscal decision-making process and the incentives and restrictions on its participants? This paper argues that all three factors—shocks, decision-making processes and actors—should be combined to produce an adequate account of these patterns.

## **4. The Fiscal Decision-Making Process in Argentina: The Rules and the Actors**

The review of the rules and actors involved in fiscal decision-making suggests that rules provide incentives, resources, and opportunities for actors to shape the outcomes of decision-making because they encourage the formation of oversized coalitions in Congress. The actors, in turn, are prepared to extract gains from those opportunities due not only to the power invested in them by the rules but also to their organization. This is particularly the case with the main political parties, through which both the federal and the provincial governments exercise their ability to shape reform outcomes. By encouraging the formation of oversized coalitions, rules create opportunities for subnational party leaders to bargain for the accommodation of their local interests within reform designs and/or the distribution of compensation for their consent to reforms. When the main political parties are highly integrated, and their national leadership is correspondingly strong, they may put a check on the subnational pressures enabled by decision-making rules. In contrast, when the parties are poorly integrated and their national leadership weakened, subnational leaders are in a better position to profit from the opportunities created by fiscal decision-making rules. This section illustrates these patterns by describing the rules of fiscal decision-making and the nature of the actors who participate in decision-making processes.

### ***4.1. The Rules***

Fiscal decisions in Argentina are typically made by an act of Congress, but unlike ordinary legislation, for which minimum winning plurality coalitions are sufficient, lawmaking in all fiscal areas necessitates the formation of oversized coalitions.<sup>13</sup> This is probably an institutional legacy of the formation of the Argentine federation that rules have managed to lock in. The Argentine federation was the outcome of a process in which the provinces, as constituent units, fought each other over the authority to impose taxes on exports and the distribution of their proceeds (Burgin, 1946). As a device to protect the power of all provinces from the potential hegemony of any coalition of provinces that might capture the presidency, the Constitution

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<sup>13</sup> The use of the term *oversized coalition* in this paper is a variation of Riker's (1962) notion. Whereas Riker defined as oversized any coalition larger than minimal winning size, the term is reserved here to connote any coalition larger than the size legally required to form a given decision. In Riker's terminology, coalition size is a purely mathematical concept "A minimum winning coalition is one which is rendered blocking or losing by the subtraction of any member" (page 40), whereas in this paper it is related to legal definitions.

established procedural rules and majority requirements that enabled the provinces to exercise veto power in taxation matters. This veto power was greatly expanded when the first co-participation regime was established in 1934: the agreement of all provincial legislatures was required for revenue-sharing rules to take effect (Porto, 1990). Subsequently, the power of provincial executives over revenue-sharing decisions was enshrined in the 1994 constitutional reform by incorporating specific rules for revenue-sharing lawmaking: reforms to co-participation now require not only the consent of an absolute majority of members of Congress, but also prior agreement between the president and the provincial governors and the subsequent ratification of the bill by provincial legislatures (Eaton, 2001a). These rules make provincial governors and provincial delegations to the national legislature key actors in fiscal decision-making.

Many features of the ordinary lawmaking procedures established by the Constitution generally apply to fiscal decision-making, but two of them have a direct influence on legislative coalition sizes: the open amendment rule for bills; and the majorities required to overturn decisions by the second chamber and presidential vetoes. The Argentine Congress is divided into two houses: the Senate and the Chamber of Deputies. Each of these is in turn divided into committees.<sup>14</sup> Bills are initially referred to committees, which may report on them or be relieved of this duty by special motions approved by a majority of the members present of their parent house of Congress. Bills may be initiated by Congress or the Executive; they could shuttle twice per house of Congress until the 1994 constitutional reform, and only once since then. The amendment rule for bills is open and generalized: any committee or chamber may amend or reject any bill without restrictions, with the exception of fiscal federal legislation. If the second chamber discussing any bill amends it, then the majority required to overturn or change those amendments must match in size the majority employed to introduce it. If the president vetoes a bill, wholly or partially, and Congress intends to insist upon it, then both houses—first the

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<sup>14</sup> The Senate consists of three senators per province, which amounts to 72 senators; the Chamber consists of one representative per 33,000 inhabitants, with a mandatory floor of five per province, which amounts to 257 deputies. Both houses thus over-represent the smaller provinces. Senators are elected by plurality, with the winning party taking two seats and the second party the third. Deputies are elected by closed-list proportional representation using the D'Hont formula, which in principle allows for both the representation of local minorities or local majority party factions at the national level and the strengthening of the local political leaders that control nomination processes.

original, then the second—must gather a two-thirds majority of their total membership to force the Executive to implement it without reservations.<sup>15</sup>

The effect of combining the generalized open amendment rule typical of all legislation and the majority requirements typical of fiscal lawmaking is to stimulate the formation of oversized coalitions. The reason for this, as Baron (1989) has noted, is that under an open amendment rule there is structural uncertainty as to who will enter any winning legislative coalition. The majority requirements only add to such uncertainty.

Decision-making in each fiscal area operates by rules that require the formation of oversized legislative coalitions. In tax policymaking, this requirement arises from three limitations imposed by the Constitution: the division of tax sources between the provinces and the federal government; the procedural advantage on tax initiatives granted to the Chamber of Deputies; and the special majority required to introduce or change any earmarking of tax revenues.

The division of tax sources in the Constitution indicates that a) the provinces and the federal government must share direct and indirect taxes apart from customs duties; b) the proceeds from customs duties belong exclusively to the federal government; and c) Congress may impose direct taxes only for specific periods of time, so only indirect taxes may be in force indefinitely. These rules imply that the federal government cannot obtain any tax revenues without the cooperation of provincial delegations in Congress, and is also unable to avoid sharing the proceeds from taxation with the provinces.<sup>16</sup>

The power to initiate tax legislation conferred on the Chamber of Deputies grants a procedural advantage to the larger, richer provinces that have the biggest contingents of deputies. By coalescing in the Chamber, these provinces have an opportunity to impose their preferences on the smaller, poorer provinces overrepresented in the Senate.<sup>17</sup> But since the smaller provinces are dominant in the Senate, they might gather a large enough majority to amend or overturn the

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<sup>15</sup> However, the Executive may refrain from publishing the acts of Congress in the Official Bulletin, in which case they do not enter in force.

<sup>16</sup> Unless, of course, customs duties are enough to finance federal spending, and economies of scale in tax collection generate no gains that might be appropriated by rational politicians at the federal level. None of these provisions have obtained since the 1930s.

<sup>17</sup> According to Stepan's (1999) data on overrepresentation in federal democracies, the Argentine Senate has the highest degree of overrepresentation in the world: its best represented decile holds 44.8 percent of seats.

Chamber's decision. Consequently, to pass tax legislation, coalitions are necessary that simultaneously comprise large and small, rich and poor provinces.

To create new taxes, only a plurality of the present members of each chamber is needed according to the Constitution, but the majority required to introduce or change any *earmarking* of tax revenues is 50 percent plus one of the members of each house of Congress. This strongly encourages legislators from both large and small provinces to agree upon earmarking criteria and forces them to review those agreements every few years.

If a majority of more than 50 percent of each house's members is required to make a decision on the earmarking of tax revenues, and if a coalition of large and small provinces is necessary for tax bills to pass both houses of Congress, then every party and every provincial representative has an incentive to trade in their vote for amendments that would cater to their territorial and/or income-based constituencies. The incentive for logrolling is generalized because, as Shepsle and Weingast (1981) have argued, nobody can rest assured that they would be part of the winning coalition, so they all strive to get on board with the threat that, should they be rejected, they would have a reason to reject cooperation in subsequent negotiations with those who excluded them in the first place.<sup>18</sup>

The decision rules for *revenue-sharing* legislation also stimulate the formation of oversized coalitions. Revenue-sharing legislation is required by the Constitution to be crafted in the *covenant law* format.<sup>19</sup> This format entails that laws concerning the incorporation of new taxes to the common revenue pool and the criteria for the distribution of shareable revenues must be previously agreed upon by the president and the governors, then presented to Congress for their approval, and, subsequent to Congressional approval, they must be ratified by provincial legislatures.<sup>20</sup> This entails that covenant laws cannot be modified unilaterally by the provinces,

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<sup>18</sup> This dynamic works for both intra-legislative bargaining and Executive-legislative negotiations since in both instances the Treasury must bear the financial cost of any agreement and the president has veto power. A presidential veto may leave most legislators worse off, so the appropriate way to secure benefits is to build the largest possible coalition in order to signal to the president that the veto may be rejected.

<sup>19</sup> This format was first used in 1934 to introduce the first revenue-sharing regime. Its origins are unclear, but its nature is consistent with the spirit of balancing the power of rich and poor provinces enshrined in the 1853 Constitution (Eaton, 2001a).

<sup>20</sup> There is no explicit majority requirement for agreements between presidents and governors, but in practice they have been either unanimous or near-unanimous, i.e., involving over two-thirds of the provinces. Approval in Congress and ratification by provincial legislatures requires only a qualified majority of 50 percent plus one. Still,

the president, or Congress.<sup>21</sup> Thus, to make a decision on the distribution of fiscal revenues every interested party—the president, the governors, legislators, parties—must be in agreement.

In budgetary *policy* decision-making, the formation of oversized legislative coalitions is encouraged by the reversion point in the process. The budget is like a regular bill in that it may be passed by a mere plurality of legislators, but if Congress fails to pass it before the beginning of the fiscal year, then the previous year's budget must be used, duly actualizing its expenses according to their specific maturity. This gives the Executive the chance to renege on any agreement concerning expenditures that might have been reached before with governors and/or legislators. Since governors and legislators typically seek to increase or, in hard times, at least maintain the level of expenditures targeted to their districts, Congress is typically interested in passing the budget on time, and legislators from all parties and provinces are keen to have their preferred expenditures included.<sup>22</sup> Failure to cooperate by excluding demands from the bill—as scores of articles on the U.S. budget process have demonstrated—may trigger future, equivalent retaliations by those excluded.

In turn, reforms of budgetary *institutions* are subjected to ordinary lawmaking procedures, so they do not explicitly require qualified majorities of any kind and may thus be passed by minimum winning coalitions. However, since what is at stake in the discussion of budgetary institutions is who controls the allocation of government expenditures, the same structural uncertainty noted by Shepsle and Weingast (1981) and Baron (1989) is at play. No province can ascertain whether it would be part of the winning coalition, but given the high cost of exclusion, bargaining to be included appears to be the more rational course of action for all. This prompts the formation of oversized legislative coalitions, despite the absence of rules explicitly encouraging it.

Alternatively to the legislative path, the Executive may enact fiscal policy by decree, but only in the budgetary area because decrees on taxation—and hence, on revenue-sharing—are explicitly banned by Article 99, clause 3 of the Constitution. The Executive may find it attractive

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the unanimity among the executive branches appears to have precedence over the legislatures: no fiscal federal agreement between presidents and governors has failed to obtain the required legislative majorities for ratification.

<sup>21</sup> However, despite this restriction, important covenant laws such as the 2004 Fiscal Responsibility Law have been changed by Congress without previous explicit approval of the president and the governors or subsequent ratification by provincial legislatures. The rationale for this will be analyzed later.

<sup>22</sup> Congress has unlimited power to introduce amendments to the budget bill, with the only requirement being that the financial sources of any expenditure added to the Executive's proposal be identified.

to enact budgetary policy by Decrees of Necessity and Urgency (DNU) insofar as it enables the president to circumvent the restrictions on budgetary amendments set by the Financial Administration Law.<sup>23</sup> The unilateral decision-making path may thus relieve the president from the transaction costs typically imposed upon executive initiatives by governors and legislators. But since the Constitution precludes the use of DNUs for taxation and fiscal federalism, this path may not be used as readily as in the budget area.

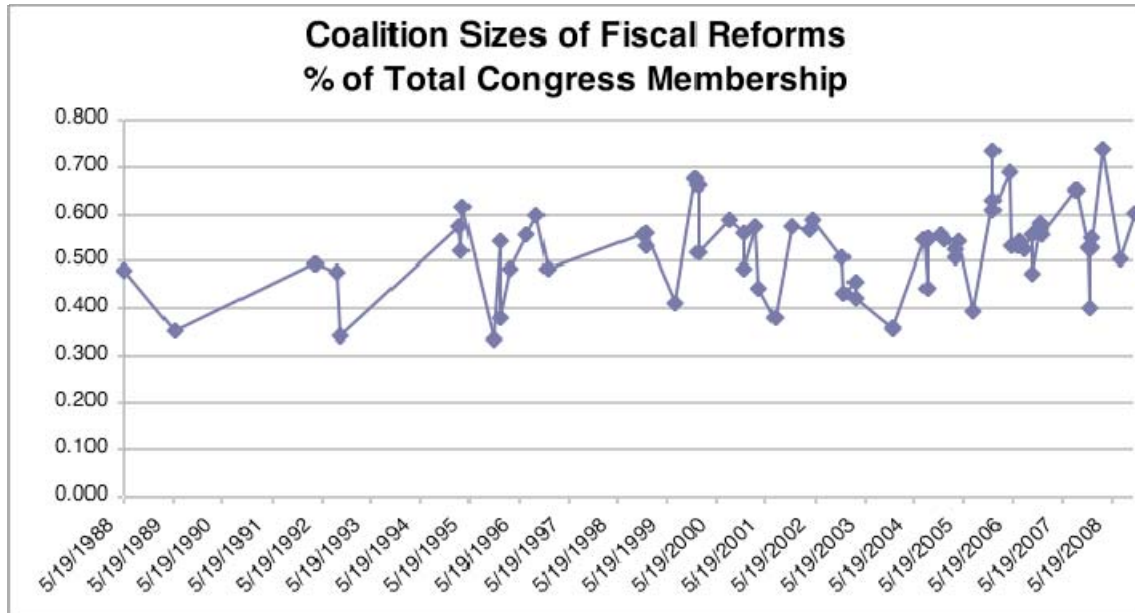
The overwhelming majority of fiscal reforms in the past two decades have been enacted by oversized legislative coalitions. As depicted in Figure 7, 68.6 percent of the fiscal reforms for which roll-call votes were taken since 1988 were approved by coalitions comprising over 50 percent of the total number of members of Congress.<sup>24</sup> Many fiscal decisions require qualified majorities of 50 percent plus one, but coalition sizes have sometimes been much larger. This suggests that both large and small provinces, hegemonic in the Chamber of Deputies and the Senate, respectively, have managed to enter into the deals underpinning the enactment of each of these reforms.

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<sup>23</sup> DNUs must be reported to Congress as mandated by the 1994 Constitution, but until 2006 no procedure was established to deal with those decrees. This has meant that unless Congress passed a bill rejecting or amending a DNU, then the DNU stayed in force. Since 2006, a bicameral Committee on Legislative Procedure must report on each DNU to both houses of Congress: if they remain silent, DNUs remain in force; only explicit rejection may render them void. Approval of DNUs has thus been fairly easy: before 2006, because Congress had to repeal them by law, which was subjected to presidential veto and since 2006, because the government party may keep DNUs in force merely by imposing silence on one house of Congress (Bonvecchi et al., 2005).

<sup>24</sup> The dataset comprises 70 out of 113 reforms—i.e., 61.9 percent of the reforms analyzed in this paper. Coalition sizes were calculated the following way. All bills for which roll calls had been taken in at least one house of Congress were included. Coalition size for each chamber was calculated as the share of the total membership voting in the affirmative. Congress coalition sizes were calculated as the sum of positive vote shares in each chamber over the total Congress membership. When data from one chamber was missing, it was assumed that 50 percent plus one of the specific chamber members voted positive.

**Figure 7. Coalition Size of Fiscal Reforms in Argentina (1988-2007)**



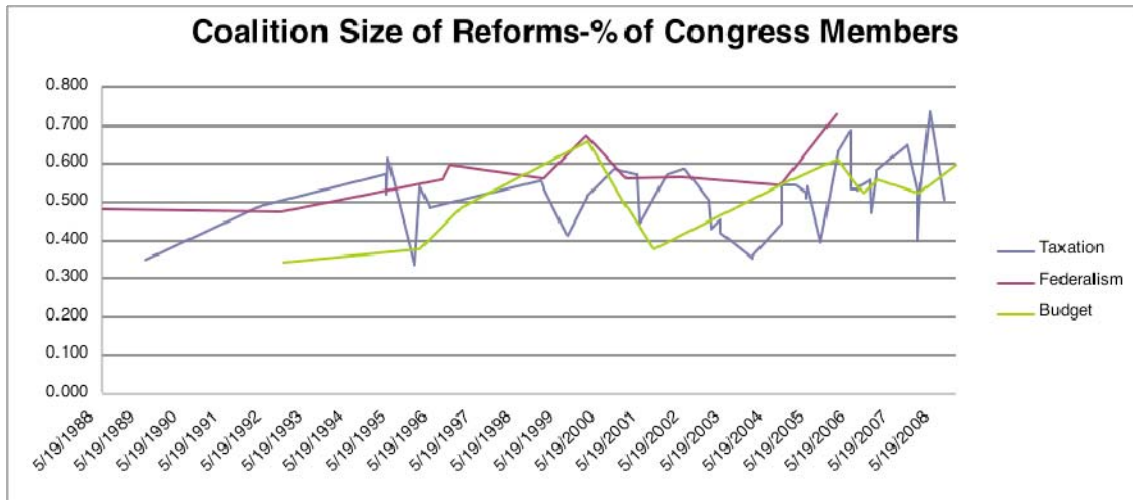
*Source:* Author's compilation based on data from the Chamber of Deputies' Parliamentary Information Database.

Data for coalition sizes for each fiscal area also appear to correspond to the incentives provided by fiscal decision-making rules. As depicted in Figure 8, most tax and fiscal federal reforms have been enacted by oversized coalitions, which would be consistent with the majority requirements established by the Constitution and the relevant legislation. Instead, coalition sizes for budgetary reforms have experienced more pronounced variations over time, as would be consistent in a decision-making setting in which the stimulus to form oversized coalitions is contingent on the perception of the stakes by the actors: if legislators perceive budget reforms as a threat to their ability to channel resources to their provinces, then they might bargain for inclusion in the coalition, which would then probably be larger than minimum winning.

However, the significant variations in coalition sizes from one reform to another as exhibited in the data for each fiscal area suggest that there should be more to coalition sizes than the rules which govern decision-making. While many reforms, particularly in taxation or budgetary institutions, may have been initiated by minimum winning coalitions as required by law, other reforms appear to have been passed by coalitions larger than necessary according to the rules on decision-making.



**Figure 8. Coalition Size of Fiscal Reforms in Argentina (1990-2007)**



Source: Author's compilation based on data from the Chamber of Deputies' Parliamentary Information Database.

#### 4.2. The Actors

The ability of the main actors involved in fiscal decision-making to profit from rules and influence outcomes has changed over time. The key to this change has been the decrease in the level of integration of the main political parties. The transition from highly integrated parties with strong national leadership to poorly integrated parties with weak national leaders and strong subnational players has complicated the coordination of intra-party bargaining for fiscal decision-making, and has concurrently forced the federal government to build larger coalitions in order to secure approval for fiscal reforms.

The resources that enable the different actors in the fiscal decision-making process to influence the outcomes are varied. On the federal government side, the finance minister and the president have access to technical advice that enables them to dominate the formulation of reform proposals. They also have access to legal capabilities with which they can entice governors and legislators to accept those proposals, by controlling, albeit with different degrees of discretionality, an important set of intergovernmental transfers (Bonvecchi and Lodola, 2009). On the provincial side, governors develop expertise in fiscal negotiating because their consent is required for fiscal federal reforms and because they control the political careers of at least some of the legislators and are thus able to influence their decisions. On the congressional side, legislative leaders also develop expertise in fiscal bargaining because their consent is required

for most fiscal decisions, and because their cooperation is also needed by presidents and governors in other decision-making areas. The political parties to which these governors and legislators belong therefore encourage the specialization of their leaders in fiscal affairs because the more factionalized and de-nationalized they become, the more they are able to increase the transaction costs of coalition formation either in Congress or in the inter-governmental arena. Business groups and labor unions are typically organized at the national level and have continuous interaction both with parties and their constituents at the local level, which enables them to credibly claim that they represent those constituents at the fiscal bargaining table.<sup>25</sup> International financial institutions (IFIs) have a marginal influence on reform outcomes, contingent on the leverage that the financial and political situation of the federal government may confer upon them.<sup>26</sup>

The president, as head of the Executive branch, usually intervenes only in two stages of decision-making: the initiation of reforms, and, if required by events, the closing of negotiations with other actors. The president's ability to intervene at these stages rests on the fact that the office is endowed by the Constitution with the power to initiate legislation and to enact legislative measures by decree, as well as to wholly or partially veto legislation. By using their legislative initiative, presidents usually set policymaking processes in motion. By threatening to use their decree or veto powers, they might be able to coerce legislators and/or governors into consenting to the Executive's preferred outcome. However, the use of these powers is not at the president's discretion but rather, as Amorim Neto (2006) contends, subject to a calculus which factors in several other variables. The most important in the Argentine case is the extent of decree powers. In Argentine fiscal history over the past two decades, the recorded instances of

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<sup>25</sup> However, the influence of these actors has not been as decisive as that of parties. They have typically intervened in tax policymaking processes, and to a lesser extent in budgetary processes, but not in fiscal federal policymaking. There are two reasons for this. One is institutional: fiscal federal rules do not directly affect concentrated private economic interests, whereas taxes directly concern economic actors, and the budget may well contain expenditures or fiscal management provisions of interest to those actors. The other reason is organizational: unions and business associations with the technical capacity to intervene in policy discussions are usually those organized at the national rather than the local level.

<sup>26</sup> IFIs have only episodically participated in fiscal policymaking, and their participation has been mostly restricted to tax policy, and marginally to fiscal federal issues. The IMF, the World Bank, and the IDB have influenced policymaking at its formulation stage, and only exceptionally at the enactment stage. The main channel for their influence has been the conditionality attached to the loans they have negotiated with the Argentine government. Still, the concern of these institutions with fiscal federal issues has increased both in intensity and in publicity over the last two decades—*pari passu* with an assessment that charged Argentina's fiscal federal rules with responsibility for the country's recurrent fiscal problems (Mussa, 2002).

unilateral decision-making have been restricted mostly to the budget area, although, as reported by Ferreira Rubio and Goretti (1996), President Menem issued several DNUs concerning tax policy before this practice was banned in the 1994 constitutional reform. There is no record of unilateral decisions on fiscal federalism in this period.

