

The Institutional Foundations of Public Policy: A Transactions Approach with Application to Argentina

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Public policies are the outcomes of complex intertemporal exchanges among politicians. The political institutions of a country constitute the framework within which these transactions are accomplished. We develop a transactions theory to understand the ways in which political institutions affect the transactions that political actors are able to undertake, and hence the quality of the policies that emerge. We argue that Argentina is a case in which the functioning of political institutions has inhibited the capacity to undertake efficient intertemporal political exchanges. We use positive political theory and transaction cost economics to explain the workings of Argentine political institutions and to show how their operation gives rise to low-quality policies.

1. Introduction

Why do some countries have fairly consistent policy stances while other countries go back and forth? Why do some countries have fairly sensible discretionary monetary policy delegated to a competent bureaucratic agency, while others need to tie themselves to masts such as currency boards and the like? Why do some countries have consistent regulatory

This article is dedicated to the memory of Guillermo Molinelli, who as friendly critic and invaluable source of knowledge helped us improve our understanding of political institutions in Argentina. We are indebted to Matías Iaryczower, Sebastián Saiegh, Mark Jones, Valeria Palanza, Juliana Bambaci, and Gisela Sin for valuable input into this project, and Fundación Gobierno y Sociedad for financial support. We are thankful for the valuable comments and suggestions of Oliver Williamson, two anonymous referees, Daron Acemoglu, Xosé C. Arias, Bob Bates, and various seminar participants, especially in the Research Group on Political Institutions and Economic Policy (PIEP) at Harvard, supported by the Waterhead Center for International Affairs, and by the Center for Basic Research in the Social Sciences at Harvard. The article has been shrunk to fit editorial considerations, with the consequent reduction in bibliographic notes, empirical material, and acknowledgements. We refer to the working paper version for those missing details: <http://www.udes.edu.ar>, Department of Economics, Working Paper 28.

The Journal of Law, Economics, & Organization, Vol. 19, No. 2,
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DOI: 10.1093/jleo/ewg012

frameworks across sectors, while others have idiosyncratic sectoral policies? These and related questions reflect the fact that the quality and characteristics of public policies present substantial variation across countries.

In this article we suggest a framework for the comparative analysis of the impact of political institutions on public policy. We provide a theory linking the features of public policies to the institutional capacity to enforce cooperative intertemporal political exchanges. We view political institutions as the rules of the game of political exchange. As a learning exercise on the way to a comparative logic, we apply this framework to Argentina, a country with a constitutional structure similar to that of the United States, yet with profound differences in the way public policy is conducted.

Our framework is an elaboration of previous work on transaction cost economics and its application to politics.¹ Transaction cost economics, as developed by Williamson (1979, 1985, 1991) and others, attempts to understand economic organization, taking *economic* transactions as the unit of analysis. Characteristics of the institutional environment (such as the workings of the judiciary) are taken as given, and a deep analysis of the features of different economic transactions is undertaken. This microanalytical approach to transactions attempts to explain the governance structures that support those transactions (distribution of ownership, contracts, etc.). In Levy and Spiller (1996), the institutional characteristics of countries vary, and the features of the (now) *political* transaction, the regulation of utilities, are held constant. Levy and Spiller (1996) explain the governance structure of transactions between “the government” and “the firm,” taking into account the features of each institutional environment. The approach we are suggesting here is, in a sense, a generalization and deepening of Levy and Spiller (1996). It is a generalization in that we purport to study policies broader than utility regulation; it is a deepening in that we study in more detail the political-institutional environment of a country. This environment, together with the underlying features of the policy issues at stake, will determine the governance structure for each *political* transaction. The endogenously derived features of political transactions are the characteristics of public policies.²

1. North (1990) and Dixit (1996) have labeled *transaction cost politics* as the use of transaction cost reasoning to think about politics. While North and Dixit emphasize transactions among citizens and politicians, we emphasize transactions among politicians. In that sense our work is closer to the pioneering articles by Weingast and Marshall (1988), Moe (1990a,b), and Moe and Caldwell (1994), and to the recent books by Epstein and O'Halloran (1999) and Huber and Shipan (2002). Recent work attempting to map political institutions into features of public policies, in a vein similar to that of this article, are the articles collected in Haggard and McCubbins (2001), in particular Cox and McCubbins (2001) and Shugart and Haggard (2001).

