

Published in *Economía*, Journal of the LACEA, Spring 2001.

**Fiscal Federalism in Argentina
Policies, Politics, and Institutional Reform**

Mariano Tommasi

Universidad de San Andrés

Center of Studies for Institutional Development (CEDI, Fundación Gobierno y Sociedad)

Sebastián Saiegh

New York University

Center of Studies for Institutional Development (CEDI, Fundación Gobierno y Sociedad)

Pablo Sanguinetti

Universidad Torcuato Di Tella

Abstract

Argentine fiscal federalism is considered to be very inefficient by all specialists. Its allocation of tax and spending authorities, and its system of intergovernmental transfers do not correspond to any economic criteria and provide all sorts of perverse incentives and obstacles for sound economic policies.

Agreeing with the above diagnostic, we attempt to take a step further and to provide an explanation for the many inefficient features of Argentine fiscal federalism. In order to do that, we apply and further develop an approach, presented in Spiller and Tommasi (2000) that tries to explain public policies as the outcome of political transactions. This approach argues that the nature and characteristics of the observed policies will be conditioned by the rules of the political game under which those transactions / policies are made. Hence, it re-focuses “policy recommendations” from the level of *policy reform* to the level of *institutional reforms*, with emphasis on political institutions.

1. INTRODUCTION

Argentine fiscal federalism is considered to be very inefficient by all specialists.¹ Its allocation of tax and spending authorities, and its system of intergovernmental transfers do not correspond to any economic criteria and provide all sorts of perverse incentives and obstacles for sound economic policies.

Agreeing with the above diagnostic, we attempt to take a step further and to provide an explanation for the many inefficient features of Argentine fiscal federalism. In order to do that, we apply and further develop an approach, presented in Spiller and Tommasi (2000) that tries to explain public policies as the outcome of political transactions.² This approach argues that the nature and characteristics of the observed policies will be conditioned by the rules of the political game under which those transactions / policies are made. Hence, it re-focuses “policy recommendations” from the level of *policy reform* to the level of *institutional reforms*, with emphasis on political institutions.

Even though we believe that some of the problems described here are common to other Latin American countries, we leave for further research the task of exploring the other cases in as much detail as we have explored the Argentine one. We are convinced that our current diagnostic can be improved by comparative analysis, but the institutional approach we are using is heavily demanding in terms of institutional detail. Not having the time for a deeper analysis of many countries, we refrained from quick generalizations based on a few variables. Nonetheless, we believe that the current paper might be of help, not only for its specific suggestions for the Argentine case, but also as a methodology to be applied in other cases.

The paper is organized as follows. Section 2 summarizes some key features and deficiencies of the Argentine federal system. Section 3 presents a sketch of the theory that explains the features of public policies as determined by the rules of the game under which actors engage in political transactions. The theory predicts that environments that do not facilitate cooperative intertemporal exchanges will generate policies which are fairly inefficient and awkward from an economic point of view. Section 4 maps the implications of the theory to the characteristics of Argentine fiscal federalism. Section 5 provides some evidence to support the claim that the rules of the political game in Argentina do not facilitate efficient intertemporal exchanges. Section 6 contains our recommendations for institutional and policy reform in Argentina. The conclusion attempts to provide the more general message on how to tackle reforms in federal fiscal finances.

¹ See for instance Aizenman (1998), Bird (1993), FIEL (1992), Porto (1990), IADB (1998), World Bank (1992 and 1996), Schwartz and Liuksila (IMF, 1997).

² Some of these ideas have been anticipated in Iaryczower, Saiegh and Tommasi (1999) and Saiegh and Tommasi (2000).

2. KEY FEATURES OF FISCAL FEDERALISM IN ARGENTINA

In this section we present several stylized facts regarding the workings of fiscal federalism in Argentina. We start with a background description of some basic institutional features. We describe the division of expenditure and tax responsibilities between the national and provincial jurisdictions and indicate the resulting level of vertical fiscal imbalance, and how this imbalance has been addressed through intergovernmental transfers. We then describe briefly some provincial fiscal institutions, such as the existence of formal limits for provincial borrowing and the legal status of provincial state banks. After this institutional description, we illustrate the behavior of national-provincial finances in recent years. The main message coming from this evidence is that the fiscal relationship across provincial governments and between them and the national authorities has been subject to opportunistic behavior and lack of coordination. The resulting inefficient outcomes not only compromised the fiscal and macroeconomic stability of the country as a whole, but also have had negative effects on the provision of some basic public goods.

2.1 Facts

Argentina is a federal country. The Constitution has given a great deal of responsibilities in terms of expenditure and tax decisions to the subnational units, the Provinces. Regarding expenditures, the only activities that are of exclusive competence of the national authorities are those associated with defense and foreign affairs. In the areas of economic and social infrastructure the national government shares responsibilities with provinces, while the latter have exclusive competence in primary education and local (municipal) organization and services. The Constitution defines then a broad area of public services where national and provincial authorities can both supply public goods at the same time, though the tendency in the last two decades has been for the national government to decentralize the direct operation of these services to provinces. Thus provinces today are in charge of most of the social expenditure (basic education, health services, poverty programs, social security, housing) and also economic infrastructure (roads, ports, environment, natural resources, etc.). Still the national government conserves a significant regulatory power in many of these areas and directly manages many programs within these sectors (like in social security, income support to the poor, complementary educational programs subsidizing the poorest schools, etc).

This decentralization process lead Argentina to have one of the most decentralized public sectors in Latin America. Sub-national governments are responsible for almost 50% of the total consolidated public sector expenditures, and more than two thirds of public sector expenditures if we exclude pensions (see Piffano 1998 and IDB 1999).

On the tax side the Argentine Constitution establishes that the national government has exclusive jurisdiction over taxes on foreign trade. Provinces and the national authority can both use “indirect taxes” to finance their expenditures. Finally, “direct taxes” are in principle exclusive jurisdiction of provincial governments, but the Constitution allows the national government to use direct taxes on temporary basis under special circumstances (“whenever the defense, common safety or general welfare of the State so require”.)

Additionally, all powers not explicitly delegated to the national government, remain with the provinces.

In spite of these ample faculties of provincial authorities on tax decisions, in practice provinces have delegated to the national government the task of collecting most important taxes, like taxes on income (both on individuals and firms), on consumption (VAT and some specific duties) and on wealth. Provinces directly control a tax on gross production, on real state and cars, together with a duty applied to contracts. This level of tax centralization together with the above-indicated level of expenditure decentralization has given origin to a high level of vertical fiscal imbalance. As figure 1 shows, in 1997, on average, 56% of provincial expenditures were financed through transfers from a common pool of national taxes, with only 44% financed from direct own-provincial revenues. Still there is a high variation around this 44% (weighted) average.³ Nine provinces finance less than 20% of their spending with their own resources.

This large vertical fiscal imbalance has been addressed with a complex system of intergovernmental transfers. The most important is the tax-sharing regime (coparticipation) which is the process by which the collection of the main taxes is then re-allocated to provinces. This coparticipation regime has received constitutional status in the reformed constitution of 1994, which has given a mandate to enact a new law by 1996, requirement that has not been fulfilled as yet. Thus the current legislation regulating the coparticipation regime is still law 21548 issued in 1988. It established that the federal government retains 42% of these taxes while 57% were distributed among the provinces, with the remaining 1% set aside “to finance unforeseen crises in the provinces.”⁴ The law also establishes the percentages of the secondary distribution, and is supplemented by several other laws regulating the distribution and destination of some specific taxes that finance a set of predetermined activities. Some of the main features of the 1988 coparticipation scheme prevail today, even though there have been numerous changes and adjustments. One of the main changes was to establish “precoparticipations,” that is, to redirect parts of the tax revenue originally going into the tax-sharing pool, towards other purposes. For instance, in 1992 and 1993 the national government was able to achieve a 15% reduction of the amount to be shared with the provinces, in order to finance the growing deficits of the pension system. Another important change was to provide some fixed-sum transfers and a minimum transfer guarantee to the provinces. Another factor was the decentralization of many educational and health services since 1992. This was to be financed by a transfer equivalent to the estimated cost of the services transferred. As a consequence of these various reforms new types of transfers besides coparticipation per se were introduced. Additionally, there are a variety of “special channels” linking some fraction of some specific taxes to some (often economically unrelated) specific spending purposes. Figure 2 shows the so-called federal fiscal labyrinth of Argentina.

³ The simple average is just 23%, the difference being explained by the fact that the larger provinces (like Buenos Aires) tend to have smaller imbalances.

⁴ In practice, these funds, called National Treasury Contributions (ATNs) are distributed in a discretionary way by the National Executive, through the Ministry of the Interior (the “political” ministry par excellence).

Within Argentina's federal structure all levels of government are generally permitted to borrow both domestically and abroad. During the 1980s both levels of government borrowed extensively, reflecting the weak fiscal management of the period. In addition, both accumulated sizable arrears on payments for wages and pensions, to suppliers and for debt service. (During the 1990s the federal government tried to consolidate those arrears; the clearance operation added up to a total of 9 percent of 1995 GDP).⁵

Provincial state banks had in most provinces a legal status that makes them very dependent on the provincial executive power. Thus in practice they acted as captive sources of financing. In this sense, the provincial government banks were considered to be akin to the central bank of each province: they provided funds to the provincial governments upon demand and, in turn, received rediscounts from the Central Bank of Argentina.⁶ Given their portfolio of bad assets (resulting to a significant extent from lending to provincial governments) provincial banks were among the prime candidates for restructuring and consolidation, process that was accelerated after the 1995 Tequila crises induced a run against most provincial financial institutions. As of mid 1999 only six provincial banks remain in the hands of the provincial public sectors.

2.2 Problems

The recent evolution of federal finances in Argentina, in particular those associated with provincial governments, has been a subject of much concern. Provincial deficits and debts have been rising at a worrisome pace compromising not only macroeconomic stability, but also the financing of basic public goods. Below we summarize and provide some evidence of a number of facts we identify as major deficiencies of the workings of federal finances in Argentina.

a) High deficits, increasing indebtedness and procyclical finances of provincial governments.

As Table 1 shows since 1991 and for the aggregate of all jurisdictions, provincial authorities have run continuous deficits, which on average are significant, both compared to their own total revenues and to the deficit of the national government. In this regard, up to 1994 the aggregate provincial deficit was equal to or larger than that corresponding to the central authorities. Though this tendency changed after 1995 it is still true the provincial fiscal disequilibria still explain a large part of the consolidated fiscal imbalance. The decline in the consolidated provincial deficits after 1995, especially in 1996 and 1997, is

⁵ In many provinces, the provincial Constitution imposes some restrictions on the borrowing ability of the government (see Sanguinetti and Tommasi, 1997). In some jurisdictions it requires an extraordinary legislative majority to approve new debt; they also impose restrictions on the level of indebtedness and on the use of debt. Nevertheless, in most provinces, these restrictions are very mild and when they specify quantitative limitations they are rarely binding (see Sanguinetti and Zetner 1999). It is not surprising then to find that borrowing limits had no significant effect on the fiscal behavior of provinces (Jones, Sanguinetti and Tommasi 1998).

⁶ For example, those rediscounts amounted to over 2 percent of annual provincial spending during 1983-1990.

mainly explained by the reduction operated in few large jurisdictions like Cordoba and Mendoza. As table 2 shows, in many jurisdictions deficits continue to be very high representing more than 15% of their total revenues.

The accumulation of deficits has been reflected in increasing levels of debts. As table 3 shows, for the aggregate of provinces the level of indebtedness raised from 40% of total revenues in 1994 to 53% in 1999. This average value is, nevertheless, very much influenced by the behavior of few large provinces. In particular the province of Buenos Aires that in 1997 launched an aggressive program to reduce its debt obligations, reducing them from 40% of their total resources in 1996 to 14 % in 1997. Instead, in other provinces like Rio Negro, Corrientes, Tucuman, the level of debt grew steadily reaching values well beyond 100% of their total revenues in 1999 (see table 4).

