

Introduction

Argentina's sovereign debt default in December 2001 attracted the attention of scholars and policy makers around the world. A country that had a per capita income comparable to Canada's at the turn of the nineteenth century had become an economic disaster 100 years later, with 50 percent of the population living in poverty. Its inability to produce consistent public policies is, we contend, the cause of its economic misfortunes as well as a puzzle that requires explanation.

Argentina's policies have tended to shift dramatically over time. Its aggregate economic policy stance has moved from highly interventionist to extremely promarket and back. After many years of very high inflation and many unsuccessful stabilization attempts, the government introduced a rigid stabilization mechanism known as *convertibility* in 1991. This mechanism allowed for a reduction of inflation to international standards and resulted in a decade of relative macroeconomic prosperity. But the convertibility regime fell chaotically in early 2002 in the aftermath of the default, leading to one of the worst economic crises in recent world history. Argentine microeconomic policies have also been volatile. The geographical distribution of welfare payments changes as frequently as does the minister in charge of social welfare. Public utility policy moves from promoting private investment in infrastructure to asking foreign investors to leave. And, unlike some of its regional neighbors like Brazil or Chile, Argentina also seems unable to steer a well-defined course in its relations with the rest of the world. This lack of definition and incapacity to maintain commitments is mirrored in other areas such as social policy or environmental policy, which are erratic, fragmented, and ineffective.

Argentina is one (rather extreme) example of the point that policy-making capabilities and the quality of policies differ substantially from

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one country to another. Modern macroeconomics places great importance on the credibility of economic policies as a determinant of their effects (see, for instance, Pritchett 2004; Drazen 2000; Calvo 1989; Kydland and Prescott 1977). No matter how good a policy looks on paper, it will not have the desired effects if economic and social actors do not believe that it will be implemented effectively. We believe that credibility and many other desirable policy qualities depend on a policy's political microfoundations – that is, on the extent to which political institutions facilitate the political agreements necessary to sustain effective public policies. Our concern is not so much with the specific content of policies as with some properties of policies, such as whether they are stable, credible, well enforced, and adjusted in a timely manner when circumstances change. Our conviction of the importance of policies' political microfoundations led us to study political and policy-making behavior and their institutional determinants.¹

In this book we develop a framework for the comparative analysis of the impact of political institutions on public policies. Our framework combines and develops preexisting insights from several quarters of institutional economics and political science, making use of transaction cost analysis,² the theory of repeated games, and positive political theory.³ We

1. To some extent, we are reopening a partly forgotten discussion about “state capacity,” which had its high points in works such as Weaver and Rockman (1993), which looks at industrialized countries, and Evans (1995), which looks at developing nations.
2. We borrow from transaction cost economics an emphasis on the importance of intertemporal considerations in exchanges (in this case, political exchanges) as well as a microanalytic approach to the study of transactions and their governance (Williamson 2000).
3. The framework suggested in this book draws extensively on a rich literature relating political institutions to political behavior and policy outcomes. Following William Riker's and Oliver Williamson's usage, several authors refer to this literature as *positive political theory* (PPT) (Amadae and Bueno de Mesquita 1999; Williamson 2000). In a recent review of the origins of PPT, Amadae and Bueno de Mesquita assert that it “represents the attempt to build formal models of collective decision-making processes, often relying on the assumption of self-interested rational action” (1999: 269). It is interesting to complement that definition with the words of Robert Cooter who writes: “American political scientists adopted another label to describe their application of economic models to politics. John Ferejohn, Matthew McCubbins, Ken Shepsle, and Barry Weingast (to name but a few) refer to themselves as ‘positive political theorists.’ This label stresses the difference between the positive task of explaining how politics actually works and the normative task of philosophizing about how politics ought to work. Thus, positive political theorists distinguish themselves from philosophers who traditionally dominated political theory in American universities” (2000: 7).