Finance ministers are usually the instigators of fiscal reforms. The design of tax, budgetary, and fiscal federal policies is their responsibility according to the Cabinet Law. They control or supervise the design of tax legislation, the performance of revenue services, the workings and evolution of intergovernmental fiscal relations and, alongside the Cabinet chief, the formulation of the budget. Finance ministers typically promote and protect the financial interests of the National Treasury, regardless of whether this entails conflict with provincial treasuries, international financial institutions, or the private sector. For this purpose, they are empowered to a) withhold payment of any discretionary intergovernmental transfer by instructing the Treasury secretary to freeze payment orders; b) stop disbursement of any automatic intergovernmental transfer by instructing the revenue services to refrain from depositing their proceeds in the provinces' current accounts at the National Bank; c) postpone the payment or reduce the amount of budgetary quotas, or reallocate them to other expenses; d) deny authorization or guarantees to provinces that seek to contract new debt; and e) reject requests of firms that seek to obtain fiscal credit, federal guarantees, or financial assistance for their investments (Bonvecchi and Lodola, 2009).

The discretionality of intergovernmental transfers is a key component of fiscal decision-making processes. Intergovernmental transfers are used to gather support for fiscal reforms either by conferring benefits to provinces or by compensating them for (actual or potential) losses emerging from reforms in exchange for their vote.<sup>27</sup> They are the means of payment through which fiscal reforms are achieved. Table 5 presents a thorough, albeit incomplete, list of intergovernmental transfers classified according to the level of discretion that their institutional format confers upon the president and the governors.<sup>28</sup> The level of discretion of transfers, as discussed below, is used in this paper to measure the nature of the compensation received by the provinces in exchange for their support for fiscal reforms. If compensation is the means of

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<sup>27</sup> The literature on the topic is vast, and particularly so for Argentina. For a recent argument, see Díaz-Cayeros (2006). For a critical review, see Bonvecchi and Lodola (2009).

<sup>28</sup> The nature of these variables and indicators is discussed in greater detail in Section 4.

payment for reforms, then changes in the nature of the actors involved in fiscal decision-making, i.e., changes in the level of nationalization of political parties, should have an impact on the nature of the currency through the distribution of which fiscal reforms are initiated.

**Table 5. Discretionality of Intergovernmental Transfers in Argentina**

	<b>High</b>	<b>Medium</b>	<b>Low</b>
<b>Presidential</b>			
<b>Gubernatorial</b>			
<b>High</b>	National Treasury Contributions  Regional Development Fund	Industrial Promotion Non-Industrial Promotion Co-participation Advances	Co-participation Fiscal Disequilibria Funds Housing Fund Special Tobacco Fund Fund for Electricity Development Oil Royalties
<b>Medium</b>	Central Bank Rediscounts  Fund for Provincial Public Sector Reform	Budget for Public Works Road Co-participation Ordered Finance Programs  Loan Approvals	Education Transference Funds Basic Social Infrastructure Funds Greater Buenos Aires Fund Utility Rate Subsidies and Compensation Funds
<b>Low</b>	Bailouts through Bonds	Debt Consolidation Schemes Pension-System Bailouts	

Source: Bonvecchi and Lodola (2009).

Provincial governors typically intervene in fiscal policymaking processes in order to amend the president's initiatives. Their ability to do so depends on three factors: their role as territorial party leaders, the availability of fiscal resources in provincial treasuries, and their party's degree of factionalization.<sup>29</sup> In their capacity as party leaders, particularly in provinces with low district magnitude, governors are able to control political careers: they manage candidate selection processes for significant offices and can thus promote or end the careers of provincial politicians who are currently acting as legislators, ministers, etc. (Jones, 2002; Benton, 2003). This capacity enables them to credibly threaten presidents with withdrawal of support for their initiatives by provincial legislative contingents in Congress. This threat appears credible insofar as governors typically have a higher probability of being re-elected in their districts than presidents to their office. This can be appreciated in the significantly different party system situations faced at each level of government: the victory margin for the election of provincial governors since the mid-1990s has been consistently higher than that for presidential and national legislative elections.<sup>30</sup> This indicates that governors have faced increasingly less electoral competition than presidents, and have thus become able to solidify their leadership over parties at the provincial level.

However, the credibility of governors' threats to block fiscal legislation critically depends upon the availability of fiscal resources in provincial treasuries. Governors from provinces highly dependent on intergovernmental transfers due to the lack of sufficient tax bases or governors from provinces experiencing a fiscal crisis pose less credible threats than governors from provinces less dependent on federal transfers or with financially sound administrations. This may have an impact on the timing of fiscal negotiations between governors and the Executive, but does not necessarily alter the nature of the benefits they extract in those negotiations.

The degree of factionalization of parties at the subnational level matters because it impacts on governors' hold over national legislators and, hence, on the ability of governors to credibly threaten presidents with legislative deadlock. If parties are highly factionalized, then it

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<sup>29</sup> Some authors (Jones, 2001) have argued the importance of a fourth factor: the alignment of governors with the president's party. However, research on the distribution of intergovernmental transfers refutes this hypothesis and stresses over-representation (Giraudy, 2006) and competition (Schijman, 2005).

<sup>30</sup> Calvo and Escobar (2005) explain these differences by focusing on the electoral reforms that enabled the reelection of governors and strengthened the majoritarian bias of electoral systems for local legislatures.

is likely that national legislators may not belong to the governor's faction, and may even be—due to their feud with the governor—inclined to side with the federal government. As Jones (2002: 162) puts it, “the national party's influence on candidate selection is greatest when [...] the district-level party elites are not unified,” which is typically the case the higher the district magnitude—since more seats are available for different factions to grab (Mustapic, 2000: 579)—and the greater the level of competitiveness at the local level—because uncertainty about electoral outcomes increases incentives to gain autonomy from leaders who are potentially losers (Benton, 2007). In contrast, the lower the district magnitude and the level of competitiveness, the less propitious the conditions for party factionalization—hence, the greater the governors' control over political careers and thus their ability to credibly threaten presidents with legislative deadlock of Executive initiatives in Congress.

National legislators may intervene in fiscal policymaking processes in the stages of design and/or enactment of policies, but they typically participate as agents, not as principals. They are empowered to act by their constitutional role as lawmakers, but their effective ability to exercise this role is neither straightforwardly given nor reliant upon their discretion. Legislators typically have an input in policymaking if a) the Constitution and/or the law mandates Congressional intervention; b) the governors who control their political careers request it (Jones and Hwang, 2005); c) the president believes it to be rational to pursue a statutory policymaking strategy (in terms of Amorim Neto, 2006); d) the president and/or the policy under discussion is sufficiently unpopular (Calvo, 2007) for legislators to reap political credit for opposing or amending it; e) the president's legislative contingent is not large enough to prevent a reversion of policy by Congressional act (Bonvecchi and Zelaznik, 2006); and/or f) the president seeks to avoid blame for enacting a particular decision. Since these incentives may coincidentally influence legislators, it may be difficult, as Mustapic (2002) has argued, to distinguish whether they are serving their governors and local constituencies by extracting benefits from the Executive within fiscal negotiations, or pleasing the president by voting for the proposed reforms. It is also likely that they are catering to both principals simultaneously.

The political parties to which presidents, governors, and legislators belong are the main actors in fiscal decision-making processes.<sup>31</sup> The nature of their influence on fiscal decisions has been contingent on their level of integration. Political parties are integrated, according to Phillipov, Ordeshook and Shvetsova (2004: 192), if they satisfy the following conditions: 1) their organization exists and fields candidates at all levels; 2) their electoral success at the national level facilitates electoral success at the local level; 3) their regional organizations and candidates are autonomous enough to direct their own campaigns and to defect from the party; 4) their national platforms are acceptable to local branches and interpreted in local terms by local politicians who campaign on behalf of national parties in national elections; 5) every component of the party contributes to the party's overall success; 6) winning nationally requires that candidates campaign locally; and 7) the offices the parties seeks to fill at the subnational level are meaningful—i.e., they control valuable resources and are empowered to make decisions that can either aid or foil policy implementation at the national level. Integrated parties would be capable of transforming intergovernmental conflict into intra-party conflict, and would therefore not be prone to disruptive bargaining: their meaningful electoral presence throughout the territory would lead them to a) assess “the benefit of each federal subject as being of approximately equal importance”; b) be unattached to any “identifiable group within the electorate”, and therefore c) prefer a “more equitable allocation of benefits” (Phillipov, Ordeshook and Shvetsova (2004: 188). In contrast, poorly integrated parties encourage their leaders to be concerned with preserving their electoral strongholds, so they become increasingly autonomous from national leaders, prioritizing the interests of their local constituencies rather than those of

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<sup>31</sup> The main political party in Argentina is the *Partido Justicialista* (PJ), which typically draws its electorate from working-class voters in urban areas and both working-class and upper-class voters in rural areas (Mora y Araujo, 1980; Gibson and Calvo, 1997; Calvo and Escolar, 2005). It has controlled the presidency and the majority of provincial governments for four and a half out of six terms since 1983, and the Senate since 1983. The second party is the *Unión Cívica Radical* (UCR), which typically draws its voters from middle-class sectors all over the country, has controlled the presidency for one and a half terms, has been the second party in control of provincial governments since 1983, and has commanded the majority at the Chamber of Deputies in 1983-87 and 1999-2001. Provincial parties such as the *Movimiento Popular Neuquino* (MPN), *Movimiento Popular Fueguino* (MPF), *Partido Demócrata* (PD), *Partido Demócrata Progresista* (PDP) and others have typically drawn their electorate only from their original jurisdiction—where they have usually recruited voters from all social strata (Gibson, 1996)—and controlled governorships and legislative seats in some districts (Neuquen, Tierra del Fuego, Mendoza, Santa Fe, Jujuy), which has enabled them to act as pivots in Congress. Some flash parties from the left and the right, such as the UCeDe and FREPASO, emerged in the 1980s and 1990s, but they affected outcomes only marginally.

the party's national constituency, and thus generate the conditions for disruptive bargaining in both institution-building and policymaking decisions.

The level of integration of parties impacts fiscal decision-making and its outcomes through the balance of power between national and subnational leaders. By weakening national leaders and concurrently empowering subnational leaders, a decrease in the integration of parties increases the number of veto actors in Congress and thus also the transaction costs of coalition formation at the national level. This, however, does not imply that poor party integration makes institutional or policy change impossible: it means that the price of change must vary with the state of the parties and the party system. Highly integrated parties are better able to impose more centralizing and hierarchical fiscal reforms than poorly integrated parties, and pay for those reforms with schemes that accrue benefits to all districts rather than only a chosen few.

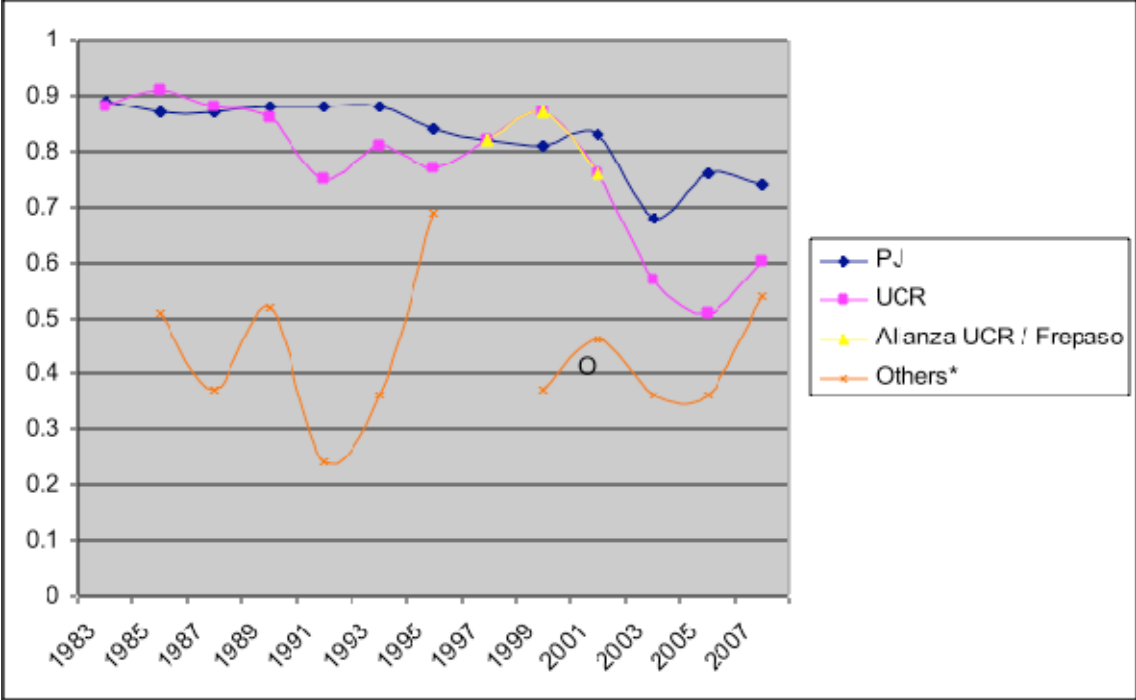
The degree of nationalization of political parties is an adequate proxy measure for their level of integration. Political parties are nationalized if they compete at different levels of vote aggregation and reap similar shares of the vote at all levels. In contrast, they are de-nationalized—and may be labeled as regional or local—if the reverse is the case, that they compete only at one level of aggregation or reap unequal shares of the vote at different levels (Jones and Mainwaring, 2003). Changes in the level of nationalization indicate changes in the main conditions for party integration: if parties are not equally competitive in all districts, then the incentives for their leaders to coordinate decisions in the national arena are significantly weakened. By concentrating the parties' vote shares in specific districts, de-nationalization erodes the bases for the political integration of each party, and thus of the party system in general.

The two main political parties in Argentina have indeed experienced a process of de-nationalization from the mid-1990s. Nationalization is measured, according to Jones and Mainwaring (2003), as the attainment of a fairly equal share of the vote by a political party across all electoral districts within a country, so de-nationalization would consist of the loss of equality in the share of the vote across electoral districts. De-nationalization has been more pronounced for the UCR, but, as depicted in Figure 9, it has also affected the Peronist party, and significantly so at times when it controlled the federal government. Figure 9 also shows how other minor parties have gained from the de-nationalization of the UCR and the PJ. These gains have resulted in significant increases in the Effective Number of Parties in Seats at the Chamber



of Deputies: from an average of 2.89 between 1983 and 2001, to averages of 4.01 in the 2001 election and 4.44 in the 2007 election (Calvo and Escolar, 2005; Leiras, 2006).

**Figure 9 . Party Nationalization Scores of the Main Argentine Parties (1983-2007)**



Sources: 1983-2001, Jones and Mainwaring (2003; 2003-2005) Leiras (2006); 2007, author's calculations based on information from the Interior Ministry.

The de-nationalization of the PJ as a federal governing party from the mid-1990s is, as will be argued in more detail below, a crucial factor in the recent history of fiscal reforms in Argentina. The strengthening of local leaders and factions vis-à-vis the national leadership made it increasingly difficult to form legislative coalitions for fiscal reforms. This led the Peronist party to propose and enact tax and budgetary rules that delegated to the Executive the authority to set rates and allocate public spending.

This section has shown that the rules governing fiscal decision-making in Argentina provide the actors who participate in decision-making processes with opportunities and resources to influence decision outcomes, and also that those actors have both capacities and incentives to exploit the opportunities that the rules afford them. The institutional incentives for the formation of oversized coalitions provide significant opportunities for governors and legislators to shape fiscal decisions. Every actor in the fiscal game is equipped with resources to profit from those chances, but some actors have gained more power lately: subnational politicians have become increasingly more capable of influencing outcomes as party integration has decreased. How the interaction of rules and actors has generated reform activism, centralization and hierarchization of fiscal resources in the federal government, and continuous compensation for the provinces is the topic of the next section.

<i>Areas</i>	<i>Rules</i>	<i>Actors</i>
<i>Fiscal Federalism</i>	Covenant Law: (Near) Unanimity among Executives; Qualified Majorities in Congress; Ratification by Provincial Legislatures	Main: President, Finance Minister, Governors Secondary: National and Provincial Legislators
<i>Taxation</i>	Initiative by the Chamber of Deputies To create taxes: Plurality of present members of both houses of Congress To establish and renew earmarks: 50 percent plus one majority in both houses of Congress	Main: President, Finance Minister, Governors, Legislators Secondary: Economic Actors, IFIs
<i>Budget</i>	Initiation via Chamber of Deputies Plurality in both houses of Congress Reversion Point in Budgetary Policy: use of previous Budget if not approved by December 31 <sup>st</sup>	Main: President, Finance Minister, Governors, Legislators Secondary: Economic Actors

## **5. The Fiscal Decision-Making Process in Argentina: Dynamics of the Game**

Fiscal decision-making in Argentina is a bargaining game between the federal government and the provincial governments over the nature, control, and allocation of fiscal resources. This bargaining is prompted by factors that affect the overall volume of available resources, either shrinking or augmenting the common pool of revenues, i.e., the receipts from shareable taxes. These factors are economic shocks such as hyperinflation, recessions, and changes in the country's terms of trade, or policy shocks such as exchange-rate-based stabilization policies or debt defaults. But while these shocks may explain the regularity with which federal and/or subnational governments seek changes to the ways fiscal resources are extracted and distributed, they do not account for the nature of the changes produced. The institutions and policies that emerge from fiscal decision-making are shaped by the way political parties coordinate their behavior under decision-making rules that encourage the formation of oversized coalitions. These rules give most parties and provinces a chance to make their imprint on decision outcomes. But the ability of provincial governors and legislators to shape those outcomes depends on their ability to coordinate with other provinces and co-partisans. This ability is, in turn, determined by two factors: the level of integration of political parties, which indicates the capacity of national party leaders to internalize inter-provincial differences and impose a national line; and the availability of resources at the provincial level, which signals their moving power, i.e., the ability of each province to sustain a bargaining position vis-à-vis the federal government. This section describes the dynamics of fiscal decision-making in Argentina by explicating all these factors, and proposes a set of variables to measure the operation of this process.

### ***5.1. The Main Determinants of Fiscal Decision-Making Processes***

Fiscal reforms are prompted by shocks, of either an economic or policy nature, because these shocks change the overall volume, and sometimes even the nature, of the resources available to finance public spending. Hyperinflation, recessions and negative terms of trade typically shrink the common pool of revenues raised by the federal government and subsequently distributed among the provinces. In contrast, stabilization, recovery, and positive terms of trade typically increase the size of the pool. These changes move federal and provincial governments to act in order to secure the largest possible share of funds.

The preferences of each set of actors over the nature of fiscal reforms depend on the political and economic incentives they face. Reforms are generally initiated by presidents or finance ministers, who are typically interested in outcomes at the national level because they are a) elected by national constituencies; b) dependent, to govern on a daily basis, upon coalitions made up of provinces with different economic volume and interests; and c) responsible for macroeconomic results and for social security spending—which constitutes the biggest chunk of the budget. Consequently federal government officials typically seek to impose hierarchical, centralizing, rigid, and restrictive fiscal institutions and policies, regardless of the economic context. When negative shocks hit the economy, they push for those rules and policies because they deem them necessary to adequately manage stabilization efforts and to secure financing for national spending commitments. When positive shocks hit, they promote them because they consider them necessary to adequately manage the public debt and control spending at all levels of government, and thus boost confidence in the overall economic framework by maintaining fiscal sustainability.

Reforms are resisted by governors and legislators, who are interested in tailoring them either to spare their constituents from their consequences or to postpone the effects of reform on their constituents as much as possible. These strategic aims of governors and legislators stem from the fact that their power depends upon a) local electoral control and b) access to intergovernmental transfers, which finance between 50 percent (Buenos Aires) and over 80 percent (La Rioja, Formosa) of their expenditures (Cetrángolo and Jiménez, 2003). Provincial actors thus typically seek to impose institutions and/or policies that a) decentralize spending and the management of resources in general (such as social programs, funds for public infrastructure, etc.) and b) are flexible enough to enable subnational governments to obtain federal aid in hard times. As argued elsewhere (Bonvecchi and Lodola, 2009), provincial governments prefer fiscal institutions and policies that combine security in the reception of intergovernmental transfers and maximum discretionality for the governors in the management of those transfers: access to resources helps governors stabilize their position vis-à-vis other subnational politicians; security in transfer reception guarantees they will capture at least some federal funds; and since governors typically enjoy some discretionality over transfers, getting some money—albeit a little—can help them maximize their political interests better than getting nothing. This preference for both security and discretionality is independent of the economic context: when times are good, it suits

the aim of maximizing local electoral support by boosting public spending; when times are bad, it suits the aim of maintaining order and support by sparing local economies from adjustment. If security proves unattainable, then governors prefer high discretionality, which enables them to maximize liquidity and credit-claiming before their constituents.

The nature of fiscal reforms depends on which actor—federal or provincial—is able to exert more influence on the decision-making process. The rules that govern decision-making are more beneficial to the provinces in this respect. By stimulating the formation of oversized coalitions, the decision rules for taxation, fiscal federalism, and budgetary affairs encourage coordination among governors and legislators from all provinces and parties in order to jointly exploit the federal government and the common pool of resources. But coordination among provinces and parties is not a given outcome: not all governors and legislators have the same incentives to coordinate against the federal government or the same resources to sustain a bargaining position in negotiations that would enable them to set a high price for their entry into coalitions. Thus, the ultimate determinants of the nature of fiscal reforms are those factors that shape the incentives for coordination against the federal government and the moving power of the provinces in fiscal negotiations.

The level of integration of political parties is the main determinant of coordination against the federal government. As noted in the previous section, parties with a high level of vertical political integration (Filippov, Ordeshook and Shvetsova, 2004) have an organizational structure that fosters cooperation in intra-party bargaining and coordination of such bargaining by national leaders. Nationalized political parties fit this description. They have strong organizational incentives to internalize the distributive conflicts that may arise among provinces due to economic or policy shocks, and thus to come up with institutions and policies that explicitly incorporate compensation and payoffs into legislation of general validity and reach. Since nationalized parties compete at all levels of government and need similar shares of the vote from all provinces to maintain political integration at the national level, the fiscal institutions and policies they promote need to distribute benefits to the maximum possible number of provinces. If a nationalized party controls the federal government, then the president, governors and legislators from that party would typically settle negotiations by a) allocating side payments to the districts their party controls in order to secure electoral domination in them, and b)

establishing explicit general policies for the country that would allow the party to improve its electoral chances in those districts it does not control. Such a payoff structure would simultaneously enable the federal government to maintain control over fiscal management, and nationalized party leaders to maximize their electoral chances at the local level. In sum, leaders from nationalized parties would tend not to coordinate with other parties or provinces against a federal government of their own party because intra-party bargaining would allow them to obtain better payoffs.