2. To be more precise, the features of those political transactions are either themselves characteristics of policies (for instance, when fixing a fairly rigid policy rule), or are the

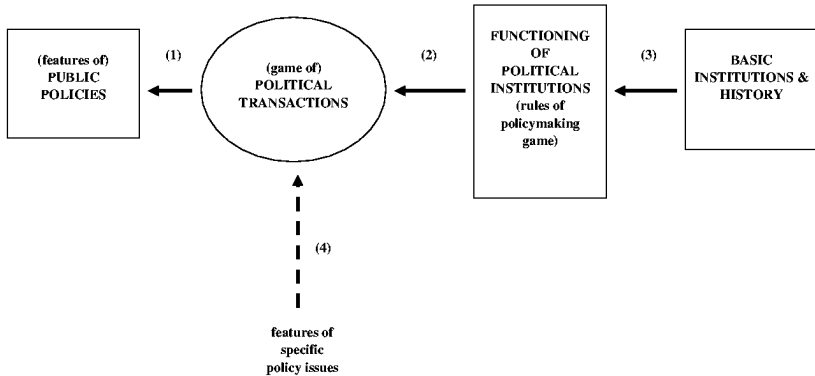


Figure 1. The framework.

The overall agenda we are pursuing could best be understood by reference to Figure 1. We are ultimately concerned with the features of public policies, which thus constitute our dependent variable. We view public policies as the outcome of intertemporal transactions among political actors. These transactions, in turn, are conditioned by the rules of the political game, the workings of political institutions, which in turn depend on basic institutional features of a constitutional and historical nature.

The nature of the “objects” being exchanged (i.e., the features of the underlying policy issues) impacts upon the features of the resulting policies. As in transaction cost economics, political issues can be characterized by a number of properties, including the temporality of exchanges, actions, and flows of benefits; the volatility of the underlying economic environment; the observability of shocks; and the nature of the interests involved.³ Although the links between the features of the underlying policy issues and those of the resulting policies are important in the overall approach, we do not emphasize these explicitly in this article. Instead, we focus on understanding the workings of the policy-making game in one country, Argentina, and the resulting *generic* characteristics of *all* policies.⁴ We summarize these characteristics in the remainder of this introduction.

determinants of those characteristics (for instance, when delegating to an agency with a particular structure).

3. For instance, building a statue for a country hero, or setting up a pension system, are political decisions involving very different transactions. In the first case, once the decision is made, there is little more action rather than occasional maintenance. The latter involves a very complex intertemporal deal in which money is taken from current workers against the promise of a pension 20 or 30 years down the road. There are many important transaction hazards along that path.

4. In this article we provide a streamlined and synthetic version of the connection running from basic institutional determinants to public policies for the case of Argentina. Looking at one country is, of course, just a building block toward broader comparative exercises. Yet this approach places heavy demands in terms of political-institutional detail; so that determining each “data point” is fairly time consuming.

Argentina's economic policy is highly volatile. In a ranking of countries by the volatility of the "economic freedom index" published by the Fraser Institute for the period 1970–1999, Argentina shows up as the seventh most volatile case in a sample of 106 countries. More generally, few observers will disagree that Argentina produces public policies of lower quality than many other countries. Monetary policy is a case in point. During many years, Argentina suffered from a very high and volatile inflation rate, with episodes of hyperinflation. In 1991, monetary policy switched to an extremely rigid mechanism, the Convertibility Law, a straitjacket preventing any monetary or exchange rate action, which was eventually removed in 2002 under very adverse economic circumstances. The instability of policies has also operated at the micro level and has had an important impact on investment behavior.⁵