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view public policies as the outcome of political transactions made over time. Using insights from the theory of repeated games, we identify the conditions that are more likely to foster cooperative, credible, and adaptable policies as opposed to noncooperative, noncredible, volatile, or rigid policies. We then draw on the comparative analysis of political institutions to identify the configurations of political institutions most likely to lead to more or less cooperative policy-making environments.

Using our framework, we argue that political institutions in Argentina induce a noncooperative policy-making process that is unable to produce the political agreements necessary to sustain orderly public policies. As a consequence, policies are erratic over time and uncoordinated at any point in time. Although Argentina has occasionally generated temporarily successful policies, most have eventually been hindered by inherent policy instability, short-sighted political behavior, and lack of adequate policies in complementary domains.

OUR APPROACH TO STUDYING POLICY MAKING

The core of our approach is the idea that public policy is a sometimes explicit, sometimes implicit agreement (or “transaction”) among policy makers. Thus, important features of public policies depend on the ability of political actors to work together. Since public policies are not spot transactions, cooperation requires striking and enforcing intertemporal political agreements – that is, agreements that can be enforced over time. In environments that facilitate the creation of intertemporal political deals, policy making will be a cooperative process, leading to public policies that are more effective, more sustainable, and more flexible in responding to changing economic or social conditions. In contrast, in settings where political cooperation is hard to develop and sustain, policies will be either too unstable (subject to political swings) or too inflexible, there will be poor coordination between policy-making actors, and the overall process will be characterized by weak state capacities.

Within this framework, the ability to achieve political cooperation affects not so much the content of specific policies as it does some features of public policies: whether they are stable and predictable, whether they can adjust to changing economic conditions, and whether they are well coordinated, implemented, and enforced. These features, we believe, may have as much of an impact on the long-term expectations and behavior of economic agents as the policies themselves do. In other words, current public policies may not have their expected long-term economic impacts

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if the policy-making process that creates them does not generate adequate beliefs about their long-term sustainability.

Thus, our central question is how the workings of the policy-making process tend to facilitate or hinder cooperative outcomes in the game of political transactions. The literature on repeated oligopoly games provides useful insights. According to the theory, cooperative equilibria are more likely to exist if the number of actors is small, the actors interact repeatedly, the immediate benefits of deviating from cooperation are relatively minimal, deviations from cooperative behavior are easily observed, and there are credible enforcement mechanisms to penalize those who deviate from cooperation.

Mapping how the abstract variables of repeated oligopoly games affect actual policy making and politics in specific countries is not a simple matter. To some extent, such mapping is as much an art as a science. But there are some possible hints toward empirical implementation. While in oligopoly games the number of actors is associated with the number of firms in the market, in politics it should be associated with the number of relevant political actors – that is, those with substantial influence on the making of policy. Likewise, the discount factor may depend on the expected tenure of the political actors or, if the relevant actors are political parties, on the degree of party institutionalization. The availability of credible enforcement mechanisms may be related to the existence of an independent judiciary or to the characteristics of the bureaucracy.

In trying to understand these characteristics of the workings of political institutions, we follow the insights of positive political theory and look into the basic features of the institutional environment, such as whether the government is presidential or parliamentary, what electoral rules are in place, what rules govern interactions between the executive and the legislature, what structure the federal system has, and whether the judiciary is independent.

We believe that the behaviors and outcomes we are interested in are not the result of a single factor but of the interaction of many factors. Thus, we take a systemic approach to studying the connection between institutional variables and the policy-making process. Because we feel it is misleading to characterize countries by a small number of institutional characteristics identified a priori, we proceed backwards from identifying relevant outcomes – the characteristics of public policies, our dependent variable – to characterizing the policy-making process that led those outcomes and then to identifying the institutional and historical reasons the policy-making process operates as it does. This “archeological” approach

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requires a deep immersion in the workings of politics and policy making in each country studied.

