

# The Political Economy of Economic Reforms in Argentina

JULIANA BAMBACI, TAMARA SARONT and MARIANO TOMMASI\*

*Centro de Estudios para el Desarrollo Institucional (CEDI)/Fundación Gobierno y Sociedad & Universidad de San Andrés*

*(Received 29 December 2000; Revised 19 April 2002)*

In 1989, Argentina entered a process of sweeping transformation of its economic institutions which provided for the (temporary) recovery of economic growth and the taming of inflation. The Argentine experience with market-oriented reforms has been regarded by the literature as a salient case of radical and ‘unconstrained’ reform. Yet, a closer scrutiny portrays that the building and maintenance of a pro-reform coalition determined the pace, depth and characteristics of the ‘new economic institutions’. The idiosyncrasies of Argentina’s political institutions, in turn, conditioned this coalition-building strategy. The same idiosyncrasies were at play in the 2001/2002 collapse of the convertibility regime and ensuing social and political chaos.

**Key words:** Political Economy; Economic Reforms; Argentina

*JEL:* E5, O5

## 1 INTRODUCTION

During the last decade of the 20th century, Argentina undertook profound reforms of its economic institutions resulting in economic growth and low inflation for about a decade. The literature described the Argentine experience as a salient case of radical economic reforms. However, a detailed analysis shows that the need to construct and maintain a pro-reform coalition determined the pace, depth and features of the “new economic institutions”.

The argument presented in this paper is twofold. On the one hand, we contend that the 1989 crisis created the incentives to make President Carlos Menem initiate economic reforms, and at the same time triggered a pattern of delegation of authority that eased the adoption of a reformist agenda. On the other hand, we assert that the political and institutional implementation of these reforms left noticeable imprints on its outcomes. The pro-reform coalition, including influential economic groups alongside the traditional constituency of the Peronist Party, imposed limits to the reform agenda, in terms of design, sequencing, horse-trading and compensations. Although several aspects of “the old regime” were changed, a considerable number of “illiberal enclaves” (such as the institutions that regulate the labor market, the provincial economies, and the federal fiscal system) were maintained. Our main point is that the fundamental reforms – privatization, liberalization and convertibility – were politically viable thanks to the maintenance of those enclaves.

\* Corresponding author.

## 2 THE REFORMS

“Reform” could mean different things at different times. We treat the so-called Washington Consensus (Williamson, 1994) as both the agenda of the reformer and the benchmark against which we measure the degree of success of the reforms implemented. This “consensus” included macroeconomic stabilization, trade liberalization, privatization, deregulation, and related market-oriented policies.<sup>1</sup>

Overall, the Argentine transformation was considered a successful case of economic reforms. However, when comparing the results from each policy area with the set of recommendations derived from the Washington Consensus, that assertion has to be qualified. According to the index of the degree of reform across Latin American countries constructed by Lora (1997), Argentina was a fast and deep reformer in the 1988–1993 period. However, when we look at his 5 sub-indexes, even though Argentina is ahead in privatization and in trade and financial liberalization, it falls behind in labor market liberalization and in fiscal reform.

Upon entering office in 1989, the government initiated the privatization program and trade liberalization. Structural reforms were bundled with stabilization measures; policy decisions in several fronts were taken with an eye to their impact on short-term fiscal needs. Additionally, due to the reputation of the Peronist party, the government had to send signals of commitment with the reformist course, which was attempted via a speedy and simultaneous pattern of reform in several fronts.<sup>2</sup>

Despite those efforts, stabilization during the initial period failed, resulting in renewed inflationary episodes in 1990, and the resignation of two Ministers of the Economy. The Convertibility plan of 1991 marks the beginning of the most important stage of reform, which included monetary reform (Convertibility Law and Central Bank independence), fiscal reform (simplification of the tax system and strengthening of the tax collection agency), liberalization of domestic and external markets, and strengthening of the privatization program. The appointment of Domingo Cavallo (and his team) in the Ministry of the Economy brought renewed unity, coherence and credibility to the reform effort.<sup>3</sup>

Macroeconomic stability and economic growth were the immediate results of the above measures. The exchange rate based stabilization, together with the reappearance of credit; lead to a consumption boom which was important to acquiring the people’s enthusiastic approval of the new course. At the same time that the economy began to grow, traditional public funds manipulation for electoral purposes reappeared. That fragility became notorious in 1994 when the Tequila crisis hit. At that point, a renewed sense of crisis gave room for the last bout of structural reforms of the Menem administration, which included pension reform, some labor market flexibilization, and the privatization of some provincial banks. Interestingly, fear of economic instability helped Menem to get reelected in 1995, under the idea that the President and his team were the best pilots in stormy economic waters.

<sup>1</sup>This is a simplification made for operational purposes. As argued by Moises Naim (2000), there was never such a consensus. See also Acuña and Tommasi (1999).