In contrast, political parties with low levels of political integration have strong organizational incentives to do just the opposite. De-nationalized parties fit this description because of the unevenness of their vote share across districts. This unevenness leads to territorial specialization of the electoral strategy and prioritization of local interests in public policymaking. This makes it extremely hard for their leaders to agree on general rules and policies, so they typically delegate the distribution of costs and benefits to the Executive and strive to legally preclude restrictive reforms from becoming effective in provincial economies. Since de-nationalized parties are competitive only in some provinces rather than all over the country, their leaders need only to maintain their vote share in the competitive districts. This electoral incentive leads to the factionalization of the parties and to the empowerment of local leaders—particularly those from districts where the party obtains better vote shares—over national leaders. These incentives encourage the leaders of local factions to promote institutions and policies that would enable them to directly allocate benefits to their districts or to reap political credit for obtaining benefits for them from the federal government. If a de-nationalized party controls the federal government, the incentive for each governor and legislator is to maximize the extraction of benefits for their districts alone in order to boost their electoral chances, because local electoral control is the condition for political survival or advancement to national executive office.

The consequences of this incentive structure are that the president cannot count on governors and legislators from his/her own party to settle fiscal negotiations, and that governors or legislators cannot count on their co-partisans for non-disruptive intra-party bargains. Delegation of power to the president and continuous bargaining for intergovernmental transfers by all districts are thus the solution to the impossibility of coordinating to make a collective decision: centralization of decision-making about the distribution of resources is instrumental to avoid provincial overspending and destructive competition; discretionary distribution, in turn, is

useful for the president to build coalitions and for the governors to obtain and spend resources at will. The structure of payoffs from the federal government to the provinces for their support for fiscal reforms is therefore variable and contingent to the access that specific provincial leaders might have to the president.

The decrease in the level of integration of the main Argentine parties has developed from within the political system. Its main driving factor, as noted by several scholars (Calvo and Escobar, 2005; Calvo and Micozzi, 2005; Leiras, 2006), has been the series of electoral reforms at the provincial level that enabled governors to seek re-election. These reforms enabled local party leaders from national parties to increase their electoral hold over their districts and thus to decouple their survival from the electoral outcomes of the national party label. Consequently, the decrease in political integration of the parties can be adequately observed through the evolution of the nationalization of their vote shares.

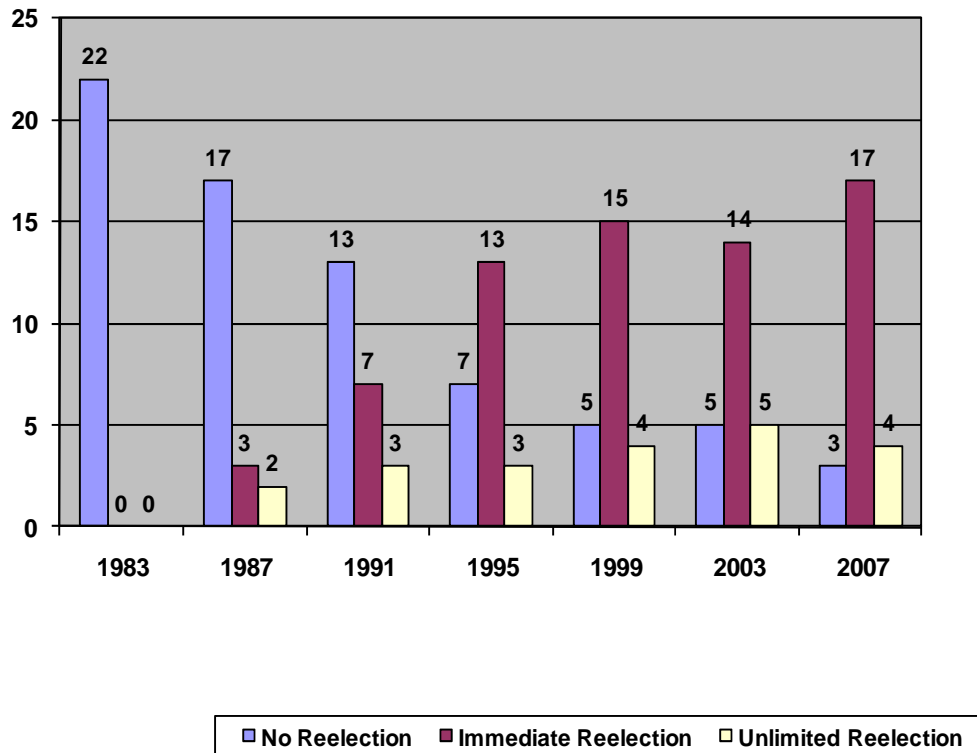
As depicted in Figure 10, a flurry of electoral reform activity took place between 1991 and 1995, with another peak between 2003 and 2007: these were the years with the largest number of constitutional reforms that introduced the re-election of provincial governors.<sup>32</sup> These periods are precisely those that preceded the sharpest declines in the Party Nationalization Scores shown in Figure 9: the PJ's de-nationalization began to show in the 1995 election, and all parties experienced the greatest drops in nationalization of the vote in 2003 and 2007. The victory margin data alluded to before are also consistent with these patterns: margins in gubernatorial elections increased in the mid-1990s and, despite recent drops, have been consistently higher than margins for presidential and legislative elections ever since. This indicates that the possibility of re-election increases via incumbency advantage: the electoral returns of local leaders. In addition, the type of re-election allowed by provincial constitutional reforms may strengthen some leaders more than others. Provincial constitutions that allow for unlimited re-election of their governors may help consolidate local leaders with more significant electoral support than that of governors who may aspire to only one immediate re-election or no re-election at all: the former typically have more secure access to public resources with which to reward followers than the latter, so the latter would be more vulnerable to electoral competition

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<sup>32</sup> In Argentine constitutional law, provincial constitutions are invited to mirror the national Constitution. Thus, provincial reforms to introduce the re-election of the governor after 1994 were legally facilitated by the introduction of the re-election clause for the president in the 1994 national constitutional reform.

from other factions or parties (Benton, 2007). This contributes to the de-nationalization of the voting patterns of parties.

**Figure 10.**  
**Types of Re-election in the Argentine Provinces per Year of Gubernatorial Election**



*Source:* Almaraz (2008) on the basis of provincial constitutions. Immediate re-election = only one re-election possible, consecutive to current term. Unlimited re-election = any number of re-elections possible.

In short, Argentine political parties have become de-nationalized because provincial leaders have been able to legally increase their re-election chances and, thus, their electoral hold over their districts. It might be argued that the relative decoupling of provincial fiscal situations from that of the federal government may have contributed to the strengthening of local leadership by projecting to local voters the image that their governors could deliver economic returns regardless of the evolution of the macroeconomy (Remmer and Gelineau, 2003). However, as noted in previous sections, the maintenance of the spending abilities of the provinces—and hence the decoupling of their fiscal situation from that of the federal Treasury—has been a constant over the past two decades, a phenomenon that predated the aforementioned



electoral reforms and persisted afterwards. Consequently, it cannot explain the party denationalization process.

The availability of resources for the negotiating parties is the main determinant of their moving power in fiscal negotiations: the more resources readily available, the greater the moving power of the actors. Provinces in good financial standing may resist the imposition of bargains biased toward the interests of the federal government and may demand greater levels of compensation in exchange for their consent. In contrast, provinces in bad financial shape are typically forced to submit to the federal government's line, or may only obtain modest compensation for it. The variable works in the opposite way for the federal government. A federal government in a good financial position would be typically unable to resist provincial demands for compensation in exchange for fiscal reforms because it cannot credibly argue that it cannot dispense with the money; whereas a federal government in a bad financial state would be more able to resist provincial demands precisely because its lack of available funds would appear to be more credible.

The availability of resources is partly related to economic and policy shocks. Negative shocks such as hyperinflation, recessions, and adverse changes in the terms of trade negatively affect all levels of government, just as positive shocks such as recoveries and stabilization affect them positively. However, a negative economic shock in the form of high inflation acceleration would typically damage the position of provincial governments and strengthen that of the federal government: since inflation erodes the real value of intergovernmental transfers, then the more protracted the negotiations, the lower the value of transfers to the provinces and the greater the real savings accrued to the federal government (Bonvecchi, 2003).<sup>33</sup>

The interaction of the variables that prompt the initiation of fiscal reforms and the variables that shape reform outcomes would lead to a specific set of theoretical expectations. Reforms initiated in the context of *positive shocks* and *highly integrated parties* would be marked by a *limited centralization* of fiscal authority in the federal government and *generalized compensation schemes* for the provinces. Positive shocks would augment the size of the common pool of resources to such an extent that it would be plentiful enough to supply both the public-

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<sup>33</sup> This pattern emerged in the intergovernmental fiscal negotiations of 1986-87. In 1986, the provinces lost to the federal government because they agreed on nominal monthly transfers for Co-participation that were eroded by an inflationary upsurge. Having learned the lesson, in 1987 they bargained for percentages.

debt reduction policies of the federal Treasury and the spending increases of each level of government. The concern of highly integrated parties with maximizing their vote shares across all districts would lead them to coordinate in their bargaining with the federal government and thus to obtain compensation for everyone in exchange for consenting to the centralizing rules and policies proposed by the president. The balanced relationship between national and local leaders would enable the latter to impose limits on the centralization of fiscal authority sought by the former. In other words, centralization of fiscal authority would be limited because highly integrated parties would be structurally interested in guaranteeing a balance of fiscal power between the federal government and the provinces. This rationale would also account for the way spending responsibilities over education and health were decentralized, i.e., without funding and, following subsequent negotiations, with matching grants. The takeover of policy responsibilities satisfied provincial demands for control over the delivery of local public goods, and the cap on national funding of those goods satisfied the federal government's aim of reducing national fiscal imbalances.

Reforms initiated in the context of *negative shocks* and *highly integrated political parties* would also be marked by the centralization of fiscal authority in the federal government and compensation for the provinces, but *centralization* would be *greater* and the extent of compensation would *differ across fiscal areas*. Greater centralization across areas would be the typical outcome of a delegation decision by Congress in a separate powers system (Epstein and O'Halloran, 1999) where legislators delegate to the president on complex issues in which policies usually distribute generalized costs. Compensation in *taxation* and *fiscal federalism* would be *generalized* just like in the context of positive shocks. The reason behind this outcome would be the same as before: the incentive of highly integrated parties to maximize their vote shares across the country. In areas which directly affect the availability of resources at the subnational level, the leaders of highly integrated parties would not shy away from demanding compensation for adjustment even in the face of a national economic crisis. In contrast, in the *budget* area, centralization of authority in the federal government would *not be accompanied by compensation* for the provinces. The reason behind this outcome would be one of administrative logic: if centralizing budgetary rules reinforce the federal government's power to manage expenditures, it would be inconsistent for budgets to simultaneously earmark and shield new

spending for the provinces. A federal government controlled by a highly integrated party could theoretically resist attempts to introduce such inconsistent provisions in the budget.

Reforms initiated in a party system made up of *poorly integrated* political parties would be marked by *greater centralization* of fiscal authority in the federal government and *limited compensation schemes* for the provinces regardless of the nature of the economic context. The reasons for this outcome would be the incentive of local leaders from poorly integrated parties to maximize the extraction of benefits from the federal government, and the incentive for national leaders to satisfy such demands in order to maintain governability and boost national electoral chances. A federal government controlled by a poorly integrated party would be forced to form coalitions on a daily basis whose composition would be contingent on the moving power of each province. Consequently, it would be unable to coordinate decision-making with its governors and legislators. The federal government would need the support of local leaders either to distribute the benefits of good times or to allocate the losses in bad times. Given the fact that it cannot count on intra-party bargaining to impose a national line and is forced to purchase support one by one, all provinces have an incentive to maximize their price and to use their moving power as far as possible. Since the federal government would be typically unable to include every province in the coalition—because neither in good times nor in bad would there be enough money to pay their top entry prices—compensation in exchange for provincial support of centralizing rules or policies would vary according to the moving power of each province. Provinces with high moving power would be able to extract higher or tailor-made compensation, whereas provinces with low moving power would be either unable to extract any compensation at all or forced to accept token or insufficient transfers.

The availability of fiscal resources would therefore operate as an intervening variable whose relevance would increase with negative shocks and with the decrease in the integration of political parties. With negative shocks, they would typically affect provinces differently according to their economic structure, so some would be more able than others to sustain a bargaining position against restrictive federal government measures. With poorly integrated parties, local leaders would have stronger incentives to exercise their moving power as far as possible in order to maximize their price of entry into coalitions.

**Table 6. Theoretical Expectations of Fiscal Reform Outcomes**

Party Integration / Shocks	Positive Shocks	Negative Shocks
Highly Integrated Parties	Limited Centralization of Fiscal Authority in Federal Government Generalized Compensation for Provinces	Greater Centralization of Fiscal Authority in Federal Government Generalized Compensation in Taxation and Fiscal Federalism No Compensation in Budgetary Affairs
Poorly Integrated Parties	Greater Centralization of Fiscal Authority in Federal Government Limited Compensation for Provinces	

The interaction of these variables also shapes the dynamics of fiscal decision-making processes in Argentina.<sup>34</sup> The usual structure of this process pits the federal government, represented by the finance minister or the president, against provincial governments, represented by the governors, all of whom engage in a relatively standardized bargaining sequence. This sequence typically begins with a move by the finance minister, which consists of presenting a given reform proposal as necessary to overcome a state of fiscal emergency or to consolidate fiscal accounts at the federal level. Since federal government proposals typically entail reducing the provincial share of revenues, rolling back intergovernmental transfers, increasing the federal government's discretionary management of the budget and/or weakening the provinces' ability to develop their own fiscal and financial policies, the governors' response is typically to reject the federal proposal arguing that its enactment would either create or aggravate a state of fiscal or financial emergency at the provincial level. Federal officials then generally react by escalating their offensive with threats of dire consequences to the whole country if the federal Treasury goes bust, in order to make the justifications for the reform proposal more credible. The governors' response is contingent on the economic context. In hard times, they argue that the provinces should receive adequate resources to deal with the crisis. In good times, they claim that the provinces should be rewarded for their contribution to the country's newfound wealth. Either way, the governors accept the need for the federal government-sponsored reform but also

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<sup>34</sup> This depiction of fiscal decision-making processes follows the analysis presented in Bonvecchi (2003) on the basis of the study of all fiscal negotiation episodes between the federal government and the provinces in the Alfonsín and Menem administrations (1983-1999).

require that the national Executive cater to each district's demands. This prompts the federal government to offer short-term compensation schemes for the prospective long-term losses to be experienced by the provinces.

Whether these compensation schemes are generalized or limited depends on the nature of the political parties leading the negotiations. Highly integrated, nationalized parties usually arrange generalized compensation schemes, with benefits for all districts, whereas poorly integrated, de-nationalized parties typically arrange limited schemes that benefit only a handful of provinces at the expense of the rest. If the latter is the case, then the moving power of the provinces may lead to the extension of negotiations for further moves.<sup>35</sup> While provinces with a lower availability of resources typically arrange compensation packages at this stage, the provinces with the higher availability of resources generally reject the federal offer and push for more, typically by threatening to block decision-making unless further concessions are made. The federal government then responds by improving the compensation schemes to obtain the consent of the remaining provinces while simultaneously threatening all provinces with renegeing on all promises unless a general agreement is promptly reached. Whether this is the final move in the bargaining process is contingent on provinces' moving power: the more resources available to them, the greater the chance that particular provinces would push for separate, tailor-made deals. If negotiation rounds extend through time, presidents are typically called upon by finance ministers to put an end to bargaining by brokering a deal with the recalcitrant governors.

This dynamic explains how, contrary to expectations grounded in formal models such as the veto-players theory, institutional and policy change may be achieved despite an increasing lack of cohesion within political parties. The decrease in party integration may increase the number of veto players by diminishing party cohesion, but these players may be unable to exert their influence if their moving power is low. The greater the number of provinces with low moving power in fiscal negotiations, then, the greater the ability of the federal government to

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<sup>35</sup> The disparate moving power of the different provinces is precisely the reason underpinning their collective preference for centralization of fiscal authority in the federal government when parties are de-nationalized. Since some provinces may hold out longer than others in negotiations and the federal government must form oversized coalitions to get reforms through Congress, then the chances for each individual province to maximize their benefit from negotiations are greater the more empowered the federal government is to allocate those benefits than if the provinces try to bargain it out within Congress. In such a case, the lack of incentives and leadership to coordinate among provinces would prevent the emergence of compensation schemes of a generalized nature.

build reform coalitions: provinces with low moving power cannot resist the federal government's offers for them to join reform coalitions.

The combination of variables hereby proposed as determinant of fiscal reform processes is generally consistent with the depiction of the Argentine policymaking process (PMP) presented by Spiller and Tommasi in various works (Spiller and Tommasi, 2003, 2005, 2007, 2008). These authors have aptly characterized policymaking in Argentina as “a non-cooperative game in which each actor behaves opportunistically and tries to maximize short-term benefits” (Spiller and Tommasi, 2008: 70). This inclination to opportunistic short-term maximization has been explained by the authors as an outcome of the absence of institutionalized arenas in which the main actors of policymaking processes can make intertemporal agreements. This “weak institutionalization” (see also Levitsky and Murillo, 2005) has in turn been considered a result of the combination of several factors: historical legacies and a constitutional framework that disproportionately strengthens the Executive and weakens Congress as a policymaking arena; an electoral system that empowers provincial governors and local party leaders vis-à-vis national party leaders; the absence of an independent judiciary and a professional bureaucracy; and the existence of a “labyrinthine” (Saiegh and Tommasi, 1998) fiscal federal framework that enshrines a significant vertical fiscal imbalance which reinforces the power of the governors at the expense of the federal exchequer by enabling them to continuously demand federal aid to cover for spending commitments the provinces are typically unable to finance.

According to this account of Argentine policymaking, the gubernatorial control over political—and especially legislative—careers via control over candidate selection, in combination with the aforementioned vertical fiscal imbalance, creates strong incentives for politicians to pursue executive careers at the provincial level rather than legislative careers at the national level. This leads politicians to a) concentrate their organizational effort in strengthening their position within the local sections of parties, b) disregard Congress as a policymaking arena, and c) focus on promoting policies and rules that might accrue direct benefits to their districts in time for the next election, in which they would run for executive office at the provincial or municipal level (Jones, 2002). Consequently, short-termism would be the rule of policymaking dynamics and content, and local political leaders would be typically able to extract resources from the center with which to build and consolidate their power vis-à-vis national leaders.

The depiction of the fiscal decision-making process presented in this paper elaborates on some aspects of the general PMP logic explicated above by focusing on the nature of the main participants in the process and on the contextual incentives they face. The focus on the level of integration of political parties makes it possible to identify the conditions under which politicians would be inclined to agree on rules or policies whose short-term reversion would be more costly than not. Leaders operating in highly integrated parties would be more likely to develop such inclination for long-term rules than politicians from poorly integrated parties: the former have stronger organizational incentives to internalize bargaining costs within the party than the latter. The organization of the main political parties would thus help illuminate the conditions for long- and short-term arrangements.

On the other hand, the focus on economic and policy shocks makes it possible to pinpoint the preferences of the participants in the policymaking process for specific types of rules or policies—rigid or flexible, centralized or decentralized. Building the conflicting preferences of the federal and provincial governments into the PMP model enables it to account more precisely for the dynamics of fiscal negotiations. Using each actor’s theoretical preferences stated above as a parameter, it is possible to trace the development of fiscal decision-making processes as marked by the moves and countermoves that typically displace all actors from their preferred outcomes. Whether long-term or short-term, the outcomes of fiscal decision-making would thus appear not only as products of the structural incentives of the PMP but also of the interaction between those incentives and the changing economic environments in which actors have to operate.

Thus inscribed in the logic of the broader PMP framework, the theoretical expectations about fiscal decision-making developed above would indicate that the outcomes of fiscal decision-making processes would typically be *compensated reforms*. The federal government would generally obtain provincial consent for institutional or policy changes that centralize revenues and tighten federal control over expenditures and debt in the long term, but provincial governments would be compensated for these long-term losses by the short-term maintenance—or even improvement—in the availability of funds to keep up with spending. The nature and extent of this compensation would depend on the level of integration of the political parties in control of the main decision-making arenas.

## ***5.2. Measuring Fiscal Decision-Making in Argentina***

To measure how the variables proposed as determinants of fiscal decision-making in Argentina affect decision-making processes and their outcomes, this paper uses the indicators specified below. It must be noted that information is not always available for every indicator in every reform, and some indicators are probably not pertinent in some cases. The area and case analyses attempt to convey as much information as possible.

For economic shocks and policy shocks, the indicators are their impact upon total national and provincial income and expenditures in terms of GDP. These indicators would straightforwardly show whether shocks expanded or reduced the volume of fiscal resources, and whether they affected spending behavior by both levels of government. In the case of expansion, shocks were classified as positive; in the case of reduction, they were considered negative.

For the level of integration of political parties, the paper uses the Party Nationalization Score developed by Jones and Mainwaring (2003). As noted above, the PNS measures the extent to which a party wins equal vote shares across all subnational districts. A high PNS indicates high equality of vote shares, and vice versa. Jones and Mainwaring (2003) count as highly nationalized those party systems with average PNS over 0.90, and classify Argentina as a “low nationalization” country. Hence, the PNS of each of the main parties was counted as high or low depending on how close to or how far from 0.90 that it was located. As noted above, the PJ’s denationalization dates back to 1995, whereas the UCR’s nationalization score oscillated between 1991 and 2001 and plunged since 2003.

To size up the effects of the level of integration of parties on legislative behavior, two indicators are employed. One is the Rice Index for party discipline, which measures the extent to which legislators vote with their party in roll calls. The higher the index is, the higher the voting unity of each party. The other is the partisan support for committee reports developed by Mustapic and Goretti (1991), which takes stock of a) which parties vote for each report and b) whether parties vote united or divided on each report. Unfortunately, data are not available for all fiscal reforms. In some cases, voting unity data are missing because no roll was called and legislators voted without identifying themselves. In other cases, data on partisan support for committee reports are missing because no report was issued and bills were directly dealt with by the floor. In the latter case, the following counting rules were adopted: if only one house reported on the bill, then the pattern of support for that report was counted in; if no house reported on the



bill, then no data were included. The more divided the parties, the less partisan and more factional the composition of support for committee reports. Support is counted as factional if legislators from the same party voted for and against a given report.

To measure the availability of resources by each province, this paper uses the public debt/current income ratio. This ratio indicates the share of current income available for expenditures after payment of interest on the debt and amortization: the higher the ratio, the lower the available income, and vice versa. When available, the provincial government balance was also used: the more positive the balance, the higher the available income.

To assess the moving power of each province in particular negotiation episodes, a Moving Power Index was constructed combining the data on electoral victory margins, income/debt ratios, and provincial government balance. Moving power was classified as high if all values in the index were above the country average; as intermediate if two values were above the country average; and as low if two or more values were below the country average.

