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What Makes Strong Federalism Seem Weak?  
Fiscal Resources and Presidential-Provincial  
Relations in Argentina

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## Abstract

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*Recent administrations support conflicting conclusions about the nature of Argentine federalism. President Carlos Saúl Menem (1989-1999) easily pushed through policy changes with the rubber stamp governors and Congress, implying that federal institutions are weak. President Fernando De la Rúa (1999-2001) faced considerable provincial and congressional opposition, leading to the appearance of strong federal institutions. To understand recent presidential experiences, I highlight the economic context of federal institutions. I argue that economic growth renders presidential-provincial relations positive-sum, lending to the appearance of strong presidentialism. Economic decline turns presidential-provincial relations zero-sum, giving the appearance of strong federal institutions.*

## Resumen

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*Administraciones recientes sostienen conclusiones conflictivas respecto a la naturaleza del federalismo argentino. El presidente Carlos Saúl Menem (1989-1999) impulsó fácilmente cambios de políticas, con la aprobación casi rutinaria del Congreso y de los gobernadores, reflejando la debilidad de las instituciones. Por otra parte, el presidente Fernando De La Rúa (1999-2001) enfrentó una oposición considerable de parte del Congreso y de las provincias, dando la apariencia de instituciones federales fuertes. Para entender las recientes experiencias presidenciales, subrayo la importancia del contexto económico de las instituciones federales. Argumento que el crecimiento económico provoca una relación de suma positiva entre la presidencia y las provincias, lo cual da la apariencia de un presidencialismo fuerte, mientras que un declive en la economía cambia la relación entre el presidente y las provincias a una situación de suma cero, dando la apariencia de instituciones federales fuertes.*



## *Introduction*

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The ill-fated presidency of Fernando De la Rúa of the Unión Cívica Radical (UCR) (December 1999–December 2001) has led scholars and pundits alike to speculate about the capacity of Argentine presidents to correct this country's dire economic problems. Though popular opposition certainly contributed to president De la Rúa's inability to implement urgently needed economic reforms, there is growing consensus that federal institutions were more important for impeding policy change. Most scholars now agree that excessive provincial spending undermined national macro-economic stability<sup>1</sup> and that De la Rúa was unable to change the fiscal behavior of provincial governments due to the considerable political autonomy reserved to them in the constitution.<sup>2</sup> Strong federal institutions thus appear to have prevented De la Rúa from resolving his country's economic problems, leading to economic crisis, popular unrest and his early political demise.

Despite evidence that Argentine presidents appear to be powerless to curb provincial leaders, analyses of other presidential administrations support different conclusions about the nature of Argentine federal rule. Scholars have often used the presidency of Carlos Saúl Menem of the Partido Justicialista (PJ) (1989–1999) to highlight the influential position of presidents in Argentina. Unlike his successor, Menem easily implemented radical economic reforms that negatively affected most provincial economies with little provincial or congressional interference. The sizeable constitutional powers and economic resources reserved to Argentine presidents are said to have enabled Menem to dominate other branches and levels of government, implying that Argentine federal institutions are weak.

Recent presidential administrations thus support conflicting conclusions about the relationship between presidents and provinces in Argentina, something that not only reflects disagreement about the empirical causes of De la Rúa's political downfall and of Menem's relative political success but also a larger theoretical debate about the nature presidential-provincial relations in this country. In this article, I address this empirical puzzle by first resolving the theoretical debate. I explain how defining Argentina's federal institutions as strong or weak to understand the success or failure of prior administrations in undertaking major policy change begs the question of how presidents facing remarkably similar political environments —De la Rúa and Menem each assumed office with 48% share national presidential votes and 45% support in congressional elections— and institutional contexts —federal institutions were largely unchanged between the administrations— could face

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<sup>1</sup> Karen L. Remmer and Erik Wibbels, "The Subnational Politics of Economic Adjustment", *Comparative Political Studies*, vol. 33, no. 4 (2000); Erik Wibbels, "Federalism and the Politics of Macroeconomic Policy and Performance," *American Political Science Review*, vol. 44, no. 4 (2000).

<sup>2</sup> The Economist, "The Austerity Diet," *The Economist*, August 23, 2001.

such different political ends. I argue that different economic environments affect Argentine federalism in different ways. When national leaders have access to plentiful fiscal resources to transfer to provincial governments, governors are less likely to interfere with presidential policy plans, making federalism appear weak, even in systems with technically strong federal institutions. When presidents are unable to provide benefits to provinces to ensure their support, provincial leaders can use the powers reserved to them in the system to undermine presidential policy initiatives, making presidents appear weak especially in cases where federal institutions are strong.

My approach differs from most prior analyses of Argentine federalism which have tended to focus on analysis of institutions and which cast federalism as a zero-sum game between presidents and provinces, particularly when presidential and provincial interests collide. In this case, presidential success in pursuing policy objectives occurs thanks to provincial frailty; presidential failure is the result of provincial strength. Instead, I argue that plentiful fiscal resources turn presidential-provincial relations into a positive-sum game, leading to inter-governmental cooperation and the illusion of presidential power, especially when presidential policy objectives conflict with the interests of provincial leaders. Limited fiscal resources, on the other hand, turn presidential-provincial negotiations zero-sum, a game that provinces have the capacity to win particularly when they are backed by strong federal institutions.

Understanding the economic conditions under which Argentina's federal bargain is zero- and positive-sum helps shed light on the nature of inter-governmental relations in Argentina, as well as resolves the empirical puzzle motivating this study. De la Rúa's critical fiscal situation meant fewer resources available to negotiate with provincial leaders, raising the level of inter-governmental conflict and enabling politically powerful local leaders to impede policy change. Plentiful fiscal financing during the Menem administration, in contrast, turned presidential-provincial relations more cooperative, allowing him to undertake radical economic policy change.

To build this argument, the article proceeds as follows: First, I discuss the theoretical debate about Argentine federal institutions and how it was inspired by empirical inconsistencies in recent presidential administrations. Second, I discuss the basic structure of Argentine federal institutions to show that Argentine federalism is technically quite strong, even compared to other well-known federal systems. As argued in section three, though Argentine federal institutions are strong, the nature of presidential-provincial relations has varied according to economic context. The remainder of the article focuses on studies of federal relations during the administrations of Menem, De la Rúa, and current President Néstor Kirchner (PJ) to support the argument. To conclude, I discuss how couching federalism in terms of economic context helps shed light on federal relations in Argentina and elsewhere.

## ***Argentine Federal Institutions in Theory***

There has been a proliferation of studies in recent years demonstrating the important role of provincial politics in shaping national parties, politics and government in Argentina while another trend highlights the power of national political leaders. Several scholars have noticed, for example, that thanks to the highly federalized nature of this country's electoral system, most electoral competition occurs at provincial levels, even that affecting national government.<sup>3</sup> Provincial party leaders are responsible for composing party lists and running campaigns for the national Congress, provincial governments, and municipal offices. Given that local party bosses manage the careers of most politicians in the system, national legislators tend to choose committee assignments based on the wishes of provincial party leaders more than any other political criteria.<sup>4</sup> Such studies support contentions that De la Rúa was weak in the face of powerful provincial opposition to policy reform, leading to economic crisis and his early political demise.

Studies about the ability for national party leaders to enforce party discipline in the national Congress, in contrast, demonstrate the strength of national politicians over congressional and local interests.<sup>5</sup> Research on presidential decrees, prompted in part by Menem's centralized policy-making practices, depicts a concentration of power in the national executive, with presidents controlling most aspects of public policy-making.<sup>6</sup> Analysis of the national executive's power of federal intervention in provincial affairs and the ability for the national Congress to reject provincial constitutions also supports arguments about the strength of national leaders in relation to local ones in Argentina's federal system.<sup>7</sup>

Empirical research to date about Argentine federal institutions thus leaves us wondering about the exact nature of presidential-provincial relations in this country, and whether and how it has changed over time. Indeed, this theoretical debate is driven more by empirical variation in presidential-provincial relations than by any variation in analysis of the country's federal institutions. However, I argue that this empirical variation has left us asking the wrong theoretical question: whether Argentine presidents are strong or

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<sup>3</sup> Mark P. Jones, "Federalism and the Number of Parties in Argentine Congressional Elections," *Journal of Politics*, vol. 59, no. 2 (1997).

<sup>4</sup> Mark P. Jones, "Explaining the High Level of Party Discipline in the Argentine Chamber of Deputies," in *Legislative Politics in Latin America*, ed. Scott Morgenstern and Benito Nacif (New York, 2002); Mark P. Jones et al., "Amateur Legislators-Professional Politicians: The Consequences of Party-Centered Electoral Rules in a Federal System," *American Journal of Political Science*, vol. 46, no. 3 (2002).

<sup>5</sup> N. Guillermo Molinelli, *Clase Política y Reforma Electoral* (Buenos Aires, 1991); Ana María Mustapic, "Oficialistas y diputados: las relaciones ejecutivo-legislativo en la Argentina," *Desarrollo Económico* (Argentina), vol. 39, no. 156 (Jan-Mar, 2000).

