

Menem and the Governors: Intergovernmental Relations in the 1990s

In the popular and academic press, Argentina's 1991 convertibility law has received a great deal of attention from those who have sought to explain the country's economic successes in the first half of the 1990s and its failures later in the decade. According to an argument that is by now familiar, new institutional rules that prevented national policy makers from printing money halted the exchange rate speculation and hyperinflation that did so much to de-stabilize the Argentine economy in the 1980s (Acuña 1995, Corrales 1997, World Bank 1993). Over the course of the 1990s, the institution of convertibility increasingly proved to be a straightjacket, however, as the real appreciation of the exchange rate reduced the competitiveness of the Argentine economy (Pastor and Wise 2001) and as labor market rigidities continued to raise the costs facing exporters (Molano 2001). For most of the 1990s, convertibility as an institution enjoyed widespread support among political parties and voters, and seemed to indicate a major departure from a past characterized by a great deal of institutional instability and volatility (Tomassi and Spiller 2000). Yet, when evidence mounted that convertibility was unsustainable, policy makers did not respond with proposals that would make rule-based change in exchange rate institutions possible. Instead, convertibility ended with a bang in 2001 and 2002, as a major assault on property rights marked the beginning of yet another agonizing period of institutional uncertainty. What is particularly striking is that, given the serious problems associated with institutional fluidity in the past, it is the

stickiness of one particular institution – convertibility – that proved so devastating in recent years.

Convertibility is undeniably a large part of the story, but the roots of Argentina’s ongoing economic crisis are “not just the currency board (Schamis 2002, 82).” The purpose of this paper is to focus on another institutional arena that was similarly implicated in Argentina’s success in the early 1990s and in its later difficulties: the institutional rules governing the fiscal relationship between the federal and provincial governments. To date, provincial profligacy has figured prominently in the literature on Argentine economic performance in the 1990s. For example, in their survey of policy change during Menem’s two terms as president, Tomassi and Spiller (2000, 136-40) underscore the absence of concerted reforms at the provincial level. Gibson and Calvo argue that Menem used advantageous transfers to the provinces that constitute Peronism’s “peripheral coalition” in order to build political support there for economic reforms that would impose significant losses on its “metropolitan coalition (Gibson 1997, Gibson and Calvo 2000).” According to Remmer and Wibbels (2000), federal transfers likewise emboldened provincial officials to flout the preferences of national politicians and dramatically expand provincial payrolls. Jones, Sanguinetti and Tommasi (2000) find that opposition governors posed particularly acute problems for the president’s fiscal adjustment drive, and Eaton (2002) argues that provincial officials in the 1990s used the legislators who represent their districts in Congress to acquire preferential policy treatment from the center.¹ Journalistic accounts of Argentine difficulties in 2001

¹ Apart from analyses that link the provinces with the economic successes and failures of the last decade, the 1990s proved to be a fruitful time for research into provincial actors and institutions more broadly. On the incidence of provincial factors in privatization, see Llanos 1998 and 2001. On the importance of provincial parties, see Sin and Palanza 1997. On the provincial incentives facing legislators, see Jones,

similarly paid significant attention to the provinces, identifying the breakdown of negotiations over revenue transfers between the four most powerful Peronist governors and de la Rúa in October as the proximate cause of the country's move toward "selective default."²

This paper attempts to innovate by focusing on the *institutional* aspects of federal-provincial relations. In the early 1990s, Menem introduced major changes in the rules governing revenue sharing with the provinces through the negotiation of two distinct fiscal pacts. By replacing percentage-based revenue sharing with a rigid system of minimum revenue guarantees, Menem introduced the most radical change in the institution of revenue sharing since its creation six decades earlier. These rule changes were critical to the broader attempt to control federal budget deficits, fight inflation, and meet the rigors of a new fiscal paradigm in which money printing was no longer an option. Like convertibility, the two fiscal pacts helped Menem achieve stability at the center. Also like convertibility, Menem's institutional innovation in the guise of minimum revenue guarantees dramatically constrained the flexibility of the federal government once revenues declined at the end of the 1990s. Rule changes that had represented a revenue grab by the federal government and an assault on provincial property rights in 1992 and 1993 were transformed into a major boon to the provinces and a serious problem for the center after 1996. Like convertibility, the revenue guarantee as an institution also had a ten-year existence, ending in February 2002 when

Saiegh, Spiller, and Tommasi 2002. On the role of provincial party leaders relative to both national and grassroots Peronist actors, see Levitsky 2001. For a comparative study of the transfer of education to provincial governments, see Murrillo 1999. For a case study of provincial resistance to changes in excise taxes, see Kolodziej 1998.

² See "Argentina Says It Will Restructure Debt: Government Hopes to Avoid Defaulting on Loans as Economic Crisis Deepens," *Washington Post*, October 29, 2001, p. A14; "Argentine Leader in Talks to Avoid Default on \$132 Billion Debt," *The New York Times*, November 1, 2001, p. 6.

Duhalde was able to rescind the guarantee and return to a system in which revenue transfers are determined by fluctuations in the actual amount of tax revenues.

Thus, questions of institutional volatility and stickiness are central to the discussion of intergovernmental relations in Argentina. On the one hand, there has been a great deal of volatility in revenue sharing rules, with nearly constant political conflict and negotiations between governors and representatives of the federal government. Though I argue that the fiscal pacts of 1992 and 1993 mark a fundamentally new departure, intergovernmental relations in the last 30 years have been subject to numerous and significant changes: revenue decentralization in 1973, revenue centralization after the 1976 coup, the devolution of some education and health care responsibilities in the early 1980s, an ad-hoc system of revenue transfers in the mid-1980s, and the passage of further revenue decentralization in 1987. One could argue that this volatility in the area of center-provincial relations was itself a serious problem, and that Menem certainly showed insufficient respect for formal institutional rules (de Riz 1996, Ferreira and Goretti 1998).