Argentina's public policy is also incoherent. Different policies operating over the same realities seem to lack consistency.⁶ Regulatory policy is made in an ad hoc and decentralized manner (Abdala and Spiller, 2000). A bureaucracy with substantial executive interference and with only partial congressional involvement conducts the regulatory process. In contrast with commonalities across sectors in regulatory policies in other post privatization environments such as the United Kingdom or Chile, in Argentina each sector has its own way of being regulated, reflecting the discretion of and lack of coordination among the sector secretariats. Social policies (such as antipoverty programs) show large changes without changes in congressional mandates. Ministers and secretaries, whose rotation in Argentina is very high,⁷ often have discretion to funnel resources to their provinces of origin, generating substantial policy volatility. Policy incoherence is further exacerbated by the fact that a large portion of social spending takes place at the provincial level, and (as we describe later) interjurisdictional interactions are fairly noncooperative and poorly coordinated.

While some policies and public allocations show large fluctuations over short periods of time, other policies are very rigid. Such rigidity is evident in monetary policy, but also in other policies such as federal fiscal arrangements. In Section 3.3 below we explain the various rigidities that provincial and national actors impose on each other so as to prevent opportunistic behavior. In summary, Argentina presents low-quality and incoherent public policies, with instability in some dimensions and excess rigidity in others.

5. Acuña (1991) documents the unwillingness of industrialists to invest in building export capacity at times when they were offered rather generous export promotion policies, because of the uncertainty about the duration of the policy.

6. This concept is related to the notion of "Balkanization" in Cox and McCubbins (2001).

7. The average duration of department heads at the National Secretariat for Social Development, for example, is less than a year. Furthermore, the agency has been switching status back and forth from undersecretary to ministry.

Section 2 presents our theory linking features of public policies to the nature of equilibrium in a policy-making game and relate the elements of the description of that game to observable features of political institutions. Section 3 uses that framework to explain why policies in Argentina have the features described above. We argue that they are the result of non-cooperative behavior in the policy-making game, and we trace back the institutional (and historical) determinants of noncooperation.

2. A Transaction Theory of Policy

2.1 Intertemporal Political Exchanges and Public Policy

Using the framework of Figure 1, we are interested in explaining the features of public policies. Public policies and their features are determined by the functioning of political institutions such as Congress, the bureaucracy, and interjurisdictional relations. The ultimate independent variables are fundamental political institutions such as the constitutional powers of the president, basic legislative institutions, the constitutional and historical configuration of federalism, electoral rules, as well as the history of democracy in the country. Multiple links are at work among basic institutions, the workings of political institutions, policy features, and outcomes.⁸ Yet in this article we focus on what we believe are some of the stronger directions of causality within that broader system.⁹

The workings of the political system (i.e., the rules of the policy-making game) constitute here the equivalent of the “institutional environment” in Williamson (1993, 1996). The transactions undertaken, given the institutional environment, are the resulting public policies, whose features are equivalent to “the institutions of governance” or “governance structure of specific transactions” in Williamson (1996). More specifically, we view public policies as the result of agreements among political actors, in what we call “contracting moments,” and of the actual play of the policy game, given those agreements.

Consider a number of political actors who have to make collective decisions (under certain rules to be specified) and who may also take “individual” actions.¹⁰ Conflict and commonality characterize their

8. For instance, some aspects of electoral laws are changed from time to time, often in response to the performance of institutions and to policy outcomes. Similarly, as we explain in Section 3 on Argentina, some features of fiscal federalism, which are among the determinants of the incentives of legislators and governors, are themselves an equilibrium outcome over time. At a broader level, we take as exogenous the military spells, notwithstanding the fact that there is important literature that relates such spells to constitutional features—Linz (1994) stresses the perils of presidentialism; Przeworski et al. (2000) show that presidential democracies have shorter lives than parliamentary ones.

9. Our choice of independent variables coincides with that of other similar efforts; see for instance, Haggard and McCubbins (2001) and Cowhey and McCubbins (1995).