The measurement of the impact of changes in the level of integration of political parties on the cost of coalition building for fiscal reforms deserves separate consideration. The ideal measure would be the financial cost of the compensation distributed to each province in exchange for their support of reforms. However, this measure cannot be constructed for the Argentine case for two reasons. First, because of the frequency of changes: no sooner is a rule in force than another rule amends or replaces it, so there is not enough time for the purported effects of the previous rule, or of the compensation paid for its acceptance, to fully develop at the provincial level. Second, this measure cannot be constructed because of the unavailability of information both on amendments introduced in committees and on the exact amount and number of transfers distributed from the federal government to the provinces. Consequently, as a substitute for the ideal but impossible measure, this paper develops two measures that focus on changes in the nature of the compensation received by the provinces in exchange for supporting fiscal reforms. Data on these measures are more readily available.

One measure is the scope of compensation: whether it is generalized or limited. Generalized compensation schemes accrue to all provinces, whereas limited compensation accrues only to some provinces and not to others. The other measure is the level of presidential and gubernatorial discretionality of intergovernmental transfers, developed by Bonvecchi and

Lodola (2009). Intergovernmental transfers are defined here as the means of payment through which reforms are accepted. If parties are highly integrated, the adequate device to form fiscal reform coalitions would be a generalized compensation scheme with high discretionality for the governors and low discretionality for the president: highly integrated parties internalize bargaining costs and strive to maximize benefits and support throughout districts. However, as parties become poorly integrated, the compensation schemes employed to form coalitions should confer high discretionality on the president regardless of the governors' discretionality level: high presidential discretionality in compensation would enable the Executive to overcome coordination problems and form the oversized coalitions needed.

Presidential discretionality over transfers is measured as a continuous variable that indicates whether the president exerts control over five dimensions present in most intergovernmental transfers: *amount*, *timing*, *geographic targeting*, *payment*, and *earmarking*. Amount refers to the quantity or total volume of resources assigned to a given transfer. Timing indicates the temporal order in which a transfer is allocated to its recipients. Geographic targeting denotes the allocation of transfer shares to subnational districts. Payment points to the act of depositing the transferred money in the recipients' bank accounts. And earmarking indicates the formal restrictions established over the free use of the transferred funds.

Transfers with a high level of presidential discretionality are those with an institutional arrangement that enables the president to control the amount, timing, geographic targeting, payment, and earmarking. A transfer with a medium level of discretionality gives presidents complete control over the amount, timing, and payment of the resources, but not over their geographic distribution and earmarking levels, which are instead determined by specific legislation or constitutional clauses emerging from either bilateral or multilateral negotiations. A transfer with a low level of discretionality only allows donors to control the timing and payment of resources. A non-discretionary transfer precludes donors from controlling any of the five dimensions. The higher the level of presidential discretionality of the transfers used to build the coalition supporting a fiscal reform, the more limited the nature of the compensation conferred upon the provinces: transfers with high presidential discretionality can be used to distribute particularistic payoffs, whereas transfers with low presidential discretionality are usually distributed among all provinces.

Gubernatorial discretionality is measured as a continuous variable concerning the authority over the execution of funds and is operationalized by identifying whether governors control four dimensions: *reallocation*, *timing*, *procurement*, and *monitoring*. Reallocation refers to where transferred resources can be redirected: within or across policy areas. Timing concerns governors' formal ability to freely determine when intergovernmental transfers can be spent. Procurement indicates the ability to decide on the hiring of staff or contractors to implement federally funded projects. Monitoring refers to the existence of actors and procedures to oversee governors' spending choices. A federal transfer with a high level of gubernatorial discretionality enables governors to control all dimensions of funding execution. Gubernatorial discretionality over transfers diminishes, as governors lack leverage over each dimension and are instead forced to spend resources within a predetermined policy area and time, with no hiring power, and under the strict supervision of external agents.

The dependent variable analyzed in the remainder of this paper is the content of fiscal reforms. This content is defined according to the project framework and the theoretical expectations about fiscal outcomes developed in Section 4.1 (Table 6). Reforms may lead to limited or greater centralization of fiscal authority in the federal government. Centralization is *limited* when a) tax sources are concentrated in the federal government but receipts are shared with the provinces according to the Co-participation regime; and/or b) authority to manage tax bases and exemptions is given to the federal government but limited to specific decisions and time-periods. In contrast, centralization is *greater* when a) tax sources are concentrated in the federal government and receipts are either not shared with the provinces or shared according to rules more favorable to the center than the Co-participation regime; and/or b) unlimited tax authority is granted to the federal government. In the budget area, according to Filc and Scartascini (2007), reforms are classified as *centralizing* if they concentrate decision-making power in the Executive to the detriment of Congress or in the Finance Ministry to the detriment of Congress and the Cabinet, and as *hierarchical* if they concentrate decision-making power in the federal government to the detriment of subnational governments.

The next section uses the framework proposed here to account for the different configurations of fiscal reform activism described in Section 1 by analyzing the general patterns

of decision-making processes for each fiscal area and focusing on some of the most salient cases of fiscal reforms in the past two decades.

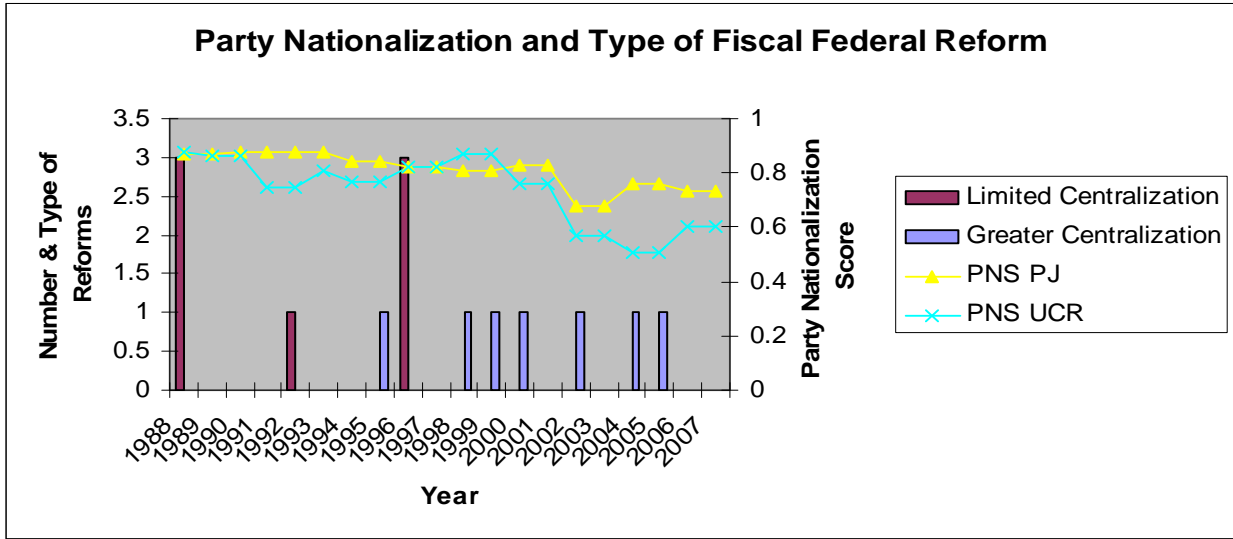
## **6. The Political Economy of Fiscal Reforms in Argentina: General Patterns and Case Studies**

This section describes the general patterns of fiscal decision-making in each of the fiscal areas that emerge from the analysis of reform processes through the theoretical lenses proposed above. Each subsection deals with one area, by presenting the general patterns and two case studies that illustrate them in greater detail. The cases were selected following the variation of the two main independent variables: the nature of shocks and the level of integration of political parties. Thus, for each area, the analysis includes one case that occurred under a positive shock and one under a negative shock, one initiated by highly integrated parties and another by poorly integrated parties. The comparison across all areas is left for the concluding section.

### ***6.1. Fiscal Federalism***

Developments in the fiscal federal area were generally consistent with the theoretical expectations about fiscal reform outcomes and the compensation transferred by the federal government to the provinces in order to obtain support for reforms. The columns in Figure 11 depict the number and type of reforms per year, while the lines trace the evolution of the Party Nationalization Scores of the main Argentine parties. This figure shows, as predicted, that fiscal federal reforms became increasingly more centralized as party integration decreased, i.e., as parties de-nationalized. With the exception of the 1996 deferrals of provincial compliance with the 1993 Fiscal Pact obligations, which allowed provinces to maintain their most important tax source, the turnover tax, all reforms enacted after the PJ's nationalization score started to drop in 1995 entailed greater centralization of fiscal authority in the federal government.

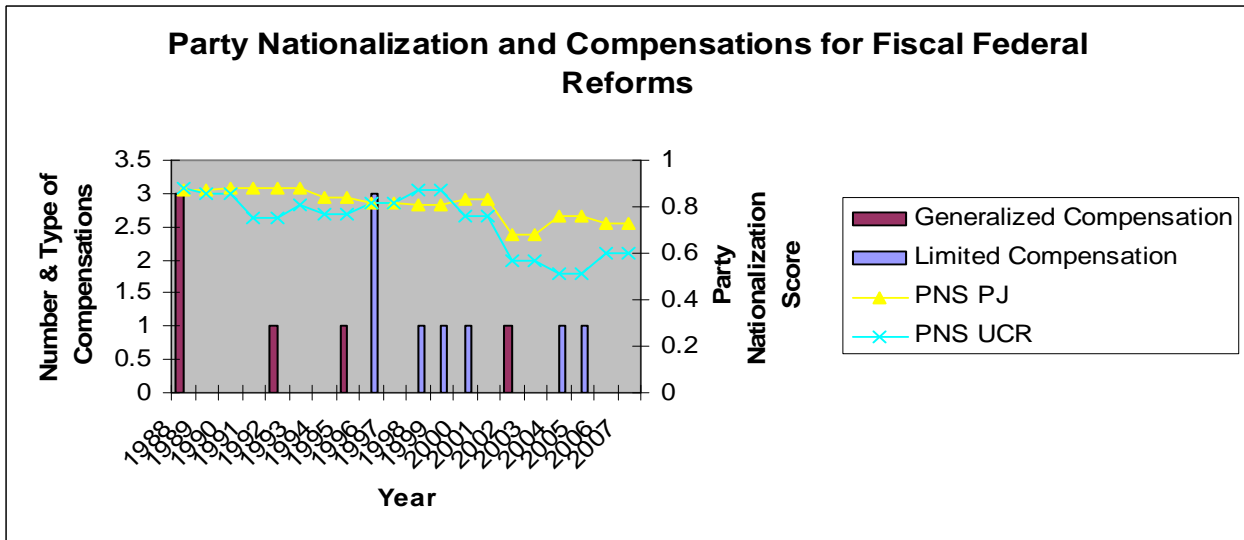
Figure 11.



Source: Author's compilation based on Table 7 for reforms and Figure 9 for PNS.

The theoretical model also seems to account for the evolution in the nature of the compensation schemes allocated by the federal government to the provinces in exchange for their support for fiscal reforms. As Figure 12 shows, compensation was generalized in nature to all provinces when parties were highly nationalized, and limited to some provinces as parties de-nationalized.

Figure 12.

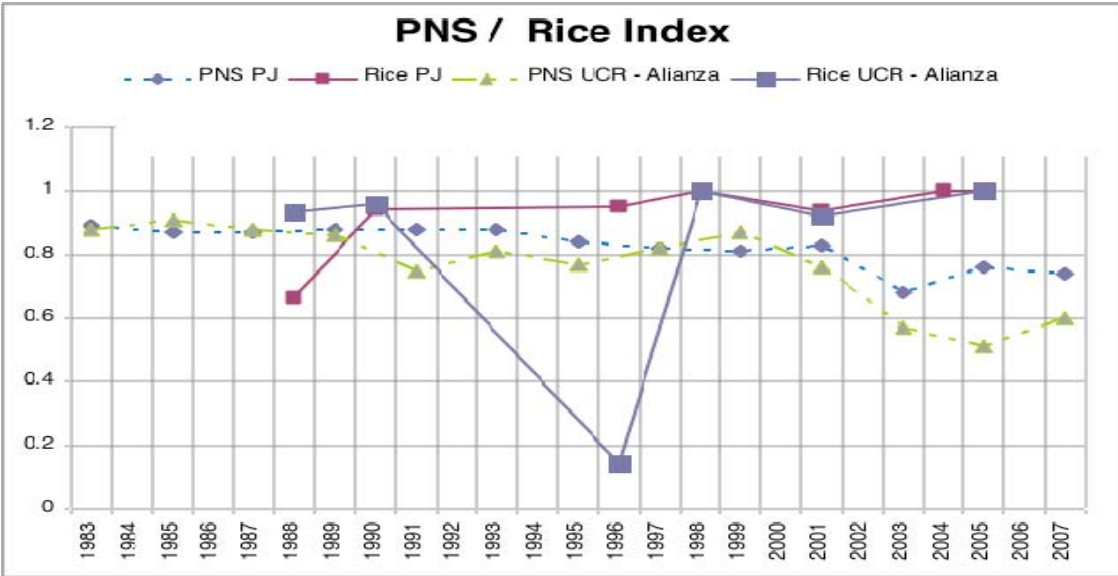


Source: Author's compilation based on Table 7 for compensation and Figure 9 for PNS..

The decision-making process of fiscal federal reforms in Argentina over the past 20 years has recurred in the following patterns. On the one hand, the federal government sought and obtained provincial consent for reforms that concentrated revenues and centralized authority over debt management at the federal level while decentralizing expenditures to subnational units. On the other hand, the provinces were granted in exchange either discretionary transfers or discretionary management over transfers that could offset in the short term the long-term losses that those reforms entailed for provincial exchequers. These patterns may be explained by the following factors.

First, compensation was adapted to the varying nature of partisan support. Fiscal reforms were generally passed, as Figure 13 shows, with high indices of party discipline in Congress. However, as can be seen in Table 7, the composition of support for committee reports became less partisan and more factional as the integration of parties decreased. When party integration, measured by nationalization scores, was high, the whole of the PJ and UCR contingents in the Budget and Treasury Committee had perfectly opposing positions on fiscal reforms; when parties de-nationalized, these contingents broke up, with some factions siding for and some against fiscal reforms.

**Figure 13.**  
**Party Nationalization and Party Discipline in Fiscal Federal Reforms (1983-2007)**



Source: Author's compilation based on Chamber of Deputies data.

**Table 7. Fiscal Federal Reforms and their Determinants, 1988-2007**

Law	Year	Description	Shocks	PNS	Partisan Composition of Support	Nature of Compensation	Nature of Changes	Presidential Discretionality of Compensation	Gubernatorial Discretionality of Compensation
23548	1988	Co-participation Regime	Negative: Inflationary Acceleration	High	PJ + UCR vs Others	Generalized: National Treasury Contributions Fund for Provincial Disequilibria	Limited Centralization	High	High
23562	1988	Temporary Provincial Fiscal Disequilibrium Fund	Negative: Inflationary Acceleration	High	PJ + UCR	Generalized: Provincial Fiscal Disequilibrium Fund	Limited Centralization	Low	High
23658	1988	Provincial Financial Overhaul Bond	Negative: Inflationary Acceleration	High	PJ + UCR	Generalized: Provincial Financial Overhaul Bonds	Limited Centralization	High	High
24130	1992	Ratification of 1992 Fiscal Pact	Positive: Stabilization and Recovery in Revenues after Convertibility	High	PJ	Generalized: Monthly Fixed Sum, Transfer of Management of Special Funds to Provinces	Limited Centralization	Low	High
24463	1995	Income-Tax Sharing Rule	Negative: Tequila Crisis	High	PJ + UCR	Generalized: Extraordinary \$ 1.2 billion contribution for all provinces	Greater Centralization	Low	High
24671	1996	Deferral of Provincial Compliance with Fiscal Pact Obligations	Negative: Tequila Crisis	Low	n/d	Limited: deferral for provinces in infraction	Limited Centralization	None	High
24699	1996	Deferral of Provincial Compliance with Fiscal Pact Obligations	Negative: Tequila Crisis	Low	n/d	Limited: deferral for provinces in infraction	Limited Centralization	None	High

Law	Year	Description	Shocks	PNS	Partisan Composition of Support	Nature of Compensation	Nature of Changes	Presidential Discretionality of Compensation	Gubernatorial Discretionality of Compensation
24762	1996	Deferral of Provincial Compliance with Fiscal Pact Obligations	Negative: Tequila Crisis	Low	n/d	Limited: deferral for provinces in infraction	Limited Centralization	None	High
25082	1998	Revenue-Sharing and Appropriation Rules	Negative: East Asian and Russian Financial Crises	Low	PJ vs PJ + UCR + Others	Limited: National Treasury Funds for Municipalities	Greater Centralization	High	High
25235	1999	Ratification of 1999 Federal Agreement	Negative: Recession and Brazilian devaluation	Low	PJ vs PJ + UCR + Others	Limited: Debt Rescheduling for Poor Provinces, Bailout of Cordoba and Santa Fe Pension Regimes	Greater Centralization	High	Low
25400	2000	Ratification of 2000 Federal Agreement	Negative: Recession and Financial Crisis of Convertibility	High	PJ vs. UCR + Others vs. UCR + Others	Limited: <i>ibid.</i> above + Social Program Funds	Greater Centralization	High	Low + High (Social Program Funds)
25570	2002	Ratification of 2002 Fiscal Pact	Negative: Collapse of Convertibility and Default	Low	PJ vs. PJ + UCR + Others	Generalized: Bailout for Provincial Debts	Greater Centralization	High	Low
25917	2004	Fiscal Responsibility Law	Positive: Stabilization and Recovery after 2002 Devaluation	Low	PJ vs. PJ + Others	Limited: deferral for provinces in infraction	Greater Centralization	High	None
26075	2005	Education Finance Act	None	Low	PJ + UCR + Others vs. UCR + Others	Limited: education infrastructure funds	Greater Centralization	High	Low

Source: Author's compilation based on Chamber of Deputies and Senate data..



The increasing de-nationalization of parties and its impact on party unity help explain the varying patterns of compensation identified in Table 7. Reforms negotiated by highly nationalized parties were usually approved in exchange for compensation of a generalized nature, which accrued to all provinces. In contrast, reforms passed by de-nationalized parties typically yielded limited compensation which—albeit with exceptions—accrued to some provinces but not to others. These patterns, as noted in Figure 11, are in line with theoretical expectations, and thus indicate that the federal government adapted the nature of its compensation schemes for the provinces to the changing party system environment. This enabled the Executive to obtain consent for reforms and the provinces to gain resources with which to maintain spending levels.

Second, the effects of the shocks were also in line with theoretical expectations. All reforms were prompted by either economic or policy shocks except for the 2005 Education Finance Act. Reforms produced limited centralization when triggered by positive shocks and negotiated by parties with a high level of integration; they produced greater centralization in every other scenario. The exceptions to these rules were the 1988 and 1996 reforms. In the 1988 cases, the Co-participation Law, Fiscal Disequilibria Fund, and Provincial Financial Overhaul Bond, the high level of integration of the main parties adopted a particularly extreme form: bipartisan cooperation organized by the national party leaders.<sup>36</sup> This form of bargaining, which required that both the government and the opposition party leaders pleased their intra-party coalitions, may have been the reason why, despite the crisis context, fiscal reforms yielded only limited centralization in favor of the federal government. In the 1996 cases, the deferral of deadlines for compliance with the tax clauses of the 1992 and 1993 fiscal pacts implied sparing the non-compliant provinces from reforms which centralized tax sources in the federal government. Given the fact that important tax and administrative reforms—the increase in VAT rates and the reduction of pension payments—took place almost simultaneously, the 1996 fiscal federal reforms may be plausibly interpreted as payoffs for consenting to those other initiatives. Aside from these cases, the nature of the shocks, in combination with the party integration variable, helps explain the nature of fiscal federal reforms.

Third: the level of presidential discretionality over the transfers employed to construct the coalitions that supported these reforms also behaved as expected. As can be seen in Table 7,

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<sup>36</sup> See below the case study of the 1988 Co-participation Law.

highly discretionary transfers were associated with limited compensation schemes, whereas transfers with a low level of discretionality were associated with generalized compensation schemes. The exceptions are, again, the 1988 reforms, in which generalized compensation was implemented via highly discretionary transfers.<sup>37</sup> In turn, gubernatorial discretionality over the management of compensation decreased when de-nationalized parties were forced to operate under negative shocks. This seems consistent with the strengthening of the federal government vis-à-vis the provinces due to debt bailouts and the reintroduction of export duties since 2002. The hunger for transfers among most provinces is such that their moving power to push for greater gubernatorial discretionality is generally low. This might also help explain how provincial consent for reforms could be manufactured. By increasing the level of presidential discretionality and decreasing the level of gubernatorial discretionality as party integration decreased, the federal government was able to boost the level of party discipline: provincial leaders have become much more loyal and compliant with centralizing reforms as their dependence on highly discretionary intergovernmental transfers grew.

To illustrate these patterns and show how the nature of shocks and the moving power of provinces shaped reform outcomes, two cases are studied in greater detail: the 1988 Co-participation Law and the 1999 Federal Agreement.

### *6.1.1 The 1988 Co-participation Law*

Discussions on the revenue-sharing regime between the federal government and the provinces as well as among the provinces themselves had been blocked since the expiration of the 1973 Co-participation Law in December 1984. The overlapping cleavages of government/opposition and rich/poor provinces made it impossible for either the Peronist party or the UCR to form a winning coalition in intergovernmental bargaining. The small, poor districts controlled by the Peronists proposed highly redistributive revenue-sharing criteria at the expense of the large, rich provinces and the federal government, then under UCR control. The provinces of Buenos Aires, Cordoba, Mendoza and the Federal Capital wanted revenues to be distributed according to population and local fiscal effort. Moreover, all provinces advocated a larger share for all districts at the expense of the federal Treasury. And given the fact that the expiration of the

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<sup>37</sup> A possible motivation behind this exception is analyzed in the case study below.

previous revenue-sharing regime had granted the federal government complete control over transfers, the president was not interested in promoting any negotiations on the matter.

The status quo was broken by an economic shock, the inflationary acceleration that followed the collapse of the Austral stabilization program. The monthly Consumer Price Index rose from 4 percent in May 1987 to 13.7 percent in August, partly due to the duplication of Central Bank rediscounts to provincial banks—from 1.2 percent of GDP in 1986 to 2.06 percent in 1987. This led to a deepening of the total public sector fiscal deficit from 3.2 percent of GDP in 1986 to 4.5 percent between June and September 1987 (Machinea, 1990: Table II.12). The federal government thus missed the fiscal targets agreed upon with the IMF, and was consequently forced to pursue new adjustment policies.