Despite this image of volatility, one particular institutional rule – the extension of the revenue floor or *piso mínimo* – generated significant staying power. Once granted, the minimum revenue guarantee proved to be quite difficult to rescind, and governors rallied at various points in its defense.³ When they no longer had cause to worry about sudden decreases in transfers due a drop in federal tax collection, the minimum revenue guarantee enabled the governors to reduce provincial tax effort and to slough off demands from the center for provincial adjustment. Furthermore, subsequent to the shift

from percentage-based sharing to an actual revenue guarantee, provincial authorities used these guarantees as collateral that enabled them to run up significant debts with private sector banks. In other words, the *piso mínimo* let governors partially circumvent the privatization of provincial public banks that the federal government had achieved at such great effort in the mid-1990s. The revenue floor can thus be understood as an institutional rule that clearly shaped the behavior of provincial officials and that generated negative consequences at both the provincial and federal levels. At a deeper level, one could also cite the stickiness of the underlying norm of revenue sharing, initiated in the 1930s when the provinces delegated responsibility for the collection of key provincial taxes to the federal government. In the decades that followed, politicians have debated which tax bases should be subject to sharing and what percentage should be sent to the provinces, but not the more fundamental question of whether the federal government should continue to collect provincial taxes. The severing of the connection between tax collection and expenditure has profoundly compromised the integrity of provincial governments, and the crisis of the current period should generate a substantive debate that revisits the fateful decision of the 1930s to delegate tax collection.

In its focus on provincial revenue sharing, my argument echoes the call from Remmer and Wibbels to pay greater attention to “the structure of the public sector (2000, 446).” Where Remmer and Wibbels demonstrate that transfers in the Argentine fiscal system worsened subnational reform outcomes, I argue at a lower level of analysis that the particular form these transfers took (e.g. the guaranteed nature of the transfers for much of the 1990s) deserves to be highlighted. Where Gibson and Calvo emphasize the

³ In earlier work (Eaton 2001a), I emphasized the centralizing aspects of the 1992 and 93 fiscal pacts without perhaps paying sufficient attention to the significant extent to which features of those pacts favored

discretionary use of transfers to build political support among certain provinces, particularly critical in the case of the *Aportes del Tesoro Nacional*, I underscore the importance of non-discretionary minimum transfers as a rule that came to favor all provinces, and that shifted the balance of power toward provincial authorities once tax revenues collapsed.⁴ ATNs are undoubtedly significant, especially in the 1983-1987 period when no transfers were governed by automatic sharing procedures. After the 1987 revenue sharing law and stabilization in 1991, however, changes in the terms of automatic revenue transfers (*co-participación*) eclipsed discretionary transfers in importance in terms of the amount of public revenue they affected.

In addition to its intrinsic importance and deep impact on the country's macroeconomic successes and failures, the institution of automatic revenue-sharing also illustrates some of the broader dilemmas facing Argentina. Is the key challenge that institutions in the country are weak, or that they have been poorly designed?⁵ In the attempt to identify scenarios through which Argentina can begin to move forward from its current economic and political crisis, is insufficient institutionalization in the Huntingtonian sense the chief problem, or is it institutional design? On the one hand, the political and economic institutions that were put into place in the course of Argentina's simultaneous pursuit of democratization and liberalization have clearly come under enormous strain in recent years. In the last two years, the failure of the federal government to respect both provincial property rights by withholding guaranteed transfers and personal property rights by freezing bank deposits (the so-called *corralito*)

the provinces later in the decade.

⁴ Unlike Remmer, Wibbels, Gibson and Calvo, all of whom focus on transfers *and* provincial employment figures, I privilege the former. To a significant extent, the provincial patronage/public employment story

have generated real institutional uncertainties and sharp conflicts between the executive and judicial branches. In this sense, the picture that Tomassi and Spiller (2000) paint of Argentina as a country of profound institutional instability, as reflected in such phenomena as Supreme Court turnover and federal interventions in the provinces, remains highly accurate.

On the other hand, it would be a mistake to overstate the lack of institutionalization. As Schamis (2002) argues, for all the turmoil in the (Argentine) summer of 2001-2002, one should not overlook the important role played by the country's foremost representative institution – Congress – in weathering the political crisis. Furthermore, the *content* of institutional rules clearly generated independent effects. The last decade suggests that design considerations, such as the appropriate balance between rigidity and flexibility, are hardly superfluous. As examples of two very rigid rules, revenue guarantees and the convertibility system are easy to criticize because they hindered flexible responses to crisis. However, convertibility succeeded in halting inflation in 1991 precisely because it tied the hands of politicians whose irresponsible spending and money printing were driven by short-term political calculations. In the area of revenue sharing, the experience of the 1990s suggests that the federal government needs more flexibility than revenue guarantees allowed, and yet in the past “flexibility” has often opened up the scope for the highly political use of transfers.⁶ How can elected leaders deepen institutional stability while eschewing the design of overly rigid

was a function of the structure of transfers, which went a long way in financing the provincial employment binge of the 1990s.

⁵ For a discussion of the challenges facing institutional approaches in Latin America, see Weyland 2001.

⁶ For more on the trade-off between rules and flexibility in the Argentine context, see Saiegh and Tommasi 1999b.

institutional rules? How can these same actors build flexibility into rule-based decision making without opening the door to too much discretion?

This paper is organized in the following manner. In the next section I discuss the origins of co-participation in the wake of the economic crisis of the 1930s because all subsequent changes have essentially been reforms of this earlier arrangement. The depth of the current crisis also suggests the need to return to the logic of the initial decision to delegate taxing powers. In the third section, I delve into some of the details of the fiscal pacts that Menem and the governors worked out in the early 1990s. The fourth section then turns to the “frozen intergovernmental relations” that characterized Menem’s second administration, during which period provincial actors successfully stalled federal reform proposals in the area of public revenue. The fifth section reviews the content and outcome of reform attempts under the aborted de la Rúa administration and closes with a discussion of how Duhalde built political support for the revoking of the *piso mínimo* in early 2002. The final section concludes by returning to the question of institutional (in)stability.