<sup>6</sup> Delia Ferreira Rubio and Matteo Goretti, "When the President Governs Alone: The Decretazo in Argentina, 1989-93," in *Executive Decree Authority*, ed. John M. Carey and Matthew Soberg Shugart (Cambridge, 1998).

<sup>7</sup> Austin F. Macdonald, *Government of the Argentine Republic* (New York, 1942); L. S. Rowe, *The Federal System of the Argentine Republic* (Washington, D.C., 1921).

weak in the face of powerful provincial politicians? Given that federal institutions have not changed significantly in recent years but presidents have enjoyed markedly different relationships with provincial governments, the focus on measuring the institutional strength of presidents relative to provinces seems misplaced. As a result, it is worth taking a step back and thinking about other features of Argentina's political and economic system that interact with federal institutions to produce different presidential-provincial political games.

### ***Argentine Federal Institutions in Practice***

Before moving to the argument about the economic context of federal institutions, a description of Argentine federalism is in order. Federal institutions in Argentina are technically strong, with provincial governments commanding an important position in both local and national politics. According to the 1853 and 1994 Constitutions, democratic government in Argentina is federal, organized into executive, legislative and judicial branches. A senate represents the country's 23 federal districts, or provinces, and the Federal Capital. Between 1853 and 1994, presidents were elected for six-year terms and could not be immediately reelected. Each province elected two senators who served nine-year terms, with 1/3 of the seats in this body elected every three years. The 257 seats in the Chamber of Deputies are distributed among provinces and national territories according to population. Less populated provinces have been traditionally over-represented in this chamber since every province has at least five deputies. Deputies serve four-year terms, with 1/2 being elected every two years. There are no reelection restrictions for senators or deputies.

Provinces enjoy substantial electoral, policy, fiscal and thus political autonomy from the national government. Electorally speaking, provinces have the right to adopt their own constitutions and to establish representative governments that consist of elected governors and legislatures, and locally appointed judiciaries. Local authorities choose rules for electing governors and provincial legislatures, something that has led to a variety of provincial electoral systems, including single-tiered proportional representation systems, the use of multiple lists (*lemas*), and two-tiered systems with both proportional and plurality districts. Provincial governments are also responsible for overseeing elections for national offices, though all provinces follow the same electoral rules, and this has strengthened the role of local leaders in national politics, as discussed below.

In terms of policy, provincial governments retain all powers not delegated to the federal government in the national constitution and are also able to make policy in a variety of areas not specifically reserved to national authorities. Provinces retain the right to levy and collect some types of taxes,



discussed below. Provincially-appointed bureaucracies administer local policy initiatives and often control the implementation of national policies, and they can promote industry, immigration, railway and canal construction, the settlement of lands, the establishment of new industries, the importation of foreign capital and the exploration of rivers. They are able to contract loans and issue bonds and to create their own utilities, enterprises, industries, and banks. Provincial authorities are responsible for creating and financing municipal governments.

Since the 1990s, provincial and municipal governments have accounted for somewhere between 50 and 60% total governmental spending. Though provincial governments retain the right to levy some taxes, the lion's share of provincial governmental financing comes from transfers from the federal government. Excluding the Federal Capital, federal transfers represent on average about 75% total provincial financing, with some provinces reaching upwards of 95%. Since the mid-1990s, revenues collected under the Sistema de Coparticipación Federal de Impuestos or Federal Tax Revenue Sharing System have accounted for about 70% total transfers going to local governments. The Revenue Sharing System includes a series of taxes collected by the federal government that are then shared between the federal and provincial governments. National taxes such as individual and corporate income taxes and the value added tax fall under the Revenue Sharing System. Provincial governments collect taxes on gross production, real estate and automobiles, and on a duty applied to contracts. Taxes such as those on external trade are exempted from the Revenue Sharing System and are the sole purview of the federal government.

The Revenue Sharing System gained constitutional status in 1994, with the objective of reforming the technical aspects of the regime governing the system. However, no such law has yet been passed and a law predating the constitution governs the system. This law allocates 42.44% Revenue Sharing resources to the federal government, 56.66% to the provinces, and 1% for Aportes del Tesoro Nacional or National Treasury Grants. Revenue Sharing funds are unearmarked and thus can be spent by provincial governments according to their own policy and political objectives. National Treasury Grants and royalty payments to oil and natural gas producing provinces account for another 5 to 10% of total transfers and are also unearmarked. The remaining 20 to 25% transfers include funds earmarked for Coparticipación Vial or the Highway Fund, the Fondo de Desarrollo Regional or Regional Development Fund, the Fondo de Desarrollo Eléctrico del Interior or Energy Development Fund, the Fondo Nacional de Vivienda or National Housing Fund. However, governors have been able to direct these resources to favored projects and individuals.

As mentioned, provinces serve as Argentina's principal federal electoral districts, and politicians aspiring to national and provincial office must have the province as their principal point of reference. Provincial leaders control

the composition and order of party lists used to elect representatives to the national Chamber of Deputies. During the 20<sup>th</sup> century, provincial legislators elected representatives to the Senate. Although senators have been directly elected since 2001, provincial elites remain prominent players in choosing senatorial candidates, in running provincial electoral campaigns and in cultivating support for candidates at the polls. Provincial political leaders shape the career paths and electoral fates of their representatives to the national Congress, giving them significant power over their congressional delegations and thus national policy positions. Thanks to this control, presidents regularly seek the support of governors and local political leaders for major or unpopular policy measures, especially those needing congressional approval.

Provincial political elites also play a central role in the election of national presidents. Between 1853 and 1994, the national executive was indirectly elected through an electoral college. Citizens in Argentina went to the polls to select provincial presidential electors, with each province's allocation equal to twice the number of representatives sent to both houses of the national Congress. Provincial leaders, however, controlled the order and composition of slates of provincial electors, as well as the ultimate votes of their delegates, giving them important sway over national electoral outcomes.<sup>8</sup> The traditional independence of local political elites meant that presidential candidates were not automatically guaranteed the support of their electors. Though electors usually cast their votes for their designated presidential candidate, they occasionally received orders to defy the popular vote and, instead, support candidates favored by their local party leaders.<sup>9</sup>

Although the electoral college is no longer used today, presidential hopefuls regularly seek the support of provincial governors and local party leaders during their efforts to win internal party nominations, as well as during subsequent electoral campaigns. Provincial elites control local party organizations, making them important allies during presidential contests. Indeed, national parties in Argentina can best be described as coalitions of provincial party organizations. As a result, politicians aspiring to the national presidency must seek the backing of provincial political elites and their party machines in order to become viable contenders for this office. The role of provincial political leaders in electing local and national governments has enabled them to become prominent players in national politics without ever having reached public office beyond provincial borders.

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<sup>8</sup> Between 1862 and 1910, and in 1937 and 1946, electors were chosen using a complete list system, with parties receiving a plurality of provincial votes in presidential elections entitled to choose all electors in that province. Between 1916 and 1932, and in 1958, an incomplete list system was used. Here, the leading presidential candidate's party in each province named 2/3 of that province's electors, with the remainder going to the runner up. More recently, a proportional system allocated electors, though since 1995 presidents have been directly elected by national popular vote.

<sup>9</sup> Molinelli, *Clase política y reforma electoral*.

Since national and provincial electoral competition occurs in provincial ballots, national parties are organized along federal lines. Local party branches compose their own constitutions and party platforms, and draft rules and procedures for deciding local party matters. They elect their own leaders and party officers, as well as maintain their own membership lists and party activists. Local party organizations are responsible for forming party lists for both local and national elections, as well as running electoral campaigns. Sometimes local branches of national party organizations have different names than their national counterparts. Provincial party leaders frequently negotiate with other local parties to run joint lists in local and national elections. Provincial coalitions have been important in cultivating support for gubernatorial and presidential candidates as well. This has given local leaders considerable autonomy from their national party apparatus. Provincial party branches in the Partido Justicialista (PJ) and the Unión Cívica Radical (UCR) have followed this federal organization.

The traditional role of provincial party branches has meant that national politics is the aggregation of local party systems. This has made truly national parties almost nonexistent.<sup>10</sup> Local party systems operate independently from national ones, with both local and national politicians loyal to provincial party leaders. Thanks to the role of provincial parties in Argentina, the country is peppered with numerous provincial and regional parties.

In several provinces, these parties have become major players in local politics, regularly winning provincial elections, including gubernatorial races.<sup>11</sup> Provincial parties are important allies and nationally organized parties actively pursue coalitions with these groups in order to increase their chances at the polls.

Recent studies support the important role of local party branches and provincial parties in national politics. When Argentine provincial gubernatorial elections are held concurrently with those for the national Chamber of Deputies, provincial contests have a strong, negative impact on the level of multipartism at the national level.<sup>12</sup> Non-concurrent national-provincial elections, on the other hand, result in higher levels of multipartism in Congress. Such studies imply that candidates for national office improve their chances when local political leaders support their campaigns. Indeed, as mentioned above, the influence of local party leaders over political careers has led national legislators choose committee assignments based on the wishes of provincial leaders.<sup>13</sup> In order to protect their political power, provincial bosses rotate politicians through different public offices, thus

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<sup>10</sup> Peter G. Snow, *Political Forces in Argentina* (New York, 1971).