The economic shock brought about the UCR's defeat in the September 1987 legislative and gubernatorial elections, which gave the Peronist party control over 17 out of 22 provinces and reduced the UCR majority in the Chamber of Deputies to a mere plurality. Two emergent Peronist leaders competed thereafter over the nomination for the 1989 presidential election: Antonio Cafiero, governor-elect of Buenos Aires and party chairman; and Carlos Menem, re-elected governor of La Rioja. With the UCR weakened and a Peronist majority in the provinces, the formation of a coalition to reform revenue-sharing seemed more likely, and the fiscal crisis at both levels of government provided the incentive for the president to negotiate a new Co-participation Law in exchange for Peronist support for an adjustment package.<sup>38</sup>

Bargaining for the new Co-participation Law took place simultaneously in two arenas. On the one hand, the federal government negotiated with the whole of the provinces over the primary distribution of revenues between the federal and the provincial treasuries. On the other hand, the provincial governors bargained among themselves over the secondary distribution of the provincial share of revenues. But it was only when the arenas intersected that agreements could be reached.

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<sup>38</sup> The adjustment package included long-term measures to liberalize the economy (a phased opening process, deregulation and de-monopolization of public services) and short-term decisions to check inflation and fiscal disequilibria (a two-tier exchange market, a price freeze, and a tax reform oriented at strengthening direct over indirect taxation). The Tax Reform comprised the reintroduction of the forced-savings scheme, modifications to Income Tax and Net Assets legislation, the Unimproved Land Tax, and increased rates on the financial transaction and real estate taxes.

National-provincial negotiations soon stalled. The finance minister moved to freeze the primary distribution incepted by the 1973 Co-participation Law. The Peronist governors rejected this and demanded to incorporate other issues of provincial interest to the agenda: equalization of national and provincial public sector wage policies, “fiscal emergency status” to guarantee immediate assistance for certain districts, and Central Bank bailouts for provincial public-sector banks. The federal government resisted these demands and threatened to suspend rediscounts for provincial banks’ temporary liquidity problems, force provincial treasuries to cancel all outstanding debts with the federal government, and conditioned Central Bank bailouts to provincial banks to the revenue improvements expected from the tax reform.

At this point, consistent with the incentives of the leadership of a highly integrated, nationalized party, intra-party bargaining in the PJ began to shape the decision-making process. On November 6, an assembly of PJ governor-elects summoned by Cafiero proposed a primary distribution of 56.6 percent for the provinces, 40.34 percent for the federal government, and 3 percent for the Regional Development Fund, but Menem denounced the proposal and refused to sign it. Cafiero reacted on December 8 by presenting another proposal which allocated 54.66 percent to the provinces, 40.34 percent to the national Treasury, 2 percent to “restore the relative participation of Buenos Aires, Neuquén, Chubut, and Santa Cruz”—the secondary-distribution losers—and 3 percent to a Regional Development Fund to be directly managed by the provinces. To entice the remaining provinces into agreement, the proposal also comprised clauses that shielded Co-participation monies from Executive discretion and from real depreciation due to inflation: automatic equalization of national and provincial wage policies, and daily automatic transfer of shared revenues by the National Bank. Cafiero’s proposal also incorporated revenues from the Forced Savings and Oil Transfers taxes to the common pool, thus increasing the volume of transfers available for all provinces.

Pivoting on the net losses that this second proposal would entail for certain provinces, Menem rejected it and called for bilateral bargaining between each province and the federal government (Cronista Comercial, 16/12/87). Fearing that this might lead to a breakdown of negotiations that might jeopardize his leadership, the PJ chairman Cafiero lobbied the Finance Ministry for an increase in the share of revenues for La Rioja, Menem’s province. But Menem’s threat seemed more credible to the federal government, so the Finance Ministry came up with a variation on the second Peronist proposal: increase the federal government’s share by two

percentage points—to 42.34 percent of all revenues—and institute a National Treasury Contributions (ATN) Fund with the remaining 1 percent of total revenues to be discretionally used by the Interior Ministry to compensate the loser provinces in case of fiscal disequilibrium. The overwhelming majority of the governors agreed, but it was only when the Treasury secretary made an explicit commitment to finance La Rioja's deficit that Menem signaled his final agreement. The bill was subsequently sent to Congress, approved in both houses without amendments alongside the tax reform, signed by the president without objections, and swiftly ratified by provincial legislatures as well.

The decision-making process of the 1988 Co-participation Law illustrates the theoretical expectation that when the leadership of highly integrated and nationalized parties is in charge of negotiations, intra-party bargaining can be efficiently coordinated even in the presence of internal factions, and negotiations can be brought to conclusion without individual provinces being able to significantly block them. Menem's stance against the co-participation agreement was indeed short-lived and barely credible: a governor competing for the presidential nomination could not afford to bring down a deal that would benefit the majority of the provinces if he intended to incorporate them into his electoral coalition. The incentives available to the leaders of highly nationalized parties were used to the fullest advantage: both Menem and Cafiero put their aims as national leaders (to obtain as many votes as possible from as many provinces as possible) before their responsibility as local leaders (to maximize the revenue share of their provinces).

The 1988 co-participation negotiations also illustrate two significant patterns of fiscal federal negotiations in the context of negative economic shocks and highly integrated parties. The first pattern is that the federal government can only obtain provincial consent for restrictive fiscal policies in exchange for generalized compensation. Governors only agreed to the federal proposal when it incorporated an institutional device that would assist them in case of financial difficulties. Second, that compensation enacted in the context of negative shocks typically confers high discretionality to the president: the ATN Fund created by the Co-participation Law would be under the political and administrative control of the Interior Ministry, which would be the sole authority capable of determining whether provinces needed the assistance of this fund.

### *6.1.2 The 1999 Federal Agreement*

The 1999 Federal Agreement was prompted by the combined effect of the Russian default of August 1998 and the Brazilian devaluation of 1999 on the accounts of Argentina's national and subnational governments. Russia's default had reignited negative expectations regarding the sustainability of the convertibility regime. It had also driven financial investors to sell Argentine bonds, thus causing the risk-premium and therefore the interest rates on Argentina's debt services to rise sharply. Brazil's devaluation had greatly undermined Argentina's exports competitiveness and shifted the trade balance in Brazil's favor. These shocks caused tax revenues in the third quarter of 1999 to drop by 4.6 percent compared to 1998 (Ministry of the Economy, 1999). In the same period, expenditures grew by 6.2 percent, powered by sharp increases in the interest rates on domestic and foreign debt (Ministry of the Economy, 1999). Such dismal fiscal performance reinforced investors' expectations of devaluation and default, which contributed to additional interest rates hikes<sup>39</sup> and further crowding-out of the private sector from credit markets, which in turn resulted in less investment and deepened recessionary tendencies.<sup>40</sup>

Provincial accounts were in no better shape, which reduced the moving power of provincial governments in fiscal negotiations. Nineteen out of 24 jurisdictions presented negative budget-balance results: 12 of them over -12 percent, with Buenos Aires displaying one of the largest deficits: -18 percent (Sanguinetti, 2001). Eighteen districts had over 10 percent of their income allocated to debt service—with five sacrificing over 25 percent. And fifteen provinces had over 30 percent of their co-participation receipts automatically seized by creditors—with nine surrendering over 50 percent (Sanguinetti, 2001). Total provincial spending increased by 1.28 percent of GDP during 1999, which amounted to a 10.34 percent boost compared to 1998. Spending in personnel grew 4.21 percent, while total provincial income grew by only 0.2 percent of GDP (see Figures 3 and 5). The combined prospect of a recession and a credit crunch yielded an outlook of debt default and deep fiscal adjustment. The stage was thus set for a clash between

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<sup>39</sup> Upon Brazil's devaluation on January 13, 1999, the country-risk premium jumped from 771 basis points on January 12, to 1097 two days later and subsequently fluctuated between 581 and 947 basis points until the October 24 presidential election. Country-risk data were drawn from J.P. Morgan's Emerging-Markets Bonds Index, in [www.ambitoweb.com.ar](http://www.ambitoweb.com.ar).

<sup>40</sup> Between the third quarter of 1998 and that of 1999, Argentina's GDP dropped 4.1 percent, exports fell by 5.9 percent, and private consumption by 4.4 percent. See Ministerio de Economía (1999).

a federal government seeking to impose restrictive fiscal policies on the provinces and subnational governments seeking to obtain federal aid to avoid default and relieve citizens from the effects of adjustment.

The political environment for the upcoming bargaining was markedly different from the one in which the 1988 Co-participation Law was negotiated. The level of integration of both parties had decreased. The Party Nationalization Score of the UCR had dropped from 0.88 in the 1987 election to 0.77 in the 1995 election. While the formation of the Alliance with the center-left party FREPASO had improved the UCR's nationalization scores, the improvement was not enough to wrest a majority of provincial governments from the Peronists. In the PJ's case, the PNS had decreased around 10 percent (from 0.87 in 1987 to 0.81 in 1999), which meant that while this party still controlled the majority of the governorships, its electoral hold on some provinces was more tenuous than on others. The victory margins of Peronist candidates for governor in 1999 were above the national average (13.86 percentage points) in six out of 12 governorships controlled by the PJ before the 1999 election: Formosa (47.65), La Rioja (39.08), La Pampa (16.89), Santiago del Estero (25.90), Salta (18.29) and Santa Fe (16.16). The margins were significantly below average in the remaining provinces the PJ won in the 1999 election: 6.89 in Buenos Aires, 9.12 in Cordoba, 1.14 in Jujuy, 7.92 in Misiones, 9.33 in San Luis, 10.29 in Santa Cruz, 1.80 in Tierra del Fuego, and 0.68 in Tucuman.<sup>41</sup> This heterogeneity in electoral and financial indicators suggested that each province would have a different level of moving power before the negotiation, that is, a different ability to hold its ground in negotiations with the federal government. Table 8 presents the calculation of each district's moving power.

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<sup>41</sup> The Victory Margin data was constructed on the basis of information provided by the Interior Ministry.

**Table 8. Moving Power of the Argentine Provinces before the 1999 Federal Agreement Negotiation**

Province	Victory Margin (a)	Financial Result (b)	Debt/Income (c)	Moving Power (d)
Buenos Aires	6.98	-18	3.0%	Intermediate
Buenos Aires City	16.11	1	3.6%	High
Catamarca	7.88	-9	6.7%	Low
Chaco	27.45	-14	5.9%	Low
Chubut	5.85	-16	8.2%	Low
Cordoba	9.12	-5	8.3%	Intermediate
Corrientes	28.82	-12	11.6%	Low
Entre Rios	1.62	-6	5.2%	Intermediate
Formosa	47.65	-19	15.2%	Low
Jujuy	1.14	-14	8.0%	Low
La Pampa	16.89	1	1.6%	High
La Rioja	39.08	5	1.0%	Intermediate
Mendoza	5.77	-15	6.8%	Low
Misiones	7.92	-17	6.6%	Low
Neuquen	7.53	-21	4.8%	Intermediate
Rio Negro	6.89	-13	12.5%	Low
Salta	18.29	-8	4.3%	High
San Juan	13.40	-6	5.4%	Intermediate
San Luis	9.33	21	1.0%	Intermediate
Santa Cruz	10.29	-13	0.6%	Low
Santa Fe	16.16	-8	1.8%	High
Santiago del Estero	25.90	5	2.2%	High
Tierra del Fuego	1.80	-12	3.6%	Low
Tucuman	0.68	-6	7.5%	Low

*Measures:* (a) Percentage points between the first and second parties; (b) Percentage points of total provincial income; (c) Percentage points; (d) High: all values over country average; Intermediate: two values over country average; Low: two or more values below country average.

*Source:* Author's compilation based on data from the Interior Ministry for (a), Sanguinetti (2001) for (b), and Finance Ministry for (c).

The first move in these negotiations was made two days after the Alliance won the presidential election, when its shadow finance minister, J.L. Machinea, indicated that the incoming administration would seek multilateral aid to finance provincial debt rescheduling and would simultaneously cut \$1,500 million from subsidies to the provinces. To this move, which entailed net losses for all provinces, governors and legislators from all parties responded by demanding that the status quo over subsidies remain and that a new co-participation regime and precise debt-rescheduling arrangements be approved.

Faced with such extended resistance, Machinea announced that provincial subsidies would remain intact. However, budgetary expenditures would have to be cut by \$1.2 billion and a tax reform generalizing the value-added and income taxes and raising excise tax rates would have to be enacted in order to reduce the federal deficit and generate enough confidence in the



private and public capital markets so that the federal government could obtain financing for debt-rescheduling arrangements. This move still meant net losses for many provinces, since the budgetary expenditures to be cut would affect programs executed in the provinces.

Provincial responses to Machinea's move differed according to the moving power of the provinces. The governor-elect of Buenos Aires, who faced a significant budget deficit and a strong local opposition—which was, in turn, the same party of the incoming federal government—offered to cooperate with the new administration. In contrast, the re-elected governor of La Pampa, who enjoyed a high moving power due to the combination of fiscal surplus, low debt, and a large margin of victory, urged his colleagues not to discuss any new co-participation regime before knowing exactly what taxes the Alliance intended to introduce. This status quo stance seemed to predominate, for the PJ only offered the Alliance to approve the 2000 budget with all subsidies in place, but remained silent on new co-participation arrangements.

This forced the incoming finance minister to specify the features of his co-participation proposal, which consisted of a fixed annual sum that would be allocated to each district in the same amount received in 1999, with any revenues beyond that sum to be appropriated by the federal government. The fixed sum would provide the provinces with income security, while the appropriation of excess revenues would help the federal government reduce the fiscal deficit and improve the country's credit rating. But provincial rejection was again generalized, led once again by a leader from a province with high moving power, the governor-elect from Santa Fe, who insisted that no co-participation arrangement be made until the performance of the new tax reform could be assessed (*Ambito Financiero*, November 17, 1999).

To break provincial intransigence, the incoming finance minister presented governors with a Federal Agreement proposal that extended the validity of the 1988 Co-participation Law, the Fiscal Pacts, and all existing earmarks of shared revenues until December 31, 2005. In 2000, the federal government would distribute co-participation transfers equivalent to the average annual amount received by all provinces in 1998 and 1999. This sum, which would amount to \$1.25 billion in January and would be subsequently modified to comply with the annual guarantee, would function both as a floor and a ceiling, so that any excess revenues from existing or future taxes would be appropriated exclusively by the federal government. From 2001

onwards, revenues would be distributed according to the existing legislation using mobile quarterly averages. The differences between current revenues and mobile averages would be channeled to a Provincial Counter-Cyclical Fund to be used in hard times.

At this point, provinces with low moving power started to give in to federal pressure. First, the provinces of Formosa and Tucumán took Machinea's deal in exchange for special aid to reschedule their short-term debt.<sup>42</sup> The rest of the provinces with low moving power followed suit, but those with high and intermediate moving power remained adamantly opposed. Buenos Aires and Córdoba, both with intermediate moving power, and Santa Fe, which had higher moving power, demanded that the federal government finance their pension-systems' deficits and announced they would only sign a one-year pact—and only for a higher fixed sum than proposed. In addition, the re-elected governor of La Pampa conditioned his support to the Executive's ratification of the creation of a duty-free zone in his province.

Machinea then responded that the federal government would only accept a higher fixed sum and gradual financial assistance for provincial pension-system deficits if the provinces reformed their pension legislation in accordance with the national regime and signed a two-year co-participation arrangement.<sup>43</sup> Thus, the Federal Agreement was closed and was subsequently approved without amendments by both houses of Congress and ratified by provincial legislatures. The federal government therefore obtained all excess revenues beyond the fixed sum by paying off the provinces with limited and highly discretionary compensation: provincial pension deficit financing and the debt-rescheduling arrangements that would be set in future negotiations.

The 1999 Federal Agreement episode thus illustrates the bargaining problems that ensue when the negotiators are leaders from poorly integrated, de-nationalized parties. No provincial leader, whether incoming or outgoing, from a rich or a poor or a powerful or a weak province, was able to coordinate a bargaining position vis-à-vis the federal government. Each governor jockeyed alone to maximize benefits for his district. Consequently, federal officials were forced to design limited compensation schemes that would enable them to buy off each jurisdiction one by one. On the other hand, precisely due to the provinces' inability to coordinate, the federal

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<sup>42</sup>As shown in Table 9, Formosa was indebted for 159 percent of its income, and had 62.2 percent of its co-participation transfers withheld for debt-servicing; for Tucumán, the respective values were 123 percent and 90.9 percent.

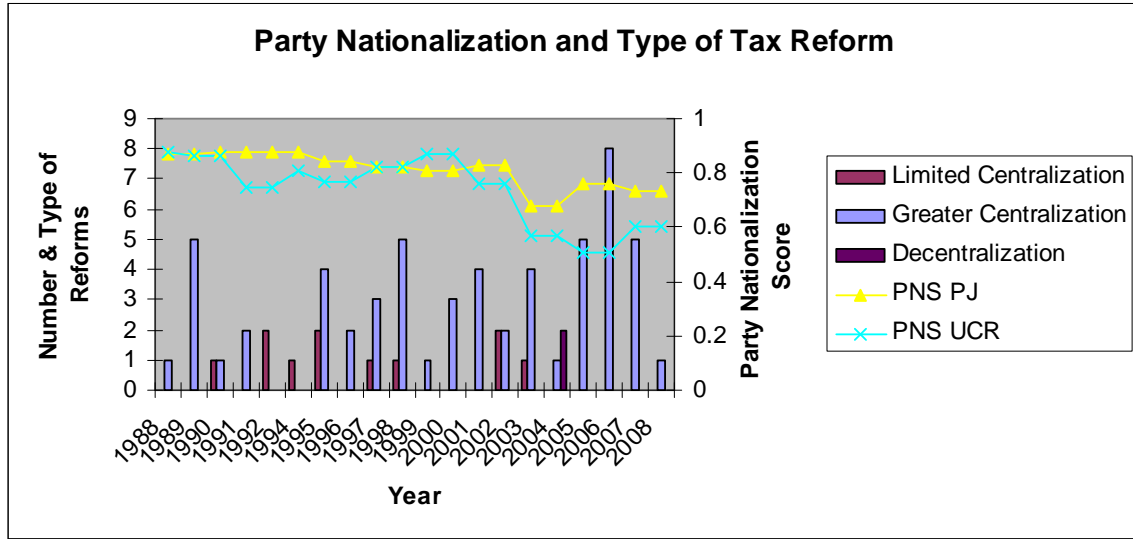
<sup>43</sup> Interview with Machinea, 26/12/02.

government was able to impose a centralizing reform—the appropriation of new revenues in excess of the fixed co-participation sum—which entailed a short-term loss for the provinces in exchange for uncertain medium-term gains, i.e., debt rescheduling. Thus, the 1999 Federal Agreement negotiations are an example of how the combination of negative shocks and parties with low levels of party integration would typically generate centralizing fiscal reforms with limited compensation to provinces under the highly discretionary control of the federal government.

## **6.2. Taxation**

Developments in the taxation area also turned out to be generally consistent with theoretical expectations. The columns in Figure 14 depict the numbers and types of tax reforms introduced, while the rows indicate the evolution of the Party Nationalization Scores of the main political parties in Argentina. This figure shows, again as expected, that the number of reforms yielding greater centralization of authority and revenues in the federal government increased as party integration decreased, i.e., as parties de-nationalized. Also as expected, the number of reforms generating limited centralization diminished as parties de-nationalized, and the only cases of decentralizing tax reforms were initiated by poorly integrated, de-nationalized political parties.

Figure 14.



Source: Author's compilation from Table 9 for reforms and Figure 9 for PNS. .

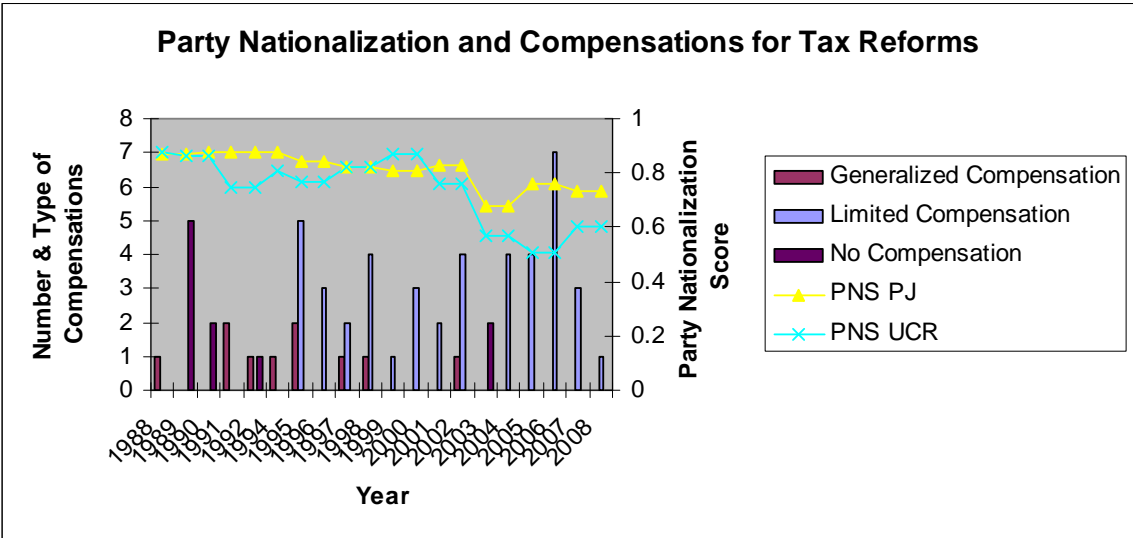
As shown in Table 9, again according to theory, all tax reforms enacted by highly nationalized parties under positive shocks for which data could be gathered (3 out of 5) yielded limited centralization of authority in the federal government, and 93.33 percent of reforms (14 out of 15) enacted by nationalized parties under negative shocks generated greater centralization.<sup>44</sup> Also as expected, most reforms enacted by de-nationalized government parties produced greater centralization of fiscal authority in the federal government. The exceptions (6 out of 63) generally corresponded to tax exemptions whose administration was either delegated with clear restrictions to the federal government or decentralized to the provinces.

The theoretical model was not as accurate in predicting the nature of the compensation distributed by the federal government to the provinces in exchange for their support for tax reforms. The columns in Figure 15 depict the number of cases and corresponding types of compensation distributed for their inception, while the lines trace the PNS of the main parties. This figure shows that the compensation distributed to the provinces was of a generalized nature when parties were highly integrated and nationalized, and became limited or was eliminated as party integration and nationalization decreased. However, what the figure does not show, but can nevertheless be seen in Table 9, is the lack of match between the type of shock, the level of party

<sup>44</sup> The only deviation was a bill introducing exemptions to the VAT which was vetoed by the president.

integration, and the type of compensation. While much of the compensation for reforms enacted by highly nationalized parties under positive shocks was, as expected, of a generalized nature, the rest of the cases mostly turned out contrary to expectations. The deviations, as analyzed below, yielded either no compensation or limited compensation schemes that were built into tax bills.

**Figure 15.**



Source: Author’s compilation based on Table 9 for compensation and Figure 9 for PNS.