The growing deficits and the accumulation of debt have been the result of significant increases in expenditures induced by rapid raises in total provincial resources during the period of strong economic growth that followed the implementation of the convertibility plan in 1991 (see table 1). Thus between that year and 1994 expenditures almost doubled while current income also increased but at lower pace so the deficit raised. This behavior was again replicated, though in a somewhat moderated way in the other expansionary wave that took place between 1996 to 1998. This highly pro-cyclical fiscal policy had negative consequences when the cycle changed its sign. Thus, when the Tequila crisis hit the Argentine economy during 1995 provinces had a hard time finding sources to finance both current deficits and their debts. A similar though again more moderate phenomenon occurred during 1999 when, after the Brazilian devaluation, Argentina entered again into a sharp recession. The significant raise in deficits and in debt in those years should not be considered as a sign of greater access to financing. As table 5 indicates a significant part of this additional financing was taken in a compulsory way with suppliers and, most importantly, with public employees. For some jurisdictions this implied on average that public salaries have arrears up to six months. Again in 1999 we observed a similar phenomenon but of a lower magnitude.

b) Bailouts.

In various cases the above-indicated high and unsustainable provincial deficits have been financed by rescue operations undertaken by the federal government. As documented in Nicolini et al (2000a) these bailout operations took in the nineties various forms and not always implied the direct transfer of money to the provincial authorities. For example, between 1992 and 1994 the federal government assisted financially seven provinces⁷ that were going through fiscal and financial difficulties. Financial aid took the form of handling national treasury bonds available at the federal level at that moment. The Provinces then obtained the required resources by selling those bonds in the secondary markets. The importance of the rescue operation involved in these loans can be appreciated by the fact that these funds represented a significant proportion of the financial needs of the

⁷ The seven episodes involved the provinces of Catamarca in 1994, Corrientes in 1992 and 1994, Formosa in 1994, Misiones in 1994, Rio Negro in 1994, Santiago del Estero in 1993 and 1994 and Tucuman 1994.

jurisdictions. If we consider only the loans granted during 1994 we see that these loans covered 89,5% of the necessities of financing of these provinces in that year. When we include the loans made to Corrientes in 1992 and to Santiago del Estero in 1993, the total amount of resources that were handed out reached 800 millions dollars.

Another interesting case of bailout occurred during the transfer to the national government of some of the provincial pension systems. One of the main sources of deficits in the provincial finances was the state provincial pension system. These systems generated large deficits due to poor mechanisms for collecting revenues and too generous benefit payments. Between 1994 and 1996 the national authorities took direct responsibility of the operation of the provincial pension regimes in eleven jurisdictions (they were “nationalized”), merging them with the national system. As a consequence, the national government had to assume a significant fiscal cost given the significant disequilibria that ex-post were found in those regimes. Though it was originally calculated at about 500 millions a year in 1996, the actual cost “jumped” to 1500 millions in 1998.

c) Poor local tax collection.

At the root of the financial difficulties facing many provincial governments there are poor performances of provincial authorities at tax collection. This is associated with weak local tax agencies where there is a lack of updated information regarding tax bases and other key data. Thus tax compliance is very low. There are no good estimations of tax evasion in provincial tax systems but the data presented in table 6 brings some evidence suggesting that some jurisdictions are not doing their best to strength their local sources of income. The table shows estimates of total tax income over provincial GDP for 1999. It also shows data on income from Regalias (cannon paid to provinces from the exploitation of natural resources) and other non-tax resources. We see that for the aggregate of provinces the average provincial tax rate is about 4.5%. But there is a strong variation across jurisdictions around this average. This could be taken as an unjustified difference in tax effort if there are no significant disparities in the tax system across provinces (in terms of, for example, tax decentralization) and also no major differences in terms of other sources (non-tax) of income. Thus, looking at the data of the table we can conclude that provinces like Corrientes, Chaco, Formosa, Jujuy, Misiones and, notably, La Rioja are well below the country average in terms of tax collection and this is not justified for the existence of any other significant provincial source of in come.

d) Poor national tax collection

Compliance of the nationally collected VAT (the main revenue source for the consolidated public sector) was estimated to be 55%, while neighboring countries like Chile (80%) and Uruguay (70%) have better compliance rates (Crotty and dos Santos, 1996).

We cannot pin all the responsibility for this poor tax compliance on the federal fiscal system, but many observers believe that the current regime, by virtually eliminating any

incentive for the provincial authorities to cooperate in the collection of coparticipated taxes,⁸ is part of the explanation.

e) Inefficiencies in the fiscal mix

The fact that some taxes are shared and others are not has induced the federal government to make some inefficient decisions. As Tanzi (1996) argues, this leads to situations where non-shared taxes acquire greater weight in the tax system, even when they are less efficient. For instance, national payroll taxes are considered to be too high for a country suffering very high unemployment.

At the provincial level there is an excessive reliance on the turnover tax. While the turnover tax is easy to collect and constitutes the largest source of provincial own revenue, it is a cascading tax which constitutes a drag on enterprise cost, fosters inefficient vertical integration, benefits imports over domestic products, increases the cost of exports, has a tax base that competes with the federal VAT, and makes it difficult to audit interprovincial transactions.

f) "Industrial promotion" regimes and tax competition affecting national taxes.

The non-cooperative behavior among provincial governments has also affected the collection of national taxes even though provinces do not directly administrate those taxes. This has been occurred through very generous and poorly controlled regimes of industrial promotion. Under these regimes tax exceptions of major national taxes can be allocated to industries and other activities established in certain regions of the country. The two more important regimes were those established for the provinces of Catamarca, La Rioja, San Luis and San Juan, on one hand, and Tierra del Fuego on the other. More recently there has been enormous pressure to extend the regimes to other provinces especially for non-industrial activities (like forestry and tourism). This regional policy has been a significant source of tax expenditures that only recently has started to be quantified and somewhat controlled. The magnitudes of the benefits were important because, especially in the case of the five indicated provinces, they allowed to postpone payments of VAT obligations for a period up to 15 years. The workings of these regimes generated in practice a form of tax competition (involving national taxes) between the favored regions as the regime permitted the province to be the major authority in the selection of projects. This has implied that a huge amount of national resources were directed to these regions. For the fiscal year 2000 they have been estimated to be around 1.8 billion dollars (see Budget 2000). Estimations done by the Federal Tax Authority of the fiscal cost of the system between 1992 and 2010

⁸ Why pay the political cost of using local police to close down businesses that fail to pay taxes if there is no connection whatsoever between how much is collected in each province and how much is received by each province out of coparticipated taxes. There have even been episodes of local citizens and local authorities ganging up against the national tax collector.

(when many of the benefits expire) arrive at an amount close to 8 billion dollars (see Consejo Empresario Mendocino 1999)

g) Transfers and inefficiencies in the provision of local public goods.

Federal transfers redistributed resources across jurisdiction without clear criteria. As indicated, the secondary distribution is based upon fixed coefficient established in the same law without any justification. Transfers do not respond to changes in the factors affecting the demand and supply of public services or changes in other relevant socioeconomic indicators. For example, in the area of basic education many provinces have witnessed a strong increase in the rate of enrollment in the nineties. Though provincial government increased in real terms the amount they spend on education, it was not enough to maintain the level of expenditure per student (see Figure 3). In fact in some jurisdictions like Neuquen, Rio Negro, Catamarca, San Juan and Tierra del Fuego expenditure per student went down at a significant rate in recent years. Though this evidence does not per se indicate a significant reduction in the quality of education, it signals that the federal system is not providing a stable financing for such critical public goods as basic education.⁹ This is the more critical when we realize that the Argentine Constitution explicitly demands that federal transfers should aim at assuring equal development opportunities and quality of life across the country.

3. THE THEORY

In this section we present a sketch of a theory that tries to explain features of public policies like those described above, as the outcome of political transactions, which are conditioned by the rules of that transactions game (i.e., by the incentives and constraints faced by political actors).¹⁰

We analyze the workings of federal systems (including fiscal federalism) as a game, in which the players are: the constituent subnational units and some “independent” national political actor/s. The last expression highlights the fact that a national government is, in part, constituted by representatives of the subnational units. The exact details of that representation, as well as the incentives of the independent national actor/s, will vary depending upon constitutional rules, electoral systems, some characteristics of the party system, etc. For simplicity think of the independent national actor as the President.

A Federal System can be characterized by the allocation of policy jurisdictions across units (the central government and each local government), by the decision making rules for those

⁹ There is other casual evidence suggesting that some jurisdictions are not doing their job at providing public goods. For example in 1999 in the Province of Corrientes public schools were closed almost half of the school year.

¹⁰ Spiller and Tommasi (2000) suggest the general framework that we apply here to fiscal federalism. Tommasi (2000) formalizes some of these conjectures.

policies assigned to the central government,¹¹ and by the explicit or implicit decision making rules for those issues that inevitably fall in a gray area requiring collective decision making. The latter includes decisions about changing the jurisdictional allocations.

At a given point in time, a federal country will inherit a set of jurisdictional allocations and of decision making rules, and the federal (fiscal) game will take place under those conditions. (Iaryczower, Saiegh and Tommasi, 1999, attempt to endogeneize the original contract / constitution and the subsequent dynamics).

The game is one in which the players have to make collective decisions, and also take “individual” actions. Collective decisions are made in different arenas: one is the national congress, another are the explicit intergovernmental agreements, including for example the decision to decentralize some educational service from the national government to the provincial governments, or a new tax-sharing agreement. The outcome of the collective decision will take the form of some “contract” (such as laws in the first case, or Fiscal Pacts or other federal agreements in the second case).

The individual actions include decisions such as government spending or government borrowing by a particular unit in any given period. They also include participation in pairwise agreements between, say, the national government and a particular provincial government; and investment-like decisions such as a provincial government deciding whether to invest in developing sophisticated technologies to acquire information about the tax bases in the province, or the decision to pay the short-term political cost of fiscal adjustment.¹²

Decisions and actions map into payoffs for each of the players. Applying the logic of transaction cost economics we can characterize these decisions and actions by their duration, reversibility, fungibility, and temporality of payoffs.

The environment is, in part, a repeated game, but with some stochastic features (i.e., it is a dynamic game.) We can simplify the stochastic environment as being subject to two types of shocks: (1) “economic” shocks coming from international markets, policy decisions in other countries, technological changes, diseases, natural disasters, social and demographic changes, etc; and (2) “political” shocks that represent shifts in the relative political power of the players (unrelated to changes in “fundamentals”). An example would be the fact that the President is a native of a particular province, or the particular realization of some powerful coalition in Congress, able to trade support for some national legislation in exchange for federal moneys. This type of political uncertainty could be modeled by some variation of a “random recognition rule” used in legislative bargaining models pioneered by Baron and Ferejohn (1989). (See also Alesina, 1988, Tommasi, 2000, and Dixit et al, 2000).

¹¹ The decision making rules “at” the central government include the rules of the national legislative process, the electoral connection to provincial governments, etc.

¹² The difference between actions and investments relates to the temporal flow of payoffs associated with the given “policy”. For brevity we will speak of them generically as actions, except when we specifically want to emphasize investments.

Define the benchmark of first best policies as those that would be agreed and enforced in a complete contract before the uncertainties realize. These optimal policies will be responsive to economic shocks, but irresponsive to political realizations (Tommasi, 2000). In a non-cooperative game, the degree of possible cooperation will depend on several features of the game. Those features will include the discount factors (horizons) of the players, the number of actors, the observability of moves, as well as some other “institutional” features specifying the timing of moves, the existence or not of some “exogenous” enforcement mechanisms, etc. For brevity of exposition, we will collapse all of those features of the game under the term “transactions environment.”