<sup>11</sup> Some of the larger provincial parties include the Pacto Autonomista Liberal in Corrientes, the Movimiento Popular Neuqueño in Neuquén, the Renovador de Salta in Salta, the Bloquista Party in San Juan, and the Movimiento Popular Fugeño in Tierra del Fuego.

<sup>12</sup> Jones, "Federalism and the Number of Parties in Argentine Congressional Elections."

<sup>13</sup> Jones, "Explaining the High Level of Party Discipline in the Argentine Chamber of Deputies."

preventing politicians from building long congressional careers, policy expertise or independent bases of support.<sup>14</sup> The electoral rules, policy authority and fiscal resources enjoyed by provincial governments give them a pivotal role in Argentine politics and government.

The convergence of scholars of Argentine politics around the conclusion that Argentine federal institutions are strong and that provincial politicians play an important role in national politics has sparked an extensive literature analyzing how Argentine federalism affects policy-making processes and policy outcomes. Though many authors have written on this topic, probably the best known work is by scholars such as Jones, Saiegh, Sanguinetti, Spiller and Tommasi. Using a transactions cost approach, Spiller and Tommasi, for example, highlight how Argentina's political institutions, particularly its federal structure, reduce the ability of politicians to construct efficient inter-temporal exchanges, leading to suboptimal economic policy outcomes.<sup>15</sup> Several other authors follow a similar approach and discuss how Argentina's federal institutions, among other political structures, resulted in this country's inefficient and costly fiscal federal regime.<sup>16</sup> Using a common pool resource approach, Jones, Sanguinetti, and Tommasi argue that Argentina's fiscal and institutional federal system produce over usage of common pool fiscal resources by provincial governments, leading to excessive provincial spending.<sup>17</sup> Taken together, these authors' research implies that any measures undertaken to change the direction of economic policy must begin with reforms to Argentina's political (federal) institutions.

This article is designed to fit within these studies of Argentine federal institutions. However, instead of focusing on how Argentine federal institutions affect policy-making processes and policy outcomes, this article highlights something that scholars have not yet addressed: how Argentina's economic environment interacts with its particular set of federal institutions to affect the nature of presidential-provincial relations. To this end, this article builds on studies that argue that Argentina's federal institutions affect Congress' ability to act as a check on president.<sup>18</sup> Rather than placing the lion's share of explanatory power on federal institutions, however, this article

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<sup>14</sup> Jones, Saiegh, Spiller and Tommasi, "Amateur Legislators-Professional Politicians: The Consequences of Party-Centered Electoral Rules in a Federal System."

<sup>15</sup> Pablo T. Spiller and Mariano Tommasi, "The Institutional Foundations of Public Policy: A Transactions Approach with Application to Argentina," *Journal of Law, Economics and Organization*, vol. 19, no. 2 (2003).

<sup>16</sup> Mariano Tommasi, Sebastian Saiegh and Pablo Sanguinetti, "Fiscal Federalism in Argentina: Policies, Politics, and Institutional Reform," *Economía: Journal of the Latin America and the Caribbean Economic Association*, vol. 1, no. 2 (2001); Mariano Tommasi, "Federalism in Argentina and the Reforms of the 1990s," (2002); Sebastian Saiegh and Mariano Tommasi, "Argentina's Federal Fiscal Institutions: A Case Study in the Transaction-Cost Theory of Politics," Center of Studies for Institutional Development (CEDI), Document 11 (1998).

<sup>17</sup> Mark P. Jones, Pablo Sanguinetti, and Mariano Tommasi, "Politics, Institutions and Fiscal Performance in a Federal System: An Analysis of the Argentine Provinces," Center of Studies for Institutional Development (CEDI), Documento 8 (1999).

<sup>18</sup> Jones, Saiegh, Spiller and Tommasi, "Amateur Legislators-Professional Politicians: The Consequences of Party-Centered Electoral Rules in a Federal System."

highlights the additional important contribution of the Argentine economy to presidential-provincial (and thus congressional) relations. That different presidents have experienced stronger and weaker relationships with provincial governments and Congress while federal institutions have remained largely unchanged reveals the limitations of focusing on stationary institutional structures in explaining varying inter-governmental and inter-branch relations.

### ***Fiscal Resources and Zero- and Positive-Sum Presidential-Provincial Relations***

The significant political powers reserved to the Argentine provinces speak of a set of strong federal institutions that rival some of the most well-known federal systems in the world, like Brazil, Canada, Germany and the US. However, despite very few changes to Argentina's federal institutions over time, the nature of presidential-provincial relations in Argentina has varied dramatically since the return to democracy in 1983. President Carlos Saúl Menem (PJ) dominated provincial governments, built stable coalitions in Congress, and was able to undertake radical policy change, even at the expense of provincial economic well-being. President Fernando De la Rúa (UCR), in contrast, was unable to rule over rebellious provincial leaders and faced congressional stalemate, leading to the absence of badly needed policy change and his political ouster in 2000. More recently, president Néstor Kirchner (PJ) (May 2003-present) has been able to tame provincial leaders and bring them and their congressional delegations on board a series of significant policy reforms.

To explain presidential-provincial relations in Argentina, I analyze variation in each administration's underlying economic situation. I argue that, even in a context of strong *de jure* federal institutions, fiscal resources are critical for a president's capacity to maintain cooperative relationships with provincial governments and for building the support of their congressional delegations for his policy proposals. When national leaders are able to transfer sizeable fiscal resources to provincial governments, thanks to growing economies, high tax revenues, or periods of fiscal windfalls, governors are less likely to interfere with presidential policy plans and they will effectively pressure their congressional delegations to support policies in Congress presidential policy programs, even ones that stand to hurt them. As a result, plentiful fiscal resources turn presidential-provincial relations into a positive-sum game, leading to the appearance of weak federal institutions.

In contrast, declining fiscal resources give the appearance of strong federal institutions. When presidents are unable to provide benefits to provincial politicians, federal institutions undermine presidential capacity to exact policy change. Provincial governors and their congressional delegations prefer

to protect their positions in the system, preventing presidents from undertaking any policy change that might hurt their political and economic interests. Limited fiscal resources in a context of provincial political autonomy turn presidential-provincial negotiations zero-sum, a game that provinces have the capacity to win at the expense of presidents in systems with *de jure* strong federal institutions.

The principal explanatory variable under study here is the capacity of presidents to reward governors with fiscal resources, measured as the size of federal transfers to provincial governments. The principal dependent variable is the strength of presidents relative to provincial governments, measured as the capacity of presidents to build support for policy goals—that might even be contrary to the interests of provincial leaders—both among provincial leaders themselves and among their delegations in Congress. If the relationship between fiscal resources and federalism is correct, we should then observe two things. First, we should observe that periods of economic growth, high tax collections and federal fiscal windfalls that enable plentiful fiscal transfers to provincial governments strengthen the leverage of presidents relative to subnational governments, leading to the tacit acceptance of provincial leaders of presidential policy programs, stable coalitions in Congress and the appearance of weak federal institutions. Second, we should see periods of economic stagnation or recession, falling federal tax collections, federal fiscal shortfalls and declining fiscal transfers to provincial governments weakening the leverage of presidents relative to provincial leaders, leading to increased opposition from local governments to presidential policy priorities, congressional stalemate and the appearance of strong federal institutions.

Before proceeding to the case studies, it is important to note that the argument made here does not dismiss a role for relative partisan strengths in presidential-provincial (and congressional) relations. That PJ presidents, like Menem and Kirchner, have appeared stronger relative to other institutions in the system compared to UCR presidents, like Alfonsín and De la Rúa, could lead one to argue that the PJ is simply better at ruling over unruly provincial governments and thus Congress due to its historically strong position in both provincial and national government. Indeed, as shown in Table 1, the PJ has been an important force Congress and has ruled a majority of provincial governments since the return to democracy (and even before this) in 1983. Even periods when UCR presidents were strongly supported in the Chamber of Deputies, the PJ still held a plurality of seats in the Senate and a majority of provincial governments, and was thus in a position to block policy change.

**TABLE 1. THE PARTISAN MAKEUP OF ARGENTINE GOVERNMENT  
(PERCENT SHARE CONGRESSIONAL SEATS OR PROVINCIAL GOVERNORS)**

	1983-85	1985-87	1987-89	1989-91	1991-93	1993-95	1995-97	1997-99	1999-01	2003-05
PRESIDENT'S PARTY	UCR	UCR	UCR	PJ	PJ	PJ	PJ	PJ	UCR (ALIANZA)	PJ
PJ DEPUTIES	43.7	38.4	38.4	47.1	48.6	49.8	51.4	46.6	38.8	49.8
UCR (ALIANZA) DEPUTIES	50.6	50.6	44.7	35.3	32.9	32.9	35.3	41.6	47.0	17.5
PJ SENATORS	45.6	45.6	45.6	61.2	61.2	61.2	55.7	55.7	55.7	52.8
UCR (ALIANZA) SENATORS	39.1	43.5	43.5	26.1	21.7	21.7	28.6	28.6	28.6	26.4
PJ GOVERNORS	52.2	52.2	73.9	73.9	58.3	58.3	58.3	58.3	62.5	66.7
UCR (ALIANZA) GOVERNORS	30.4	30.4	8.7	8.7	16.7	16.7	20.8	20.8	29.2	29.2

Source: Calvo, Ernesto and María Victoria Murillo, "Who Delivers? Partisan Clients in the Argentine Electoral Market," American Journal of Political Science, vol. 48, no. 4 (2004); and Ministerio del Interior, Republica Argentina. Note: The 2001-03 period was ruled by an interim PJ government and is not included here.