This book is a preliminary step in a broader comparative agenda. We develop here a pilot case, studying the workings of political institutions, the policy-making process, and policies in Argentina. It is our hope that this work will stimulate other researchers to join the effort, applying and extending its framework to other countries. Structured comparison of several countries along the lines suggested here is the natural next step.⁴ Cross-sectional econometric analysis may have to wait for further case-based digging and theoretical development.

OVERVIEW OF THE BOOK AND OUR ARGUMENT ABOUT
ARGENTINA'S POLICY MAKING

Chapter 1 lays out a sketch of the analytical framework (more formally presented in Chapter 2), summarizes the implications in terms of policy characteristics and their effects on the relevant economic outcomes, and warns against naively technocratic approaches to policy and to institutional reform.

Chapter 2 uses the theory of repeated games to argue that efficient and effective policy making requires an environment that provides for political cooperation over time. If that is not the case, political and policy actions will be characterized by short-term horizons, inflexible rules, the inability to implement efficient policy changes, and underinvestment in capacities, all leading to low-quality policies. The chapter also identifies various elements that affect the capacity to create efficient intertemporal exchanges. These elements include the number of political actors with power over a given decision, their intertemporal linkages (how long they are in office), the characteristics of the arenas where they undertake their political exchanges, and the availability of enforcement technologies, such as an independent and capable bureaucracy or an independent supreme court.

The rest of the book applies this framework to Argentina and argues that *the workings of political institutions in Argentina lead to short-sighted policy making, and this, in turn, to low-quality policies*. Part II

4. For some progress in that direction, see the project “Political Institutions, Policymaking Processes, and Policy Outcomes in Latin America” at the research department of the Inter-American Development Bank, http://www.iadb.org/res/network_study.cfm?st_id=82.

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of the book analyzes the workings of the main institutions of the policy-making process in Argentina. Chapters 3 to 6 provide details of the workings of key political institutions and arenas, while Chapter 7 describes the impact of those workings on policy making and the characteristics of policies in several policy areas.

The book shows that political practices in Argentina do not facilitate policy consensus, policy coordination, the development of consistent policies over time, or the accumulation of policy-making knowledge and expertise.

One of the most noticeable features of Argentine politics and policy making is that key political actors tend to have short political horizons. The unusual democratic instability that characterized Argentina for most of the twentieth century has contributed to the shortness of horizons, even after the return to democracy in 1983. Democratic instability has left an imprint through path-dependent behavior in Congress, the courts, the bureaucracy, the federal fiscal system, and the actions and expectations of nongovernmental actors. But, we argue in Part II, a history of democratic instability is not the only factor that contributes to short-sighted policy-making behavior. Electoral rules that transfer power away from Congress and national parties toward provincial political patrons (who are not particularly interested in building a strong national congress) also contribute to the shortening of legislators' political horizons and, in an interactive ("general equilibrium") way, affect the incentives of the rest of the polity.

In addition, weak constraints (constitutional, judicial, budgetary) on unilateral actions by the executive of the day undermine political players' ability to enter into efficient political exchanges. Weak constraints on some moves of the national government (the executive and Congress) on issues that affect the provinces have a similar impact on intergovernmental relations.

The combination of the lack of legislative incentives, the ability of the executive to act unilaterally, and the power of provincial leaders have all moved crucial political and policy bargaining away from the national legislature and into other arenas. Some key policy decisions take place in executive quarters (between the president, a key minister, advisors, and a few businesspeople), in meetings of the president with some governors, or in other closed groups. Not only are those arenas not transparent, they also lack the required institutional stickiness to enforce bargains over time.