The decision-making process of tax reforms in Argentina over the past two decades followed a path of increasing centralization of tax authority and revenues in the federal government, occasionally interrupted by decentralizing reforms seemingly oriented at utilizing tax legislation as a tool to adapt to negative shocks or to expand positive shocks throughout the economy. Provincial consent to tax reforms was obtained through various sorts of compensation that varied not only with the level of integration of parties and the nature of shocks, but also with the use to which tax reforms were put within economic policy strategies. These patterns can be explained by the following factors.<sup>45</sup>

<sup>45</sup> Unfortunately there is not enough information available to adequately assess the composition of partisan support for committee reports or the voting unity of the parties in Congress.

First, the nature of shocks affected the nature of reforms. Combinations of centralizing and decentralizing tax policy reforms, such as increases in VAT rates and VAT exemptions, have been the trademark of attempts to use tax legislation to ease the implementation of stabilization packages or to expand the fruits of economic recovery. The former was the case in the 1989-91 and 1999-2001 periods, when reforms significantly increased revenues but also granted exemptions or differential rates to specific sectors perceived by the government as potential engines for future recovery, such as exporters. The latter was the case in the 1992-95 and 2003-2007 periods, when exemptions and differential rates were used to improve the competitiveness of exporters without altering the exchange rate.

Second, the level of party integration had, in general, the expected effect on reform outcomes. Institutional reforms in taxation were decentralizing when the level of integration of the main political parties, as measured by nationalization scores, was high and decision-making took place under a positive shock, such as that which occurred in the early 1990s, whereas reforms were centralizing as parties de-nationalized. There were, however, a few cases of decentralizing reforms enacted by de-nationalized parties, which could be explained by the role of tax policy within the overall economic strategy of the federal government.<sup>46</sup>

Tax institutions have also been shaped by the level of integration of political parties. Limited centralization and written restrictions on delegation of tax authority have been the hallmarks of bargains enacted by parties with a high level of integration, as measured by nationalization scores. Conversely, unlimited delegation and centralization have been the typical bargaining outcome of poorly integrated, de-nationalized parties. The paramount case of the former was the 1992 tax reform; that of the latter was the 2001 blanket delegation of tax authority to the Executive. Both cases are studied in detail below.

Third, compensation roughly followed variations in party integration and economic context. Compensation schemes were of a generalized nature when highly integrated and nationalized parties enacted reforms during positive shocks and of a limited nature when poorly integrated, de-nationalized parties enacted reforms under negative shocks. However, two important sets of cases differed from these patterns. On the one hand, as shown in Table 9, cases of no compensation for provincial consent to reforms, which were associated with negative

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<sup>46</sup> On the use of tax policy to maintain the purchasing power of wages, see Etchemendy and Collier (2007).

economic shocks, such as many reforms during the period of hyperinflation, the 1995-96 recession, and the aftermath of the 2001 crisis.

An important number of cases of compensation were built in to the tax reforms themselves. This institutional format of compensation appears to have increased with the decrease in the integration of political parties, but it also seems to have been related to the nature of the reforms. Bills that introduced and/or expanded tax exemptions or differential rates have typically granted the Executive the authority to establish whether specific sectors, regions, or taxpayers were eligible to benefit from those exemptions or rates. The logic of this delegation implies that the president has considerable discretion to benefit some districts, firms, or individuals over others, which is precisely what limited compensation schemes consist of. The association of the delegation of tax authority with the decrease in party integration suggests that built-in compensation may have been the solution to the difficulties that leaders of poorly integrated parties faced when attempting to coordinate intra- and inter-party bargaining. By delegating to the president, legislators—and governors as their principals—avoid the costs of disruptive bargaining and thus of conflicts that might damage coalition-building efforts for potential electoral careers.<sup>47</sup>

Another emerging pattern of compensation to provinces is the packaging of tax reforms with fiscal federal reforms that included compensatory clauses for potential long-term losses by the provinces. This is encouraged by the logic of revenue-sharing. It appears to have been typical only of comprehensive tax reforms enacted in the aftermath of positive stabilization shocks, such as the 1992 reform and the 1998 special regime for small contributors.

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<sup>47</sup> Eaton (2001) has found this logic of delegation operating in the Congressional decision to transfer to the President the authority to terminate industrial promotion tax credits.

**Table 9. Tax Reforms and their Determinants, 1988-2008**

<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
23549	1988	Forced Savings, Bank Debits Tax	Negative: Inflationary Acceleration	High	Greater Centralization	Generalized: Co-participation Regime and Fiscal Disequilibria Fund	Low	High
23666	1989	Reduction of VAT Rates	Negative: Hyperinflation	High	Greater Centralization	None	-	-
23667	1989	Taxes on Agricultural Products	<i>Ibid</i>	High	Greater Centralization	None	-	-
23669	1989	Suspension of Regional and Sectoral Fiscal Promotion Regimes	<i>Ibid</i>	High	Greater Centralization	None	-	-
23760	1989	Changes in Rates and Revenue-Sharing Criteria of Taxes on Firms' Assets, Bank Debits, Income, Excise, and VAT	<i>Ibid</i>	High	Greater Centralization	None	-	-
23765	1989	Generalization of VAT	<i>Ibid</i>	High	Greater Centralization	None	-	-
23871	1990	Tax on Trade of Financial Assets	<i>Ibid</i>	High	Greater Centralization	None	-	-
23872	1990	Exemption to VAT	<i>Ibid</i>	High	Limited Centralization	None: Vetoed by President	-	-
23905	1991	Increase Rates of Income, Bank Debits, Assets, and Value-Added Taxes	<i>Ibid</i>	High	Greater Centralization	Generalized: National Treasury Contributions and Loan Approvals	High	High
23966	1991	Increase VAT and Social Security Contribution Rates, Change VAT Revenue-Sharing Rules	<i>Ibid</i>	High	Greater Centralization	<i>Ibid</i>	High	High



<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
24073	1992	Income, Value-Added, and Liquid Fuel Tax Rates Increases, Change Revenue-Sharing Criteria of Income and VA Taxes	Positive: Stabilization and Recovery after Convertibility	High	Limited Centralization	Generalized: Greater Buenos Aires Fund and Basic Social Infrastructure Fund	Low	Medium
24181	1992	Liquid Fuel Tax Exemption for the Patagonia Region	Ibid	High	Limited Centralization	None	-	High
24367	1994	VAT Exemption for Transport	Ibid	High	Limited Centralization	Generalized: inbuilt	Medium	High
24391	1994	VAT Reform	Ibid	High	n/d	n/d	n/d	n/d
24415	1994	Reform of Customs duties	Ibid	High	n/d	n/d	n/d	n/d
24468	1995	Increase of VAT Rate and Appropriation of Proceeds, deferral of provincial compliance with Fiscal Pacts, Expansion of Personal Tax bases	Negative: Tequila Crisis	High	Greater Centralization	Generalized: \$1.2 billion for all provinces	Low	High
24475	1995	Increase of Income Tax Bases	Ibid	High	Greater Centralization	Ibid	Low	High
24514	1995	Tax Exemption for Rural Mortgages	Ibid	Low	Greater Centralization	Limited: inbuilt	Medium	High
24587	1995	Tax on Private Equity, Increase of Income Tax base, general deferral for compliance with tax rules	Ibid	Low	Limited Centralization	Limited: inbuilt	Low	High

<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
24590	1995	Personal Tax Exemptions	Ibid	Low	Limited Centralization	Ibid	Low	-
24621	1995	Extension of Income Tax and Revenue-Sharing Rules	None: Periodical Renewal	Low	Status Quo	Limited: increase in Basic Social Infrastructure Fund	Low	Medium
24625	1995	Emergency Tax on Cigarettes, Earmark for Social Programs	Negative: Tequila Crisis	Low	Greater Centralization	Ibid	Low	Medium
24631	1996	Limited Delegation to the Executive for Eliminating Exemptions	Ibid	Low	Greater Centralization	Limited: deferral of provincial compliance with Fiscal Pacts	-	High
24689	1996	VAT Exemption for Consumption Goods Imports	Ibid	Low	Greater Centralization	Ibid	-	High
24698	1996	VAT Exemption for Airplanes	Ibid	Low	Greater Centralization	Ibid	-	High
24829	1997	VAT Exemptions for Medical Equipment	Ibid	Low	Greater Centralization	Ibid	-	High
24885	1997	Limits to Income Tax Deductions	Ibid	Low	Greater Centralization	Ibid	-	High
24917	1997	Amendment of Law 24885	Ibid	Low	Greater Centralization	n/d	n/d	n/d
24920	1997	VAT Exemption to Bank Transactions by Provinces and Municipalities	ibid	Low	Limited Centralization	Generalized: inbuilt	None	-
24977	1998	Simplified Tax Regime for Small Contributors	Positive: Recovery after Tequila Crisis	Low	Limited Centralization	Generalized: new revenues	Low	High
25037	1998	Blanket Tax Exemption for Theatrical Activities	Ibid	Low	n/d	n/d	n/d	n/d

<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
25053	1998	Teachers Incentive Fund	Negative: East Asian and Russian Crises	Low	Greater Centralization	n/d	n/d	n/d
25055	1998	Expansion of Liquid Fuel Tax Base	Ibid	Low	Greater Centralization	Limited: Loan Approvals	High	Medium
25057	1998	Income Tax Exemption for Fiduciary Funds	Ibid	Low	Greater Centralization	Ibid	High	Medium
25063	1998	1998 Tax Reform	Ibid	Low	Greater Centralization	Limited: Treasury Contributions for Municipalities and Loan Approvals	High	High
25123	1998	Expansion of Presumptive Income Tax Base	Ibid	Low	Greater Centralization	Ibid	High	High
25239	1999	1999 Tax Reform	Negative: Recession and Brazilian Devaluation	High	Greater Centralization	Limited: 1999 Federal Agreement	High	High (Fix Sum) + Low (Debt Rescheduling)
25300	2000	Exemptions for Small and Medium Enterprises	Ibid	High	Greater Centralization	Ibid	High	Ibid
25360	2000	Increase of VAT, Interest Payments, and Entrepreneurial Indebtedness Rates and Bases	Negative: Recession and Financial Crisis	High	Greater Centralization	Ibid	High	Ibid
25361	2000	Accrual of Liquid Fuel Tax Payments to Income Tax Payments	Ibid	High	Greater Centralization	Ibid	High	Ibid
25402	2001	Expiration Date for Taxes	Ibid	Low	Status Quo	n/d	n/d	n/d

<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
25405	2001	Limits to VAT Exemptions	Ibid	Low	Greater Centralization	n/d	n/d	n/d
25406	2001	Accrual of VAT Payments for Exporters	Ibid	Low	Greater Centralization	n/d	n/d	n/d
25413	2001	Competitiveness Act	Ibid	Low	Greater Centralization	Limited: inbuilt	High	High
25414	2001	Blanket Delegation of Tax Authority to the Executive	Ibid	Low	Greater Centralization	Ibid	High	
25525	2002	VAT Exemption for Honey Producers	Ibid	Low	Limited Centralization	Limited: National Treasury Contributions	High	High
25585	2002	Increase of Personal Assets Tax Rates	Negative: Collapse of Convertibility and Default	Low	Greater Centralization	Ibid	High	High
25710	2002	Reduction of VAT for Cattle Producers	Ibid	Low	Limited Centralization	Ibid	High	High
25717	2002	Suspension of Differential VAT Rates for Agrarian Activities	Ibid	Low	Greater Centralization	Limited: inbuilt	Medium	-
25723	2002	Reduction of Social Security Contributions	Ibid	Low	Status Quo	Generalized: inbuilt	Low	-
25731	2003	Suspension of Income Tax Exemption for Exporters	Ibid	Low	Greater Centralization	None	-	-
25732	2003	Repeal of Competitiveness Agreements	Ibid	Low	Greater Centralization	None	-	-
25745	2003	Increase of Liquid Fuel Tax Rates and Bases	Ibid	Low	Greater Centralization	n/d	n/d	n/d
25784	2003	Increase of Income Tax Bases	Ibid	Low	Greater Centralization	n/d	n/d	n/d

<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
25865	2003	VAT Exemption & Tax Amnesty for Autonomous Workers	Positive: Stabilization and Recovery after 2002 Devaluation	Low	Limited Centralization	n/d	n/d	n/d
25866	2003	VAT Exemption for Periodicals	None	Low	Status Quo	n/d	n/d	n/d
25868	2003	Extension of Excise Taxes	None	Low	Status Quo	Status Quo	-	-
25920	2004	Ratification of Blanket VAT Exemptions	Positive: Stabilization and Recovery after 2002 Devaluation	Low	Status Quo	Limited: inbuilt	Medium	-
25923	2004	Amnesty for Provinces and Municipalities for Non-Compliance with Teachers Incentive Funds	Ibid	Low		Limited: inbuilt	Medium	-
25924	2004	Fiscal Credits for Investment in Capital Goods	Ibid	Low	Greater Centralization	Ibid	Medium	High
25951	2004	Reduction of VAT Rates for Agrarian Activities	Ibid	Low	Decentralization	Ibid	Medium	High
25987	2004	Income Tax Exemption for Retirees	Ibid	Low	Decentralization	n/d	n/d	n/d
26022	2005	Gasoil and Liquid Fuel Taxes Exemptions	Ibid	Low	Greater Centralization	Limited: inbuilt	Medium	Medium
26022	2005	Liquid Fuel Tax Exemptions	Ibid	Low	Greater Centralization	Ibid	Medium	Medium
26028	2005	Tax on Gasoil Sales and Earmark	Ibid	Low	Greater Centralization	Limited: Infrastructure Funds transfers	Low	High

<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
26050	2005	VAT Reduction Rates for Fertilizers	Ibid	Low	Greater Centralization	n/d	n/d	n/d
26074	2005	Gasoil Tax Exemptions	Ibid	Low	Greater Centralization	n/d	n/d	n/d
26093	2006	Fiscal Credits for Investment in Biofuel	Ibid	Low	Greater Centralization	n/d	n/d	n/d
26095	2006	Taxes on Gas and Electricity Fares and Earmarks	Ibid	Low	Greater Centralization	Limited: Electricity Fund transfers	Low	High
26111	2006	Accrual of VAT Payments for Buyers of Reactive Substances	Ibid	Low	Greater Centralization	n/d	n/d	n/d
26112	2006	VAT Exemption for Public Financial Trusts for SMEs	Ibid	Low	Greater Centralization	Limited: inbuilt	High	-
26115	2006	VAT Exemption for Public Entertainment	None	Low	Status Quo	n/d	n/d	n/d
26151	2006	Exemptions and Differential VAT Rates	Positive: Stabilization and Recovery after 2002 Devaluation	Low	Greater Centralization	Limited: inbuilt	High	-
26154	2006	Fiscal Credits for Fuel Drilling	Ibid	Low	Greater Centralization	Limited: inbuilt	High	-
26176	2006	Income Tax Exemption for Oil Workers	Ibid	Low	Greater Centralization	Limited: inbuilt	Low	-
26180	2006	Extension of Income Tax and Revenue-Sharing Rules	None: Periodical Renewal	Low	Status Quo	Limited: Budgetary Increases for Public Works	Medium	Medium
26181	2006	Tax on Sales and Imports of Petrol and Natural Gas	Positive: Stabilization and Recovery after 2002 Devaluation	Low	Greater Centralization	Limited: Water Infrastructure Fund transfers	Low	High

<b>Law</b>	<b>Year</b>	<b>Description</b>	<b>Shocks</b>	<b>PNS</b>	<b>Nature of Changes</b>	<b>Nature of Compensation</b>	<b>Presidential Discretionality of Compensation</b>	<b>Gubernatorial Discretionality of Compensation</b>
26287	2007	Reduction of Income Tax Bases	Ibid	Low	Greater Centralization	Limited: Budgetary Increase for Public Works	Medium	Medium
26317	2007	Increase in Personal Tax Rates	Negative: Inflationary Acceleration and Reduction of Fiscal Surplus	Low	Greater Centralization	Ibid	Medium	Medium
26325	2007	Gasoil Tax Rates and Earmark	None	Low	Greater Centralization	Ibid	Medium	Medium
26340	2007	Extension of Bank Debts and Excise Taxes	None: Periodical Renewal	Low	Greater Centralization	Ibid	Medium	Medium
26346	2007	Extension of VAT Base	Negative: Inflationary Acceleration and Reduction of Fiscal Surplus	Low	Greater Centralization	n/d	n/d	
26360	2008	Fiscal Credits for Capital Goods	Negative: Inflationary Acceleration, Reduction of Fiscal Surplus and Economic Activity	Low	Greater Centralization	Limited: inbuilt	High	-

*Source:* Author's compilation based on Chamber of Deputies and Senate data.

To appreciate some of these patterns in greater detail, two case studies are presented below: the 1992 tax reform and the 2001 blanket delegation of tax authority.

### *6.2.1 The 1992 Tax Reform*

The 1992 tax reform is a unique case of failure on the part of the federal government to impose an institutional change upon the provinces in fiscal affairs. The original aim of the Finance Ministry, the gradual replacement of the income tax with a tax on the Primary Surplus of Firms (IEPE), had to be given up in the face of provincial opposition, and was replaced by significant increases in the rates and bases of the very same income tax and the VAT. At the root of this failure was a compensation scheme that conflicted with the incentives of parties with high levels of integration and nationalization.

The motivation for the tax reform was twofold: to boost economic growth by reducing the tax burden to firms, and to appropriate revenues to finance the national social security system. Inflation stabilization after the introduction of the Convertibility Law triggered, alongside economic recovery, an important increase in the net tax burden: total public sector revenues rose by 2.3 percent of GDP in 1991. The Finance Ministry intended to redistribute this burden so that it affected consumption more than investment, and thus encouraged firms to expand their activities and contribute to consolidate economic growth. Moreover, social security spending was ballooning because the federal government had accumulated a substantial floating debt during the hyperinflation years by miscalculating the due actualization of pensions. The Finance Ministry intended to capture a share of the revenue increases generated by the economic recovery to finance social security.

To address these issues, Finance Minister Domingo Cavallo came up with the idea of gradually replacing the income tax on firms with a tax on the primary surplus of firms (IEPE), which would tax only those earnings that firms did not reinvest in their production process. Combined with a generalized VAT with higher rates, this tax would induce firms to shift earnings from consumption and financial speculation to investment in their own expansion, and would concentrate the tax burden on consumption rather than investment. In addition, the revenues from the IEPE would be earmarked for social security and would therefore be distributed between the federal government and the provinces according to the number of pensioners registered in each jurisdiction.



The Executive sent the tax bill to Congress in December 1991 without any previous consultation with either legislators or governors. By then, the level of integration of the main parties was high. The PNS of the PJ was 0.88, and while the UCR's had dropped to a then-historical low of 0.75, its legislative contingent had not lost its voting unity, calculated at 1 in the Rice Index for this legislative period (Morgenstern, 2004). The incentive for the legislative leaders of both parties was therefore to obtain a generalized compensation scheme in exchange for supporting the tax reform. But the Executive's bill was proposing exactly the opposite: limited compensation that would benefit only the larger provinces at the expense of the rest.

When the bill reached the Budget and Treasury Committee (BTC) in the Chamber of Deputies, it became clear that it was heading towards deadlock. The opposition UCR deputies objected to the idea that the IEPE would encourage the reinvestment of earnings and proposed that the income tax be revamped and made stricter instead. The Peronist deputies from the smaller provinces objected to the revenue-sharing regime of the IEPE, which would benefit only the federal government and the larger provinces—where the greatest number of pensioners were registered—and would therefore entail a net loss compared to the current distribution of income tax monies. Disagreements were so heated that the BTC proved unable to produce a report on the bill for consideration by the Chamber.

The federal government reacted by building on the positive inducements previously provided to the larger provinces and pushed the deputies from these districts to call for a special session of the Chamber in which the finance minister would try to overcome the objections to the tax initiative. The special session took place, but the finance minister was unable to persuade other provinces or the opposition to support the reform. Provincial parties from Chaco, Jujuy, Neuquén, Salta, San Juan, and Tucuman joined the UCR in opposing the bill, and the PJ could not gather support for it beyond the delegations from Buenos Aires, Santa Fe and Cordoba (*Honorable Cámara de Diputados de la Nación, Diario de Sesiones*, March 11, 1992: 5778-5883).

President Menem then ordered Cavallo to kill the IEPE. The finance minister attempted to salvage the financing for national social security spending by replacing the IEPE with an increase on the income tax on firms from 20 percent to 30 percent and by requesting authority from Congress to grant exemptions to the value-added tax in order to reduce the tax burden on

firms (*Ambito Financiero*, March 12, 1992). Provincial delegations in Congress reacted by conditioning their support to the introduction of new revenue-sharing rules for income tax receipts. The province of Buenos Aires, the biggest loser from the rejection of the IEPE, demanded that a special fund be set up to finance social policy spending in the Greater Buenos Aires area, where the majority of Argentina's poor are concentrated. The smaller provinces responded that they would only consent to such an earmark if an equivalent fund was set up to finance equivalent spending in the remaining jurisdictions, and if the federal government committed to financing any fiscal disequilibria that might arise in particular provinces in the aftermath of this reform. Eager to obtain the funding for social security and to avoid further losses, the federal government yielded to provincial pressure, and the tax reform was passed by both houses in two weeks—the minimum timeframe stipulated by congressional regulations for the ordinary parliamentary consideration of bills.

The structure of the compensation scheme granted by the federal government to obtain provincial consent for the reform was the following: 10 percent of income tax revenues were allocated to the Fund for Social Programs in the Greater Buenos Aires (FCB) to be exclusively enjoyed by the Province of Buenos Aires; 4 percent was distributed among the remaining districts according to the Basic Unsatisfied Needs Index; 2 percent was channeled to expand the National Treasury Contributions (ATN) fund controlled by the Interior Ministry. The remaining 84 percent was distributed in accordance with the primary and secondary distribution coefficients from the 1988 Co-participation Law (Law 24,073, article 40). This generalized compensation scheme granted only marginal discretionality to the president in the management of the ATN fund, whereas transfers for the Greater Buenos Aires and Basic Social Infrastructure Funds were only subjected to low discretionality—i.e., the management of the timing and payment factors.

The 1992 tax reform decision-making process illustrates how the incentives of leaders of highly integrated parties shape fiscal decision-making. The limited compensation scheme proposed by the federal government was so divisive among the provinces that the PJ legislative leaders preferred not to force the party to make any explicit decision on the bill: had they pushed for a committee report, the outcome would have probably been the rejection of the bill, which would have harmed not only the Executive but also the legislative leadership itself. Instead, by blocking the bill in the Budget and Finance Committee, the PJ leadership in the Chamber forced the Executive to assume the cost of discussing and losing the floor debate and preserved its

power to negotiate a better deal once the failure of the original became clear. This made it possible for the PJ to finally coordinate its demands to the Finance Ministry, and thus obtain a generalized compensation scheme.