The argument here does not deny the importance of the partisan composition of government in presidential-provincial relations. However, it does contend that this is not enough to understand the varying experiences that PJ and UCR presidents have had with presidential-provincial relations. A cursory look at Menem's (PJ) second term (1995-1999) provides evidence that partisan politics do not wholly account for presidential-provincial relations, even if they are important in improving them or aggravating tensions. Though Menem funneled considerable fiscal funds to provincial governments (as will be shown below) during both presidential terms, these resources were not enough to moderate the effects of the growing economic recession on provincial governments. The economy slowing to 3.9% annual growth in 1998 and retracted by 3.4% in 1999, while unemployment reached 16.6% in 1996 and 13% in the late 1990s. Argentina's current account deficit also turned for the worse as well as the overvalued exchange rate favored imports over exports.

Despite his party's privileged position in Congress and among provincial governments, Menem was unable (or unwilling) to push for policy measures, including a retraction of fiscal spending and transfers to provincial governments and a readjustment of the exchange rate, designed to prevent the pending economic recession. Indeed, many provincial leaders began to run large fiscal deficits during this period, undermining national macro-economic stability, and were sometimes unable to pay provincial workers, raising political opposition to PJ rule at local and national levels. As a result, the PJ lost the 1999 presidential race to De la Rúa (UCR) and a considerable share of congressional seats.

Menem's troubled second term thus provides evidence that PJ presidents can face difficult presidential-provincial relations, even if they control a majority of provincial governments and congressional seats, and that the economic context in which they rule affects their relations with provinces (and thus Congress) and their ability to push through policy reforms.

The political exigencies of providing benefits and policies to constituents require provincial leaders to push presidents, even copartisans, to maintain the flow of fiscal resources.

### ***Fiscal Transfers and Menem's First Presidential Term***

Carlos Saúl Menem (PJ) came to office in 1989 in a context of growing economic crisis and hyperinflation. Attempts by outgoing president Raúl Alfonsín Foulkes (UCR) to deal with economic problems associated with years of heavy state spending, highly protected industrial and agricultural sectors, and rising international debt had failed, leaving the economy in a state severe economic crisis by the end of his term. Table 2 presents information on key economic indicators for Argentina between the late 1980s and early 2000s. As shown, at the time of the presidential elections, GDP was shrinking, while



inflation was on the rise, reaching 4,923% per year in 1989. Growing unemployment was also a problem. As a result of declining economic conditions, voters abandoned the UCR and threw their support behind the populist Menem (see Table 3 for presidential election results). Menem's promises to declare a five-year moratorium on foreign debt payments, redistribute income to the working classes, and create economic growth through continued state regulation and governmental financing appealed to voters hoping for an end to economic hardship. Menem took office six months earlier than planned due to Alfonsín's inability to address economic problems.

**TABLE 2. SELECTED ARGENTINE ECONOMIC INDICATORS, 1988-2006**

YEAR	ANNUAL GDP PERCENT GROWTH	TAX COLLECTIONS A PERCENT GDP	ANNUAL PERCENT CHANGE IN CPI	PERCENT UNEMPLOYMENT
1988	-1.9		387.7	5.9
1989	-6.9		4923.6	7.3
1990	-1.8		1343.9	9.2
1991	10.6	18.4	84.0	6.0
1992	9.6	21.5	17.5	7.0
1993	5.7	21.6	7.4	9.0
1994	5.8	21.5	3.9	12.0
1995	-2.8	20.3	1.6	16.0
1996	5.5	19.7	0.1	16.6
1997	8.1	20.6	0.3	13.4
1998	3.9	21.0	0.7	12.1
1999	-3.4	21.2	-1.8	13.5
2000	-0.8	21.5	-0.7	14.7
2001	-4.4	20.9	-1.5	18.1
2002	-10.9	19.9	40.9	17.5
2003	8.8	23.4	3.7	16.8
2004	9.0	26.4	6.1	13.3
2005	9.2	26.8	12.3	10.1
2006*	7.3	N/A	12.9	9.1

Source: Instituto Nacional de Estadísticas y Censos de Argentina (INDEC) and International Monetary Fund (IMF).

**TABLE 3. ARGENTINE PRESIDENTIAL ELECTIONS, 1983-1999  
(PERCENT POPULAR VOTE)**

YEAR	PRESIDENT	UCR	PJ	FREPASO	ALIANZA
1983	RAUL ALFONSÍN FOULKES (UCR)	51.8	40.2		
1989	CARLOS SAÚL MENEM (PJ)	31.9	47.5		
1995	CARLOS SAÚL MENEM (PJ)	17.1	49.8	29.2	
1999	FERNANDO DE LA RÚA (ALIANZA)		38.1		48.5

Source: Political Database of the Americas. Note: Alianza: UCR and former FREPASO parties; FREPASO: Frente del País Solidario; PJ: Partido Justicialista; UCR: Unión Cívica Radical.

Once in office, Menem reneged on his populist campaign platform and introduced radical measures to stabilize and restructure the failing economy. Nearly all reforms occurred between 1989 and 1995 when Menem implemented programs to privatize state-owned enterprises and utilities; deregulate the domestic economy through the elimination of subsidies and price supports, restrictions on industrial and retail development, and other mechanisms formerly used to allocate resources such as regulatory bodies and marketing boards; liberalize external trade through the elimination of restrictions on the import and export of goods and services, simplification of customs procedures, and improvements in transport systems through international investment; reduce expenditures in health, education and welfare services by transferring these responsibilities to provincial governments; reform and improve the tax system through increasing penalties for evasion, a simplification of the system, modernization of its administration and expansion of its base; reform of capital markets through elimination of all restrictions on transactions and improvements in market transparency in order to provide better protection to investors and make it easier to finance investments; and reform the financial system through the elimination of multiple exchange rates, and cheap loans and easy credit from the Banco Central de la República Argentina (BCRA).<sup>19</sup> In April 1991, the government introduced the Convertibility Law, establishing what amounted to a fixed exchange rate between the Argentine currency and the US dollar. In order to support convertibility, the government had to maintain low inflation, which required reducing the fiscal deficit and a continuation of market-oriented reforms.

The result of Menem's economic reforms was two-fold. First, reforms improved the national macro-economic environment significantly and

<sup>19</sup> República Argentina, *Argentina: A Growing Nation* (Buenos Aires, 1994).

increased investor confidence in the economy, leading to a surge in foreign direct investment. As shown in Table 2, economic growth returned, tax collections grew, inflation was brought into line and unemployment fell. However, Menem's policies also undermined the economic basis of most provincial economies, a second consequence of his reforms. Exchange rate convertibility restricted the ability of the BCRA to cover provincial debts and the elimination of economic subsidies hurt local economies. Throughout the 20<sup>th</sup> century, the provincial economies had been protected by government policies supporting both import-substitution industrialization and agricultural production. Table 4 lists the main agricultural products supported in the Argentine provinces and the forms of government assistance. Most products receiving governmental support could not have survived without it, especially in provinces with agricultural economies.<sup>20</sup> The elimination of subsidies thus stood to hurt the well-being of provincial economies, both industrial and agricultural.

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<sup>20</sup> Larry Sawers, *The Other Argentina: The Interior and National Development* (Boulder, 1996).