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The shortcomings of the Argentine policy-making process can be summarized by a number of propositions about the behavior of some of the main institutional actors and the characteristics of some of the main institutional arenas:

1. Congress is not an important policy-making arena.
2. The executive tends to have substantial leeway to take unilateral policy action.
3. Provincial political powers (especially provincial governors) are very important in national policy making.
4. There is a symbiotic interaction between national and provincial policy making that operates through political and federal fiscal channels.
5. Given the incentives of the executive of the day, of legislators, and of provincial governors, there is little investment in policy-making capacities in several spheres.
6. Fiscal federalism considerations are a factor in almost every policy issue, adding transaction difficulties and rigidities to policy making.
7. The bureaucracy is not an effective corps to which to delegate the technical implementation of policy bargains.
8. The judiciary does not provide much intertemporal “glue” to political or policy agreements.
9. Nongovernmental actors in the policy process (such as business groups and unions), lacking a well-institutionalized environment for political exchange, usually follow strategies that attempt to maximize short-term benefits and to build in rigidities into future policies.

Argentina, then, has a relatively large number of political actors with the ability to block policy decisions. Many have either short horizons or wrong incentives or both. Some potentially important actors, such as legislators, justices, and key civil servants, have very short time horizons. The powerful (and potentially more long-lived) governors have only marginal incentives to work for the provision of national public goods. Because the executive has had excessive leeway to undo previous agreements, legislators and others have had little incentive to work toward those agreements in the first place. Third-party and other enforcement technologies (such as courts or bureaucratic delegation) have been missing. The interaction of the capacity for unilateral moves, history, and the lack of institutionalization of Congress (and of legislative careers) has moved the center of policy decision making away from the national legislature and into other

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arenas. Crucial policy decisions are negotiated in informal arenas that are not adequately structured for the institutional enforcement of bargains. (It is worth noting that none of these aspects of the policy-making process provides accountability to the citizens or improves the quality of democratic agency more generally.)

In such a scenario, interest groups such as business and unions will also tend to follow noncooperative short-term strategies, trying to maximize short-term payoffs whenever they have access to state resources. This was clear during the reform experience of the 1990s, in which many reform measures amounted to a front-loading of payoffs to many key actors, such as local business groups favored by privatization, key unions favored by reforms in the health and pension system, and pension funds that charged very high up-front commissions (see Etchemendy 2002; Murillo 1997, 2001, 2002; and Kay 2003b). Thus, not only political actors but also socioeconomic actors undertake short-sighted political strategies. Short-term maximization of political opportunities also shortens their horizons as economic actors. The short-term nature of most policy and institutional arrangements seems well understood by economic agents, who, for instance, did not contribute much to the privatized pension system (see Chapter 7). Some short-term credibility in monetary and exchange rate policy was bought through the extremely rigid (and in the end costly) convertibility system. (See Acuña, Galiani, and Tommasi 2005.)

THE USEFULNESS OF THIS CASE

Even though we selected Argentina for personal reasons, both of us having been born near the (opposite) banks of the River Plate, we believe that looking at Argentina through the new theoretical lens we suggest is useful, and it also makes an interesting case study in its own right. The country's poor and erratic social and economic performance, as well as the policy-making weaknesses of this rather developed less-developed country, are quite notable and have gained recent international attention. The institutional prism we are using is valuable for analyzing Argentina, moreover, because its constitutional structure is very similar to that of the best-studied case, the United States. In several of the later chapters, we follow a principle of minimum differentiation in order to study the interactive effects of small variations in political institutions. In doing so, we contribute not only to the study of Argentina but also to the development of better institutional theories.

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To refine institutional theories, it is necessary to move away from the often implicit specificities of the U.S. case, but it is also necessary to conduct the study of other cases with the same level of empirical and theoretical depth. This book constitutes one step toward that broad comparative effort, studying one country, Argentina, in some detail.⁵

5. Books by Ames (2001) and Samuels (2003) provide an integrated view of the workings of the Brazilian political system within eclectic and nuanced institutionalist approaches. See also Ramseyer and Rosenbluth (1993) on Japan, Crisp (2000) on Venezuela, and Londregan (2000) on Chile. For a related effort, see the U.S.-Japan comparison collected by Cowhey and McCubbins (1995).

PART I

*An Intertemporal Approach
to Policy Making*