<sup>2</sup>An example of the multiple roles of some reforms is provided by privatization. It helped to alleviate short-term fiscal needs; but the early and quick privatization of some national symbols (airlines, telephones) helped signal the government’s commitment to the new political orientation, although it was performed with little care for developing an adequate regulatory framework, or for best practices in terms of transparency.

<sup>3</sup>Corrales (1997) argues that Cavallo’s political skills were more instrumental than his technical skills for the success of the Convertibility plan. In our view, the later turn of Cavallo into a political candidate himself also imprinted some features to the later part of the reform process, and in his second incarnation in 2001, it led to the final demise of the Convertibility regime.

The second Menem administration (1995–1999), even though maintaining the reform rhetoric, did not make any substantial additional progress. This begs the question of the persistence of the pro-reform incentives in the Executive.<sup>4</sup> We argue later in the paper that this deceleration was due to the fact that “the next frontier” required going against the core of the coalition that enabled the previous set of reforms.

The reforms put in place, even though implying a substantial achievement by Argentine standards, fall short of the Washington Consensus benchmark. The general picture was the co-existence of some important changes in economic incentives, together with the persistence of illiberal enclaves such as regulation in the labor market, fiscal indiscipline at the provincial level, the persistence of foreign protection for particular sectors, of fairly monopolistic and inefficient structures in some markets (such as health), and weak regulation of some of the privatized sectors.

### 3 THE POLITICAL AND INSTITUTIONAL PROCESS BEHIND THE REFORMS<sup>5</sup>

A successful reform requires the emergence of a pro-reform actor in the government, which in turn needs to mobilize support to resolve collective action problems and neutralize opposition. All of these “steps” are conditioned by historical circumstances and by the institutional framework in which this takes place. In this section we explore key aspects of the political process behind the reforms under Menem. As a prelude, we provide a brief summary of the salient characteristics of the Argentine institutional structure.

Argentina is a federal country (23 provinces plus the City of Buenos Aires) with a presidential form of government. This division of powers together with electoral mechanisms that empower provincial political leaders, give rise to a fragmented political system. Not only Senators, but also Deputies are elected in provincial districts, with some provisos that lead to overrepresentation of small peripheral provinces. Furthermore, the intra-party methods of candidate selection make national legislators heavily dependent on provincial party leaders. As a consequence, national legislation is sometimes constrained by strong provincial powers, especially by provincial governors. On the other hand, there is a heavy dependence of provincial governments for national funds. Furthermore, there is substantial *ex post* budgetary discretion for the executive on issues of provincial and intergovernmental impact. More generally, discretionary powers of the president render some political agreements relatively unenforceable, increasing the price of negotiations and leading to awkward mechanisms to instrument agreements (Spiller and Tommasi, 2000).

#### 3.1 Why Reform, Who Reforms, and What Reforms?

It was believed for some time that market-oriented reforms were antithetical to the democratic process. They were supposed to be a public good, to be dominated by the forces of concentrated powerful groups that benefited from the *ancien régime*. Yet, the successful enactment of economic reforms in many countries during the last twenty years indicates that reformist governments are bound to appear also in democratic regimes. The case of Argentina is particularly interesting since the reformist government was not only democratic but also based on a populist party, traditionally associated with state-centered and

<sup>4</sup>In 1996, Cavallo and his team were replaced by a number of competent but less spirited economists.

<sup>5</sup>This section draws from Torre (1998) and Gerchunoff and Torre (1996). More detailed references are provided in the working paper version.

inward-looking economic policies. In this section we shed some light on the incentives that led Menem to enact reforms. We argue that the crisis experienced by Argentina towards the end of the 1980's forced the President to embark upon actions leading to economic stabilization, a collective good whose relative importance rose in this context.<sup>6</sup> As the only political actor in the Argentine institutional framework that is elected by a nationwide constituency, the National Executive is the institutional actor with more "encompassing" interests, and hence the only one who might *possibly* initiate such reforms. But why *did* Menem embark in such a reform process?

Menem took office in 1989 in midst of a deep crisis. The economic crisis, which exploded in the hyperinflationary bout of July 1989, coupled with the ensuing political and social crises 'forced' Menem to embark upon a reformist course. The primordial interest of the politician is the survival of the structure from which he/she derives power. Consequently, a crisis of a magnitude that puts at stake this structure generates the incentives to embark upon actions leading to ensure its survival, even if it imposes costs to his/her constituency. Also, at the time of initiating the reforms, the population was more tolerant of experimenting alternatives than at other points in time. The urgency of the situation also led to a pattern of delegation that increased the chances – and hence the expected political payoff – of implementing wide changes in policy orientation. There was a window of opportunity for "some" deep policy changes. The "content" of the reformist agenda was (roughly) determined by the ideas that scholars, policy makers and the international community shared – the so-called Washington Consensus (see note 1). Some contextual conditions, such as the honeymoon effect, blaming the previous government for the crisis, and a favorable international atmosphere, including abundant financing, facilitated the reform process. But there were crucial political and institutional features, to which we turn now.