10. Think of a confederation, in which certain policies are decided collectively, while other policies are chosen “individually” by each constituent unit.

interaction. Players have a common interest in having the policy respond to a common economic or technological shock. The heterogeneity of preferences and/or the distributive nature of politics generate conflict.¹¹ Politics is also subject to random shocks that shift the relative political power of the players.¹² Assume that the political game starts with a period in which players (whether by a strong majority or unanimity) can make some agreements. This period captures the notion of a “contracting moment,” a time when the parties reach an understanding about how they will restrict their actions in the future. The set of feasible agreements constitutes an exogenous feature of the institutional environment that affects the type of policies that emerge in equilibrium.¹³

In this environment, first-best policies are those that would be agreed upon in a complete contract environment, or equivalently, those that a benevolent social planner would choose. It is easy to show that these optimal policies will be “moderate” and invariant to the realization of political shocks,¹⁴ but flexible enough to adjust to economic shocks.

It is also easy to show (see the appendix) that if political actors are infinitely lived and patient enough, they can sustain first-best policies as a Nash equilibrium in an infinitely repeated game.¹⁵ If their discount rate is high enough, (full) cooperation will not be sustainable in equilibrium. In such a case, policies will depend on the realization of political uncertainty. For instance, in the infinite repetition of the unique Nash equilibrium of the stage game, each party chooses its favorite policy whenever it is in power.

Consider now the prior contracting stage in which players can make some agreements. Suppose, for instance, that agreements can be enforced by third parties (or through some physical technologies), but that the

11. The appendix provides a formal model that captures the heuristics presented in this section. As an example of the reduced-form policy preferences used there, imagine a policy of “proportional income tax spent on a public good.” Given identical preferences, richer (poorer) players will want lower (higher) taxes, but everybody would increase (decrease) his desired level of public goods in periods in which those goods are cheaper (more expensive). See Cukierman and Tommasi (1998) and Persson and Tabellini (2000) for other examples that could deliver this type of reduced-form policy preferences.

12. This type of political uncertainty can be modeled by some variation of a “random recognition rule” used in legislative bargaining models pioneered by Baron and Ferejohn (1989).

13. The set of feasible contracts will depend on the availability of enforcement technologies—for instance, whether there is an independent and technically competent judiciary. It will also depend on the nature of the issues in question through the observability and verifiability of the various actions and payoffs.

14. That is, first-best policies will not depend on the identity of each period’s agenda-setter in Baron and Ferejohn (1989) or of the party in power in Alesina (1988).

15. More generally, the possibility of sustaining cooperation will depend on a number of factors beyond the discount rate, including the number of players, and the parameters that characterize the details of the intraperiod decision procedure.

realization of economic shocks is not verifiable (or that the physical technologies do not permit adjustment to such shocks). In that case, it will not be feasible to enforce agreements that prescribe rules contingent on the state of the economy. Simple rules, though, can be agreed upon. These simple rules will imply inflexible policies.¹⁶

Such “best-feasible” policies deliver lower welfare levels than could be obtained in a fully cooperative equilibrium or in an environment of full enforcement. Whenever the repeated game delivers full cooperation, these simple rigid rules will not be utilized: players will prefer adaptation to economic shocks to a set of rigid *ex ante* rules. When the repeated game does not develop cooperation though, there are conditions under which an inflexible policy rule will be chosen over the discretionary policy of the Nash equilibrium. That choice depends on the relative cost of not being able to adjust policies to economic shocks, compared to the cost of “partisan” policy making. (Technically it comes to a comparison between the variance of economic shocks and an indicator of the polarization of preferences.)¹⁷ Thus, when enforcement of intertemporal political exchanges is relatively weak, we may observe highly volatile or highly inflexible policies.

This discussion can be interpreted in standard transaction cost arguments. If the institutional environment facilitates political cooperation, then relatively efficient and adaptable policies can be implemented without many (and costly) safeguards. When the environment does not facilitate cooperation, but the costs of implementing safeguards are relatively low, then the policy will be implemented with the support of associated safeguards (*ex ante* rigid rules). When, on the other hand, the costs of implementing safeguards are very high, then policies will respond to political shocks. Figure 2 presents a “decision tree” that sketches policy decisions, given the properties of the polity’s transaction environment and of the issues in question.