Following Spiller and Tommasi (2000), we present here a result which we will use to explain the (inefficient) features of fiscal federalism in Argentina.

Result:

If the transactions environment does not foster cooperation, then we will observe:

- 1. Too much opportunism, leading to “volatile” collective decisions (too responsive to political realizations), and non-cooperative individual actions.**
- 2. Economically inefficient choices as prevention against such opportunism (one example consists in distributing rents in rigid manners before the realization of economic uncertainty).**
- 3. Some desirable policy reforms do not happen.**
- 4. Underinvestment in capacities, leading to lower quality policies.**

We will argue that the Argentine case is characterized by a poor environment for intertemporal political transactions, leading to the results above, which translate into many of the observed (and difficult to reform) inefficient features of fiscal federalism. The problem of an inadequate transactions environment is magnified in the Argentine case by the high degree of National-Provincial interdependence (i.e., the large size of the “gray” area).

The next section maps the implications of the result above into the characteristics of Argentina’s fiscal federalism. Section 5 presents evidence to support the claim that the environment for federal political transactions is not conducive to efficient intertemporal trades.

4. MAPPING THE PREDICTIONS OF THE THEORY ONTO THE FEATURES OF FISCAL FEDERALISM IN ARGENTINA

In the subsequent section we will describe a political and institutional context characterized by a combination of: lack of incentives in national legislators, excessive interference of provincial leaders in national policymaking, and the ability of the national executive to alter agreements via budgetary discretion and other means. This combination of features

produces a “trading” environment not conducive to the agreement and enforcement of efficient policies and reforms, with serious consequences for the workings of fiscal federalism.

Some of the stylized facts of fiscal federalism in Argentina described in section 2 can be understood as being the result of this logic. We provide below a series of examples, organized around the theoretical results of the previous section.

4.1. Opportunism

Opportunism is reflected in non-cooperative individual actions and in volatile decisions in the national arena (Tommasi 2000 and Iaryczower et al, 1999). Non-cooperative are those individual actions that negatively affect the payoffs of other players. The high deficits and provincial debts clearly indicate opportunistic behavior from provincial authorities. This behavior generates inefficiencies through the negative externalities generated in credit markets. Similarly, the poor provincial tax effort, has negative reverberations onto other provinces through the bailout mechanism. Also, the lack of provincial cooperation to foster better collection of national taxes in each province’s territory, reflects opportunistic behavior.

The often observed unilateral agreements that a province makes with the national government receiving some special favors, are also non-cooperative actions in the game among provinces; in this case fostered by institutional features that allow such discretion to the national executive (or to the national legislature, in the case of many “industrial promotion” regimes).

This last case (and mechanism) is also associated with the volatility of the provincial allocation of federal spending (including tax exemptions). In Nicolini et al (2000a) we show that the allocation of “National Treasury Contributions” to the provinces were affected by political variables each period. Nicolini et al (2000) also show dramatic shifts in the amount of transfers from the National Ministry of Education to the different provinces; shifts that cannot be explained with standard “demand” variables, which move slowly.

4.2. Economically inefficient choices (as prevention against opportunism)

Inefficient choices, at the individual level, and in the collective realm, are often made as a protection against the possibility of future opportunism. The highly procyclical behavior of provincial finances can be understood as an indirect result of opportunistic behavior. In this regard, provinces would not have incentives to save in good times because they may fear that, then, they will obtain less from the "federal fiscal pie." This is consistent with the evidence on bailouts and the level of discretion and lack of transparency that affects the design of federal transfers. Provinces can extract extra resources from the federal government by being in financial difficulties. (Nicolini et al 2000a, Jones, Sanguinetti and

Tommasi, 2000). It might also be argued that the inefficiencies in the input mix of public production, with excessive public employment in many provinces, is a mechanism to increase political leverage in order to obtain central funds.

Excessive public employment is an economically inefficient action which imposes some intertemporal rigidities (comparable to the practice of “cash hiding” in public enterprises, Savedoff and Spiller, 1999), since it is harder to fire people, than it is to postpone or suspend purchases of other inputs. There are many more rigidities embedded in the collective agreements, generically known as “Fiscal Pacts”. They include many instances (1992, 1993, 1999, 2000) in which provinces have guaranteed some floors of transfers independently of tax collection; also the very mechanism of the Tax-Sharing Law, which specified fixed coefficients of a given set of taxes for each province and for the National government (instead of making it a function of the determinants of the relevant spending needs).¹³ Some of the fairly restrictive mandates of the 1994 Constitution, can be interpreted in the same light.

4.3. Some desirable policy reforms do not happen

The inability to instrument the required intertemporal transactions is part of the explanation of several inefficiencies of the Argentine tax system. Imagine that the economic authorities consider convenient, due to high unemployment, to reduce payroll taxes. Given a tight fiscal situation, the potential reduction in revenues has to be compensated by an increase in other taxes. If payroll taxes are non-shared national taxes, and most of the taxes that have to be increased are shared ones (as it is the case in Argentina), this tax reform would require “compensation” from the provinces to the national government if previous spending paths are to be roughly maintained. The problem is that given the obvious uncertainties about the exact amount of extra shared revenues to be generated, and the incentives for strategic misrepresentation of those estimates, the provinces are likely to resist such a compensating change (unless they were able to write complete contracts.) This is not a fiction story, but has happened in Argentina in 1998, and it is a re-enacting of similar problems occurring in the past in relation to other “national” taxes, such as import duties, export taxes, and the inflation tax (Iaryczower, Saiegh and Tommasi, 1999).

The same problem is behind the inability to instrument many of the provincial tax reforms agreed in the 1992 and 1993 Fiscal Pacts.¹⁴ Table 7 presents the degree of fulfillment of the several clauses of the Fiscal Pacts. It shows that it is very uneven across provinces and across reforms. The following description by Schwartz and Liuksila is particularly telling:

“Tax reform was clearly the centerpiece of the second fiscal pact. Provinces adhering to the pact committed themselves to eliminating stamp taxes on checking accounts, taxes on the transfer of fuel, gas and electricity and, most important, phasing out the provincial turnover tax. [...]”

¹³ Additionally, in Nicolini, Sanguinetti and Tommasi (1999), we show that the current system performs poorly as a mechanism of sharing risk against shocks to tax bases.

¹⁴ It is revealing that part of the 1999 accord calls for “fulfillment of the tax reforms agreed upon in the 1993 Fiscal Pact” (!!)

Initially, the provinces were slow to join this second pact, largely because of the revenue implications of the tax reforms, particularly the initial stipulation to abolish the provincial turnover tax before June 1995. While the provinces were free to replace the turnover tax with other taxes, many have not yet done so. [...]

Overall, there is no easy short-term alternative for replacing the provincial turnover tax. [...]

Other alternatives for improving provincial revenue would be beneficial in the long run, but would not yield short-term results. [...] Similarly, improving real state taxation would require substantial initial efforts, including, for example, improving property mapping and property registries; providing better and more consistent application of valuation techniques; improving the exchange of information between local tax offices, property registries,

The announcement in December 1993 that federal payroll taxes levied on employers would be reduced, depending on region and sector, in those provinces participating in the second pact, increased pressure on provincial governments to join. By May 1994, all but one provincial legislature had ratified the second fiscal pact, and most had taken at least some initial steps toward implementation. Also the provinces were given a minimum revenue guarantee and some other guaranteed fixed payments that provided a floor of federal transfers equivalent to about 4.5% of GDP annually.

The second fiscal pact clearly shows the 'horse-trading' that is involved in implementing structural reforms of the system of fiscal federalism. [...], but came at the expense of making payroll taxes an explicit instrument of regional and sectoral policies, and contributed to the growing social security deficit."(1997: 408-412)"

This example illustrates the inability to make intertemporal trades that have the nature of investments, i.e., up-front costs and a later stream of benefits that could be appropriated. It seems that the extant federal governance structure of Argentina cannot support such trades.

4.4. Underinvestment in capacities, leading to lower quality policies

The problem of underinvestment takes the form not only of underfulfilment of collective agreements for reform, but also the form of reduced incentives to undertake what, in a regime not subject to opportunism, would be individually-efficient investments. An instance of that is the poor state of provincial tax agencies, which lack the personnel, technology and information to effectively discharge their duties. All of this can be understood as underinvestment due to the potential opportunism of other players: if you raise your capacity to collect taxes, you are less likely to benefit from future bailouts.

5. INTERGOVERNMENTAL POLITICS IN ARGENTINA

In every federal polity national and sub-national jurisdictional boundaries are established in the constitution. Constitutional provisions usually specify the assignment of policy responsibilities between the central government and the lower tiers of the federation.

However the spheres of government authority in federal systems are seldom unambiguous. In reality, federal arrangements constitute a complex intermixing of powers and responsibilities between the national and sub-national governments. Furthermore, these

“boundaries” are not permanent ones: over time, conflicts over the proper interpretation of the national/sub-national jurisdictional boundaries usually occur in federal countries.

These dynamics call for a continuous interaction between the different levels of government. Sometimes to “police” each other boundaries, sometimes to adjust to the constitutional allocation of power between them to a changing reality, and some other to establish joint responsibility over certain matters. That is, sometimes this interaction entails conflict between the constituent units of the federation and, some other times, cooperation for mutual benefits. In any case, the point is that the assignment of policy responsibilities is not unambiguous nor frozen, and intergovernmental interactions will always take place.

Now, these interactions can take place in very different ways, in more or less institutionalized environments. For example in Argentina, as in almost every federation, intergovernmental relations are often carried out informally through various means of direct communications (i.e. by letter or telephone) between ministers, officials and representatives of different levels of government with each other. Besides this day-to-day management of intergovernmental affairs, certain councils where national and sub-national ministers meet to discuss and coordinate policy in areas of non-exclusive jurisdiction (such as health, education and social programs) exist¹⁵.

Finally, adjusting the distribution of powers between the national and sub-national governments to political and economic changes sometimes requires another mechanism for concerted action, such as a formal intergovernmental agreement. These agreements usually take the form of treaties, compacts or memorandums of understandings. The Federal Fiscal Pacts of 1992, 1993, and 1999 in Argentina are good examples of these.

In terms of their content, they can establish an agreement between the different levels of government to adopt a particular policy that may be implemented administratively and without the need for legislation. Another type of agreement between the different levels of governments of a federation may ensure that their respective legislatures adopt a law whose terms have been agreed upon by them (Opeskin, N.d.).

The review of the different mechanisms for intergovernmental relations makes clear, then, that there are many ways in which the different levels of government can coordinate their actions. What it is most important, for our analysis is that the various informal mechanisms and even the written undertakings between governments within a federation such as pacts and treaties have an uncertain legal effect. That is, many of these agreements do not create legal obligations. Therefore, the value of intergovernmental agreements usually depends on the ability of the different parties to enforce whatever they have agreed upon. Countries can differ widely in their capacity to enforce intergovernmental agreements.

The enforcement problem, thus, is a crucial one. To begin with, it should be noted that these interactions are bound to be quite complex. Intergovernmental bargains involve numerous political actors with very different interests: presidents, legislators, sub-national

¹⁵ Among others, these are the Consejo Federal de Inversiones, Consejo Federal de Educacion, Consejo Inter-Ministerial de Infraestructura.

politicians, etc. This creates several coordination problems. In general, as Inman and Rubinfeld (1997) note, cooperation between the different levels of government will be difficult to achieve under incomplete and asymmetric information. They also argue that beneficial intercommunity agreements might be overlooked if proper enforcement mechanisms are not available.