Institutional Innovation: The Creation of *Co-participación*

Despite numerous lapses in constitutional rule over time in Argentina, this discussion must begin with the 1853 Constitution and its division of revenue authority between different levels of government. In a move designed to check the hegemonic pretensions of Buenos Aires province relative to the interior, one of the core features of

this constitution was its exclusive assignment of taxes on external trade to the federal government.⁷ Nominally a federal regime but in practice one that brutally repressed the interior, the government of Juan Manuel de Rosas (1829-1853) had crystallized support among the interior provinces for a national government that would be strong enough to constrain Buenos Aires and to check its abuses of the port.⁸ The provincial authorities who wrote the 1853 Constitution reserved for the provinces exclusive authority over direct taxes and stipulated that *both* levels of government could raise domestic consumption taxes (Pírez 1986, 11).⁹ Before the late 1880s, a pronounced degree of separation characterized revenue collection in Argentina: the federal government collected most of its revenues from trade taxes, and the provincial governments collected most of their revenues from domestic consumption taxes. Declining trade revenues subsequent to the Baring Crisis in 1890, however, led the federal government to strengthen its collection of domestic sales taxes, marking the beginning of a forty year period of overlapping provincial and federal tax bases (Macón 1985, Randall 1978). By 1929, the federal government was collecting approximately 65% of all domestic indirect taxes, relative to 35% by the provinces (FIEL 1993, 137).

Just as the international economic crisis of 1930 set in motion deep changes in the country's economic policy orientation (Díaz Alejandro 1970), this same exogenous shock

⁷ In a response that reflected the interior's overarching goal of restraining the most important province, Buenos Aires refused to sign the 1853 constitution, blockaded the Paraná river in an attempt to bring the interior to heel, and subsequently defeated the interior in the 1861 battle of Pavón. Subsequent to its military victory, Buenos Aires agreed to sign on to the 1853 constitution, but only after insisting on key amendments, including suppressing the language in the 1853 constitution that would transform the city of Buenos Aires into a national capital and force it to share its trade revenues. Only in 1880, with the federalization of the port city, was the centralization of trade taxation finally achieved. Ruiz Moreno 1980.

⁸ For a discussion of regional conflicts in the formation of Argentine federalism, see Gibson and Falletti 2003.

⁹ The Constitution also stipulated that every power not expressly delegated to the federal government would remain with the provinces.

led to significant changes in the structure of public revenue. The decline in external trade seriously compromised the federal government's fiscal strength at the very moment that it sought to expand infrastructure projects to keep unemployment rates from skyrocketing. In this context, the government of Augustín Justo proposed two important measures. First was the introduction of a direct tax on incomes, formally the exclusive prerogative of the provinces, though the 1853 Constitution allowed federal collection of direct taxes in emergencies and for limited periods. Second was the passage of new federal sales and excise taxes that required the provinces to cease collecting similar taxes in exchange for a share of federal revenues from these tax bases. Several aspects of this new institutional arrangement, henceforth referred to as co-participation, deserve emphasis. One is the extent to which revenue sharing initially favored the federal government, which would receive 82.5% of the proceeds from the new taxes, as against 17.5% for the provinces. Over time, the distribution of revenues between the two levels of government would increasingly favor the provinces relative to the federal government. The apparently disadvantageous terms for the provinces in the 1934 legislation raise the question of why provincial authorities agreed to this institutional arrangement. According to Pérez (1987) and FIEL (1993), the federal government offered debt forgiveness as a means of encouraging governors to agree to the co-participation scheme, essentially playing to the vulnerabilities of provincial authorities. It is also the case that revenue sharing appealed to governors, despite the small share of revenues that would come back to the provinces in the form of transfers, because it enabled them in a period of economic turbulence to shift the political and administrative costs of tax collection onto the federal government.

Focused on the short term, provincial authorities agreed to institutional changes that in effect reduced the governing capacity of the provinces.

The introduction of revenue sharing in 1934 provides an excellent example of a “contingent event” that had “deterministic properties” (Mahoney 2000, 507). Even though the 1934 laws were of limited duration, when the provinces agreed to surrender responsibility for these tax bases, their decision had powerful and highly negative consequences for the integrity of provincial governments for years down the line. Technically, the provinces in subsequent decades were free to revoke the right of the federal government to collect their taxes each time they negotiated extensions of the co-participation law.¹⁰ In his time as governor of La Rioja in the 1980s, for example, Carlos Menem threatened to do just that by calling on his counterparts in other provinces to declare a state of rebellion in the interior, cutting the supply of energy to the capital, blocking provincial ports and taking back all powers delegated to the federal government (Pérez 1986, 68). But such a threat was less than credible. Once the provinces delegated taxing authority in the 1930s, provincial tax raising capacity atrophied in a way that appears to have foreclosed this option. In effect, the 1934 decision shifted the terms of the debate over subnational institutions from a discussion over the appropriate division of governing responsibilities to nearly constant political jockeying over the division of revenues collected by the federal government. In the 1940s, 50s and 60s, decentralizing pressures from the governors almost exclusively took the form of demands for greater provincial shares of federal monies and, in the wake of repeated democratic transitions, governors were mostly able to secure their demands (Eaton 2003). In this sense, the

¹⁰ New co-participation laws were legislated in 1947, 1959, 1964, 1973, and 1988.

events of 1934 mark a watershed in the subsequent relationship between the provinces and the federal government.

Due to the continued decision to delegate provincial taxing authority to the federal government, coupled with the transfer of expenditure responsibilities in the early 1980s and again in the early 1990s, Argentina experienced increasing vertical fiscal imbalance. By 1997, as seen in table 1, the country’s fiscal structure reflected a serious disparity between the level of government where taxes are collected and the level of government where they are spent.