**TABLE 4. IMPORT SUBSTITUTE INDUSTRIAL AND AGRICULTURAL PRODUCTS IN ARGENTINA**

REGION	PROVINCES	INDUSTRY	AGRICULTURE
PAMPAS	BUENOS AIRES CÓRDOBA ENTRE RÍOS FEDERAL CAPITAL LA PAMPA SANTA FE	MANUFACTURING AND INDUSTRY OIL AND NATURAL GAS	RICE
CUYO	MENDOZA SAN JUAN SAN LUIS	WINE MANUFACTURING AND INDUSTRY OIL AND NATURAL GAS	GRAPES, VEGETABLES
NORTHEAST	CHACO CORRIENTES FORMOSA MISIONES	YERBA MATÉ PROCESSING PAPER MILLS TEA DRYING PLANTS COTTON MILLS MANUFACTURING AND INDUSTRY OIL AND NATURAL GAS	TOBACCO YERBA MATÉ PULP WOOD TEA COTTON
NORTHWEST	CATAMARCA JUJUY LA RIOJA TUCUMÁN SALTA SANTIAGO DEL ESTERO	SUGAR PROCESSING PROCESSING TOMATOES AND CITRUS FRUITS MANUFACTURING AND INDUSTRY OIL AND NATURAL GAS MINING	SUGAR CANE TOBACCO TOMATOES, CITRUS, COTTON LEGUMES AND CEREALS
PATAGONIA	CHUBUT NEUQUÉN RÍO NEGRO SANTA CRUZ TIERRA DEL FUEGO	FOOD PROCESSING WOOL PROCESSING AND SPINNING MANUFACTURING AND INDUSTRY OIL AND NATURAL GAS MINING	AGRICULTURE (FRUIT, GRAPES, TOMATOES) SHEEP

Source: Daniel Artana, "La Promoción Económica en la Argentina: Introducción y Síntesis de los Principales Resultados," in *Regulación de Actividades Económicas y Financieras*, ed. Alberto Porto, Daniel Artana and Guillermo Escudé (Buenos Aires, Argentina, 1991); Daniel Artana and Mario Salinardi, "Régimen de Promoción Industrial," in *Regulación de Actividades Económicas y Financieras*, ed. Alberto Porto, Daniel Artana and Guillermo Escudé (Buenos Aires, Argentina, 1991); Jorge Baldrich, "Promoción a la Vitivinicultura," in *Regulación de Actividades Económicas y Financieras*, ed. Alberto Porto, Daniel Artana and Guillermo Escudé (Buenos Aires, Argentina, 1991); Carlos Federico Díaz Alejandro, *Essays on the Economic History of the Argentine Republic* (New Haven, 1970); FIEL, *Hacia una Nueva Organización del Federalismo Fiscal en la Argentina* (Buenos Aires, 1993); Gustavo Kippes, "Fondo Especial del Tabaco," in *Regulación de Actividades Económicas y Financieras*, ed. Alberto Porto, Daniel Artana and Guillermo Escudé (Buenos Aires, Argentina, 1991); Gustavo Kippes and José Libonatti, "Regulaciones a la Yerba Maté," in *Regulación de Actividades Económicas y Financieras*, ed. Alberto Porto, Daniel Artana and Guillermo Escudé (Buenos Aires, Argentina, 1991); República Argentina, *Síntesis Socioeconómica de las Provincias Argentinas* (Buenos Aires, 1996); Mario Salinardi, "Régimen de Promoción de Tierra del Fuego," in *Regulación de Actividades Económicas y Financieras*, ed. Alberto Porto, Daniel Artana and Guillermo Escudé (Buenos Aires, Argentina, 1991); Sawers, *The Other Argentina: The Interior and National Development*.

Most economic reforms were largely an executive branch undertaking, implemented by presidential decree or with the rubber stamp of Congress. Menem's key role has led many scholars to conclude that Argentine federal institutions are weak. However, Menem's relationship with provincial governments profited from changes to the Revenue Sharing System in 1988, prior to his succession to office, and from certain benefits brought to provincial governments as a result of his economic reforms.<sup>21</sup> In addition, Menem strategically paved the way for economic reforms by cultivating the support of provincial leaders who carry sway with congressional delegations.

Reforms approved by the PJ dominated Congress to the Revenue Sharing System in 1988 created a provincially beneficial fiscal environment as the reform conceded the greatest share of fiscal transfers to provincial governments in Argentine history. Though the provincial share of Revenue Sharing resources dropped with the new agreement, absolute funds transferred to provincial governments increased dramatically. Provincial governors were compensated for a drop in share with promises of increased future tax collections gained from improvements to the federal tax administration, as well as guaranteed minimum monthly payments (*Cláusula de Garantía*), and an increase in funds designed to cover newly transferred education and healthcare responsibilities. However, as pointed out by Tommasi, Menem's structural reforms also improved the fiscal position of provincial governments.<sup>22</sup> Changes to the federal tax structure raised the amount of shared taxes, while economic growth improved provincial collections of some taxes. The 1992 and 1993 Fiscal Pacts (*Pacto Fiscal*) further favored provincial governments by increasing the base-line level of transfers going to the provinces, promising to postpone or forgive some provincial debt obligations, and fund provincial social security systems.<sup>23</sup>

Figure 1 shows the dramatic rise in governmental spending, especially provincial spending, in the first years of Menem's administration. Growth in Revenue Sharing transfers during this period is depicted in Figure 2. Elites in the poorer interior<sup>24</sup> provinces, in particular, profited from federal fiscal transfers that accounted for, on average, 83% of governmental resources in this region during this period, compared to only 53% for their counterparts in the more industrialized pampas.

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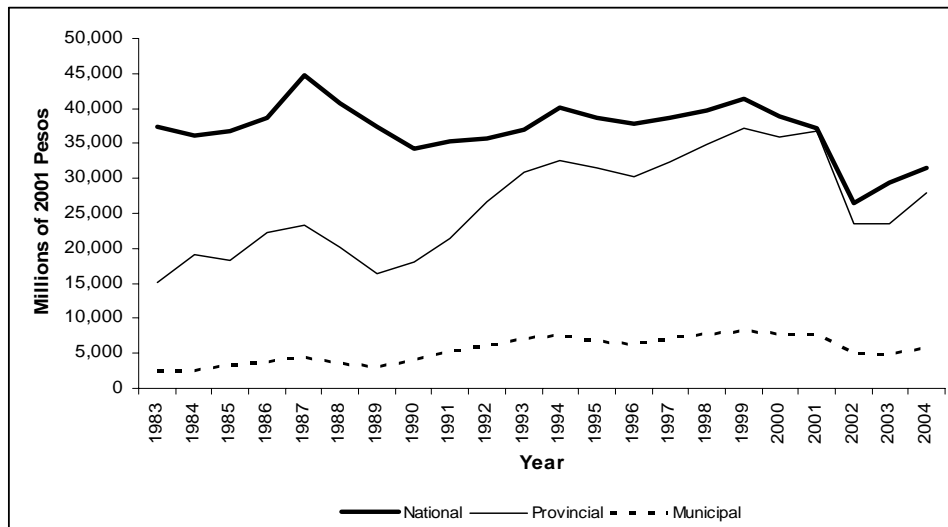
<sup>21</sup> Tommasi, "Federalism in Argentina and the Reforms of the 1990s."

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*

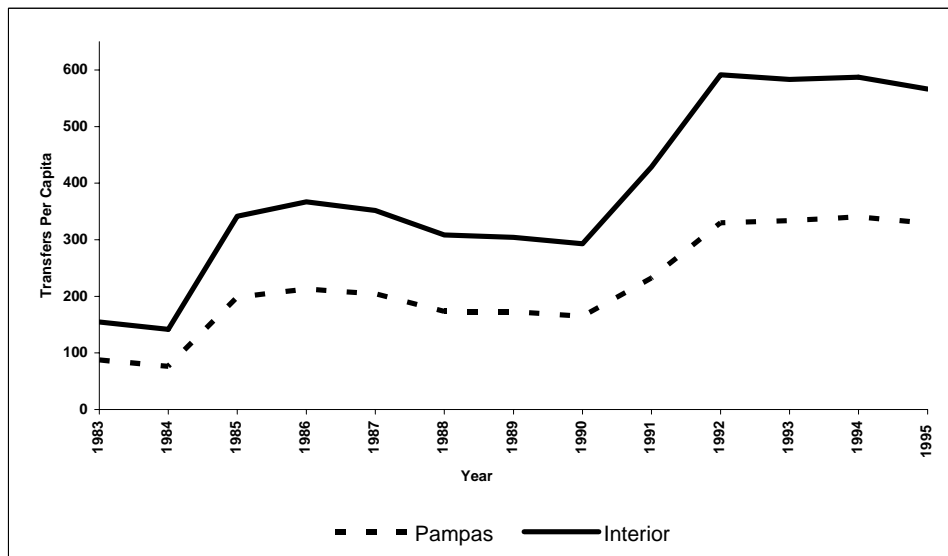
<sup>24</sup> Interior provinces include Catamarca, Chaco, Chubut, Corrientes, Formosa, Jujuy, La Rioja, Mendoza, Misiones, Neuquén, Río Negro, Salta, San Juan, San Luis, Santa Cruz, Santiago del Estero, Tierra del Fuego and Tucumán. These provinces have suffered from lower GDP per capita and higher unemployment than the wealthier pampean provinces where most industrial development occurred. The pampas includes the provinces of Buenos Aires, Córdoba, Entre Ríos, La Pampa and Santa Fe. The urban Federal Capital is often included along with pampean provinces in analyses of the Argentine regions.

**FIGURE 1. ARGENTINE PUBLIC SPENDING BY LEVEL OF GOVERNMENT, 1983-2004 (MILLIONS OF 2001 PESOS)**



Source: Based on data collected from the Dirección de Análisis de Gasto Público y Programas Sociales - Secretaría de Política Económica.