Analytically, then, we can differentiate intergovernmental agreements not by the mechanism that is employed but instead, in terms of its enforceability. In this sense, the overall institutional environment in which these negotiations are carried out and not just the mechanisms through which intergovernmental relations occur, is crucial to understand why in some countries mutually beneficial bargains between the different levels of government are struck and in some other they are not.

In the Argentine case, the environment for intergovernmental transactions has not been the most appropriate. First, because the jurisdictional boundaries between the different parts of the federation evolved in a very particular way throughout the 20th century. Second, because intergovernmental agreements did not have the necessary institutions to carry out their enforcement.

With respect to allocation of powers between the different levels of government, intergovernmental competition and conflict prevailed over cooperation in areas of concurrent jurisdiction. Given Argentina's political and economic instability since the 1930s (including numerous military "interruptions" and high and recurrent inflation), political actors in general tended to adopt a particularly myopic perspective. Hence, the national and subnational governments did not invest in building intergovernmental institutions, and usually attempted to protect their (quite vulnerable) property rights instead of collaborating among them (both vertically and horizontally).

This historical legacy deeply affected, for example, the revenue sharing system. Sudden changes that improved the bargaining power of a group of agents lead in some cases not just to minor adjustments at the margin, but to steep radical changes (sometimes, the alteration of the rules of the game altogether). Rules that were put in place by civilian governments were subsequently reversed by military regimes and vice-versa. The changes usually involved alterations to the criteria for revenue sharing between the national and the sub-national governments as well as among the latter. When the power was more concentrated in the national government (mostly during military regimes), the changes were intended to shift the distribution of shared taxes in its favor. Conversely, with democratic opening, the once again elected governors engaged in new debates over the distribution of tax revenues in order to reverse the changes that were produced during the previous regime. This usually resulted in modifications to the distribution of shared taxes in the sub-national governments' favor (Saiegh and Tommasi 1999).

With respect to the enforceability of intergovernmental agreements it is important to emphasize also the reinforcing interactions between Argentina's intergovernmental relations, and the country's overall incapacity to implement efficient intertemporal political exchanges. A combination of lack of legislative incentives, a disproportionate power of

provincial leaders in national policy-making, and the ability of the national executive to act opportunistically deeply affected intergovernmental relations.

5.1. Intergovernmental bargains and their environment

A noteworthy feature of Argentine intergovernmental relations has been the prevalence of “executive federalism”. That is, the predominant role of governmental executives in intergovernmental relations (Watts, 1999).

Another important feature has been the bargaining process that usually took place between them. Given Argentina’s political configuration, deals struck between the national and sub-national executives could be easily altered at the legislative or at the execution stage. Sub-national leaders’ influence in national policy-making gave them enough political clout to obtain benefits at the expense of the national government or other sub-national units. On the other hand, the national executive could easily unravel at the execution stage agreements reached or ratified in the national legislature. Thus, these agreements often took place outside the national legislature and, when feasible, established very rigid rules in order to avoid their modification.

We summarize below some of the main features of the Argentine political game that explain why this environment is inadequate for efficient political transactions among jurisdictions.¹⁶

a) The short-term horizon of Argentine legislators

As long as the legislature serves as an institution which can secure political agreements by reducing uncertainty and transaction costs, beneficial intercommunity agreements may be reached.

The case of a legislature such as the United States Congress is usually seen in the literature as an illustration of an institution with those characteristics (Weingast and Marshall, 1988; Cox and McCubbins, 1993; Krehbiel, 1991). Indeed, as Weingast and Marshall (1988) note, its internal organization facilitates the achievement of complex intertemporal agreements between its members. This internal organization, in turn, reflects the institutionalization of the U.S. House of Representatives during the 20th century, as membership became more difficult and turnover less frequent.

Although Argentina’s national legislature is formally very similar to the US Congress¹⁷, its actual functioning uncovers striking differences. First and foremost, due to the recurrent

¹⁶ Part of this section draws from Jones, Saiegh, Spiller and Tommasi (2000).

¹⁷ Argentina possesses a presidential form of government with a bicameral legislature whose members are elected in non-concurrent elections. The Argentine Chamber of Deputies has 257 members who are elected from province-wide multi-member districts (the 23 provinces and the federal capital) for four year terms. The deputies are elected from closed party lists using the d’Hondt divisor form of proportional representation. One-half (127 and 130) of the Chamber is renewed every two years, with every district renewing one-half of

political instability, the turnover rate of political actors in general was extraordinarily high throughout the 20th century. As expected, this political instability deeply affected congressional careers, which became brief and discontinuous.

Even today, after seventeen continuous years of democratic government (the longest spell since 1930), turnover rates in Congress remain extremely high. Table 8 shows the very low reelection rate of Argentine legislators in comparative perspective.

In this context, it is very difficult to knit intergovernmental agreement when these have a differential intertemporal pattern of benefit flows for the different jurisdictions. For example, take a tax reform. Even though there may be some potential losers in the short run, there can be benefits for all levels of government in the long run. However, these type of agreements are difficult to sustain in the Argentine Congress. Given the short-term horizon of most legislators, the probability that the benefit flows will be curtailed in the future is relatively high, and thus, trades go unconsummated.

b) Weak legislators, powerful governors

Such brevity in Argentine congressional careers is rooted in the existing electoral rules. To be re-elected legislators must obtain once again a spot on the party list. Many legislators do not return to Congress because they are not included in the party lists. Only one quarter of incumbent deputies seeking reelection in the 1989-1999 period were renominated by their parties (Table 8; see also Jones et al, 2000, for more detail).¹⁸

That is, in Argentina, the process by which the regional party lists are formed largely affect who runs on the party list, what order they occupy, and hence the chances of winning candidates have. This gives local party leaders an upper hand in this process.¹⁹

This results in a disproportionate power on the hands of the Argentine governors, who can exert substantial influence through national legislators. Instead of being just a group of sub-national leaders who may potentially seek national office (as in any other federal country), they are continuously involved in “national” policy-making.²⁰

its legislators. The Senate is composed of 72 members, with every province (and the federal capital) represented by three senators. Prior to the 1994 constitutional reform all of the country's provinces and its federal capital were represented by two senators.

¹⁸ Also, due to the vagaries of electoral politics, every election several deputies who are on the party lists may not be elected as a consequence of the sagging electoral fortunes of their party. However, as Jones et al. (2000) note, this factor is less important in the Argentine case: between 1989 and 1999, three quarters of those incumbents who obtained a position on the party list achieved re-election.

¹⁹ Actors other than local party leaders may exercise influence over for the election of Chamber deputies (i.e. the national party organization, the district level rank-and-file party members). However, as De Luca et al. (2000) note, the decision whether to hold a primary to select list members usually depends heavily on whether or not the party controls the governorship at the provincial level. As governors are likely to bear a disproportionate share of the costs of any divisive primary, they have both the incentive to and means by which to arrange a negotiated list of candidates. Thus, they are usually able either to impose their candidates, co-opt potential opponents, and/or successfully negotiate an agreement with other party factions.

²⁰ For an American observer, it is peculiar to notice that the President often gets together with governors to discuss national policies, a very rare event in the U.S.

Such power in the hands of the sub-national governments clearly affects the nature of intergovernmental relations. Agreements between national and sub-national executives that require the approval of the national legislature may give rise to opportunism on the part of the sub-national governments. Given the legislators' allegiance to the governors, these can hold-up national policies in the national legislature, or include in the agreements policies that have nothing to do with intergovernmental relations.

c) A weak "horizontal" separation of powers

Sub-national leaders in Argentina exert disproportionate influence through congress. On the other hand, as we mentioned above, "horizontal" separation of powers (between the president and the national legislature) may prevent the national government from renegeing on the agreements.

Hence, the national legislature plays a key role in keeping a balance in the intergovernmental relations. In particular, one has to look the relationship between the legislature and the executive at the national level. In the Argentine case, the link between local party leaders and legislators described above has a noticeable impact on the internal organization of the national legislature. Again, legislators have stronger incentives to please those provincial leaders who will place them on the party list than to improve their visibility in the eyes of the voters, develop legislative policy expertise, or take actions to be able to claim credit with their constituencies.

Thus, instead of specializing in particular policy areas, Argentine deputies tend to serve on numerous committees. As Jones et al. (2000) note, committee memberships are more a way to obtain individual perks and to be in good standing with the local party leadership than instruments for legislators' electoral objectives.

This certainly affects the way the national congress as a whole operates vis-a-vis the executive power. The short-term horizons coupled with the lack of incentives to specialize make Argentine legislators very ill-suited to control and supervise the administration. That is, important dimensions of policymaking are left to the executive because legislators do not find their career advancement chances affected by this delegation of authority. Second, because they do not have the technical expertise (nor the proper incentives to hire the appropriate staff) to make some certain decisions, they usually find it very difficult to accurately specify what the bureaucracy should do. This results in a *de-facto* delegation of authority in the executive power.

This "abdication" to the executive is specially salient on budgetary matters. Congress has a very limited role in budget preparation and discussion, and does not control ex-post the execution of the budget, leaving substantial discretion in the hands of the executive in terms of the geographical allocation of funds from national programs. (There are some recent efforts to improve the budget along all these dimensions.)

Such delegation to the executive is further aggravated by another institutional factor. Argentina's political instability during the 20th century undermined the ability of the

judiciary to place effective restraints on executive action (Iaryczower, Spiller and Tommasi, 2000). Hence, since 1983 there were many instances where the executive made unilateral moves on matters previously discussed by Congress without being challenged by the courts (i.e. “regulating” and altering the content of bills passed by the legislature through its decree authority).

Hence, agreements reached or ratified in a particular way in the national legislature can be easily unraveled at the execution stage (i.e. through changes in the composition of the national budget). This, of course, limits the incentives to undertake such deals in the first place.

5.2. Weakly institutionalized intergovernmental relations and its consequences

In a context such as the one described above, intergovernmental relations in Argentina have been carried out in very different ways, mostly on an ad-hoc basis and in multiple and superimposed political arenas.

Informal mechanisms have dominated, but formal intergovernmental agreements have also been used. A good example of the latter are the “Federal Fiscal Pacts”: intergovernmental compacts hammered out by the national and sub-national government executives and ratified by the legislatures of the constituent units (Fiscal Pacts of 1992 and 1993) and the national legislature (Fiscal Pact of 1999). Also in 1994, important aspects related to fiscal intergovernmental relations were included in Argentina’s revised constitution, establishing that new coparticipation law, on the basis of agreements between the central government and the provinces, had to be drafted before 1996. However, up to this date this remains unsolved.

However, besides these formal instances of negotiation, intergovernmental relations have been predominantly conducted in a much more informal way, and without any criteria reflecting the balance of power between the national and sub-national governments and among the latter. For example, in the period 1983-1988 (in between Coparticipation laws), to decide the allocation of transfers to the provinces, each sub-national government negotiated bilateral agreements with the federal government (Saiegh and Tommasi 1999). Since then, many other negotiations and changes to the coparticipation scheme took place in the executive quarters, or in ad-hoc meetings of the President with Governors. This reflects the separate political power of the national executive and the provinces and the lack of institutionalization of the mechanisms to carry out these agreements.

This lack of institutionalization in the mechanisms through which intergovernmental relations have been handled had serious effects on the nature of policy making in the federal fiscal realm. On the one hand, these arenas did not provide enough institutional “stickiness”, making changes in the allocation of policy jurisdictions and in the allocation of federal funds too volatile. On the other hand, in order to avoid such uncertainty with respect to intergovernmental boundaries and redistributions, these have been in some cases defined very rigidly (some of them were even enshrined in the constitution) although it was more convenient to leave them open in order to adapt them to changing circumstances.