### 3.2 Politico-Institutional Resources for Reform

Policy preferences are seldom mirrored by policy outcomes. Public policy is the result of a politico-institutional process influenced by many actors. In the Argentine case, the partisan distribution, the delegation of legislative faculties to the Executive, and its control over the Supreme Court, as well as the use of certain resources of doubtful constitutionality enabled the Executive to concentrate political power. In this section we address the distribution of institutional power during the first (1989–1995) and second (1995–1999) Menem administrations and the delegation mechanisms present at the onset of his first mandate.

#### 3.2.1 Distribution of Institutional Power

The electoral results throughout Menem's presidency were favorable to his party (Tab. I), conferring Menem an ample mandate at the onset of his first administration, and further reinvigorating the reformist course later on. Favorable electoral results were mirrored in the resulting distribution of institutional power (Tab. I). This power composition implied that several of the pivotal political negotiations were with actors within the party.

The favorable partisan composition at key institutional nodes was furthered by a law that increased the number of members of the Supreme Court from 5 to 9. Through this device

<sup>6</sup>This is consistent with Rodrik (1994)'s notion that the likelihood of a reform is a function of the ratio of net social gain to net reallocation (redistribution). In times like those of Argentina in the early 1990's, efficiency gains from halting hyperinflation were large enough to swamp many distributive considerations (see also Mondino *et al.*, 1996, proposition 3).

TABLE I Electoral Results and Partisan Composition During Menem's Government.

<b>Electoral Results, 1989–1997*</b>						
<i>Political Party</i>	<i>1989<sup>b</sup></i> (%)	<i>1991<sup>a</sup></i> (%)	<i>1993<sup>a</sup></i> (%)	<i>1994<sup>c</sup></i> (%)	<i>1995<sup>b</sup></i> (%)	<i>1997<sup>a</sup></i> (%)
Peronist Party (PJ) and allies	47	40	43	39	50	36
UCR and allies	33	29	30	20	17	7
Center and Provincial Parties	12	16	18	12	1	9
Left and Center Left Parties (including Frepaso up to 97)	7	10	3	17	31	6
Alianza (UCR+ Frepaso)	–	–	–	–	–	36
Others	2	4	6	12	2	6

  

<b>Partisan Composition of the Chamber of Deputies, 1987–1999</b>						
<i>Political Party</i>	<i>Deputy Periods</i>					
	<i>1987–89</i> (%)	<i>1989–91</i> (%)	<i>1991–93</i> (%)	<i>1993–95</i> (%)	<i>1995–97</i> (%)	<i>1997–99</i> (%)
Peronist Party (PJ)	43	50	50	50	52	47
Unión Civica Radical	46	37	33	33	27	26
Center-Right Provincial Parties	6	7	9	9	8	11
Other Parties	5	6	5	8	12	16

  

<b>Partisan Composition of the Senate, 1986–1998</b>				
<i>Political Party</i>	<i>Senate Periods</i>			
	<i>1986–89</i> (%)	<i>1989–92</i> (%)	<i>1992–95</i> (%)	<i>1995–98</i> (%)
Peronist Party (PJ)	47	54	62	56
Unión Civica Radical	39	30/29	23	29
Center-Right Provincial Parties	15	15/17	15	14
Frepaso	–	–	–	1

  

<b>Partisan Composition of Provincial Governorships, 1987–1999</b>			
<i>Political Party</i>	<i>Gubernatorial Periods</i>		
	<i>1987–91</i> (%)	<i>1991–95</i> (%)	<i>1995–99</i> (%)
Peronist Party (PJ)	77	61	61
Union Civica Radical	9	17	22
Provincial Parties	14	22	17

\*Source: authors.

<sup>a</sup>Legislative elections; <sup>b</sup>Legislative and presidential elections; <sup>c</sup>Elections for Constitutional Assembly.

Menem was allowed to appoint four judges (with the agreement of the Senate). Then, when one of the Ministers of the Court resigned in protest, Menem had the opportunity for a fifth appointment.<sup>7</sup> In addition, Menem resorted to the use of two types of legislative instruments of dubious constitutionality until the 1994 Constitutional reform: the decrees of “necessity and urgency” and the line-item veto; in a way that far exceeded the historical trend.

<sup>7</sup>The interference of politics in the composition of the Supreme Court seems to be a constant feature in recent Argentine institutional history. For more on this see Iaryczower *et al.*, 2001.

### 3.2.2 *Delegation Mechanisms*

A second effect of the economic crisis was to trigger a series of delegation patterns; in particular, a political agreement for the 1989 anticipated presidential succession, and two laws by which the Executive was conferred with ample margins for defining the details of reform policies. The 1989 crisis helped to forge a political agreement between the two major parties: the radical party (the outgoing administration) and the Peronist party. The agreement was made to move forward the presidential succession in order to deal with the economic crisis. President Alfonsín (1983–1989) resigned, Menem agreed to take office five months before originally scheduled, and in exchange the radical party committed to give legislative support to the new administration.