The basic model just outlined can be extended in multiple ways. For example, it assumes that the “policy issue” is a fairly simple one-shot policy chosen anew every period. Many policies, however, are intertemporally linked.¹⁸ Saporiti, Spiller, and Tommasi (2002) explore such

16. The case analyzed in the text and in the model of the appendix is obviously a simplification. Actual rules are very seldom unbreakable, but strong rules are only broken under severe stress, in fairly costly ways. [See Galiani, Heymann, and Tommasi (2003) for a description of the Argentine convertibility system along those lines.] The model of the appendix captures such situations in a simple manner, as the cost of large deviations from desired policies.

17. This result is similar to the standard rules versus discretion result in monetary policy. See for instance, Persson and Tabellini (2000: chap. 17).

18. Those linkages could arise because of technical reasons (i.e., policies that have intertemporal effects), legal reasons (a law is in place until it is changed), or economic reasons (present fiscal actions have future effects through intertemporal budget constraints).

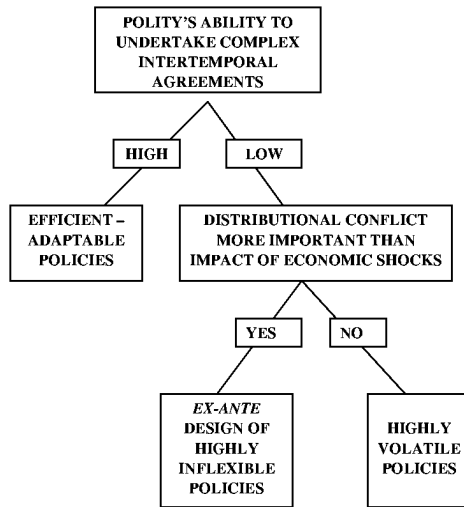


Figure 2. Features of public policies.

linkages and show that in bad transaction environments, some welfare-improving policies (or reforms) are not undertaken and there is also underinvestment in policy-making capabilities.

The model we sketched also assumes that policies are always collective choices. Another simple extension would introduce individual policy actions (by governors, ministers, etc.). In bad transaction environments, those individual policy actions will be less cooperative, leading to poorly coordinated policies.

2.2 The Determinants of Political Cooperation

We are ultimately interested in the effects of political institutions on features of public policy. In the previous section we suggested that several features of public policies depend on the extent of cooperation in political interactions—that is, link (1) in the framework of Figure 1. We still need to identify what aspects of political institutions are conducive to more or less political cooperation—link (2). We do that in two steps. First we list elements pertaining to the description of the policy-making game that facilitate cooperative behavior. Then we map those abstract elements into observable characteristics of a political system. In this section we take the first step and outline how to go about the second, which would constitute an exercise in comparative politics. In Section 3, as an illustration of the framework and as a learning exercise on the way to a comparative logic, we describe the aspects of Argentina's political institutions that are particularly important in determining the structure of incentives for cooperation in that case.

So far our discussion of the qualities of transaction environments (i.e., of the likelihood of political cooperation) has focused on the longevity of political actors, that is, on their discount factor. We draw insights from the analysis of repeated oligopoly games to extend our discussion to incorporate other elements of the description of the game that facilitate the enforcement of cooperative play.¹⁹

2.2.1. Number of Political Actors with Power Over a Given Decision. The theory predicts that the larger the number of players, the smaller the set of other parameters for which cooperation obtains. This result obtains in general games under some reasonable conditions on the set of feasible payoffs. In some simple games, such as common-pool ones, the result is fairly straightforward and general.²⁰

2.2.2. Intertemporal Linkages Among Key Political Actors. The intertemporal pattern of interactions among individuals in formal political positions (such as legislators, governors, and bureaucrats) matters for developing cooperative outcomes. It is not the same to have a legislature in which the same individuals interact over extended periods of time as to have a legislature where individuals are drawn at random from given populations (parties, provinces, etc.) with frequent replacement.

2.2.3. Timing and Observability of Moves. Cooperation is harder to sustain if unilateral moves are hard to observe or hard to verify (Green and Porter, 1984; Lehrer, 1989).