6. RECOMMENDATIONS

There is almost absolute consensus among observers and political actors that Argentina should undertake various reforms to its federal fiscal system. Major lending organizations and other specialists have produced many reform proposals seeking to correct several of the problems we described in section 2.

However, these “recipes for change” are not followed. As we argued in the paper, even if there are efficiency gains, transactional problems (specially the enforceability of those transactions) make the reforms difficult to enact.

We believe, therefore, that a feasible and sustainable reform strategy must focus at a higher level of institutional reform.²¹ Our proposal is to reform the structure and process of intergovernmental decision-making.

Before diving into the details of our proposal for fiscal federalism in Argentina, let us make a “general equilibrium” caveat. According to the approach reflected in this paper (and in Spiller and Tommasi 2000 and 2000b), public policies are the outcome of a game that has as rules the overall set of incentives and constraints faced by political actors, in multiple arenas. Hence, in order to improve the workings of fiscal federalism, as well as the general process of policy-making in Argentina, reforms are necessary in several fronts. In Spiller and Tommasi (2000b) we present the general strategy, which should include:

- ?? reforms to the electoral mechanisms to lower the dependency of national legislators from local party elites
- ?? reforms to the instruments of legislative interaction between the President and Congress
- ?? reforms to the budget process
- ?? institutional reforms to intergovernmental relations

For obvious reasons, we focus here exclusively on the last point. Even there, there are many aspects to consider. In Iaryczower, Sanguinetti and Tommasi (2000) we present a more complete proposal which considers not only the politico-institutional (i.e. *governance*) changes, but also the complementary reforms in the specific areas of macro-economic coordination, a new transfer-mechanism, and the (initial) redefinition of tax and spending authorities and constraints. None of those individual recommendations will stand alone, without the required institutional changes to permit a more flexible, yet more credible, federal system. For matters of space, we summarize below only the recommendations for changes in the “governance structure” of fiscal relations.²²

²¹ See Acuña and Tommasi (2000) for a similar point in the broader context of reforms needed by Latin America.

²² NOTE TO THE EDITORS AND REFEREES: WE PRESENT HERE AND EXTREMELY COMPACT SUMMARY OF OUR RECOMMENDATIONS. FOR YOUR INFORMATION, WE ACCOMPANY THIS PAPER WITH A MORE DETAILED REFORM PROPOSAL (IN SPANISH) WE WILL GLADLY EXPAND THE RECOMMENDATIONS SECTION OF THE PAPER IN ANY DIRECTION REQUESTED.

The Constitution amended in 1994, calls for a new Coparticipation Law (article 75, 2nd paragraph). It explicitly includes several aspects that the new law should take into consideration. Those conditions can be understood in light of the argument developed in this paper, as constraints that the actors try to impose on each other to prevent from opportunism, at the same time that they attempt to enforce some efficient reforms.²³ In particular, the Constitution mandates the creation of a Federal Fiscal Institution to instrument that law. We take a broad interpretation of this mandate, and suggest using this constitutionally mandated Federal Fiscal Institution, to redefine the governance structure of federal fiscal relations, making it into a formal arena in which issues of fiscal federalism are (continuously) decided.

It is important to understand that a Federal Fiscal Law is an incomplete contract reflecting the political agreement at the time of its creation. If the Law were to specify a set of specific mechanisms to distribute taxes (i.e., a “rule”) it will still always require adjustments to many changing circumstances, as the history of fiscal federalism in Argentina shows (Saiegh and Tommasi 1998, Iaryczower et al, 1999). If no explicit change is made to the federal governance structure, the contract will be “completed” under the “default” extant governance structure. But we have argued that the features of the extant governance structure, described in section 5, are precisely the underlying determinants of the many economic inefficiencies observed today. That is why this higher-level institutional change is required, so as to “complete” the contract with better ex-post decision procedures (see Saiegh and Tommasi 2000 for more detailed references to the incomplete contracts literature supporting this reasoning).

The purpose of the Federal Fiscal Institution (“*Órgano Fiscal Federal*”) will be to provide the proper channel for intergovernmental dealings, away from the national legislature, from informal and unenforceable executive-executive deals, and from some excessive ex-post discretion in the hands of the National Executive. This will help to minimize the crisscrossing patterns between national and regional policies described above, and will also help the actors to make decisions in a foreseeable setting. This should allow them to handle intergovernmental relations more effectively and to be able to adjust policy decisions to changing circumstances.

The changes we suggest in the federal decision making procedure, coupled with changes in the transfer system that substantially increase the Wicksellian connection at the margin (Iaryczower, Sanguinetti and Tommasi, 2000), constitute a profound redefinition of fiscal federalism in Argentina. The provinces *individually* assume greater responsibilities, and *collectively* acquire more power in the federal decisions.

The new design has to:

²³ The Constitution requires that the new law be a “ley Convenio”, i.e., a law that has to be agreed by the national and all provincial executives, and then ratified by the national and provincial legislators. This is a way of insuring “unanimity”, so that no one is harmed by the reform.

- ?? Strengthen federalism by bringing many decisions that today are at the discretion of the national government, into an explicitly intergovernmental decision mechanism.
- ?? Bring inside the collective decision process a number of choices that in the past have been dealt with through “informal” mechanisms
- ?? Reduce the chance that viable policies are overlooked because information on their viability is provided by one of the interested players
- ?? Ensure the monitoring and enforcement of political agreements

In terms of the details of governance:

- ?? We suggest a “Federal Fiscal Institution” organized in a manner somewhat similar to the Australian Commonwealth Grants Commission. It will be composed of a highly qualified and well-equipped Technical Commission (TC) with technical capabilities comparable to those of the Central Bank and of the Ministry of Finance; and a Council of Ministers (Federal Fiscal Assembly—FFA) with political representation from the national government and each of the provincial governments.
- ?? The Technical Commission will be in charge of generating the studies and information, on the basis of which the FFA will make decisions. These studies may include the data necessary to adjust the distribution of revenue as a function of sharing-formulas previously decided (if indeed, formulas are used), as well as suggestions for changing those formulas in light of changes in other parts of the system (say a new Tax Law by Congress), in order to maintain the spirit of the original agreement
- ?? The *political property rights* of the different jurisdictions will be protected by appropriate voting mechanisms in the FFA. The details of the voting rule for each type of issue are presented in Iaryczower, Sanguinetti and Tommasi (2000).

7. CONCLUSIONS

The aim of this paper was to analyze the main factors behind some of the deficiencies present in intergovernmental fiscal relations in Argentina. We develop a theory that endogeneizes the political decisions giving shape to the current system.

Even though the details of our recommendations are specific to the Argentine case, the main message of the paper can be generalized. Intergovernmental relations are always incomplete contracts in continuously changing environments. For that reason, any reform effort requires an understanding of the nature of the exchanges involved, in order to design the institutions most adequate for handling those negotiations.

References

- Acuña, C. and M. Tommasi (2000) "Some Reflections on the Institutional Reforms Required for Latin America" in (YCIAS Vol. 1) Institutional Reforms, Growth and Human Development in Latin America. Yale Center for International Area Studies. New Haven, Connecticut.
- Aizenman, J (1998) "Fiscal Discipline in a Union" in F. Sturzenegger and M. Tommasi (Eds.) The Political Economy of Economic Reforms, Cambridge: MIT Press
- Alesina, A. (1988) "Credibility and Policy Convergence in a Two-Party System with Rational Voters" *American Economic Review* 78 (4).
- Baron, D. and J. Ferejohn (1989) "Bargaining in Legislatures." *American Political Science Review*, Vol. 83, 1181-1206.
- Bird, Richard (1993) "Threading the Fiscal Labyrinth: Some Issues in Fiscal Decentralization" National Tax Journal 46(2), June: 207-27
- Consejo Empresario Mendocino (1999) Impacto económico para la Argentina y Mendoza de los regimenes de promocion industrial.
- Cox G. and M. McCubbins (1993) Legislative Leviathan: Party Government in the House. Berkeley, University of California Press.
- Crotty, J. and P. dos Santos (1996) "Provincial Tax Issues" Mimeo, Washington: Fiscal Affairs Department, International Monetary Fund, July.
- De Luca, M., M. Jones, M. I. Tula. 2000. "Argentine Political Parties and Their Candidate Nomination Procedures: 1983-1999." Presented at the XXII International Congress of the Latin American Studies Association, Miami, FL, March 16-18.
- Dixit, A. G. Grossman and F. Gul (2000) "The Dynamics of Political Compromise." *Journal of Political Economy*, Vol. 108 (3), 531-68.
- FIEL (1993) Hacia una nueva organización del Federalismo Fiscal en la Argentina. Fundación de Investigaciones Económicas Latinoamericanas.
- Iaryczower, M. S. Saiegh and M. Tommasi (1999) "Coming Together: The Industrial Organization of Federalism." Serie Documentos de Trabajo, CEDI.
- Iaryczower M. , J. Sanguinetti and M. Tommasi (2000) "Una Propuesta de Reforma al Federalismo Fiscal Argentino" Mimeo, CEDI. (with appendix by S. Saiegh)
- Iaryczower, M. P. Spiller and M. Tommasi (2000) "Judicial Decision Making in Unstable Environments, Argentina 1935-1998." Mimeo CEDI.

Inter-American Development Bank (1997) "Fiscal Stability with Democracy and Decentralization," Part 3 of Report on Economic and Social Progress in Latin America. Johns Hopkins University Press - IDB.

Inman, R. and D. Rubinfeld (1997) "Rethinking Federalism", Journal of Economic Perspectives, Vol. 11, No. 4: 43-64.

Jones, M. P. Sanguinetti and M. Tommasi (1998) "Politics, Institutions, and Public-Sector Spending in the Argentine Provinces.", in Poterba, J.M. and J. Von Hagen Fiscal Institutions and Fiscal Performance, Chicago, The University of Chicago Press.

Jones, M. P. Sanguinetti and M. Tommasi (2000) "Politics, institutions, and fiscal performance in a federal system: an analysis of the Argentine provinces." *Journal of Development Economics*, Vol. 61, 305-333.

Jones, M. S. Saiegh P. Spiller and M. Tommasi (2000) "Professional Politicians, Amateur Legislators. The Argentine Congress during the XXth Century." Mimeo, CEDI.

Kopits, G. Jimenez, J.P. and Manoel, A. (1999) "Responsabilidad fiscal a nivel subnacional: Argentina y Brasil". Mimeo IMF.

Krehbiel, K. (1991)) Information and Legislative Organization. Ann Arbor, University of Michigan Press.

Nicolini, JP, Sanguinetti, P. and Sanguinetti, J. (2000) "Análisis de alternativas de financiamiento de la educación básica en Argentina en el marco de las instituciones fiscales federales." Mimeo, UTDT.

Nicolini J.P. , P. Sanguinetti and M. Tommasi (1999) "Redistribution, Risk-Sharing and Inefficiency in the Argentine Federal Fiscal System" Mimeo.

Nicolini, JP. Posadas, J., Sanguinetti, J., Sanguinetti, P. and Tommasi, M. (2000a) "Decentralization, Fiscal Discipline in Subnational Governments, and the Bailout Problem: The case of Argentina." Mimeo, IDB.

Opeskin, (N.d) presented at Forum of Federations: International Conference on Federalism.

Piffano, H. (1998) "La asignación de las potestades fiscales en el federalismo Argentino." Serie Documentos de Trabajo, CEDI.

Porto, A. (1990) . Federalismo Fiscal: El Caso Argentino. Buenos Aires, Instituto Torcuato Di Tella, Editorial Tesis.