Table 1: Vertical Fiscal Imbalance in Argentina, 1997¹¹

	Taxes excluding social security contributions		Taxes including social security contributions	
	Where taxes are collected (<i>recaudación</i>)	Where revenues are spent (<i>recursos</i>)	Where taxes are collected (<i>recaudación</i>)	Where revenues are spent (<i>recursos</i>)
Federal Government	77.3%	45.4%	81.6%	55%
Provinces	22.7%	54.6%	18.4%	44%

In order to appreciate the significance of how Menem altered the system in the early 1990s, it is also important to note what did *not* change in the nearly six decades between 1934 and 1992. In these years, the exact size of provincial revenue transfers was determined by applying a fixed percentage to a pool of revenues that changed with actual tax collection in any given year (Nuñez Miñana 1982, Porto 1990). Taxes were taken in and out of the revenue pool, and provinces experienced increases and decreases in the share they received, but the sharing was consistently percentage based, and therefore highly pro-cyclical (IDB 1997). In good years, the increase in federal tax collection

could translate into sharp real increases in the amount of revenues provinces would receive from the federal government. In bad years, provinces could likewise experience debilitating declines in actual revenue transfers. Nothing was guaranteed in this period other than the application of an exact percentage to a changing pool.

Because co-participation asks the provinces to forego collecting some of the tax bases the constitution has assigned to them in exchange for receiving federal transfers, it raises important and difficult questions about their rights to these transfers and the status of these revenues as either provincial or federal in origin. On the one hand, provincial claims that transfers are their due seem justifiable given the constitutional rules, particularly in the case of the direct taxes that the constitution reserves for the provinces alone. In 2001, Peronist governors were recalcitrant in their demands that the De la Rúa administration make good on its past revenue sharing obligations before it would contemplate any changes in the system. Though the press typically understood these transfers as handouts, they were essentially revenues that came to the federal government at least in part due to the ongoing provincial delegation of taxing authority. On the other hand, it is the federal government that has long paid the administrative and political costs of collecting taxes that the provinces stopped collecting decades ago.

Institutional Re-design in the first Menem Administration: *Los Pactos Fiscales*

After two harrowing years, President Menem's attempts at macroeconomic stabilization finally succeeded in 1991 with the adoption of the convertibility law.

¹¹ Source: Piffano 1998b.

Success immediately posed serious problems for Menem, including the reality that stabilization and the consequent strengthening of tax collection would automatically generate a sharp increase in provincial transfers. Ironically, the chief problem for the president was a 1987 co-participation law pushed by the Peronists that had dedicated 57% of revenues to the provinces. For Menem's purposes, the defense of convertibility would require a revision in the rules governing revenue sharing to benefit the federal government so that it could meet its obligations and eschew its former reliance on the inflation tax. Accordingly, in 1992 and 1993, he proposed two fiscal pacts that would reduce provincial revenue shares by reserving 15% of the revenues subject to provincial sharing and dedicating these revenues to a key expenditure of the federal government: social security. The effect was to reduce the percentage share of the provinces, which was not a new phenomena in Argentina since similar centralizing changes had occurred in the wake of military coups in 1966 and 1976 (Eaton 2003). What was new, however, was that Menem offered in exchange the introduction of a minimum revenue transfer below which he promised that revenues would not dip, irrespective of actual revenue collection. Thus in the first fiscal pact of August 1992, the federal government committed itself to transfer no less than \$720 million to the provinces every month, which it raised to \$740 million in the second pact one year later. Neither pact was designed to be permanent; indeed the terms of the second pact were binding only until July 1, 1995.

It is important to note that the logic behind these changes was not to benefit the provinces in the attempt to thereby build support for Menem's market reforms. Though the revenue guarantee would later prove to be a godsend for the provinces, in 1992 and

1993 the pacts demanded that the governors give up their legal shares of tax revenues at a time when these revenues were finally becoming more substantial. Percentage cuts for provincial transfers were difficult for the governors to swallow given the growth in tax revenues and the symbolic quality of the 1987 legislation, which had sought to reverse the prejudicial treatment suffered by the provinces under the preceding military dictatorship. Several legislators warned in Congress that governors who signed these pacts and surrendered their provinces' full legal shares in revenues might very well find themselves on the receiving end of lawsuits.¹² Support for my argument that provincial authorities considered the fiscal pacts to be first and foremost a loss for them are seen in the months that preceded the signing of the pacts, during which Menem depended heavily on the use of selective incentives to get a sufficient number of governors on board. For example, his Economy Minister increased the pressure on provincial governments to sign by pledging to lift certain taxes on companies located in provinces that had signed the pact. Menem also pledged help in a variety of forms for provinces that were inclined not to sign (CGE 1993). Governors in Chaco and Formosa, for example, reversed their initially hostile stances after Menem pledged federal help with provincial debts (Chaco) and the establishment of a special free-trade zone (Formosa). In other words, that the *piso mínimo* turned out to be such a boon for the provinces should not blind us to fact that the pacts were inspired by the central government and, in the flush times of 1991 and 1992, represented an immediate and huge loss in revenue to the provinces. According to Cétrangulo and Jimenez, the provinces lost approximately U.S. \$13 billion between 1992 and 1996 due to the pacts (Fundación CECE 1997, 43). Nor should the problems later

¹² *Diario de Sesiones de la Cámara de Diputados de la Nación*, August 19-20, 1992.

created by revenue guarantees prevent us from appreciating the extent to which the fiscal pacts helped Menem defend macrostability at the center in the first half of the 1990s.