Congress delegated to the Executive vast legislative powers through *Ley 23.696 de Emergencia Económica* (Economic Emergency Law) and *Ley 23.697 de Reforma del Estado* (State Reform Law). The first of these laws dismantled most of the institutions related to the state-centered, inward-looking development model: subsidies, industrial subsidy regimes, etc. The second one conferred vast powers on the executive to define the details of the reform policies, including the privatization of state-owned enterprises.

In sum, the partisan distribution of institutional power coupled with these delegation patterns allowed the Executive to leap over institutional hurdles for the initiation of structural reforms. Yet, this did not completely numb relevant political and institutional actors, which recovered their voice in the context of stability.

### 3.3 The Political Steering of Reform: Vote-buying Tactics

Contrary to what much of the literature on the political economy of reforms in Argentina asserts, the reform process was not carried out by an Executive power in isolation of social, political and institutional actors. Rather, reforms were the product of a series of transactions between the Executive and some key actors within the governing coalition at every step of the process. In this section we present the relevant actors with whom the Executive “dealt” in order to advance the reformist course. We implicitly use a theory in which an agenda-setting executive needs a given level of support for his reform package, and insures it by “buying” the necessary number of votes, if the total price to be paid is lower than his benefits from the reform package. We can think as the executive facing a price schedule for votes in favor of his desired policies. The price to be paid will depend on the intertemporal political linkages between the President and each legislator or set of legislators.

Cheapest votes, probably price zero, or even negative, will be those of actors who directly benefit from the reform package. From the actors who do not benefit from the package, the cheapest votes will come from those legislators with whom there are credible intertemporal reward mechanisms. These mechanisms will include future appointments in the executive or in the party. Legislators from the same party will be first in line, legislators from small independent parties will come second, and legislators from the main opposition party/parties will be the most expensive. The spot currency used to buy votes might include outright bribery, policy benefits to the relevant constituency, or exemptions sparing reforms costly to the relevant constituency.

Which votes are actually purchased will depend on the rules of the game (for instance, what is the required majority), and on the actual composition of the legislature at the time of the reform. In the Argentine case under Menem, the pivotal votes were in the Peronist party (from provincial blocks and from union-related legislators) as well as in the small provincial parties. We look at these actors in turn.

### **3.3.1 The Peronist Party**

There are two reasons why the first actor we look into is the governing party. First, even a reformist executive has major concerns about his electoral fate, which is closely related to the party structure. Second, due to the partisan distribution of institutional power, the Peronist party had a high degree of leverage on the legislative process, becoming the fundamental veto player at the time of approving reforms (Corrales, 2000). When referring to the Peronist party as a fundamental political actor, we are basically concerned with its two major constituencies: provinces and trade unions, which we analyze in the next subsections.

Menem's Peronist credentials, on the one hand allowed him to achieve the acquiescence of popular sectors; a "Nixon goes to China" effect analyzed in Cukierman and Tommasi 1998 and 1998b. On the other hand, there was a major disruption in the party since the policies Menem was propounding constituted a dramatic break with the populist policies Peronism traditionally embodied. This break produced resistance and criticism inside the party, yet both the intellectual efforts devoted to "rebuild" the Peronist identity as well as the concessions used to construct support, helped moderate these tensions. (Levitsky, 1999 provides an insightful analysis of the internal process of Peronist adaptation to the new policies). Menem's 'conversion' to neo-liberal policies created discrepancies between the government and official legislators which lead to schisms in the Peronist block of the Deputy's Chamber. Additionally, in contrast to the vision of an insulated all-powerful executive power, between 1992 and 1994 Congress modified around 46% of legislative initiatives of the president.

The Executive managed to tackle these discrepancies through the extensive use of "Decrees of Necessity and Urgency" and vetoes that strengthened his bargaining position in the legislature, through political transactions with provincial and small national parties, and through concessions in policy design.

### **3.3.2 Provinces**

The Peronist machinery in the provinces constitutes one of the fundamental electoral pillars of the party. Argentine federalism confers a high degree of political and institutional power to the provinces, especially as veto players in the national arena. In this sense, it is possible to trace, throughout the reform period, a strong reformist impetus at the national level that contrasts with scarce advances at provincial levels.

Gibson and Calvo (2000) show that the territorial organization of the electoral coalition – to the extent that poor and under-populated provinces received special treatments to generate legislative support to sustain the reformist agenda – was an important element in the successful implementation of reforms. Peronism historically encompassed two distinctive and regionally based coalitions: a "metropolitan" coalition, which gave support to the party's development strategies, and a "peripheral" coalition, which carried the burden of generating electoral majorities. The metropolitan coalition is of very high economic importance, but carries less political weight in Congress given the notable mis-apportionment of seats. Under the Gibson and Calvo hypothesis, Menem decided to have the metropolitan coalition shoulder the full blow of adjustment costs, while he speared the peripheral coalition through several concessions in tax benefits and by allowing the subsistence of interventionist and populist enclaves.<sup>8</sup>

---

<sup>8</sup>Tommasi (2002) provides empirical evidence on the details of this strategy, supporting the Gibson and Calvo hypothesis.