This episode also illustrates how the high level of integration of parties generates outcomes of limited centralization of authority in the federal government and generalized compensation for the provinces. Once the limited compensation scheme attached to the IEPE was dropped, party leaders were quickly able to coordinate a bargaining position vis-à-vis the Executive. This common position revolved around a generalized compensation scheme from which all provinces would draw benefits and the limitation of the tax authority to be delegated to the Executive. The earmarking of income tax revenues for social spending provided fresh funds for the provinces that governors could manage with a moderate level of discretionality (see Table 10). The limited delegation of tax authority to the president signaled the interest of leaders from highly integrated parties to avoid a manipulation of tax rates and bases that could introduce inequalities in the tax burden across provinces. By avoiding such inequalities and introducing a generalized compensation scheme of low presidential discretionality, party leaders managed to maximize benefits and minimize costs for all districts—an outcome consistent with the strategic electoral aim of maximizing vote shares across the country.

### *6.2.2 The 2001 Blanket Delegation of Tax Authority*

The 2001 blanket delegation of tax authority is one of the few tax reforms in the period that was approved by urgent parliamentary treatment in the course of three days. It also constitutes the broadest, least limited delegation of tax authority in Argentine democratic history, and it was passed by parties whose integration was falling steadily and which were therefore experiencing a lack of effective leadership.

The blanket delegation of authority to reduce or eliminate taxes was sought by the federal government as a tool to fight the recession that had been plaguing the Argentine economy since 1998 and which had been deepened by the financial crisis that exploded in October 2000. In 1999-2000, Argentina's GDP had dropped by 4.2 percent while the tax burden of the total public sector on the economy had increased by 0.5 percent of GDP. The typical alternative policy tool used to improve competitiveness and growth in the context of exchange-rate appreciation, the

devaluation of the currency, was perceived both by the government and the opposition, as well as by investors and the general public, to be extremely costly, since it entailed the breakdown of an extensive network of dollar-denominated contracts that hinged on the maintenance of the dollar-peso parity fixed by the Convertibility Law (Galiani et al., 2003). With exchange-rate devaluation foreclosed, the option remained to pursue a fiscal devaluation strategy, based on tax reductions, exemptions, and credits.

The Finance Ministry, led again by Domingo Cavallo, requested from Congress on March 22, 2001, a blanket delegation “to create or eliminate exemptions and reduce taxes or rates” (Message 0001-PE-01, Article 11, clause II.b) as well as to create taxes earmarked for infrastructure projects, restructure public administration, and eliminate regulations that could be hampering economic activity (*ibid.*: various clauses). In order to finance tax reductions, the government also requested that Congress reintroduce the Bank Debits Tax and allocate its full revenues to the federal Treasury, without sharing any of the proceeds with the provinces. The wording of the requested delegation did not clarify which taxes the Executive would be empowered to manipulate—national, provincial, or both. In addition, the appropriation of revenues from the Bank Debits Tax meant that the provinces would be deprived of fresh funds from one of the only tax sources still available to the public sector in the absence of devaluation and inflation.

The Congress from which Cavallo requested the blanket delegation of tax authority was almost the exact opposite of the one to which it had presented the 1992 tax reform. The Peronist party had become a de-nationalized party (with a PNS of 0.81, the lowest since 1983) and the UCR was only hiding its de-nationalization in the coalition it had formed with FREPASO. The Peronist leadership was divided among former President Menem, the losing presidential candidate Duhalde, and the aspiring governors of the provinces of Buenos Aires, Cordoba, Santa Fe, San Luis, Misiones, and Santa Cruz, among others. The UCR leadership was divided between President Fernando de la Rúa and former President Alfonsín. The FREPASO leadership was divided between former Vice-President Alvarez—who had resigned his position in October 2000—and Minister Fernandez Meijide, who had remained in the Cabinet. Parties with increasingly unequal shares of the vote across districts and no effective national leadership constituted the poster case of a poorly integrated, de-nationalized party system.

Governors and legislators from all political parties except Cavallo's *Acción por la República* (APR) objected to the proposal that the finance minister had labeled *Competitiveness Law*. The governors objected to the vagueness of the tax authority delegation requested and demanded that the bill make it explicit that only national taxes would be subjected to manipulation by the Executive. Advised by legislators, governors conditioned their support on an explicit reassurance that intergovernmental transfers emerging from the Co-participation Law, the fiscal pacts, and special funds legislation would not fall under the scope of the delegated authority. This reassurance was perceived as necessary insofar as the bill stipulated that the Executive would be empowered to allocate the payment of the Bank Debits Tax to the value-added and income tax bills of firms. If such an accounting rule were introduced, then the revenues for these taxes would decrease proportionally to the payments accrued, and so would the co-participation monies corresponding to those revenues. The effect of the explicit reassurance would be that accrued payments from the Bank Debits Tax would be financed entirely from the federal government's share of the income and value-added taxes. In turn, legislators objected to the packaging of the Bank Debits Tax and the blanket delegations on tax, administrative, and regulatory matters, and suggested that delegations be discussed and voted on in a separate bill. By slicing the original bill in two, legislators would win time to bargain among themselves and with the federal government. The Executive accepted these amendments, and the Competitiveness Law was approved on March 23, 2001, without the blanket delegation of powers to the president.

The Chamber of Deputies resumed discussion of the blanket delegation two days later via a discharge petition supported by both main parties. The Alliance's legislative leaders then presented the Chamber with a text that introduced substantial amendments to the original bill. On the tax delegations, the new bill specified that a) exemptions and reductions could only be applied to national taxes; b) no exemption benefiting the basic consumption basket, local economies, cooperative associations or union-run health-care organizations could be eliminated; c) tax reductions would be oriented to improving the competitiveness of economic sectors and regions; d) infrastructure projects to be financed with any new tax revenues would be distributed equally across the country; and e) special tax deferrals, reimbursements, deductions, discounts, and amortization regimes would be established for those municipalities where unemployment

was caused by the privatization of public enterprises (Law 25,414, Article 1, clauses II.a, c and d). In sum, the fiscal devaluation would be entirely financed by the federal government, and its beneficiaries would be determined by the Executive. After two full days of debate, the Chamber approved the delegation with a rather small coalition—42.18 percent of its membership—which meant that the government’s coalition was unable to get even its own majority behind the initiative. The Senate passed it one day later without amendments, due to the cooperation of the Peronist opposition majority.

The 2001 blanket delegation of tax authority illustrates the combined effect on tax lawmaking of negative economic shocks and the decrease in the integration of political parties. The negative shock prompted the federal government to ask Congress for the most centralizing tax institution of all: the delegation to create, eliminate, and manipulate taxes, rates, and exemptions. The shock also led deeply divided parties to cooperate and pass the initiative in record time. But at the same time, the low level of integration of parties and the absence of effective national leadership prevented party leaders from introducing any significant detailed limitation on the delegated tax authority. On the contrary, intra- and inter-party negotiations simply made more explicit the highly discretionary nature of the delegation. By authorizing the Executive to allocate exemptions according to the competitiveness needs of sectors and regions, and by empowering it to create all sorts of tax benefits for municipalities experiencing high levels of unemployment, Congress granted the president a limited compensation scheme with which to distribute benefits to some districts over others. In short, the episode suggests that an extreme centralization of tax authority may be achieved if a negative shock occurs and the level of party integration is low enough that parties have no effective leadership to coordinate and internalize bargaining costs.

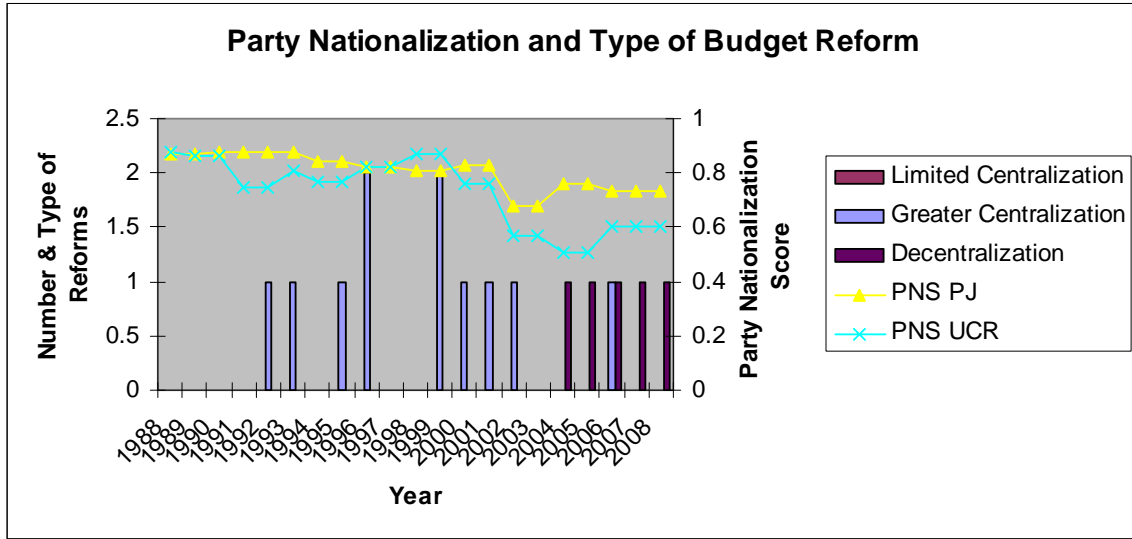
The comparison between this episode and the 1992 tax reform could hardly be more striking. In 1992, a Congress made up of highly integrated and nationalized parties rejected the Executive’s proposal of a tax reform that centralized revenues in the federal government and granted the president the authority to manipulate VAT rates and exemptions. In 2001, a Congress made up of poorly integrated, de-nationalized parties accepted the Executive’s proposal of a new tax to be entirely appropriated by the federal government and granted the president a blanket authority to create, eliminate, and manipulate any national tax. In 1992, in the midst of a strong positive shock to the economy, Congress passed a reform that increased the tax burden by about

2 percent of GDP and distributed the proceeds among the provinces using a generalized compensation scheme. In 2001, in the midst of a negative strong shock, Congress passed a reform intended to decrease the tax burden and distributed its benefits using a limited compensation scheme. This contrast suggests that the higher the level of party integration and the better the economic environment, the less likely that centralizing tax reforms with limited compensation schemes will ever be enacted.

### **6.3. Budget**

The theoretical model was only partly accurate in predicting fiscal reform outcomes in the budget area. As Figure 16 shows, the reforms of budgetary institutions produced greater centralization of authority in the federal government in more contexts than expected—i.e., not only, as expected, when party integration was low, but also when it was high according to Party Nationalization Scores. This might be explained either by the nature of compensation, which mostly accrued to all provinces, or by actual budgetary policy, which, as argued elsewhere (Rodríguez and Bonvecchi, 2006), also yielded benefits to most subnational districts. The deviant cases of decentralizing reforms enacted by poorly integrated, de-nationalized parties, in turn, might be interpreted as compensation from the federal government to the provinces in the aftermath of the consolidation of a most centralizing reform: the delegation of budgetary amendment powers to the Cabinet chief, analyzed below.

Figure 16.

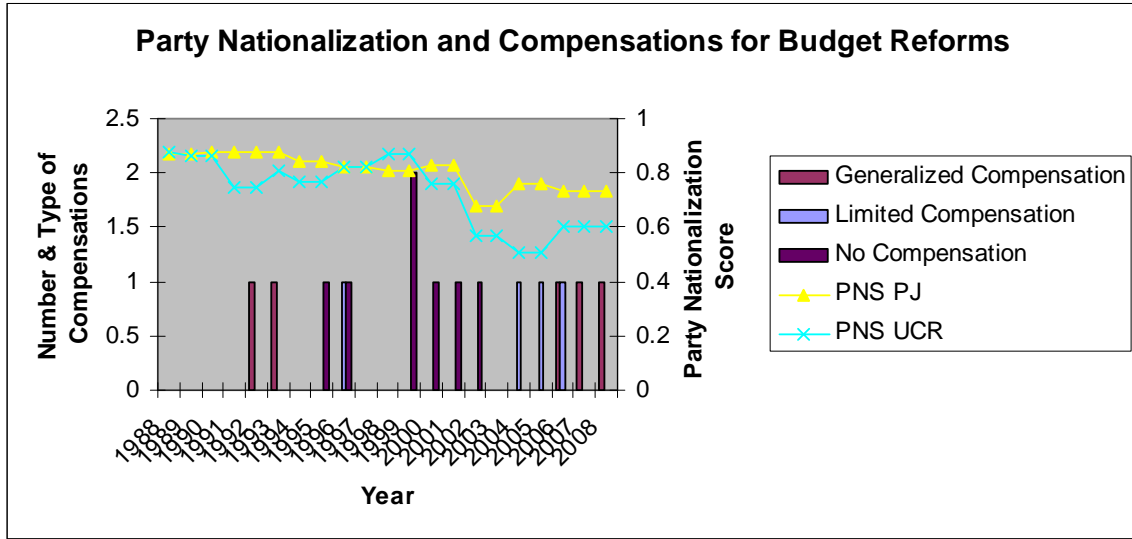


Source: Author's compilation based on Table 10 for reforms and Figure 9 for PNS.

The theoretical model was more accurate in predicting the nature of the compensation schemes with which the federal government obtained provincial support for budgetary reforms. Figure 17 shows that the theoretically expected association between the type of compensation and the Party Nationalization Scores of the main Argentine parties obtained: generalized compensation schemes distributed when party integration was high; limited or no compensation as party integration decreased. The interaction with the types of shocks, however, did not entirely turn out as expected. Table 10 shows that all cases of reforms enacted by highly integrated and nationalized parties were paid for as theoretically expected: with generalized compensation schemes under positive shocks, and without compensation under negative shocks. But there were deviant cases, as the same table shows: reforms enacted without compensation by de-nationalized parties. This pattern, however, may be explained by the relatively higher power of the federal government vis-à-vis provincial government in such party contexts.



Figure 17.



Source: Author's compilation based on Table 10 for reforms and Figure 9 for PNS.

The decision-making processes of *institutional* reforms in the budgetary area since 1992 have revolved around the following patterns: centralization of budgetary authority in the federal government in exchange for compensation during positive shocks and no compensation during negative shocks until 2006, and decentralizing reforms with limited compensation thereafter. In contrast, budget *policies* have remained fairly constant, with regular spending priorities and increases, except for the recession years of 1995-96, and 2000-2002.<sup>48</sup> The only innovations in budgetary policy were the introduction of fiduciary funds managed by some ministries apart from the budgetary system but under the control of the president, the re-creation of public enterprises as units with specific budget systems, and the withdrawal of certain entities from the budgetary system. These changes weakened the hierarchical position of the Finance Ministry in the budget process and therefore its control over spending and financial management, but they simultaneously increased the dominance of the president over these expenditures. These patterns can be explained by the following factors.

First, the effects of shocks were consistent with theoretical expectations: they mostly triggered the introduction of centralizing institutions. All budgetary institutional reforms except for the 2006 Financial Administration reform were prompted by shocks, and all shocks incited

<sup>48</sup> For this reason, the analysis in this paper concentrates on institutional reforms rather than budget policies.

the federal government to seek centralizing reforms except for the recovery after the 2002 devaluation and the acceleration of inflation after 2005. All centralizing reforms seem to have been motivated by the aim of reinforcing stabilization policies. The exception is the 2006 Financial Administration reform, analyzed below. As for budgetary policy reforms, the inception of the fiduciary funds also seems to have been prompted by negative shocks. These funds were created during the recession years of 1995-96 and 2000-03 in order to enable the public sector to increase expenditures in certain areas—particularly infrastructure—without counting the extra spending within the regular public sector budget. This made it possible to avoid an official increase in the budget deficit and the subsequent boost of risk premiums and interest rates on the public debt (Abuelafia et al., 2006: 237-240).

Second, the decrease in party integration complicated the internal bargaining dynamics of parties. Voting unity in the floor, as shown in Table 10, decreased for all parties in the second half of the 1990s as party de-nationalization deepened, but the PJ recovered its previously high ratings as the Congressional delegation of budgetary powers was consolidated as a regular practice. In turn, partisan support for committee reports became increasingly divided as the level of party integration decreased. This appears to be consistent with a recent trend in the reform of budgetary institutions: the federal government's resorting to rules that enable provinces to increase spending beyond the limits set by the Fiscal Responsibility Law.

This form of decentralizing institutional change seems to have followed a deepening in intra-party division, particularly in the PJ, as can be appreciated in the recurrent division of the party in committee coalitions depicted in Table 10. The federal government's response to these deepening intra-party clashes appears to have been a combination of generalized and limited compensation. By allowing all provinces to increase spending beyond the limits of the Fiscal Responsibility Law, the federal government effectively compensated subnational units for the lack of access to the credit markets experienced by the whole country as a consequence of the incomplete resolution of the 2001 default. By repeatedly and significantly amending the budget in favor of specific provinces and/or programs to be executed in the provinces, the Executive distributed more benefits to some jurisdictions over others. This enabled the federal government to build highly disciplined coalitions on the floor of both houses of Congress despite the low level of integration of political parties.

**Table 10. Budgetary Reforms and their Determinants, 1992-2008**

Law	Year	Description	Shock	PNS	Committee Support Coalition	Rice Index PJ	Rice Index UCR	Nature of Changes	Nature of Compensation	Presidential Discretionality of Compensation	Gubernatorial Discretionality of Compensation
24156	1992	Financial Administration Law	Positive: Stabilization and Recovery after Convertibility	High	PJ vs UCR (D) PJ + Others vs UCR (S)	n/d	n/d	Centralizing and Hierarchical: numerical rules, restrictions to spending increases	Generalized: 1992 Fiscal Pact	Low	High
24307	1993	1994 Budget	Ibid	High	n/d	n/d	n/d	Centralizing and Hierarchical: authorization to increase spending	Generalized: increase of Public Works spending via Treasury Obligations Fund	Medium	Medium
24624	1995	1996 Budget	Negative: Tequila crisis & recession	Low	n/d	1	1	Centralizing and Hierarchical: delegation of amendment powers	None	-	-
24629	1996	Second State Reform Law	Ibid	Low	n/d		n/d	Ibid	None	-	-
24764	1996	1997 Budget	Positive: Recovery after Tequila	Low	PJ vs PJ + UCR vs PJ + Others vs Others (D) PJ vs UCR + Others (S)	0.35	n/d	Ibid	Limited: non-industrial promotion tax credits	Medium	High
25152	1999	Fiscal Solvency Act	Negative: Recession & Brazilian Devaluation	Low	PJ vs UCR (S) PJ vs Others (D)	n/d	n/d	Centralizing and Hierarchical: numerical & transparency rules	None	-	-

Law	Year	Description	Shock	PNS	Committee Support Coalition	Rice Index PJ	Rice Index UCR	Nature of Changes	Nature of Compensation	Presidential Discretionality of Compensation	Gubernatorial Discretionality of Compensation
25237	1999	2000 Budget	Ibid	High	PJ vs PJ + UCR (S) PJ + Others vs PJ + UCR + Others vs Others (D)	n/d	n/d	Centralizing and Hierarchical: delegation of amendment powers	None	-	-
25401	2000	2001 Budget	Negative: Recession & Financial Crisis	High	PJ vs UCR + Others vs UCR + Others (D)	0.97	1	Centralizing and Hierarchical: delegation of amendment powers	None	-	-
25453	2001	Zero Deficit Act	Ibid	Low	Ibid	0.95	0.96	Centralizing and Hierarchical: cash basis rule	None	-	-
25725	2002	2003 Budget	Negative: Collapse of Convertibility & Default	Low	PJ vs PJ + UCR + Others vs Others (D)	n/d	n/d	Centralizing and Hierarchical: delegation of amendment powers	None	-	-
25967	2004	2005 Budget	Positive: Stabilization and Recovery after 2002 Devaluation	Low	PJ vs PJ + Others vs UCR + Others (D)  PJ vs PJ (S)	1	1	Decentralizing: deferral of provincial obligations on budgetary transparency Hierarchical: finance of spending increases with Treasury Obligations Fund	Limited: increases in Public Works and University spending	Medium	Medium

Law	Year	Description	Shock	PNS	Committee Support Coalition	Rice Index PJ	Rice Index UCR	Nature of Changes	Nature of Compensation	Presidential Discretionality of Compensation	Gubernatorial Discretionality of Compensation
26078	2005	2006 Budget	Positive: Stabilization and Recovery after 2002 Devaluation	Low	PJ + Others vs UCR + Others vs Others (D) PJ (S)	1	1	Decentralizing: ibid above	Ibid	Ibid	Medium
26124	2006	Reform of Financial Administration Law	None	Low	PJ + Others vs UCR vs Others (D)  PJ vs PJ + Others (S)	1	1	Centralizing and Hierarchical: permanent delegation of amendment powers	Limited: inbuilt	High	-
26198	2006	2007 Budget	Negative: Inflationary Acceleration	Low	n/d	1	0.87	Decentralizing: exemption from spending limits for provinces	Generalized: inbuilt Limited: increases in Public Works and University spending	Generalized: none Limited: high	Generalized: High Limited: Medium
26337	2007	2008 Budget	Negative: Inflationary Acceleration and Reduction of Fiscal Surplus	Low	PJ + Others vs UCR + Others vs Others (D)  PJ vs PJ (S)	1	0.85	Ibid	Generalized: inbuilt Limited: increases in Public Works spending	Ibid	Ibid
26422	2008	2009 Budget	Negative: Inflationary Acceleration and Reduction of Fiscal Surplus	Low	PJ + Others vs PJ + Others vs Others (D)  PJ vs PJ (S)	0.98	1	Decentralizing: exemption from spending limits and budgetary transparency rules for provinces	Generalized: inbuilt Limited: increases in Public Works spending	Ibid	Ibid

Source: Author's compilation based on Chamber of Deputies and Senate data.

Third, compensation schemes were adapted to the changing level of party integration. Until 1995, parties with high levels of integration used institutional arrangements that accrued benefits to the provinces with the least possible presidential discretionality and the highest possible gubernatorial discretionality to pay for reforms that organized the budgetary process under the leadership of the Finance Ministry: the monthly fixed sum and the transfer of special funds management in the 1992 Fiscal Pact, and the use of the Treasury Obligations Fund (a.k.a. Jurisdiction 91) to finance expenditures added by legislators in Congress. Between 1995 and 2005, increasingly de-nationalized parties used particularistic benefits such as Public Works transfers—which afforded moderate discretionality to the governors—to pay for the constant increase in the Executive’s power within the budget process, both under negative and positive shocks to the economy. This helps to explain how the federal government was able to obtain provincial consent for reforms throughout these years. The exception that must be accounted for occurred in 2006, when after PJ dissidents drove Congress to resume its budgetary amendment powers and expand expenditures well beyond the Executive’s original proposal, the federal government sought and obtained the permanent delegation of those powers via the reform of the Financial Administration Law without explicit compensation.

To explain these patterns more pointedly, two cases are analyzed below: the 1992 Financial Administration Law and its 2006 reform.