Can my understanding of the fiscal pacts be reconciled with Gibson and Calvo's argument about transfers? I believe that it can. Gibson and Calvo show that federal transfers – discretionary and automatic – “more than doubled between 1990 and 1995” and that this increase characterized both discretionary transfers and transfers that are governed by the 1987 co-participation framework (Gibson and Calvo 2000, 43). As Gibson and Calvo argue, due to their spatial distribution among different types of provinces, we can trace the surge in discretionary transfers to Menem's attempt to court the “peripheral coalition.” In the area of automatic revenue sharing, however, the increase experienced over the course of the 1990-1995 period was not the result of manipulation by Menem. In fact, in the area of automatic transfers, the increase in transfers in the 1990-1995 period would have been even *greater* due to the 1987 law if Menem had not acted to *limit* the transfers. In other words, the increase in automatic transfers was truly automatic in the sense that it followed from tax reform and economic stabilization. Thus we need to distinguish the centralizing logic of these two particular instruments – *los pactos fiscales* – from the important argument that discretionary transfers were manipulated to favor peripheral provinces and to bolster reform's political sustainability.

These arguments can also be reconciled by a closer look at the terms of the second fiscal pact. Whereas the first pact was designed to help the federal government meet its social security commitments, the second pact was a more ambitious attempt to force the provinces to begin a series of pro-market reforms designed by the federal

government. These reforms included the privatization of provincially-owned enterprises and the reform or abolition of a series of provincial taxes (e.g. *sellos, ingresos brutos*) whose cascading effects make them inefficient.¹³ According to the terms of the second pact, which raised the revenue guarantee to \$740 million, the federal government would release funds beyond this minimum amount to provinces that had made satisfactory progress in implementing provincial tax reform and privatization. In other words, while the pacts bound the federal government to respect a floor in revenue sharing, they also preserved a healthy dose of discretion for the federal government, enabling it to use revenues that formerly would have been subjected to automatic sharing along the lines suggested by Gibson and Calvo.

The fiscal pacts were not the only instruments that reflect the dominance of the federal government over the provinces in the early 1990s. For example, in his first years in power, Menem was able to revise the country's expensive industrial promotion laws that had provided incentives for investment in less developed interior provinces at great cost to federal tax revenues. Under the military period, the generals had endowed four special provinces with the right to grant exemptions from federal taxes, which they quickly took advantage of in a tax break spree that encouraged high levels of tax evasion and avoidance. According to some analysts, the provincial granting of federal tax breaks in 1986 reduced the size of federal tax revenues by 11% (Artana, Duarte and Soto 1986). Thanks to a series of decrees that streamlined and controlled the system, and an enhanced system of monitoring, Menem was able to reform the program in the first years of his government (Eaton 2001b). These reforms also raise institutional questions since "promoted" companies charged that Menem's decrees ran roughshod over the federal

¹³ See decreto 1807/93 for the terms of the Federal Pact for Employment, Production and Growth.

government's contractual obligations to recipients of tax breaks. Table 2 documents the savings to the federal government produced by the president's hardline stance on the provinces' promotional activities. Pressures for additional tax revenues did not abate in Menem's second term (Sawers and Massacane 2001), but the federal government was mostly able to check backsliding in the area of industrial promotion.¹⁴ Thus, policy change in this arena that shored up the fiscal position of the federal government is an important counter to the argument that provinces were consistently able to thwart the center's reform objectives.

Table 2: Provincial Promotion Activities: Costs and Savings¹⁵

	1990	1991	1992	1993	1994	1995
Fiscal cost of provincial incentives before reforms	2,661	2,888	3,085	3,521	3,232	3,256
Fiscal cost of provincial incentives after reforms	2,143	2,128	2,455	1,403	1,303	1,346

Another change designed by the federal government to limit the independence of the provinces was the privatization of provincial banks. For decades, provincial banks proved to be highly attractive to provincial politicians who used them to direct cheap credits and employment opportunities to political supporters and to finance deficit spending (Clarke and Cull 1998; Argañaraz and Mautino 1995). While governors resisted pressures to privatize their banks in the early 1990s, capital flight following the collapse of the Mexican currency in late 1994 led to deposit losses that threatened to bankrupt the banks. In response to this window of opportunity, the federal government

¹⁴ Interview with Roxana Surballe, Legislative Analyst, Buenos Aires, August 16, 1999.

¹⁵ Source: Eaton 2001b.

established a special trust fund to pay the short-term costs of bank privatization that was financed by the World Bank and Inter-American Development Bank (the *Fondo Fiduciario para el Desarrollo Provincial*). By the end of 1998, 18 of 26 provincial banks were privatized (Clarke and Cull 1998) and in 1999 an additional two provinces, Catamarca and Córdoba, privatized their banks. Though many provincial governments were happy to get rid of the banks, privatization must nevertheless be understood as a re-centralizing change that revoked provincial authority over financial policy. As I argue in the following section, however, the earlier introduction of minimum revenue guarantees enabled the provinces to thwart one of Menem's central goals in pushing provincial bank privatization, which was to limit and control borrowing by provincial governments.

Frozen Intergovernmental Relations in Menem's Second Term

This section describes and then attempts to explain the shift in the balance of power back to the provinces and away from the federal government during Menem's second administration. While the complexity of the policies proposed and outcomes legislated makes it somewhat difficult to determine the net effect of relevant changes, it does seem clear that the federal government was less able to impose losses on the provinces in this period and, in fact, that the provinces were able to impose losses on the center. In the wake of the economic turmoil provoked by the Mexican tequila crisis in 1995 and 1996, this new dynamic was first seen in congressional attempts to extend the federal government's minimum revenue guarantee. When the second fiscal pact expired

in July 1995, the Senate proposed making this extension indefinite “until such time as representatives of the federal and provincial governments can definitively agree on the way to implement the terms of the second fiscal pact.” In compelling the retroactive extension of the revenue guarantee, legislators also proposed giving the President budgetary discretion in order to make the necessary cuts that would allow the federal government to continue to meet its obligations with the provinces.¹⁶ When the federal government argued that it was not legally bound (*no existía disposición legal*) to honor the guarantee beyond July 1, 1995, senators responded that it then had no legal right to continue deducting the 15% amount from the revenue pool for social security.¹⁷ Peronist and Radical Senators proposed extending the federal government’s obligations to honor revenue guarantees, while simultaneously eliminating from the pact the obligation that provinces would have to reform their own tax systems.¹⁸ Though Peronist party discipline prevented this proposal from succeeding, with the result that both federal and provincial obligations were formally carried over, in practice the provincial implementation of the tax and other reforms called for in 1993 proved to be very spotty. Among other things, the difficult economic situation of the provinces in the 1995/96 period bolstered the claims of the governors that they could not afford to do away with taxes simply because they were deemed to be inefficient by the Economics Ministry. According to Tommasi and Spiller (2000, 140), while provinces made significant headway in the reform of specific taxes on gas and electricity, they introduced far fewer

¹⁶ *Diario de Sesiones de la Cámara de Senadores de la Nación*, July 3, 1996, p. 3376.