### 3.3.3 Unions

The Argentine labor movement has been one of the most important bastions of the Peronist movement. During his tenure as Secretary of Labor in 1944, Perón forged the political support of labor organizations through the granting of social benefits to workers and the enactment of regulations fostering workers unions' organization and growth. Consequently, under the auspices of privileged access to public power, the labor movement developed into an important social actor. Later, Perón gave political expression to organized labor at the same time that he supplied state favors to this constituency. To date, unions remain one of the fundamental sources of the electoral base of Peronism.

Restructuring of the populist metropolitan coalition involved picking winners and losers within the business community and the labor movement. In part the success of the reform process involved the division of the labor movement and the co-opting of certain sectors to prevent unified labor opposition to economic reform. Menem's credentials also proved to be an asset during the implementation of this strategy.

In 1989, Menem deepened divisions inside the unions, precipitating a fracture that diminished their bargaining power. The policy succeeded through the administration of "carrots and sticks". Unions opposing the reforms were punished; unions supporting the reforms were brought on board via "new economic businesses", and through rewards to some leaders with government positions (Murillo, 1997).

Unions' support to the reforms was evident by the decrease in their activism compared with the levels reached during the Alfonsín administration. In exchange for their support, the government conceded to maintain their sources of power –the regulation of collective bargaining and *Obras Sociales*<sup>9</sup>– in spite of the constant decrease in the union's representations in the legislature (though concentrated in the labor legislation committee.) The number of general strikes decreased from 13 in the Alfonsín administration to 2 in the first Menem administration and 5 in the second.

### 3.3.4 Economic Groups

In the delicate fiscal situation of the 1989 economic crisis, the reactions from business leaders were crucial for the success or failure of economic policy. Menem's political background generated distrust among certain domestic and international businessmen and investors. This obliged him to overreact sending signals of credibility about his reformist intentions. Besides the Convertibility Law, other signals of commitment with the new reform path were the privatization of national symbols like the airline and telecommunication companies, the invitation to influential economic groups – traditionally opposed to the peronist party – to take part in the government, and the alignment of foreign policy with the US.

Menem included in his first cabinet as Ministry of Economy a representative from a powerful holding company of the business sector. The strategy consisted in establishing a close relationship with one particular conglomerate: Bunge & Born (in the peronist imagination, a symbol of the oppression of labor), instead of dealing with the organizations of the sector, as Alfonsín had unsuccessfully done. This conglomerate in turn became the interlocutor of the government with the business sector.

The Menem administration faced a dilemma in its relationship with business sectors. On the one hand, the import-competing industrial sector was going to be reluctant to support trade liberalization policies, since they would generate competition from international

<sup>9</sup>*Obras Sociales*, union-administered welfare organizations, very important in the health market, are the main source of financing of unions. That is the reason why a profound health reform did not take place.

products. On the other hand, privatization policies implied a cost to many of the companies that were state suppliers. To solve that dilemma the government proceeded as follows. The former group lacked the capability to organize collective action against the government's policies because the executive gave strong incentives to negotiate individual solutions to each particular sector. Fostering their participation in privatization neutralized potential reactions from the latter, which were threatened by the possibility of losing their contracts with the state. Even though not every one of the state providers benefited from the privatization process, those left out did not constitute a sufficiently important group capable of obstructing the reformist course.

#### 4 THE REFORM OUTCOMES

In sum, it was the support of the main constituencies of the Peronist party and of the main economic groups which rendered the economic reforms possible. Yet, this support came at a cost. These actors imposed constraints and left an imprint on the reformist course; the Executive had to negotiate this support throughout. Coupled with the fact that the political coalition had diverging interests, this rendered the reform process a complex combination of signaling and concessions. We turn to some of the implications of this coalition building strategy for the results of the reform process.

The negotiation (or vote-buying) process that enabled the effective implementation of the reform package determined both the pace and depth of the reforms in each area, as well as the persistence and protection of 'illiberal enclaves'. This influence can be seen in the timing, sequencing, and design of the reforms.

While privatization, some fiscal reform, and liberalization of most internal and external markets were accomplished in a rather rapid and successful manner, advances in other areas, such as labor market reform and provincial reforms have been less significant. And, whatever was done in these latter camps, was delayed during the first stages of the reformist process (*i.e.* until 1995). The Menem administration initiated cold turkey reforms in monetary policy, trade liberalization and privatization. However, efforts in labor market and provincial reforms, while present in the government's discourse, were approached in a more gradualist and negotiated manner.