**FIGURE 2. FEDERAL TAX REVENUE SHARING RESOURCES TRANSFERRED TO PROVINCIAL GOVERNMENTS IN ARGENTINA, 1983-1995 (AVERAGE PER CAPITA TRANSFERS IN US DOLLARS)**

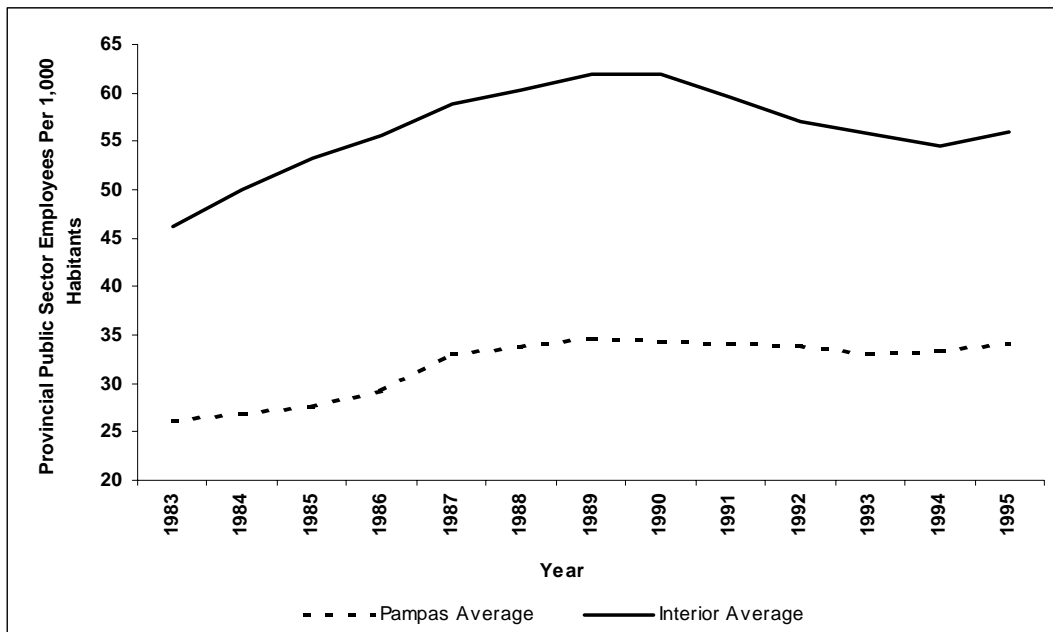


Source: Based on data collected from the Subsecretaría de Asistencia a las Provincias and the Dirección Nacional de Coordinación Fiscal con las Provincias.

Increased transfers enabled provincial governments to raise public sector spending, as shown in Figure 1, employment, and in some cases replace lost federal subsidies to key economic sectors. While national governmental payrolls decreased dramatically as a result of downsizing and privatization,

provincial governments padded public sector payrolls, serving as an employer of last resort. The provincial share of total public sector employment jumped dramatically after 1989, going from 55 to 85%. Pampean provincial governments employed, on average, 32 people per 1,000 inhabitants, while public sector payrolls in the interior accounted for, on average, 56 employees per 1,000 inhabitants.<sup>25</sup> Figure 3 shows the evolution in public sector employment between 1983 and 1995. Despite national declines in public sector employment thanks to layoffs and privatizations, provincial employment stayed largely stable, and in some cases rose.

FIGURE 3. ARGENTINE PROVINCIAL PUBLIC SECTOR EMPLOYMENT, 1983-1995  
(AVERAGE ACROSS PROVINCES)



Source: Based on data collected from the Subsecretaría de Asistencia a las Provincias and the Dirección Nacional de Coordinación Fiscal con las Provincias.

Though the national government privatized 36 national enterprises by 1993, provincial public sectors remained largely intact. Table 5 shows the status of provincial public enterprises as of December 1996. For example, despite considerable financial incentives to unload inefficient and indebted utilities, by 1996 only half of provincial governments had moved to privatize electrical utilities and only 20% had sold off provincial water services.<sup>26</sup> By the

<sup>25</sup> Based on data collected by the author from the Ministerio del Interior, Secretaría de Interior, Subsecretaría de Asistencia a las Provincias. Data available upon request.

<sup>26</sup> Based on data collected by the author from the Ministerio del Interior, Secretaría de Interior, Subsecretaría de Asistencia a las Provincias. Data available upon request.

end of 1996, 13 provinces had yet to sell-off provincial financial institutions, though several local legislatures had passed laws enabling their governments to begin privatization proceedings. In 1997, there were still 13 provincial banks in operation.



TABLE 5. THE STATUS OF ARGENTINE PROVINCIAL PUBLIC ENTERPRISES AS OF DECEMBER 1996

	UTILITIES		BANKS	TRANSPORTATION	OTHER
	ELECTRICITY	WATER			
	PRIVATIZED?	PRIVATIZED?	PRIVATIZED?	PRIVATIZED?	PRIVATIZED?
PAMPAS					
BUENOS AIRES	No	No	No	N/A	YES
CÓRDOBA	No	No	No	*	N/A
ENTRE RÍOS	YES	***	YES	No	YES
LA PAMPA	No	*	No	N/A	No
SANTA FE	YES	YES	LP	N/A	No
<b>PERCENT NOT PRIVATIZED</b>	<b>50.0</b>	<b>75.0</b>	<b>50.0</b>	<b>100.0</b>	<b>50.0</b>
INTERIOR					
CATAMARCA	YES	No	LP	N/A	YES
CHACO	No	No	YES	YES	No
CHUBUT	*	**	No	N/A	No
CORRIENTES	No	YES	YES	N/A	N/A
FORMOSA	YES	YES	YES	N/A	No
JUJUY	No	No	LP	No	N/A
LA RIOJA	YES	No	YES	N/A	No
MENDOZA	No	No	YES	No	No
MISIONES	No	No	YES	No	No
NEUQUÉN	No	No	No	YES	No
RÍO NEGRO	YES	No	YES	No	No
SALTA	YES	No	YES	N/A	No
SAN JUAN	YES	No	YES	N/A	No
SAN LUIS	YES	No	YES	N/A	No
SANTA CRUZ	No	No	LP	No	No
SANTIAGO DEL ESTERRO	YES	No	YES	N/A	YES
TIERRA DEL FUEGO	No	No	No	No	N/A
TUCUMÁN	YES	YES	YES	N/A	N/A
<b>PERCENT NOT PRIVATIZED</b>	<b>47.1</b>	<b>88.2</b>	<b>16.7</b>	<b>75.0</b>	<b>85.7</b>
<b>PERCENT NOT PRIVATIZED IN ALL PROVINCES</b>	<b>50.0</b>	<b>80.0</b>	<b>50.0</b>	<b>77.8</b>	<b>77.8</b>

Source: República Argentina, Empresas Públicas & Bancos Oficiales de Provincia: Estado de Situación en Relación a Procesos de Privatización al 15/11/96 (Buenos Aires, 1996); República Argentina, Privatizaciones y Concesiones en Provincias: Pacto Federal para el Empleo, la Producción y el Crecimiento del 12 de Agosto de 1993 (Buenos Aires, 1995); República Argentina, Situación de las Provincias Argentinas: noviembre-diciembre, 1996 (Buenos Aires, n.d.). Note: "Other" includes things such as telecommunications, gas, television stations, newspapers, press and printing facilities and other minor enterprises. See República Argentina (n.d.) for more information on these industries by province. LP means Law Passed by provincial government, though privatization is yet to occur; N/A means information not available. \* No provincial public service exists. \*\*90% of the service is privately owned by cooperatives. \*\*\*No public service exists but is in the hands of municipal governments.

New fiscal resources at the disposal of the provincial government also made it possible to continue subsidies in certain key sectors, although they did not have the capacity of the federal administration. For example, until 1991 the sugar industry in Argentina was heavily protected from international competition and received generous subsidies from the national government. In 1991, the federal government removed quantitative restrictions on sugar imports and lowered import duties, with only a 20% tariff remaining on imported sugar. Credit subsidies were also removed, as were production quotas and price supports. These changes aimed at forcing inefficient sugar mills out of business and rewarding those able to produce at lower costs. Governments in sugar producing provinces, however, executed measures to offset these reforms. Several mills in Tucumán, for example, receive direct subsidies from the provincial government. Many mill owners are not prosecuted for failing to pay federal or local taxes. One mill is 40% owned by the government, and thus continues to receive generous provincial support. The provincial government frequently bails out mills facing bankruptcy, while provincial judges overseeing bankruptcy proceedings have rented mills at low prices.<sup>27</sup> By redirecting resources to the sugar industry, the provincial government of Tucumán countermanded the objectives of national adjustment. Similar events took place in other provinces with sizeable fiscal resources at their disposal.

Though Menem's ability to undertake radical economic restructuring is often interpreted as evidence of his power over provincial governments and thus of weak federal institutions, the fiscal resources channeled to provincial governments made it possible to buy their acquiescence for reform. Indeed, that provincial governments had the policy authority and fiscal resources to avoid many national economic reforms and step in where the federal government stepped out attests to the strength of federal institutions in Argentina, not the reverse. Rather, the positive-sum game created by increased federal transfers tamed provincial opposition to national policy discussions by allowing them to act alone at the local level, though lending to the appearance of weak federalism.