¹⁷ *ibid.*, pp. 3377 and 3380.

¹⁸ See the speeches of Senators Cristina Fernández de Kirchner (Peronist, Santa Cruz) and Luis León (Radical, Chaco on pages 3378 and 3379).

changes in the turnover tax (*ingresos brutos*) that had been at the core of the second fiscal pact.

In his second administration, Menem also failed to advance two new reforms to the revenue sharing system. First, the Economics Ministry proposed changing the criteria that govern the distribution of automatic revenue transfers to incorporate rewards for provincial tax effort. Such a change would represent a major departure for the system of co-participation. While the criteria used to divvy up revenues have experienced significant change over the years, moving from the initial use of criteria that favored productive capacity and population size toward increasingly redistributive criteria that favored poor and sparsely populated provinces (Nuñez Miñana and Porto 1983), the effort exerted by provincial authorities was never included. Indeed, the fact that governors would not have to expend political capital and energy on local tax collection was one of the key factors that encouraged them to delegate taxing authority in the 1930s. When the federal government's proposal went nowhere in Congress, it proposed the more limited use of provincial tax effort to distribute funds in excess of the *piso mínimo*, but this more circumscribed proposal also failed.¹⁹ In addition to proposing new criteria, Menem also floated the idea of direct revenue sharing with the municipalities. Whether designed as a threat that would force the governors to contemplate cuts in provincial revenue sharing or as a sop to the country's numerous Peronist mayors who could help Menem in his attempt to run for a third term in 1999, the proposal did not succeed.

Even as these attempts at reform were going down to defeat in Congress, the governors were able to increase the federal government's minimum revenue guarantees

¹⁹ See "La reforma fiscal entra en la etapa del realismo político," *El Economista*, February 6, 1998.

to US \$850 million in 1998.²⁰ In the late 1990s, governors used these guarantees to substitute private bank loans for the loans from provincial banks that had been privatized. Though private banks started refusing to issue new debt to the provinces in 1999 (even loans that would be guaranteed with federal revenue guarantees), in the years leading up to this decision the provinces incurred significant debts. According to the Economist Intelligence Unit, provincial debt rose to US\$18 billion or 7% of GDP by the year private banks cut off further loans (EIU 1999). In some provinces, debt service payments amounted to nearly half of all revenue transfers from the federal government.

What explains the ability of the provinces to frustrate the reform proposals coming out of the federal executive in the second half of the 1990s? I emphasize a mix of economic, institutional and partisan factors. With respect to economic factors, the country's declining economic situation toward the end of the 1990s gave the governors additional reasons to defend the *piso mínimo*. Thanks to the decline in federal tax revenues, rules that favored the federal government in 1992 increasingly came to favor the provinces, especially after 1998. Declining revenues from provincial taxes and licensing fees, combined with surging unemployment rates throughout Argentina, transformed these revenue guarantees into a vital lifeline for many provincial governors.

With respect to institutional rules, the decisions adopted in the 1994 constitutional reform are important. Initially, the agreement between Menem and former President Alfonsín that gave rise to the reform (the so-called *nucleo de coincidencias básicas*) included no mention of provincial or revenue sharing issues. A provincial coalition among the members of the constitutional convention, however, managed to insert language on revenue sharing into the new constitution. Specifically, it stipulates that a

²⁰ See "Gobernadores se aseguran \$850 millones cada mes," *Ambito Financiero*, Oct. 10, 1998.

new revenue sharing law would be negotiated by the end of 1996, and that as a result of this new law, no province could receive fewer revenues than it had received in 1994. This new and quite rigid rule helped to worsen an already difficult process of finding agreement among the provinces in revamping the institution of revenue sharing. To date, no new law has been legislated by Congress though it is now over six years late.

With respect to partisan dynamics, growing factionalism within the Peronist party over the course the president's second term made it harder for Menem to control the governors within his party. Controlling the governors and enforcing discipline among Peronist legislators to the national party line was never easy. As Levitsky shows, few provincial leaders belonged to the party's Menemista faction (Levitsky 2001). But the struggles to succeed Menem as Peronist leader that emerged immediately after his reelection in 1995 complicated his attempts to achieve further policy changes. That Menem could not necessarily count on the support of Peronist governors for such measures as criteria that reward provincial tax effort may provide some of the story behind one of Remmer and Wibbels' main negative findings, which is that partisan ties do not explain variation in provincial adjustment in Argentina in the expected direction.

The combined effect of these stalled reforms is interesting given the argument of Gibson and Calvo about the sequencing of economic reform in Argentina (Gibson and Calvo 2000). As they argue, it was the country's metropolitan provinces that bore the brunt of the market reforms adopted in Menem's first administration. "Only after 1994, once the major adjustments in the metropolitan economies had been made, and once the local political dividends of these adjustments began to be collected, did the national government turn its attention to reform of the provinces (2000, 40)." The discussion

above suggests that when the center finally did shift its focus onto the provinces, there were sharp limits in how much reform it was able to impose. Ironically, these limits were in large part due to the very instrument, revenue guarantees, that Menem had used to build support for his centralizing reforms of co-participation in his early years as president.