Labor market reform was tarnished with ambiguity. Legislation not only did not suffice to dismantle the traditional protectionist system, but it also exhibited a rather erratic course. While some of the laws constitute movement towards a more liberalized system, others seem to reinforce the illiberal tone of markets. Even the *Ley de Emergencia Económica* included an article which raised the maximum severance pay. Hence, this law, which embodied much of the reformist impetus of the government, was tainted with the protection of regulations that lie at odds with the Washington Consensus agenda. Some advances were achieved between 1994 and 1995 through a corporatist arrangement between the government, the unions and the business sector. This limited liberalization of working relations was exchanged for the maintenance of institutions from which the unions derive economic and political power: collective bargaining rules and *Obras Sociales*.<sup>10</sup> One might conjecture that in the last part of his administration, Menem went through the motions of labor market reform, largely as a

<sup>10</sup>As part of this agreement, the unions were granted \$21 million to make up for the fall in revenue produced by the reduction in employers contributions, and a special deal for gradual cancellation of the debt that *obras sociales* had with the fisc. A few months before leaving office Menem issued a decree increasing the leverage of unions over the administration of a fund for redistribution in the health insurance market.

TABLE II Reforms in the Provinces (Degree of Fulfillment of Fiscal Pacts).

Issues	Federal Capital	Buenos Aires	Catamarca	Cordoba	Corrientes	Cordoba	Chubut	Entre Rios	Formosa	Jujuy	La Pampa	La Rioja	Mendoza	Misiones	Nuquen	Rio Negro	Salta	San Juan	San Luis	Santa Cruz	Santa Fe	Santiago del Estero	Tucuman	Tierra del Fuego
<b>1. Tax on contracts</b>																								
1.1. Short term reduction																								
1.2. Medium term reduction																								
<b>2. Specific taxes</b>																								
2.1. Tax on oil																								
2.2. Tax on gas																								
2.3. Tax on electrical energy																								
2.4. Tax on sanitary services																								
<b>3. Tax on bank accounts and payroll</b>																								
3.1. Bank accounts																								
3.2. Payroll taxes																								
<b>4. Turnover Tax</b>																								
4.1. Primary production																								
4.2. Financial services																								
4.3. Insurance services																								
4.4. Financial services (except currency transactions)																								
4.5. Lottery																								
4.6. Utilities																								
4.7. Construction																								
4.8. Tourism																								
4.9. Research and development																								
<b>5. Real estate taxes</b>																								
5.1. Valuation																								
5.2. Tax rates																								
<b>6. Tax apportion</b>																								
<b>7. Consumption tax</b>																								
<b>8. Tax on cars</b>																								
8.1. Valuation																								
8.2. Tax rate																								
<b>9. Privatizations and concessions</b>																								
9.1. Energy firms																								
9.2. Sanitary and water utilities																								
9.3. Provincial Banks																								
<b>Transfer of Provincial Pension System</b>																								



Sources: Dirección de Coordinación Fiscal con las Provincias

signal to appease international organizations and foreign investors, while remaining realistic about the internal domestic political concessions that were necessary.

Likewise, economic reforms were spared to peripheral provinces enabling the government to maintain support while inflicting the costs of adjustment to the urban sectors. Stabilization in 1991 produced an increase in the tax amounts transferred to all the provinces through the tax-revenue sharing agreement. Central Bank independence removed the possibility that the central government monetize the debts of provincial banks. However, the tax-sharing system eliminated the incentives to pursue a responsible fiscal policy at the provincial level. There have been some partial efforts at fiscal reform and privatization in the provinces, through so-called "Fiscal Pacts" which included concessions by the National government, such as absorbing provincial social security and its liabilities. The Tequila effect gave impetus to the privatization of provincial banks. Overall, progress in provincial reform was slow, uneven and incomplete (Tommasi, 2002). Table II shows the degree of fulfillment of reforms in the different provinces.

More generally, successful reforms reveal a special treatment regarding the interests of those groups whose support was fundamental for the administration. Privatization involved distributing shares to the workers, as well as generous voluntary retirement programs. Moreover, unions and provincial governments were allowed to participate in the privatization process giving to the former new business possibilities with the new privatized companies (Murillo, 1999) and to the later transfer of exhaustible resource ownership and cancellation of old debts with the Nation. The design of privatization and the regulation of public utilities generated important benefits for the new owners through monopolistic rents and/or cheap purchase prices. This had the double impact of fostering support from economic groups as well as to help the state's fiscal crisis especially during the first part of the administration. Trade liberalization contained special exemptions, which lie at odds with the uniform and strict pattern imposed by the Ministry of Economy for other sectors. These concessions, as in the case of automobiles and paper products, are associated with the ties that each sector was able to develop with the government.

## 5 CONCLUSIONS

The main conclusion of the paper is that politics and political institutions matter for economic reform. This is not totally novel, but it departs from the most standard economic approaches to reform (as reflected, for instance in the collection in Sturzenegger and Tommasi, 1998). In order to understand better economic policy reform outcomes in each country, it is necessary to look into the details of its polity. Menem was able to undertake such a remarkable transformation, not only due to the usual statements of "visionary leadership", "unconstrained decision making" and "coherent economic team" (Williamson and Haggard, 1994), but through a series of concessions in terms of content, timing, sequencing, and signaling. The nature of these political trades were, in turn, profoundly conditioned by the distribution of institutional power at the time, as well as by the more general rules of the political game in Argentina.