### *Economic Recession and De la Rúa's Failed Presidency*

In contrast to the presidential-provincial experience during Menem's administration, president Fernando De la Rúa felt the full force of provincial strength during his short time in office thanks to his incapacity to compensate provincial governments for economic losses with federal transfers. De la Rúa came to power in December 1999 through an electoral alliance between his UCR and the Frente del País Solidario (FREPASO) (see Table 3 for presidential

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<sup>27</sup> World Bank, *Argentina: Revitalizing the Tucumán Economy* (Washington, D. C., 1995).

election results). Similar to Menem's first years, upon his inauguration, De la Rúa had to contend with growing economic problems and needed to undertake additional structural reforms to address them. Growing economic recession, considerable international debt obligations, and an over-valued currency left by outgoing president Menem required immediate attention. As shown in Table 2, the economy had begun to contract in the mid-1990s, arriving to a full recession by 1999. Tax revenues as a percent share GDP and in real terms had begun to fall, placing government finances in a precarious position and also at the forefront of the new administration's agenda. Unemployment was also on the rise in the mid-1990s, and with it certain related social problems.

National and provincial fiscal austerity was required not only for resolving certain internal fiscal problems but also to maintain a favorable international credit rating for sovereign debt, foreign investment and the continued support of the International Monetary Fund (IMF). However, fiscal austerity also meant significant changes to the Revenue Sharing System to reduce funds transferred to provincial governments. This placed the De la Rúa administration in a difficult position: the loss of IMF and investor confidence would surely lead to default on international debt obligations but policy changes needed to ensure such support would be politically difficult. Any adjustments in national spending, outlined in the annual budget, needed the support of majorities in both congressional chambers and thus the support of provincial party leaders who guide congressional votes. A new Fiscal Pact or a new Revenue Sharing agreement signed by all provincial governors was the only way to reduce local spending and, more importantly, unsustainably heavy federal transfers to provincial governments. Despite dramatic increases in fiscal transfers during the 1990s, efforts to compensate for lost federal spending along with newly decentralized education and healthcare responsibilities had placed many provincial governments on the verge of bankruptcy and federal funds were keeping them afloat both economically and politically.

The economic and thus political environment during De la Rúa's time in office was thus stacked against any major fiscal reform, especially as concerned the provinces. The Fiscal Pact of 1999, affecting 2000, was negotiated by the incoming administration though signed in December, four days before De la Rúa took office. Among other things, the federal government agreed to guaranteed levels of monthly transfers to provincial governments in exchange for the passage of provincial fiscal responsibly laws that would limit provincial fiscal deficits.<sup>28</sup> Though the federal government adhered to its part of the bargain, most provinces did not adhere to their part, something that required another Fiscal Pact with the provinces in order to get provincial spending in line with 2001 governmental income and budgetary expectations.<sup>29</sup>

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<sup>28</sup> Tommasi, "Federalism in Argentina and the Reforms of the 1990s."

<sup>29</sup> *Ibid.*

In the 2000 Fiscal Pact, the federal government agreed, among other things, to increase the guaranteed amounts transferred to provincial governments through 2001, 2002 and 2003 in exchange for a commitment on the part of provincial leaders not to increase primary spending, to pass multi-year budgets, to increase transparency of fiscal accounts and public spending, to harmonize local taxes with federal ones, and to support the passage of a new Revenue Sharing Law by 2001.<sup>30</sup> Interestingly, though the 1994 Constitution required the passage of a new Revenue Sharing Law by the end of 1996, no law had been approved.

The continued deterioration in the Argentine economy and thus in tax collections meant that the federal government was not able to adhere to its promised transfers by mid-2001, putting them in arrears with provincial governments. In return, provincial governments did not adhere to their part of the fiscal bargain, though perhaps they had never intended to, and began to complain about the government's lack of fulfillment. Provincial governments rallied against De la Rúa, filed complaints with the Supreme Court, and brought pressure to bear on the government through the Congress by passing legislation requiring the new taxes on financial transactions to fall within the Revenue Sharing System.<sup>31</sup> The administration's incapacity to meet its transfer obligations at this critical stage is in large part responsible for the lack of a new fiscal agreement with provincial governments for the following year and thus for the loss of investor confidence in the government's ability to meet its debt obligations that proved so disastrous to the Argentine economy and to De la Rúa's presidency.<sup>32</sup>

Falling fiscal resources thus led to a dramatic loss in political support for De la Rúa among governors and thus by their congressional delegations for any policy change, leading to political stalemate. De la Rúa's political difficulties point to the important role of fiscal resources for building the support of governors and their congressional delegations, and for the appearance of presidential power in Argentina's federal system. However, strong federalism does not have to lead to a president's political demise. Many presidents ruling over strong federal systems survive in office alongside powerful governors, even when they are faced with political stalemate over their policy programs. Presidential-provincial policy stalemate occurred at an inopportune moment in Argentine economic history as it sent a clear signal to the international community that Argentina was likely to default on its international debt obligations in upcoming months. Investment dried up, the economy slipped further into recession, reducing tax income needed not just for provincial transfers but for meeting international debt obligations. To make matters worse, discussions over whether convertibility could be sustained led to

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<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*

<sup>32</sup> *Ibid.*

capital flight, estimated to have been around \$20 billion by December 2001, further lowering investor confidence and putting additional pressure on the economy. An executive decree issued limiting daily bank withdrawals starting on December 3, 2001 partially resolved capital flight but was detested by Argentines. In the end, the inability of the De la Rúa administration to manage the economy persuaded the IMF to halt the disbursement of funds on December 5, 2001.

Economic crisis led to massive public demonstrations, looting and a dramatic rise in violent crime. A national state of siege declared in mid-December did little to reduce the general sense of lawlessness and in fact may have contributed to it. On December 20, 2001 De la Rúa was forced to flee the Casa Rosada by helicopter in order to escape protestors banging pots and pans (known as the *cacerolazo*) in the Plaza de Mayo. He formally resigned from office the following day. De la Rúa's experience underscores how periods of economic hardship have the capacity to turn presidential-provincial relations into a zero-sum game and political stalemate. Periods of economic crisis and severe fiscal shortfalls can change federal stalemate into political instability.

### *Improving Terms of Trade and Kirchner's Weak Federal System*

President Néstor Kirchner took office amidst considerable political and economic instability, and without a clear presidential mandate. With De la Rúa's untimely exit, the presidential banner temporarily passed to the president of the Senate, Ramón Puerta (PJ), until Congress met in joint session to choose a new president.<sup>33</sup> On December 24, 2001, a majority of congressmen chose Adolfo Rodríguez Saá, the longtime PJ governor of San Luis province.<sup>34</sup> Rodríguez Saá immediately announced a cessation of international loan repayments, totaling over \$80 billion, amounting to the largest default on sovereign debt recorded. Widespread public outcry and even riots against several political appointments led to his resignation one week later. The president of the Chamber of Deputies, Eduardo Camaño (PJ), then assumed office until another congressional vote elected Senator Eduardo Duhalde (PJ).<sup>35</sup> Duhalde was sworn into office on January 1, 2002. Duhalde dismantled the convertibility program, leading to a swift and radical devaluation of the peso.

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<sup>33</sup> The vice-president, Carlos Álvarez (FREPASO), had left office the previous year over disagreements within the governing alliance.

<sup>34</sup> According to the Law of Succession (Ley de Acefalía), only current members of the Congress or provincial governors are eligible to replace a popularly elected president or vice-president.

<sup>35</sup> At the time, Duhalde was widely considered to be one of the most powerful PJ leaders in Argentina. A former governor of Buenos Aires, Argentina's most populous province, he served as vice-president for two years during the first Menem administration (1989-1995). Later, he competed against De la Rúa in the 1999 presidential race.

First round presidential elections were called for March 30, 2003 and the transfer of power on May 25, 2003.<sup>36</sup> Internal problems within the PJ led Duhalde to postpone first round elections until April 27 but the transfer of power occurred on schedule.<sup>37</sup> Table 6 shows first round presidential election results. Kirchner was actually the second place candidate receiving 22.2% support, while former president Menem won 24.5% votes.<sup>38</sup> However, a second round was never held as Menem withdrew rather than face the possibility of defeat. Economically, although Argentina's economic troubles were somewhat eased during Duhalde's caretaker government, Duhalde opted for temporary measures rather than address the fundamental problems plaguing the economy and governmental finances. Most importantly, the national budget, provincial spending and the Revenue Sharing System were left for the newly elected Kirchner to address. No attempt had been made to address defaulted debt or international creditors.

**TABLE 6. THE 2003 ARGENTINE PRESIDENTIAL ELECTIONS (PERCENT POPULAR VOTE)**

PRESIDENTIAL CANDIDATES AND POLITICAL GROUPS	PERCENT
CARLOS SAÚL MENEM* (ALIANZA FRENTE POR LA LEALTAD – UNIÓN DEL CENTRO DEMOCRÁTICO)	24.5
NÉSTOR KIRCHNER* (FRENTE PARA LA VICTORIA)	22.2
RICARDO LÓPEZ MURPHY (ALIANZA MOVIMIENTO FEDERAL PARA RECREAR)	16.4
ADOLFO RODRÍGUEZ SAA* (ALIANZA FRENTE MOVIMIENTO NACIONAL Y POPULAR – UNIÓN Y LIBERTAD)	14.1
ELISA CARRIÓ (ALIANZA ARGENTINOS POR UNA REPÚBLICA DE IGUALES)	14.0
LEOPOLDO MOREAU (UNIÓN CÍVICA RADICAL)	2.3
PATRICIA WALSH (ALIANZA IZQUIERDA UNIDA)	1.7
ALFREDO BRAVO (PARTIDO SOCIALISTA)	1.1
OTHER CANDIDATES	3.6

Source: Based on data collected from the Dirección Nacional de Estadísticas, Ministerio del Interior. Note: \*These three candidates are from the Partido Justicialista (PJ).