Saiegh, S. and Tommasi, M. (1998) "Argentina's Federal Fiscal Institutions: a case study in the transaction-cost theory of politics", paper prepared for the Conference on "Modernización y Desarrollo Institucional en la Argentina", UNDP, Buenos Aires.

Saiegh, S. and M. Tommasi (1999) "Why is Argentina's Fiscal Federalism so Inefficient? Entering the Labyrinth." *Journal of Applied Economics*, Buenos Aires, May, Vol. II (1), 169-209.

Saiegh, S. and M. Tommasi (2000) "An Incomplete-Contracts Approach to Intergovernmental Transfer Systems in Latin America." In World Bank, Decentralization and Accountability of the Public Sector.

Sanguinetti, J and Zetner, A. (1999) "El endeudamiento de los gobiernos subnacionales: el caso de las provincias Argentinas." Mimeo, Ministerio de Economía.

Sanguinetti, P. and M. Tommasi (1997) "Los Determinantes Económicos e Institucionales de los Déficit en los Presupuestos Provinciales: Argentina 1983-1996." Mimeo, IDB.

Savedoff, W. and P. Spiller (1999) Spilled Water. Institutional commitment in the provision of water services. Inter-American Development Bank.

Schwartz, G. and C. Liuksila (1997) "Argentina" in T. Ter-Minassian (ed.) Fiscal Federalism in Theory and Practice, Washington, International Monetary Fund.

Spiller, P. and M. Tommasi (2000) "The Institutional Foundations of Public Policy: A Transactions Approach with Application to Argentina." Mimeo, CEDI.

Spiller, P. and M. Tommasi (2000b) Las Fuentes Institucionales del Desarrollo Argentino. Hacia una Agenda Institucional. United Nations Development Program and Fundación Gobierno y Sociedad. Editorial Universidad de Buenos Aires (EUDEBA).

Tanzi, Vito (1996) "Fiscal Federalism and Decentralization : A Review of Some Efficiency and Macroeconomic Aspects," in Annual World Bank Conference on Development Economics . Washington : World Bank.

Tommasi, Mariano (2000) "A Model of Intertemporal Political Agreements, and their Determinants. Implications for the Characteristics of Public Policies" Mimeo, Universidad de San Andrés.

Watts, R. (1999) Comparing Federal Systems, Second Edition. Institute for Intergovernmental Relations. Queen's University. Canada.

Weingast, B. and W. Marshall (1988) "The Industrial Organization of Congress; or, Why Legislatures, like Firms, are Not Organized as Markets" *Journal of Political Economy*, Vol. 96, No. 1.

World Bank (1992)

World Bank (1996) "Argentina. Finanzas Provinciales: Temas sobre Federalismo Fiscal" Departamento I: Oficina Regional de América Latina y el Caribe.

Table 1:

LATIN AMERICAN DECENTRALIZATION:
INSTITUTIONAL FEATURES FOR SOME SELECTED COUNTRIES

	Argentina	Brazil	Colombia	Mexico	Venezuel	OECD
					a	
Expenditure Decentralization (ED)	49,3	45,6	39	25,4	19,6	34,9
Vertical fiscal imbalance (VFI)	56	33	38	61	83	42
Borrowing Autonomy (BA)	3	2,9	2	1,8	1	2
ED*VFI*BA	8282,4	4363,92	2964	2788,92	1626,8	2931,6

Source: own calculations based upon data from IADB (1997).

Table 2: Federal Finances in Argentina: 1991-1999

(In millions of current pesos)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
<i>Provincial Governments</i>									
Total income	14.859	21.804	25.515	27.365	26.691	29.077	32.631	33.091	32.055
Total expenditures	16.247	22.400	27.265	29.561	29.942	30.153	32.743	34.746	34.928
Surplus/deficit*	-1.388	-596	-2.064	-2.364	-3.480	-1.724	-1.377	-2.233	-3.340
Surplus/deficit (as % of total income)	-9,3	-2,7	-8,1	-8,6	-13,0	-5,9	-4,2	-6,7	-10,4
<i>National government</i>									
Surplus/deficit*		812	855	-2.214	-4.862	-7.735	-4.212	-5.247	-8.772

Note: (*) Does not include
income from privatizations
Source: Subsecretaría de
Programación Regional

Table 3 : Provincial deficits (as % of total revenues), 1991-1999

	1991	1992	1993	1994	1995	1996	1997	1998	1999
G.C.B.A.	-11,4	-21,8	-4,8	2,8	-0,3	-8,7	-3,1	12,5	-2,8
Buenos Aires	-16,4	4,5	0,5	-3,9	-3,5	-5,7	-7,8	-14,3	-9,5
Catamarca	-2,2	-4,2	-20,6	-25,1	-16,6	-17,8	-2,9	-1,1	-0,7
Córdoba	-16,0	-8,3	-21,6	-18,6	-19,1	8,2	2,3	-5,4	-0,6
Corrientes	-6,1	-2,7	-1,4	-14,1	-11,3	1,1	-9,3	-8,2	-10,1
Chaco	-3,4	-6,2	-8,7	-7,9	-16,5	-8,7	-9,6	-21,7	-8,7
Chubut	-12,9	-10,2	-33,1	-42,9	-17,0	-23,5	-21,3	-12,1	-16,8
Entre Ríos	-6,2	-7,5	-4,3	-7,2	-21,5	-0,3	-2,2	4,5	5,6
Formosa	-23,5	-10,7	-32,9	-27,3	-24,4	-7,0	-15,8	-11,0	-3,9
Jujuy	-7,2	10,3	-16,7	-24,1	-37,6	-20,1	-5,8	-8,4	-14,8
La Pampa	5,0	5,8	-6,5	-8,3	-16,8	-5,2	3,8	1,0	2,0
La Rioja	-2,1	-13,7	-2,3	-4,2	-2,1	8,3	11,2	4,3	2,3
Mendoza	4,6	-1,6	-15,3	0,7	-27,3	-37,7	-5,7	-5,8	-17,3
Misiones	-3,3	-8,1	-17,2	-12,8	-26,8	-9,6	-12,1	-17,8	-3,6
Neuquén	-4,9	-8,2	-27,9	-16,3	-28,5	-0,2	2,4	-8,5	-10,4
Río Negro	-9,7	-10,9	-59,3	-28,2	-43,2	-26,0	-12,9	-11,9	-7,0
Salta	-19,6	-9,5	-3,4	-7,1	-15,6	-2,4	-10,6	-1,3	3,7
San Juan	-12,0	4,1	-16,3	-46,2	-42,7	-5,9	-3,2	-2,9	-4,8
San Luis	9,5	11,6	8,5	-2,6	0,8	22,1	23,4	19,8	3,7
Santa Cruz	-19,3	12,9	-0,6	-9,6	-7,6	3,3	-0,9	-12,9	-8,1
Santa Fe	-0,7	7,3	1,9	-0,1	-11,3	-2,0	2,8	-14,7	-7,5
Santiago del E.	-7,6	-6,4	-16,0	-12,0	-3,8	7,1	8,5	6,7	7,9
Tucuman	-0,2	-5,7	2,6	-10,5	-26,8	-16,7	-6,5	2,2	-3,0
Tierra del Fuego	-5,2	-3,6	-5,7	-7,6	-20,4	-3,8	-11,3	-12,7	-7,3
Total	-9,3	-2,7	-8,1	-8,6	-13,0	-5,9	-4,2	-6,7	-10,5

Source: Subsecretaria de Programacion regional

Table 4. Aggregate provincial debt 1994-1999

Year	In millions of USD	rate of change	as % of GDP	as % of total income
1994	11120,4		4,32%	40,64%
1995	14572,8	31,05%	5,65%	54,60%
1996	15644,4	7,35%	5,75%	53,80%
1997(2)	14822,5	-5,25%	5,06%	45,42%
1998	15786,6	6,50%	5,30%	47,71%
1999	18585,5	17,73%	6,52%	57,98%

(2) The decrease in the stock of debt in 1997 is mainly due to the reduction in Province of Buenos Aires's debt during that year

Source: Subsecretaría Programación Regional.

Table 5: Provincial Debt: 1994- 1999
(As % of total income)

Province	1994	1995	1996	1997	1998	1999*
TOTAL	40,2%	54,1%	53,3%	44,9%	47,1%	58,0%
G.C.B.A.	50,4%	46,5%	40,2%	40,3%	34,5%	27,3%
Buenos Aires	37,8%	36,9%	40,3%	14,3%	16,3%	23,5%
Catamarca	78,8%	63,3%	79,9%	76,3%	77,6%	88,3%
Córdoba	46,7%	65,4%	50,0%	48,8%	44,0%	51,9%
Corrientes	89,3%	111,8%	114,8%	104,9%	128,5%	150,4%
Chaco	76,6%	80,6%	68,0%	94,5%	108,4%	146,9%
Chubut	14,4%	35,6%	44,6%	46,4%	50,4%	90,5%
Entre Ríos	41,7%	57,4%	50,2%	44,8%	50,7%	62,3%
Formosa	68,3%	132,9%	129,8%	116,9%	120,3%	141,1%
Jujuy	42,1%	86,0%	99,7%	113,9%	107,2%	124,1%
La Pampa	0,0%	7,9%	18,7%	16,6%	15,5%	15,5%
La Rioja	120,3%	90,7%	85,2%	72,3%	74,2%	74,8%
Mendoza	21,5%	103,5%	83,5%	111,1%	65,0%	90,3%
Misiones	42,6%	90,6%	74,3%	84,4%	88,0%	122,8%
Neuquén	7,5%	31,3%	33,9%	31,7%	40,7%	62,3%
Río Negro	61,1%	107,6%	108,2%	121,7%	126,3%	158,7%
Salta	37,9%	73,1%	63,1%	59,9%	61,9%	74,3%
San Juan	51,5%	79,8%	67,2%	53,6%	57,1%	83,5%
San Luis	0,0%	3,9%	12,4%	17,2%	16,8%	16,5%
Santa Cruz	16,3%	25,0%	11,9%	6,1%	21,4%	41,4%
Santa Fe	18,1%	24,8%	23,3%	23,8%	36,1%	45,4%
Santiago del Estero	26,4%	49,9%	59,6%	45,1%	42,9%	33,3%
Tierra del Fuego	7,3%	36,2%	41,3%	43,4%	45,6%	70,2%
Tucumán	61,0%	74,3%	105,3%	105,5%	96,6%	116,5%

Source: Sanguinetti and Zetner (1999)

* June 1999

Table 6. Composition of aggregate provincial debt

(in millions of U\$D and as a % of total debt)

Year	Loans with Commercial Banks	Public Bonds	International Organizations	Arrears with suppliers and public employees	Rest (1)
1995	5332,80	215,00	1485,10	4300,86	3239,00
1996	6241,90	346,00	1770,60	3499,01	3786,76
1997	4638,30	1587,40	2325,88	2901,09	3369,91
1998	5240,40	1802,30	3032,24	2541,77	3169,84
1999 (2)	5589,50	1890,10	3225,19	2860,72	3180,16
1995	0,37	0,01	0,10	0,30	0,22
1996	0,40	0,02	0,11	0,22	0,24
1997	0,31	0,11	0,16	0,20	0,23
1998	0,33	0,11	0,19	0,16	0,20
1999 (2)	0,33	0,11	0,19	0,17	0,19

(1) Includes debt with the National Government.

(2) As of June of 1999.