One additional conclusion to be inferred from the Argentine case is that it is not just "politics", but political institutions that matter. Congress was, contrary to some conventional wisdom, an important institutional actor shaping the reform process. Furthermore, the actions of congressmen were affected by their overall set of political incentives and resources. Hence, the determinants of those incentives and resources, such as the electoral system and the degree of geographical mis-apportionment, are important variables in explaining the overall "success" of the broad strokes of the reform agenda, as well as the details of implementation (or non-implementation) of reform in each specific area of policy.

Studying the impact of the rules of the political game on policy outcomes is, in the end, the core of Political Economy. The ultimate goal should be to come up with suggestions for truly institutional reforms that might improve the ability of political actors to realize political exchanges leading to more efficient policy outcomes.

## 6 POSTSCRIPT (MARCH 2002)

Argentina is, at the time of this publication, in the midst of one of its worst economic, social, and political crisis ever. It is still too early to draw too many inferences from this experience, although less conscientious observers are doing just that. We refrain from attempting the mighty task of providing an explanation for the Argentine collapse, and we limit ourselves to a brief description of events, and a loose connection of those events with the main themes of the paper.

As stated in the paper, Menem's second term in office was a far cry from the first one in terms of its reforming impetus. A simplistic, non-political, reading of that second term would blame it for not taking the opportunity during the good times of 1996, 1997 and 1998 (until the Russian crisis), in order to further improvements in the fiscal front (reforming the Federal Fiscal system), in competitiveness (improving regulation of privatized utilities, or flexibilizing the labor market in light of heavy unemployment), or even flexibilizing the currency board regime itself. The fact of the matter is that those measures did not take place, the economy deteriorated since 1998 under adverse external circumstances, and the burden was shifted to Menem's successor Fernando de la Rúa. The new government, an alliance of the Radical Party (UCR) and Frepaso, itself a center-left coalition, took office in December 1999, and was faced with cutting government spending in the midst of a recession.

An independent evaluation was given by *The Economist* (2002): "The de la Rúa government was weak and ineffective. The president lacked a majority in Congress (dominated by Peronist provincial bosses), and was further weakened when the vice-president resigned. In March 2001, de la Rúa switched Ricardo López Murphy, his defense minister and a respected orthodox economist, to the economy ministry, with a mandate to balance the budget. When López Murphy promptly announced sweeping cuts in public spending, de la Rúa failed to back him up. With López Murphy went, "the last serious chance of saving the currency board".

"But the man who turned failure into disaster was, ironically, the man responsible for the Argentine 'miracle' of the 1990s: Mr. Cavallo, drafted by Mr. de la Rúa to replace Mr. Lopez. Mr. Cavallo first tried 'heterodox' measures to try to get growth". Cavallo's bet was that his mere presence would boost enough confidence in financial markets, that Argentina would no longer need to signal commitment through fiscal austerity, and could concentrate on increasing competitiveness and growth. "He fiddled with tariffs and, fatally, with the currency board itself, so that the peso was pegged for exporters half to the dollar, half to the euro. This was, in itself, a good idea, but the timing was disastrous. By raising the idea of devaluation, it spooked foreign investors. They demanded a higher risk premium for holding Argentine bonds, driving up interest rates and deepening the recession".

"But Mr. Cavallo's reckless stubbornness did not end there. One of the main achievements of the Menem government had been to mould a strong banking system and independent central bank. Mr. Cavallo proceeded to destroy them both. Not only did he oust Pedro Pou, the Central Bank's governor, and ease bank's reserve requirements, but he raided the financial system to pay for the government". "He strong-armed local pension funds into buying government paper and local banks into swapping their holdings of government bonds in return for low interest loans".

“These actions triggered a bank run. Between July and November, Argentines withdrew some \$15 billion from the banks. Three local banks (Banco de Galicia, and two state banks, Nacion and Provincia de Buenos Aires) were particularly affected. To save them, Mr. Cavallo made his last, desperate, throw. On December 1st, he imposed a ceiling of \$1,000 a month on bank withdrawals. That was a deadly blow to the informal service economy, which functions on cash. Three weeks later, a coalition of pot-banging savers, and looters from the underclass (not impeded, and perhaps unleashed, by the Peronist machine from the Buenos Aires rustbelt), took the streets. First Mr. Cavallo and then Mr. de la Rúa resigned”.

As stated at the beginning of this Postscript, it would be incautious to attempt a serious explanation of Argentina’s implosion in a few paragraphs. There were many intervening factors, several of them related to some of the issues raised in the paper. Clearly, the currency board regime turned out to be too rigid to withstand the several adverse shocks suffered by Argentina throughout the period. On the other hand, the lack of some complementary reforms addressed in this paper (provincial finances, labor market rigidities, poor regulation of other input markets), impeded the possibility of adjusting within the convertibility regime. Furthermore, the particularities of Argentine federalism highlighted in this paper (power of provincial governors, rigidities of federal fiscal arrangements) were behind the political and economic dynamics leading to the demise of the de la Rúa government (Tommasi, 2002).