Return to Crisis: Provincial-Federal Relations after Menem

Conflict between the federal and provincial governments over revenue sharing and provincial debt occupied a great deal of Fernando de la Rúa's political capital in his two difficult years as president (December 1999-December 2001). The time line presented in table 3 charts some of the key events that had bearing on intergovernmental relations in this period. To a significant extent, it was Peronist governors who proved to be the most recalcitrant in opposing de la Rúa's attempts to re-introduce flexibility into the transfer system.²¹ As in the Alfonsín administration, under de la Rúa a majority of provinces were governed by the Peronists, and in both periods this political reality infused center-provincial relations with sharp partisan conflict. A case in point is the attempt by Graciela Fernández Mejide as the new Minister of Social Development to increase federal control over the implementation of social programs in the provinces. Designed as a measure that would reduce clientelism, the proposal provoked strong opposition in Peronist-controlled provinces.

²¹ It is also the case that Alianza governors – including Roberto Iglesias in Mendoza, Angel Rozas in Chaco, Alfredo Avelin in San Juan, and Sergio Montiel in Entre Rios – often sided with Peronist governors against de la Rúa.

Table 3: Time Line of Events Affecting the Provinces in the 1999-2002 Period

Fiscal Convertibility Law	Aug. 1999	Limited 2000 deficit to 1.5% of GDP and called for balance budget by 2003
de la Rúa-governors revenue sharing agreement	Dec. 1999	\$1.35 billion monthly transfers in 2000, \$1.36 billion in 2001 in exchange for tax increases that would not be shared with the provinces
Federal Pact for Growth and Fiscal Discipline	Nov. 2000	Stipulated that revenue transfers in 2003-2005 would be a moving average of the previous 3 years, with a floor of \$1.45 billion
Zero Deficit Law	July 2001	13% cut in revenue transfers and public sector wages and pensions
Creation of <i>Lecops</i> and <i>Bono Interprovincial</i>	Aug. 2001	<i>Lecops</i> are federally -issued bonds meant to substitute for provincial script, which can be used to pay federal taxes, and <i>bonos</i> compensate the provinces for short-falls in revenue sharing obligations
Negotiations break down b/w Peronist governors and de la Rúa	Oct. 25, 2001	Peronists insist that de la Rúa honor minimum revenue obligations before considering a broader set of reforms
Chaco defaults	Oct. 26, 2001	
La Rioja defaults	Nov. 6, 2001	
S&P lowers Argentina's credit rating to selective default	Nov. 6, 2001	
Peronist governors agree to reductions in transfers	Nov. 2001	
Elimination of the minimum revenue guarantee (piso mínimo)	Feb. 2002	Pres. Duhalde convinces governors to relinquish the guarantee by agreeing to share proceeds of a new tax on checks and to convert dollar-denominated provincial debts at a rate of 1.4 pesos to the dollar

One of de la Rúa's first moves as president in December 1999 was to propose the creation of new taxes, the proceeds of which would not be shared with the provinces (EIU 1999). By excusing the federal government from sharing additional revenues with the provinces, de la Rúa's success can be contrasted with Menem's failure to amend the criteria used to distribute excess tax revenue in his second administration (Berteau and Iturre 2000:24). However, de la Rúa paid handsomely for this proposal in the form of a commitment to increase the revenue guarantee to \$1.35 billion per month in 2000 and \$1.36 billion in 2001. Thus, if the new tax increases succeeded in generating revenue, which was risky given the state of the economy, the federal government would enhance

its stature relative to the provinces. But if tax revenues did not increase as the president had hoped, then revenue guarantees would enable the provinces to gain at the expense of the center. In the end, increases in tax revenues never materialized and the increase in revenue obligations served to hamstring the federal government precisely as it was grappling for solutions to the deepening economic crisis. Despite the worsening situation over the course of 2000, the governors were able to increase the revenue floor still further in the so-called Federal Pact for Growth and Discipline of November 2000. According to this pact, transfers in the 2003-2005 period would be a moving average of the previous three years, with a minimum floor of \$1.45 billion per month.

The year 2001 marked the beginning of the end for the rigid system of federal revenue guarantees initiated in 1992. In the middle of the year, after continued declines in tax revenues, de la Rúa managed to push through Congress the Zero Deficit Law which included a 13% cut in public sector wages and revenue transfers. In exchange for agreeing to the cut, the federal government agreed to renegotiate provincial liabilities with private banks at interest rates no higher than 7% (EIU 2001). Even after this cut, however, the federal government failed to meet its revenue obligations with the provinces and arrears began to accumulate. In August 2001, the de la Rúa government created a new inter-provincial bond (*bono interprovincial*) to be issued by a provincial development fund (*Fondo Fiduciario para el Desarrollo Provincial*), which it sent to the provinces to pay revenue sharing arrears. It was conflict over these arrears, and demands by the Peronists that de la Rúa release \$250 million in overdue transfers, that triggered the breakdown of dialogue between the president and the governors and the acknowledgement on October 28, 2001 by the federal government that it would have to

restructure its \$132 billion debt. De la Rúa's inability to reach a deal with Peronist governors over the obligations of the federal government was a key sign of his inability to govern the country in the (Argentine) spring of 2001.

In the tumultuous year that Eduardo Duhalde has governed Argentina, one of the most important changes he introduced was the abolition of federal commitments to transfer a given amount of revenues to the provinces regardless of actual tax revenues. According to a new pact signed with the governors on February 27, 2002, as Duhalde announced, "we'll only distribute what we actually collect" ("*vamos a repartir lo que ingresa*").²² Thus, on March 20, Duhalde announced that he was distributing for the very last time the monthly guaranteed revenue transfer of \$1.185 billion.²³ Though the end of the *piso mínimo* represents the most important rule change in a decade, it would be a mistake to conclude that the depth of the crisis enabled Duhalde to enforce this change in the absence of concessions to the provinces. Specifically, Duhalde purchased the support of the governors for the removal of their now-beloved *piso mínimo* in three ways. First, he agreed to share with the provinces the proceeds of a new tax on checks, a grossly distorsionary but productive generator of revenues. Initially the federal government offered 20% of this tax to the provinces, but it was subsequently forced by the governors to increase this percentage to 25% and finally to 30%.²⁴ Second, although the federal government wanted no further provincial bonds to be emitted, it was forced to let the provinces issue bonds to cover current costs (though not to pay debts with the federal government). Third, Duahlde agreed to a deal according to which dollar-denominated

²² "Las claves de un acuerdo que todavía guarda algunas dudas," *Clarín*, Feb. 26, 2002.