<sup>36</sup> Duhalde promised not to run in the upcoming presidential elections.

<sup>37</sup> Duhalde's decision to reschedule elections followed the death of two civilians at police hands in June 2002 during a political demonstration.

<sup>38</sup> During the run-up to the elections the PJ failed to select a single candidate, leading three of this party's members to compete against one another.

Table 2 gives a picture of the state of the economy at the time that Kirchner came into office. Every economic indicator spelled another difficult term dealing with provinces unwilling to accept cuts in federal funds. The economy had contracted by 10.9% in 2002, and had been in contraction for the prior three years. Low tax collections were still a problem, as they had not only declined as a percent share of GDP but in real terms as well. Inflation was around 40% in 2002 due to the devaluation of the peso that year, though inflation had fallen somewhat by 2003, and unemployment was still high. Finally, both national and provincial level spending declined dramatically, as shown in Figure 1, thanks to the contraction of the economy and thus shrinkage in tax collections.

However, the economy began to grow shortly after Kirchner took office, despite the dramatic drop in capital inflows that had begun before the default but continued after it occurred. The dramatic drop in debt servicing and imports thanks to the devaluation bolstered the current account. Kirchner arrived just in time to benefit from a sharp improvement in the international terms of trade, bringing considerable benefits to the ailing Argentine economy. Argentina is a major producer of certain agricultural commodities like soy whose prices rose dramatically with rising demand in Asia. More important, export taxes levied on these goods contributed to fiscal coffers, helping the government run primary surpluses. Argentine manufactured goods exports benefited from the devalued peso, while small and medium enterprises were given governmental support and thus flourished amidst the growing economy and low interest rates.<sup>39</sup> Increased employment and growth in real wages had a positive effect on domestic consumption and poverty rates.<sup>40</sup>

In all, economic growth between 2003 and 2005 averaged 9%, though 2006 figures are expected to be somewhat lower, as shown in Table 2. Economic growth led to a dramatic rise in tax collections, both in real terms and as a percent share of GDP, as shown in Table 2. Unemployment declined, as did poverty rates. Governmental coffers also benefited from reduced sovereign debt payments, both during the default period when payments were not made on nearly half of Argentine sovereign debt obligations, but after negotiations with debtors concluded in early 2005.<sup>41</sup> Argentine interest payments went from about 8% GDP prior to default to 2% in mid-2006.<sup>42</sup> Argentina's improved fiscal position and accumulated reserves allowed it to repay all IMF obligations early, announced in December 2005.<sup>43</sup>

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<sup>39</sup> Felisa Miceli, "Statement by H. E. Ms. Felisa Miceli, Ministry of Economy and Production, Argentina on Behalf of Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay" (paper presented at the International Monetary and Financial Committee Thirteenth Meeting, Washington, D.C., April 22, 2006).

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

<sup>42</sup> *Ibid.*

<sup>43</sup> *Ibid.*

Increased tax collections thanks to economic recovery also meant increased transfers to provincial governments, as shown in Figure 1, as well as a rise in federal spending, particularly ahead of the October 2005 mid-term congressional elections. Of course, governmental spending has not reached levels found in the late 1990s. Indeed, most provincial governments have run surpluses, as has the federal government. However, strong economic performance in a context of rising governmental spending has resulted in a favorable economic environment for provincial leaders. The positive economic and fiscal environment, both on a revenues and spending front, has thus helped Kirchner to contain provincial leaders and bring them on board his policy programs. With the tacit or formal support of most governors and their congressional delegations, Kirchner has restructured several taxes, including the income and value added tax, controlled prices charged by utilities companies for electricity, water and natural gas, created a state-run oil company Enarsa, and negotiated upward changes to minimum wages and social security payments. He also challenged the IMF, refusing to sign an agreement with this organization in 2004, and then paying them off entirely in early 2006. He also worked with governors and Congress to get rid of Menem-appointed members of the Supreme Court.

Good economic times and increased governmental spending paved the way for Kirchner's good relations with governors and Congress. Indeed, the positive economic and spending environment is largely responsible for the PJ's strong performance in mid-term congressional elections in 2005. As long as economic growth and tax collections remain strong, Kirchner will continue to dominate the presidential-provincial game, lending to the appearance of weak federal institutions and of presidential strength. In fact, strong exports thanks to the current favorable external conditions will help the government to avoid difficult economic policy reforms, such as the whole-scale lifting of price controls on utilities and key consumer goods, banking sector reform and provincial financial reform, that have undermined foreign investor confidence and that could hinder longer-term economic growth.

### ***Placing Federal Institutions in Economic Context***

This article argues that to understand the nature of federal institutions, we must place them in economic context. Even where federal institutions are technically strong, certain economic factors can work to undermine or reinforce them, appearing to shifting the balance of power toward presidents or provinces during times of economic largesse or distress, respectively. In Argentina more specifically, good economic times leading to higher tax revenues and increased fiscal transfers to provincial leaders created a positive-sum fiscal context, thereby changing the nature of presidential-provincial relation into one of cooperation even when *de jure* federal



institutions remained the same. This occurred during Menem's first term and has served to benefit Kirchner's administration. Though provinces are still technically strengthened by the federal system, they were, and have been, more apt to yield to presidential policy priorities when they have been compensated fiscally and economically for their support.

During times of economic distress, in contrast, falling tax collections and declining transfers to provincial governments, turn presidential-provincial relations more adversarial, reflecting the zero-sum fiscal and political environment. This occurred during De la Rúa's short time in office. Declining and uncertain transfers to provincial leaders caused by the country's sudden economic downturn led provincial governments to take a much more aggressive stance toward the president and oppose any plans for reform, even for reforms that stood to save the country from defaulting on its sovereign debt, leading to political stalemate in Congress and De la Rúa's early political demise. Indeed, the lack of reform to provincial spending means that current president Kirchner could find himself in a similar situation in the future, especially during a second term. A shift in external conditions caused by a shift in the terms of trade and/or a revaluation of the peso in light of inflationary pressures stands to reduce exports and thus economic growth, tax revenues, and thus the positive-sum federal game, making federal governance tougher for Kirchner.

It is important to note that it is no coincidence that Argentina's boom-bust economic cycles that have led to the illusion of radical shifts in federal institutions closely follow partisan turnover in the presidency. Periods of economic growth and fiscal plenty allowed the PJ's Menem to increase fiscal expenditures to provincial governments and thus undertake a variety of policy measures, like the Convertability plan,<sup>44</sup> that exacerbated negative shifts in the global economy and exchange rates, and that led to electoral turnover to the UCR in 1999. Faced with growing economic crisis, the UCR's De la Rúa was unable to deliver sufficient benefits to provincial leaders to push through important reforms, exacerbating the economic crisis. It also did not help that most governors were from the PJ and thus not inclined to help the beleaguered leader. After several years of interim PJ rule, voters overwhelmingly threw their support behind several PJ candidates, with Kirchner winning office in 2003. As mentioned above, so long as the Argentine economy remains buoyant and Kirchner can maintain federal transfer obligations, his party will continue to win elections. Bad economic times will likely lead to partisan presidential change.

The case of Argentina thus demonstrates that presidential-provincial relations in strong federal systems are affected by economic context. Only future research will tell us whether this is the case for other strong federal

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<sup>44</sup> Juliana Bambaci, Tamara Saront and Mariano Tommasi, "The Political Economy of Economic Reforms in Argentina," Center of Studies in Institutional Reform (CEDI), Document 28 (1999).

systems like those in Brazil, Canada, Germany, the US or Mexico (whose federal system is increasing in strength with democratization and decentralization). It is possible that economic growth only placates provincial leaders in strong federal systems when the lion's share of provincial revenues are collected by federal governments and then redistributed according to legal formulae, as in the case of Argentina, Brazil and Mexico. In systems where local leaders are responsible for collecting most taxes financing local expenditures, periods of economic growth might undermine relations between presidents and provinces while periods of decline help improve them. In cases of economic growth, provincial leaders economically and politically empowered by their tax collections might seek to rival federal rule, rather than succumb to it, to increase their leverage in system. Periods of economic decline, in contrast, necessarily weaken all levels of government, including provinces who must count on their own tax collections, thereby producing more amiable presidential-provincial environments as both sides address the factors for economic decline. Regardless, future study how fiscal financing interacts with federal institutions is needed to further our understanding of these complex systems in order to explain why in some cases they generate political stalemate and in others important policy change.

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