Coming back to the last paragraph in the conclusion of the original paper: politico-institutional conditions leading to effective policymaking are still not present in Argentina, and that has become too costly in light of the speed of economic and social events.

### **Acknowledgements**

This paper was first submitted to JPR in 2000. We have maintained the views expressed in that initial version, and only added a brief Postscript, relating the paper to the recent events in Argentina: debt default, abandonment of the Convertibility regime, and the social and political chaos surrounding those events. We thank the editor Michael Connolly, an anonymous referee, and Valeria Palanza for valuable suggestions and guidance.

### **References**

- Acuña, C. and Tommasi, M. (1999) Some reflections on the institutional reforms required for Latin America, In: Institutional reforms, growth and human development in Latin America, *A Conference at the Yale Center for International and Area Studies*, April 16 and 17.
- Corrales, J. (1997) Why Argentines followed Cavallo: A technopol between democracy and economic reform, In: Dominguez, J. (Ed.), *Technopols. Freeing Politics and Markets in Latin America in the 1990's*. Pennsylvania: Pennsylvania State University Press.
- Corrales, J. (2000) Presidents, ruling parties, and party rules. A theory on the politics of economic reform in Latin America, *Comparative Politics*, **32**(2), 127–150.
- Cukierman, A. and Tommasi, M. (1998) What does it take a Nixon to go to China? *American Economic Review*, **88**(1), 180–197.
- Cukierman, A. and Tommasi, M. (1998b) Credibility of policymakers and economic reforms, In: Sturzenegger and Tommasi (Eds.), *The Political Economy of Economic Reforms*. Cambridge, Massachusetts: MIT Press.
- Gerchunoff, P. and Torre, J. C. (1996) La política de liberalización económica en la administración Menem, *Desarrollo Económico*, **36**(143).
- Gibson, E. and Calvo, E. (2000) Federalism and low-maintenance constituencies: Territorial dimensions of economic reform in Argentina, *Studies in Comparative International Development*, **35**(3).
- Iaryczower, M., Spiller, P. and Tommasi, M. (2001) Judicial decision-making in unstable environments: The Argentine supreme court, 1936–1998, *American Journal of Political Science* (Forthcoming).
- Jones, M., Saiegh, S., Spiller, P. and Tommasi, M. (2001) Professional politicians, amateur legislators. The consequences of party-centered electoral rules in a federal system, *American Journal of Political Science* (Forthcoming).
- Levitsky, S. (1999) From Laborism to Liberalism: Institutionalization and the Transformations of Argentine Peronism in Comparative Perspective, *Mimeo*. Government Department, Harvard University.

- Lora, E. (1997) A decade of structural reforms in Latin America: What has been reformed and how to measure it? *Mimeo*. Office of the Chief Economist, IADB.
- Mondino, G., Sturzenegger, F. and Tommasi, M. (1996) Recurrent high inflation and stabilization: A dynamic game, *International Economic Review*, 37(4), 981–996.
- Murillo, M. V. (197) From populism to neoliberalism: Labor unions and market-oriented reforms in Argentina, Mexico and Venezuela, *Doctoral Thesis*, Government Department, Harvard University, Massachusetts.
- Murillo, M. V. (1999) From public to private: The politics of public utility privatization in Argentina, paper presented at the 95th Annual Meeting of the American Political Science Association, Atlanta, September 2–5, 1999.
- Naim, M. (2000) Fads and fashion in economic reforms: Washington consensus or Washington confusion? *IMF Conference on Second Generation Reforms*. Washington, DC.
- Rodrik, D. (1994) The rush to free trade in the developing world: Why so late? Why now? Will it last? In: Sturzenegger, F. and Tommasi, M. (Eds.) (1998), *The Political Economy of Reform*. Massachusetts: MIT Press.
- Spiller, P. and Tommasi, M. (2000) The institutional foundations of public policy. A transactions theory and an application to Argentina, Working Paper 29. Department of Economics, Universidad de San Andrés. <http://www.udes.edu.ar/deptodeeconomia/workp/doc29.doc>
- Sturzenegger, F. and Tommasi, M. (Eds.) (1998) *The Political Economy of Reform*. Massachusetts: MIT Press.
- Tommasi, M. (2002) Fiscal federalism in Argentina and the reforms of the 1990's, *Mimeo*. Universidad de San Andrés and Stanford Institute for Economic Policy Reform.
- The Economist (2002) Special report: Argentina's collapse, March 2, pp. 26–28
- Torre, J. C. (1998) *El proceso político de las reformas económicas en América Latina*. Buenos Aires: Paidós.
- Williamson, J. (1994) *The Political Economy of Policy Reform*. Washington: Institute for International Economics.
- Williamson, J. and Haggard, S. (1994) The political conditions for economic reform, In: Williamson, J. (Ed.), *The Political Economy of Policy Reform*. Washington: Institute for International Economics.