Source: Sanguinetti and Zetner (2000)

Table 7. Provincial tax income: 1999
(as % of provincial GDP)

Province	Taxes	Royalties other non-tax inc. (1)	Total	
Buenos Aires City	4,51%	0,00%	0,24%	4,76%
Buenos Aires	5,35%	0,00%	0,38%	5,74%
Catamarca	3,13%	0,20%	2,52%	5,84%
Córdoba	4,22%	0,00%	0,37%	4,60%
Corrientes	1,96%	0,23%	0,10%	2,29%
Chaco	3,10%	0,00%	0,24%	3,34%
Chubut	2,58%	2,07%	0,53%	5,17%
Entre Ríos	4,91%	0,41%	0,44%	5,76%
Formosa	1,96%	0,15%	0,86%	2,97%
Jujuy	2,62%	0,01%	0,41%	3,04%
La Pampa	4,43%	0,22%	2,18%	6,83%
La Rioja	1,47%	0,00%	1,62%	3,08%
Mendoza	3,81%	0,57%	0,82%	5,20%
Misiones	2,69%	0,15%	0,39%	3,23%
Neuquén	4,75%	7,50%	2,09%	14,34%
Río Negro	3,77%	0,83%	0,78%	5,38%
Salta	4,10%	0,87%	0,17%	5,13%
San Juan	3,46%	0,00%	0,88%	4,35%
San Luis	3,39%	0,00%	0,89%	4,28%
Santa Cruz	3,99%	7,76%	1,94%	13,68%
Santa Fe	4,43%	0,00%	0,33%	4,76%
Santiago del E.	4,07%	0,01%	0,68%	4,76%
Tierra del Fuego	2,69%	2,11%	0,79%	5,59%
Tucumán	3,62%	0,00%	0,51%	4,13%
Country average	4,50%	0,26%	0,45%	5,22%

(1) Includes income from cannon paid by privatized public services

Source: Subsecretaría de Programación Regional

Issues	C.F.	B.A.	Cat.	Cord.	Corr.	Cha.	Chu.	E.R.	For.	Juj.	L.P.	L.R.	Men.	Mis.	Neu.	R.N.	Sal.	S.J.	S.L.	S.C.	S.F.	S.E.	Tuc.	T.F.
1. Tax on contracts																								
1.1. Short term reduction																								
1.2. Medium term reduction																								
2. Specific taxes																								
2.1. Tax on oil																								
2.2. Tax on gas																								
2.3. Tax on electrical energy																								
2.4. Tax on sanitary services																								
3. Tax on bank accounts and payroll																								
3.1. Bank accounts																								
3.2. Payroll taxes																								
4. Gross income taxes																								
4.1. Primary production																								
4.2. Financial services																								
4.3. Insurance services																								
4.4. Foreign currency transactions																								
4.5. Industry																								
4.6. Utilities																								
4.7. Construction																								
4.8. Tourism																								
4.9. Research and development																								
5. Real estate taxes																								
5.1. Valuation																								
5.2. Tax rates																								
6. Tax agencies																								
7. Consumption tax																								
8. Tax on cars																								
8.1. Valuation																								
8.2. Tax rate																								
9. Privatization's and concessions																								
9.1. Energy firms																								
9.2. Sanitary and water utilities																								
9.3. Provincial Banks																								
Transfer of Provincial Pension System																								

Total fulfillment  Partial  no fulfillment  municipal  no 

Source: "Pact Federal para el Empleo, la Producción y el Crecimiento", UNLP, Lics. L.M.Monteverde, R. Ruiz del Castillo, S. G. Tarragona y H. Terán y Dres. T. Perez Balda y J.M. Prada sobre la base de información de la Dirección de Coordinación Fiscal con las Provincias

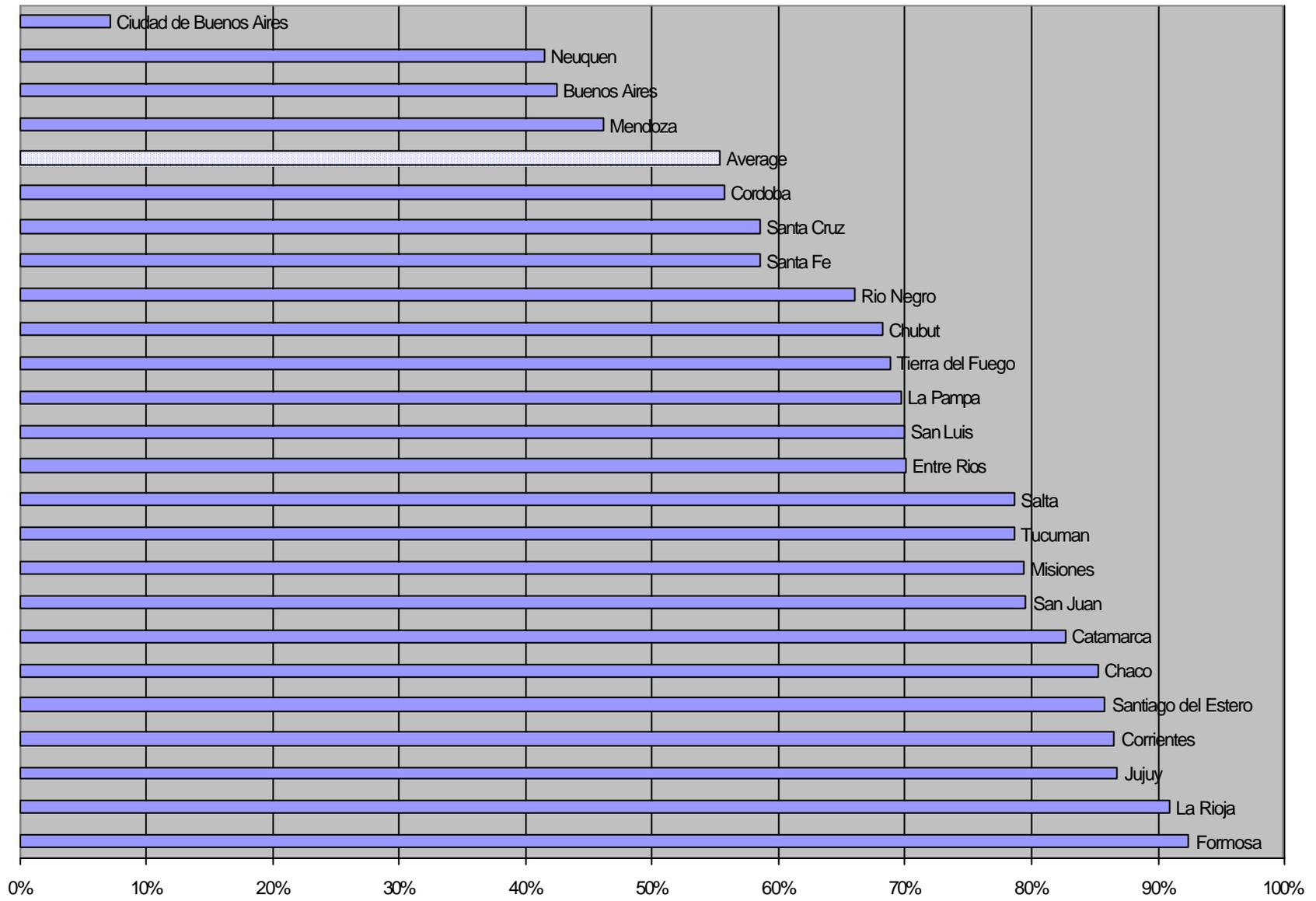
Note: The province of Buenos Aires has privatized the water company during 1999.

Table 9. Reelection of Legislators in Selected Countries in America and Europe

Country	% seeking reelection	% elected (from candidates)	% reelected
Argentina (1997)	26	67	17
Brazil (1995)	70	62	43
Chile (1993)	76	78	59
Mexico (1997)	0		0
U.S. (1996)	88	94	83
Italy (1953-72)	s/d	s/d	82
Great Britain (1950-74)	s/d	s/d	81
West Germany (1957-76)	s/d	s/d	70-75
Panama (1999)	s/d	s/d	49
Colombia (1990)	s/d	s/d	48

Source: Morgenstern (1998); Archer and Shugart (1997); Molinelli, Palanza and Sin (1999)

Figure 1: Vertical Fiscal Imbalances, 1999
 (100% - % own revenues / total spending)



Source:

Figure 2: Federal Fiscal Labyrinth in Argentina

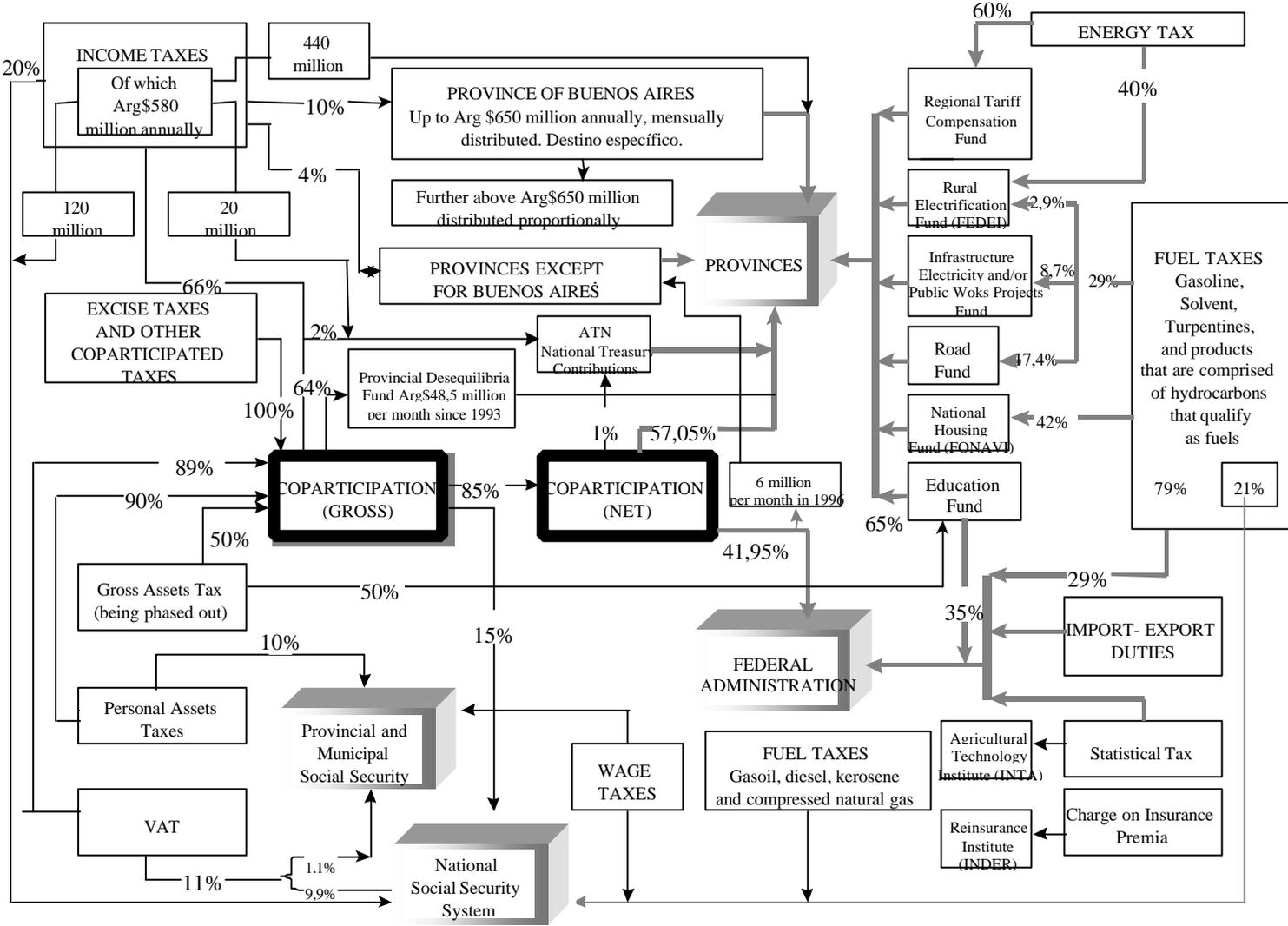
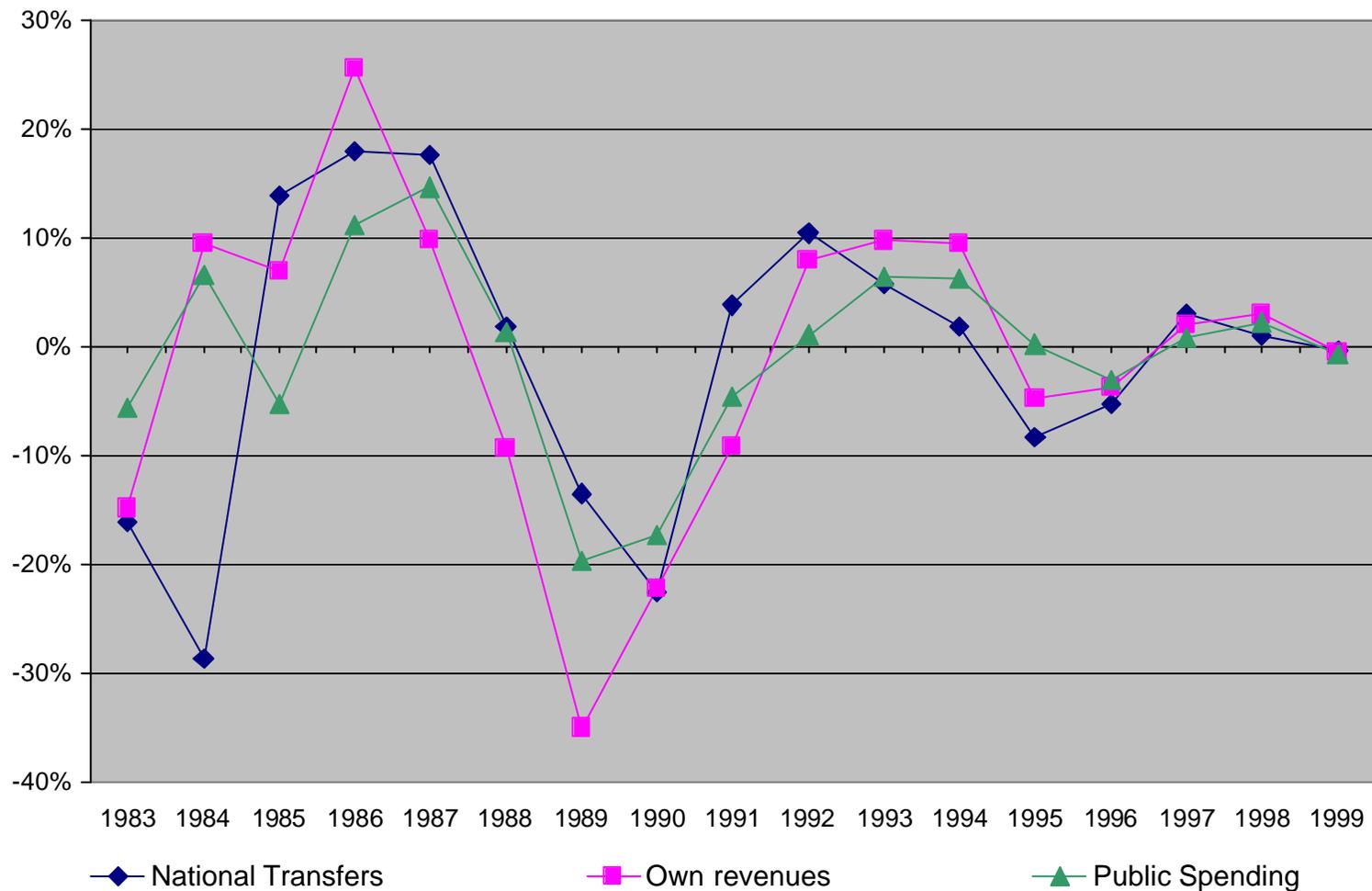
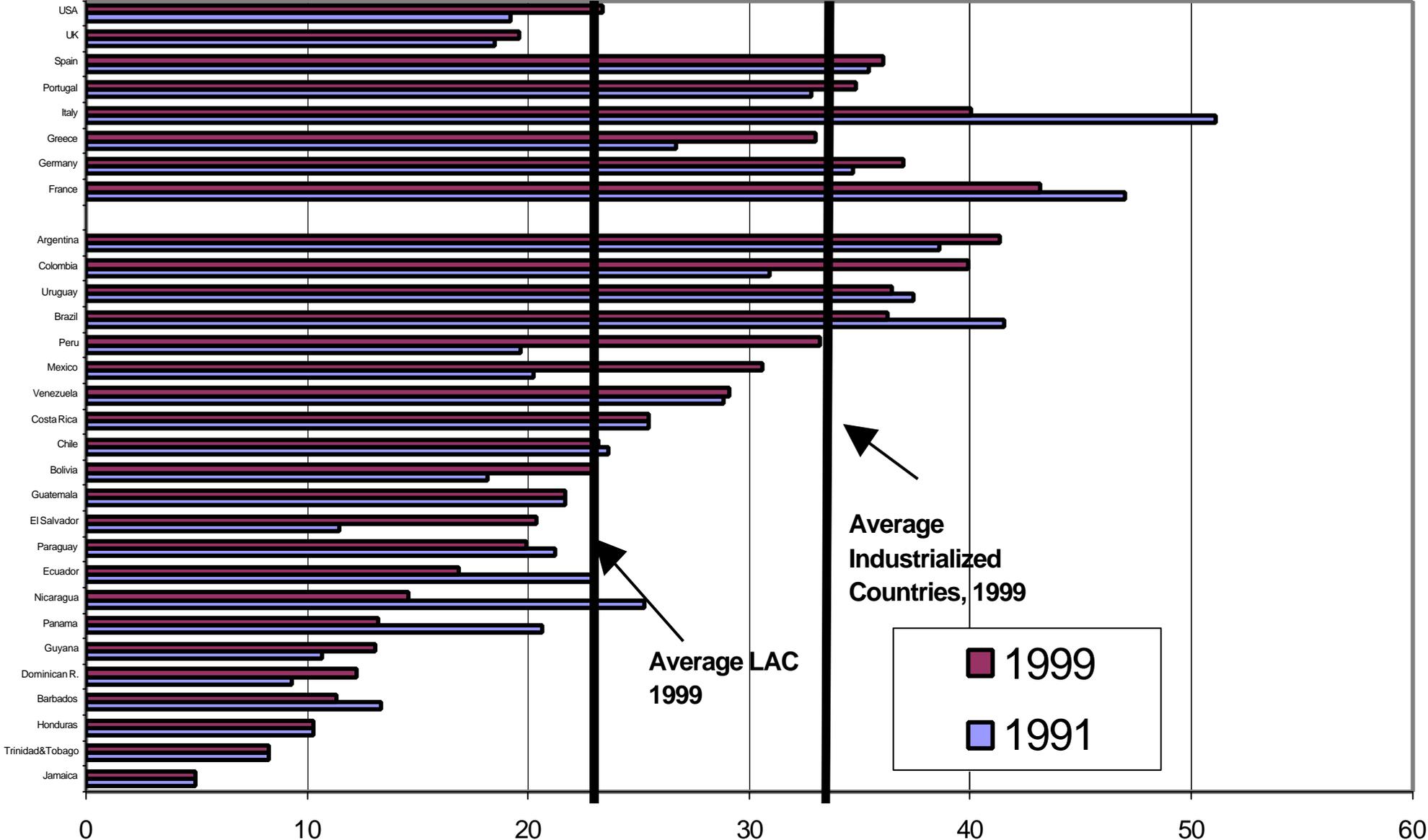


Figure 3. Aggregate national transfers, provincial own revenues and provincial total expenditures (percentual deviations from trend) 1983-1999



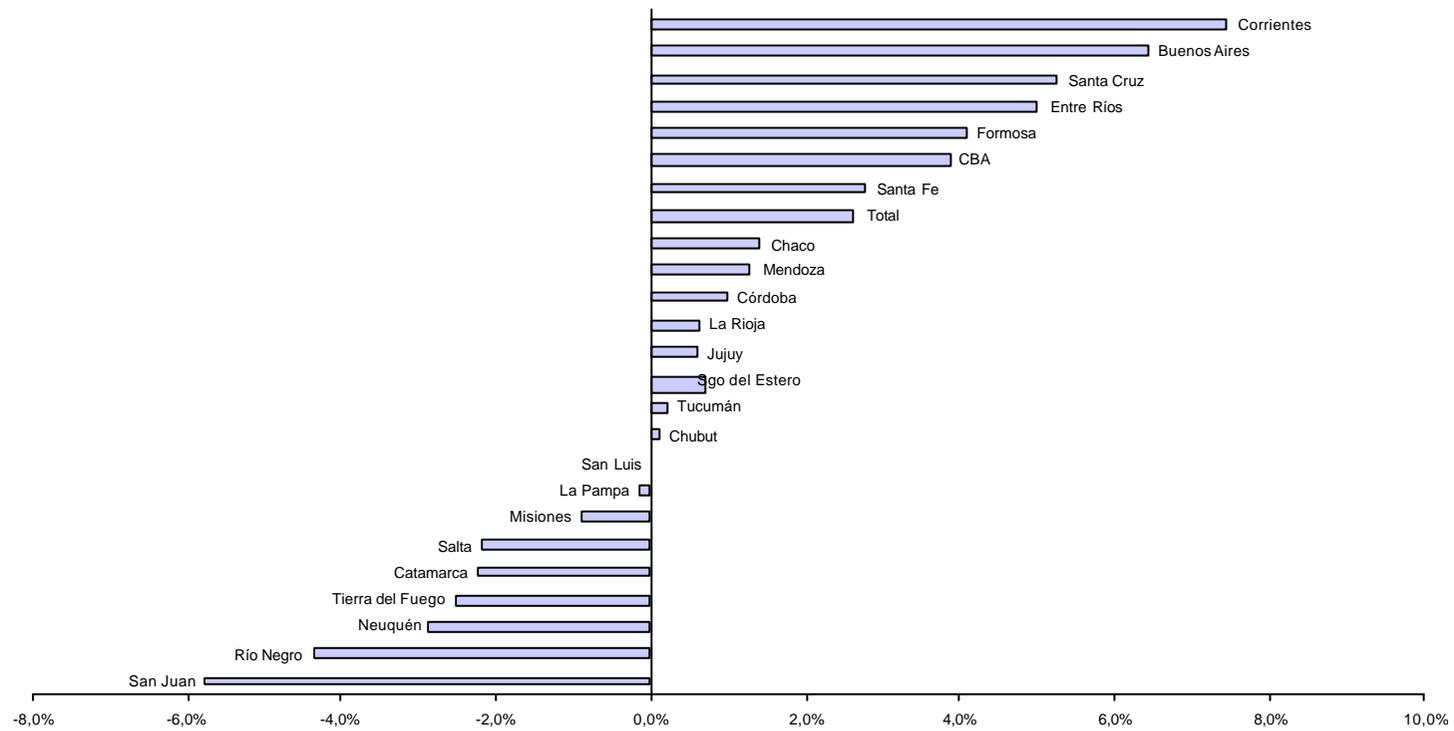
**Figure 4. Tax Wedge between Gross Labor Costs and Net Wages
(% of payroll)**



Tax wedge between labor costs and net wages (in % of payroll)

Source: Heston and Devine (2004)

Figure 5: Annual rate of growth of educational expenditure per student 1994-1999



Source: Nicolini et al (2000).