### *6.3.1 The 1992 Financial Administration Law*

The reform of budgetary procedures eventually enacted as the Financial Administration Law (Law 24,156) was launched as part of the stabilization program of which the Convertibility Law was the centerpiece. While the establishment of a currency board and a fixed exchange rate was aimed at controlling the money supply and forcing the public sector into adjustment, the budgetary reform was oriented to reorganizing the budget process in such a way that the Executive, and particularly the Finance Ministry, could control both the formulation and the implementation of the budget. This reorganization was perceived as necessary by the federal government because hitherto the Treasury Secretary at the Finance Ministry only had jurisdiction over the central administration, i.e., the federal government ministries and a few other entities, while significant chunks of the public sector budget, such as the public enterprises, the military enterprises, and the decentralized units, formulated and managed their budgets autonomously.

This limited jurisdiction effectively prevented the economic authorities from controlling public spending, and therefore structurally jeopardized macroeconomic management and, of course, stabilization efforts. The centralization of budgetary authority in the Finance Ministry and the introduction of financial management rules and operating systems to monitor and change budgetary decisions on a daily basis was thus seen both as a complement to the Convertibility Law and as a capacity that the Argentine state had to acquire.

The bill was sent to Congress on April 12, 1991. By then, both the PJ and the UCR enjoyed high levels of party integration as measured by nationalization scores (0.88 and 0.86 in the PNS, respectively) and were controlled by strong national leadership. Since leaders could coordinate intra-party bargaining, the logic of inter-party competition led congressional discussion of the initiative to focus on the budgetary powers of the Executive vis-à-vis the legislature. No debate was held or amendments introduced to the articles pertaining to the expansion of the budget's jurisdiction or the hierarchization of the Treasury Secretary within the financial administration system.

The initiative, drafted by the Finance Ministry under Domingo Cavallo, proposed several devices to curtail the power of Congress to amend the budget proposal or expand budgetary spending. First and foremost was the possibility of tacit approval of the budget bill: if the Executive's budget proposal, due to be presented by September 15 each year, was not approved by Congress before December 15 of the same year, then the Executive would nevertheless put it into effect (Message 1529: article 26). Given the technical complexity of the budget bill, the timing of its presentation to Congress, and the fact that Congress is typically forced to pass a significant number of initiatives before the end of each ordinary legislative year so that they are not killed by regulation, this rule made it highly likely that future budgets would be tacitly approved and not explicitly debated, and hence not amended, by legislators.

Secondly, there was the limitation to increase expenditures beyond those indicated in the Executive's budget proposal: according to Article 28 of the bill, any increase in the total expense budget presented by the Executive would have to explicitly identify its own financial source (Message 1529: Article 28). Thus, unless new financial sources were included, no new spending could be introduced by Congress.

Finally, there was the matter of Congressional oversight of budgetary execution, which the Executive's bill assigned to a National General Oversight office that would depend on the president of the Chamber of Deputies, would be run by an inspector general appointed by the Senate on the president's recommendation, and would be empowered to control the budgetary, economic, financial, patrimonial and administrative management of the national public sector units (Message 1529: Articles 117-127). These rules would prevent the opposition from controlling the government unless the latter lacked control of the Senate and senators proved able to impose an inspector general not aligned with the president.

The UCR deputies were adamant in their opposition to these aspects of the initiative, and the Peronist party did not show any interest in pushing for a committee report until after the September legislative and gubernatorial elections. The election outcomes were balanced: the PJ obtained a significant plurality, but lost one congressional seat and three governorships to the UCR, while the latter managed to retain its role as the largest opposition party both in Congress and in the provinces. Since the Peronists still had no control over the quorum in the Chamber of Deputies, they were unable to secure the approval of any bill without cooperation from the opposition. This led them to amend the Financial Administration bill in such a way that it could gain support from the UCR. Thus, the tacit approval rule was relaxed by incorporating the provision that if Congress would not approve the bill before December 15, then the president could call for an extraordinary session of Congress or extend the ordinary session so that it could be passed. The National General Oversight was renamed National Auditor General, placed under jurisdiction of the Joint Parliamentary Accounting Review Commission composed of senators and deputies, and its appointment rule was changed to a joint decision by both houses of Congress without Executive intervention. The UCR supported the committee's majority report, but insisted on further amendments when it reached the floor.

During the floor debate in the Chamber, the opposition pressed for and obtained the removal of the tacit approval rule for the Budget and the Investment Account, i.e., the budgetary execution report. The UCR also obtained the introduction of certain limitations to the expenditures that the Executive could increase during budget execution without Congressional authorization. Additionally, the institutional capacity of the National Auditor General was expanded: its jurisdiction was enlarged to encompass regulatory bodies and any unit that managed public monies, and it was given the capacities to file lawsuits against offenders and to



suspend the implementation of decisions made by offenders. However, the bill was stalled in the Senate, partly due to disagreements within the Executive as to the capacities and the governance structure of the Auditor General, but also because the provinces were in conflict with the federal government over the 1992 tax reform and the appropriation of Co-participation funds for social security promoted by the Finance Ministry.

The Senate's Budget and Finance Committee only reported on the bill after the signature of the Fiscal Pact in August 1992, which explicitly committed the governors to call on their legislators for the approval of the Financial Administration Law (1992 Fiscal Pact, clause 7, ratified by Law 24,130). The Senate's report reversed some of the amendments introduced at the request of the Radicals in the Chamber. The Auditor General's ability to file lawsuits and suspend administrative decisions was eliminated, and its dependence on the Joint Parliamentary Committee was strengthened. Finally, the Peronist majority in the Senate floor changed the appointment rule for auditors general: three would be appointed by each house of Congress, with at least one representing the main opposition party, and a seventh by joint decision of both houses. This implied that unless the opposition controlled one Chamber, it could never influence the oversight agenda. The bill was then returned to the Chamber, where the Peronists used their increased plurality and resorted to cooperation from provincial parties to accept the Senate's amendments despite the UCR's opposition.

The decision-making process of the Financial Administration Law illustrates how the centralization of budgetary authority in the Executive and the hierarchization of the budget process can be imposed regardless of the high level of integration of political parties. The packaging of this centralizing reform with the stabilization measures of the Convertibility program was effective in making the case for intra-Executive hierarchization of the budget process. The logic of inter-party competition and the government-opposition cleavage were instrumental in stopping the most centralizing feature of the initiative, i.e., the tacit approval of the budget. But they were not enough to prevent the government majority in Congress from weakening the institutional capacity and the political autonomy of the Congressional oversight agency (Bonvecchi, 2008). The generalized compensation schemes instituted by the 1992 Fiscal Pact seem to have done the trick: the monthly fixed Co-participation sum, the creation of the Provincial Fiscal Disequilibria Fund, and the transfer of the management of special funds to the

provinces. Once this compensation was enacted, the PJ proved able to mobilize its legislators in both houses to pass its preferred version of the bill.

### *6.3.2 The 2006 Financial Administration Reform*

The reform of the Financial Administration Law promoted by President Kirchner in 2006 is one of the few fiscal reforms in the past 20 years to be motivated not by an economic or policy shock but by entirely political considerations. It is also notable for the extremely centralizing institutional change it enshrined, as well as for the high level of support it commanded in the Peronist legislative majority. This reform therefore indicates that economic policy considerations may not be the sole factor triggering fiscal reforms and that political calculations should be incorporated as separate independent variables into future models of Argentine fiscal decision-making.

The political considerations that prompted Kirchner to initiate this reform were the recovery of the budgetary amendment powers that Congress had taken back from the Executive in the 2006 budget negotiations, and the reassertion of control over the Peronist legislative majority. Each motivation had its own history, but independent development converged precisely during those budgetary negotiations.

Since 1996, Congress had been implicitly or explicitly delegating to the Executive the power to amend the budget during execution beyond the limitations established by Article 37 of the Financial Administration Law.<sup>49</sup> This article stated that Congress had exclusive responsibility over a) decisions affecting the total amount of the budget or the total indebtedness foreseen, and b) any amendment that increased current expenditures to the detriment of capital expenditures or financial transfers, or changed the functional allocation of expenses. The Executive was prompted to systematically seek exemptions to these limitations by a combination of the changing financial situation of Argentina in the late 1990s, which generally triggered changes to the federal government's debt policy many a times in the fiscal year, and the decreasing integration of the Peronist party—visible in its lowering nationalization scores—which incited

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<sup>49</sup> Explicitly, in the 2000, 2001, 2004, and 2005 Budget Laws, the 1996 Second State Reform Law, and the 1997 Budget Amendment Law. Implicitly, by not repealing the presidential decrees that suspended the application of article 37 of the Financial Administration Law for the 1998, 1999, 2002 and 2003 fiscal years (Abuelafia et al., 2006: 237).

the Executive to create new institutional formats that could grant the president highly discretionary authority over transfers.

The economic collapse of 2001 subsequently reinforced the Executive's claim to these budgetary amendment powers. But once the economy recovered and grew steadily, the justification for these delegations came under attack by both the Peronist and the non-Peronist opposition to Kirchner. Thus, on the eve of the 2005 legislative election, the president instructed his finance minister to send a budget proposal without the request for amendment powers, in the hope that it would help him wrest some votes from the opposition.

The presidential faction of the Peronist party won the election, but the split of the PJ in the province of Buenos Aires prevented the government coalition from gaining a majority in the Chamber of Deputies.<sup>50</sup> In addition, all Peronist factions and the main non-Peronist opposition party, the UCR, were significantly de-nationalized: the PJ's aggregate PNS was 0.76—the second lowest score until then—and the UCR's was 0.51—its worst score since 1983. Encouraged by the mildly disappointing result obtained by the president's candidates and the lack of coordination within the PJ, the Peronist dissidents took advantage of their final days in the Chamber to press the rest of the PJ into passing the 2006 budget with their preferred expenses included. To entice the other legislators into cooperating with them, the dissidents pushed for a spending spree, which resulted in a 513 percent increase vis-à-vis the Executive's bill in the expenses typically amended by Congress: public works, universities, financial assistance to provinces, and national programs executed in subnational jurisdictions (Bonvecchi, 2008b). Unable to secure a loyal majority to repeal it, the president let the spending spree pass. But without the budgetary amendment delegation, the Executive was almost powerless to stop these expenditures from being made: this could only have been done via Decree of Necessity and Urgency, which would have entailed clashing with a Congress where the presidential faction was still a minority. The recovery of the budgetary amendment powers thus required the previous reconstruction of the government's legislative majority.

The first move towards rebuilding the presidential majority was the approval of the 2006 budget with the spending spree intact and without the amendment delegation. This helped

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<sup>50</sup> The split of the Buenos Aires faction had reduced the government's legislative coalition in the Chamber from 50 percent (129 deputies) to 38 percent (99 deputies). The 2005 victory only increased its size to 41 percent (106 deputies), which was still not enough for a quorum and the majority (Bonvecchi and Zelaznik, 2006).

convince some Peronist dissidents that the door was open to return to the government coalition, and many of them actually voted with the government. However, the remaining items on the legislative agenda could only be passed by slim majorities formed with tactical allies and opposed by the Peronist dissidents. It was only when the Executive pushed forward a bill to expand the Congressional majority's control over judicial appointments that the Peronist dissidence was finally divided, and the president managed to rebuild a majority with two-thirds of the dissident faction (Bonvecchi and Zelaznik, 2006).

With the presidential coalition again in control of the Chamber of Deputies, the Executive moved to recover the lost budgetary amendment powers. On June 30, 2006, President Kirchner sent a bill proposing the elimination from the Financial Administration Law of the limitations to budgetary amendments by the Executive during budgetary execution. The bill's only article deleted from Article 37 of the law the exclusive jurisdiction of Congress over amendments that increased current expenditures to the detriment of capital expenditures or financial transfers, or changed the functional allocation of expenses, and conferred upon the Cabinet Chief the power to make those amendments. The meaning of the reform was unmistakable: it implied that Congress would permanently delegate those amendment powers to the Executive.

The non-Peronist opposition and the remaining Peronist dissidents voiced their objection to the bill, but the rejection of the Peronist dissidents was actually not operative: instead of filing a minority report against the initiative, they signed the majority report in partial dissidence, which entails supporting the report, since partially dissident signatures are counted within the majority report. This paved the way for the construction of clear and highly disciplined majorities on the floor of both houses,<sup>51</sup> which passed the bill with only a minor clarification that did not affect its essence. The Executive thus obtained the most centralizing budgetary powers in Argentine democratic history without providing any explicit compensation to the provinces.

The decision-making process of the 2006 Financial Administration reform illustrates how parties with a low level of integration may opt for extremely centralized budgetary rules. Local and factional Peronist leaders were only interested in maximizing benefits for their constituencies, and were thus unable to form inter-temporally consistent winning coalitions. In the absence of incentives for inter-provincial and inter-factional coordination, the establishment

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<sup>51</sup> The coalition size in the Senate was 51.3 percent with a Rice Index of 93 percent; in the Chamber, the size was 52.7 with perfect voting unity (Rice Index of 1).

of a centralized budgetary amendment rule appeals to the majority of legislators, insofar as it enables each of them to engage in bilateral bargaining with the Executive and therefore increases the chances of outperforming each other in the competition for the distribution of budgetary spending. The compensation for provincial consent to such reform is built in: the possibility of being benefited by budgetary amendments in the future.

The contrast between the enactment of the Financial Administration Law in 1992 and its 2006 reform shows the differential effect of the party integration variable. In 1991-1992, in difficult and protracted negotiations, a Congress staffed by highly integrated and nationalized parties stopped an extremely centralizing reform—the tacit approval of the budget—and gave the Executive budgetary rules of an only limited centralizing and hierarchical nature. In 2006, a Congress made up of poorly integrated, de-nationalized parties granted the Executive an extremely centralizing budgetary rule in fast and insignificant negotiations. In 1992, the federal government had to employ a series of generalized compensation schemes via the Fiscal Pact to obtain provincial consent for the Financial Administration Law. In 2006, the limited compensation scheme was built into the reform, so no other transfer to the provinces was necessary. This comparison suggests that the lower the level of party integration, the more likely that the Executive can obtain Congressional approval for extremely centralizing and hierarchical budgetary rules.

## **7. Conclusion**

This paper has argued that fiscal reform activism in Argentina over the past two decades can be explained as the outcome of a combination of shocks that trigger government responses with the changing political integration of national parties in a polity whose decision-making rules encourage the formation of oversized coalitions. Economic or policy shocks explain the recurrence and frequency of fiscal reforms, and partly explain their nature. Shocks induce the federal government to promote reforms of tax, revenue-sharing, and budgetary rules and policies with the general intent of centralizing authority in the national Executive in order to facilitate the adaptation to those shocks. The formal and informal rules of fiscal decision-making provide the actors, and particularly the party leaders in the provinces and in Congress, with opportunities to shape the outcomes of reform processes.

The need to form oversized coalitions to enact reforms drives the federal government that promotes the reforms into accommodating the interests and demands of the largest possible number of party factions and provinces. But the level of party integration is the crucial incentive that drives party leaders to shape reform outcomes. Leaders from parties with high levels of integration, interested in maximizing their electoral chances across the country and therefore keen on pushing for rules and policies that distribute nationwide benefits, have usually negotiated and enacted reforms that afforded only limited centralization of fiscal authority to the federal government and were paid for with compensation that granted benefits to all provinces. They only operated differently under the influence of negative shocks, which generally prompted them to accept more centralizing reforms. In contrast, leaders from parties with low levels of integration, interested in maximizing votes in their own districts and hence not interested in the distribution of nationwide benefits, have typically consented to more centralizing reforms in exchange for benefits targeted to their territories. This has made fiscal reform activism possible despite the decrease in party cohesion triggered by the increasingly poor integration and de-nationalization of the main political parties.

The study of decision-making processes across fiscal areas suggests that the combination of negative shocks with a poorly integrated, de-nationalized party system has been particularly conducive to the introduction of reforms that impose a greater centralization of fiscal authority in the federal government. However, reforms of that nature have also been enacted at relatively low cost in the context of negative shocks and highly integrated, nationalized party systems. The analytical framework proposed here can account for this apparent theoretical anomaly by focusing on the differences across areas.

The incentives of party leaders in highly integrated, nationalized party systems are designed to coordinate their bargaining with the federal government by designing institutions and policies in such a way that benefits accrue to all subnational districts. In the face of a negative shock, the most suitable way to achieve this universalistic (Weingast et al., 1981) aim is through revenue-sharing rules or intergovernmental transfers that distribute funds to all districts. A generalized compensation scheme such as this would be the most effective tool to obtain consent from the governors to centralizing—and even restrictive—reforms in other fiscal areas due to the resources and incentives of highly nationalized parties. Since highly integrated parties are interested in maximizing electoral returns across districts, leaders can count on intra-party

bargaining to contain disruptive attempts to maximize benefits for particular districts. In such a bargaining environment, a generalized compensation scheme would be the most credible institutional device.

In contrast, centralizing reforms in the budgetary area under negative shocks cannot typically include generalized compensation schemes. A budgetary reform that makes decision-making more hierarchical but pays for provincial consent via new spending would be, in the midst of a negative shock, an inconsistent signal that would neutralize the efficiency of the reform itself. Hence, as the Argentine experience shows, no compensation would be granted for such a reform. In turn, centralizing reforms in the taxation area would also need to be compensated using transfers not built into the tax reform itself—such as discretionary intergovernmental aid—if the reform is to generate more revenues and centralize tax sources in the federal government. This would explain why highly integrated, nationalized parties may consent to centralizing tax and budgetary reforms: because the payoff parties can obtain for those reforms is a generalized compensation scheme through the fiscal federal area.

The comparison of decision-making processes across areas also suggests that although the decrease in the integration of political parties generally facilitates the inception of centralizing, hierarchical, and restrictive reforms, this may not necessarily be the case for budgetary reforms introduced under negative shocks. Negative shocks typically shrink revenues, both from the common pool and from the provinces' own sources, and leaders from poorly integrated parties cannot typically coordinate their bargaining positions vis-à-vis the general government. Consequently, there is little chance that they can resist the imposition of centralizing or hierarchical rules and/or restrictive policies in the taxation and fiscal federal areas. In contrast, the budgetary area provides a decision-making arena structurally more receptive to their non-coordinated demands. On the one hand, this is due to the incentives for the formation of oversized coalitions inherent in the budgetary policy decision rules, but on the other hand because poorly integrated parties have no incentive to contain the demands of subnational factions under such bargaining rules. In the absence of a national party leadership able to internalize bargaining costs and come up with a unified line, subnational leaders from poorly integrated parties would push for greater budgetary spending as a compensation scheme for their consent to centralizing, hierarchical, and restrictive reforms in other areas.

Cross-area comparisons may also help identify the conditions for specific types of fiscal reforms in Argentina. The propitious context to introduce a comprehensive reform of revenue-sharing rules that centralizes power in the federal government would be that of a negative shock and a poorly integrated party system. Negative shocks encourage centralization so that the federal government may have resources for adjustment and bear its costs. A poorly integrated party system is an environment in which subnational leaders unconcerned with nationwide benefits may trade their consent for centralizing reforms in exchange for targeted intergovernmental transfers. To introduce a decentralizing reform of revenue-sharing, any other scenario would be adequate, but not necessarily conducive. If parties are highly integrated and the economy experiences a negative shock, the federal government may veto a decentralizing reform in the name of a fair distribution of adjustment costs; if parties are poorly integrated, the federal government may block a decentralizing reform by forming minimal blocking coalitions via intergovernmental transfers that provide more benefits to the included districts than they might obtain from a revenue-sharing reform.

In the case of centralizing tax reforms, any context is conducive except that of a positive shock and a highly integrated party system. In such context, party leaders would typically coordinate actions to extract benefits from the center and distribute them evenly across provinces, rather than increase the federal government's coffers. Centralizing budgetary reforms, for their part, would be more likely if enacted by highly integrated parties regardless of the economic context or by poorly integrated parties under positive shocks: in both cases, subnational leaders can count on budgetary policy bargaining rules to extract compensation for their districts. In contrast, budgetary reforms introduced in the context of negative shocks and a poorly integrated party system would most likely be of a decentralizing nature or of only limited centralization insofar as they do not alter the federal government's budgetary amendment powers.

Finally, the comparison of decision-making dynamics in all fiscal areas points to the importance of inter-area compensation and particularly to the critical relevance of fiscal federalism as a key to the political dynamics of fiscal decision-making. As the study of the nature of the compensation granted to the provinces for their consent to fiscal reforms has shown, the increase of transfers in one fiscal area is frequently used to pay for the approval of reforms that decrease provincial access to funds in another area. The aggregate outcome of this



inter-area compensation seems to be the maintenance of spending abilities by the provinces. This, of course, would suggest that the fiscal federal system is inadequately designed, because if it were well designed, this inter-area compensation to sustain spending levels would not be necessary.

However, the patterns of decision-making identified in this paper also suggest that inter-area compensation is a rational and efficient response to the combination of an institutional structure that stimulates the formation of oversized coalitions, an economic structure that presents strong inter-provincial heterogeneities, and an increasingly poorly integrated party system. The rules for fiscal decision-making give the losers of the economic structure the chance to reduce the heterogeneities that harm them, and the parties are organized to profit from that chance. In such a setting, fiscal reform activism and short-term compensation would be inescapable.

These findings coincide in some respects with the literature on the political economy of Argentina's fiscal policy, but they differ in others. They generally coincide with Saiegh and Tommasi's (1998) view on the incomplete-contract nature of fiscal decisions in Argentina. Since decisions are usually made to adjust to the short-term effects of shocks, their nature and their crafting are not suited to withstand changes in the context within which they were enacted. They also coincide with the views of Eaton (2001a, 2001b, 2002a, 2002b, 2004) on the ways that partisan and provincial actors have to shape the outcomes of fiscal decision-making. However, they differ from these contributions in at least two important respects. On the one hand, they depict fiscal decision-making as an *efficient* process, in which provincial party leaders are adequately organized to exploit the chances that rules confer upon them to discharge the costs of economic heterogeneity on the rest of the federation, and the federal government usually has institutional and economic tools to assume those costs (Cetrángolo and Jiménez, 2004; Porto, 2004). Fiscal institutions and policies may thus be unstable, but their instability is mostly due to structural economic, rather than political, factors. On the other hand, the findings in this paper show that despite important differences in rules and timing of decision-making, reforms in all fiscal areas seem to be approached and managed by the actors as moves in a single arena, that of the distribution of resources from a common pool. Taxation, revenue-sharing, and budgetary transfers are not only economically linked for the actors, but also politically intertwined.

Further research should strive to find out whether the analytical framework proposed here and the determinants identified for the different institutions and policies in all fiscal areas also apply to other episodes of reform not analyzed in this paper and to other policy areas not concerned with fiscal resources. It should also attempt to determine how they compare to the fiscal decision-making process in other countries.

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