²³ "Negociación con el FMI: Aval y reclamos de las provincias," *Clarín*, April 12, 2002.

²⁴ *Clarín*, Feb. 26, 2000.

provincial debts would be converted to pesos (*pesificada*) at the rate of 1.4 pesos to the dollar.

Conclusion

Revenue sharing institutions in Argentina have demonstrated a curious and unhappy mix of fluidity and rigidity. On the one hand, the fiscal pacts (particularly the second one) introduced a great deal of complexity and uncertainty into the system of revenue transfers, as reflected in charges by opposition governors that partisan criteria were driving the release of transfers in excess of the *piso mínimo*. As Saiegh and Tommasi (1999a) put it, revenue sharing in the 1990s became a veritable labyrinth, rendered still more confusing each time governors, legislators and representatives of the federal government met to negotiate extensions in the life of the pacts. On the other hand, the pacts introduced a striking new aspect of rigidity into the system by binding the federal government to transfer a pre-determined level of revenues, no matter what federal tax collectors were actually able to produce. And, perhaps because of the revenue guarantees introduced in 1992, the decade witnessed unwavering support from the governors for the underlying institutional norm according to which the federal government continues to collect and distribute taxes that the constitution has, for 150 years, identified as provincial taxes.

Discussions of needed reforms in the institution of revenue sharing must begin with a clear understanding of how this institution was created in the 1930s, how it changed over the following decades, and how it has impacted the integrity of the

provinces as units of government.²⁵ In this paper I have argued that the delegation of taxing authority in 1934, combined with the introduction of revenue guarantees in 1992, produced a particularly odd combination of provincial weakness and provincial strength. Though the more advanced provinces continued to collect important revenues on their own, most provinces depended ever more heavily on transfers from the center, and the lack of greater own-source revenues is a telling sign of the weakness of provincial governments.²⁶ At the same time, revenue guarantees in the 1990s put the provinces in a position of strength relative to the federal government, whose ability to condition transfers on provincial progress toward federally-defined objectives proved to be quite limited.

Delegating taxing authority in the 1930s made a great deal of practical sense for the governors who governed in that decade, and who received debt forgiveness in exchange for letting the federal government collect their taxes. But the pressing question now is how to restructure public revenue in ways that make sense for present-day Argentina. Earlier I argued in a path dependent fashion that, while governors have been free to reclaim the powers they first delegated in the 1930s, in practice once they stopped collecting taxes their capacity to do so atrophied in a way that increased the costs of such a course of action. Recent events underscore the negative consequences of this decision, which has compromised not only the integrity of provincial governments, but important collective outcomes at the center, including the significant degree to which the federal government had to “overadjust” at the national level (Remmer and Wibbels 2000). The

²⁵ See the excellent working papers on co-participation by scholars at the *Centro de Estudios para el Desarrollo Institucional* at the *Fundación Gobierno y Sociedad*, available electronically at <http://www.fgys.org/cedi>.

answer does not lie in the decision of the provinces to completely reclaim their exclusive authority over direct taxes from the federal government, or their shared authority over a broader set of indirect taxes. Vertical fiscal imbalance is not necessarily a bad thing; public finance experts tell us that there are important reasons to use different criteria in assigning tax bases and expenditure responsibilities to various levels of government, and that tax assignment in many countries will be more centralized than makes sense for expenditures (Musgrave and Musgrave 1980). The more limited, but still politically difficult challenge in Argentina is to introduce revenue sharing criteria that reward provincial tax effort and/or find ways of increasing own-source revenue through such mechanisms as a provincial VAT surcharge (Piffano 1998a and 1998b). In hindsight, economic crisis has often made possible otherwise impossible institutional changes; perhaps the magnitude of the crisis in the current period will lead to the acceptance of reforms that proved elusive in the second half of the 1990s.

Another potentially important point deserves to be pulled out of the details of institutional change and continuity in the area of revenue sharing. It is possible to argue that when Menem set out to alter revenue sharing institutions in 1992 after the introduction of convertibility the preceding year, success came too easily and too quickly. Menem introduced the revenue guarantee that year in order to accomplish a dramatic reduction in the provinces' share of a growing pie; federal tax revenues were surging due to earlier tax reforms, stabilization, and economic growth. Menem imposed his fiscal pacts when his partisan powers were at their greatest. Once his authority began to decline over his second term, however, his authority over Peronist governors was insufficient to

²⁶ It is important not to overstate the unwillingness of provincial authorities to exert taxing effort; in many provinces it is just as important to note the difficulty of extracting local tax revenues due to the narrow

abolish the revenue guarantees when they came to be a burden on the federal government, or even to introduce changes at the margin that would encourage effort by provincial tax authorities. What is unfortunate is that Menem did not use his political capital to push forward a more serious and sustained conversation about the deeper structure of public revenue. That temporarily strong partisan powers proved to be a mixed blessing in Argentina can be contrasted with the Brazilian case. In Brazil, in the absence of strong partisan powers for the president, movement toward re-centralization in the Cardoso government occurred more slowly and was achieved as the result of interactions among a larger set of actors in a process that might ultimately prove to be more sustainable.²⁷

range of productive activities located there.

²⁷ For a comparison of decentralizing and re-centralizing changes in Argentina and Brazil, see Dickovick and Eaton 2002.

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