2.2.4. Availability of Enforcement Technologies. Other than self-enforcement through repeated play, certain forms of cooperation could be achieved by alternative institutional means. One alternative consists

19. We use the expression “elements of the description of the game” since it goes beyond “variables” or “parameters” to include aspects of sequencing and information. Some of these elements are explicitly derived in the model in Saporiti, Spiller, and Tommasi (2002). Others are identified from existing results; for instance, Alesina (1988) and Dixit, Grossman, and Gul (2000). For more general results in this class of games see Green and Porter (1984), Rotemberg and Saloner (1986), Abreu, Pierce, and Stachetti (1990), Myerson (1991), Mas-Colell, Whinston, and Green (1995). In the text we emphasize those elements that we then map into the application to Argentina. The theory has a broader range of predictions, some of which we suggest in footnotes.

20. See Fudenberg and Maskin (1986) and Fudenberg and Tirole (1991: section 5.1.2) for the result that, holding constant the dimension of the set of feasible payoffs, increasing the number of players reduces the set of equilibria toward less cooperative ones. Holding constant the number of players, the theory has predictions in terms of the parameters of the stochastic recognition process. For instance, tacit cooperation is more likely the more uncertain are election results over time; that is, the more evenly divided are the chances of being in power at each point in time (as in Alesina, 1988; Dixit, Grossman, and Gul, 2000; and de Figueiredo, 2002).

on fixing policy rules of the type analyzed above, which limit future opportunistic behavior. Another alternative is to delegate policy to an independent bureaucracy.²¹ Delegation has its problems, but there will be cases in which the cost of those problems is smaller than the cost of “partisan” policy making. A somewhat similar reasoning applies to the presence and characteristics of an impartial umpire and enforcer of political agreements, such as an independent judiciary.

2.2.5. Characteristics of the Arenas Where Key Political Actors Undertake Their Exchanges. The complex intertemporal exchanges required for the implementation of effective public policies could be facilitated by the existence of exchange arenas organized in ways that make cooperation easier to enforce. Weingast and Marshall (1988), for example, claim that the organization of the U.S. Congress is designed to facilitate intertemporal cooperation in political exchanges.²² Whether the legislature, as the arena where these transactions take place, is adequately institutionalized or not depends on several factors including legislators’ incentives and capabilities. In environments with weak legislatures, and we argue that Argentina is one such case, political exchanges will take place in alternative settings that will tend to be less formal, more uncertain, and harder to monitor, observe, and enforce.²³

2.2.6. Intraperiod Payoff Structure. The sensitivity of per-period payoff to alternative spot actions is an important determinant of whether cooperation is sustainable in equilibrium. In repeated games, if the spot payoff from deviating is very high, *ceteris paribus*, full cooperation is less likely.²⁴ We argue below that in the Argentine federal fiscal system,

21. Although bureaucratic delegation is a choice (Moe 1990; Epstein and O’Halloran 1999; Huber and Shipan 2002), it is partly constrained by some general properties of civil service in the country, like its professionalism. These generic features of the bureaucracy are themselves endogenous to more fundamental constitutional, electoral, and historical factors, but can be taken as given when considering a specific policy deal. In the example of the appendix, it can be shown that delegating policy forever to an individual with preferences in between those of the two parties leads to the first best.

22. See also Shepsle and Bonchek (1997) and the collection in Shepsle and Weingast (1995).

23. These “arenas” need not be the edifice of Congress. In most parliamentary systems these transactions are carried out outside the legislature, most often within parliamentary parties or the cabinet. Nonetheless, the degree of institutionalization of the key exchange arena is important. In Argentina, such an institutionalized exchange does not take place. In the text we emphasize the (lack of) role of Congress, by contrast to the best-studied presidential democracy, but deeper comparative analysis of this issue is open for future research.

24. In oligopoly games, this is the case with the incentives to discount: if a firm stands to gain very large short-term profits by lowering its price (for instance, because there are a large number of competitors from where to steal customers, related to property 2.2.1 above), collusive oligopoly is harder to sustain.

a province's individual payoff to deviate from a cooperative agreement (for instance, by attempting to get special benefits from the national government) is quite high. Thus the federal fiscal game has noncooperation as its equilibrium.

To sum up, political cooperation leading to effective public policies is more likely if (1) the number of key political actors is small; (2) those actors have strong intertemporal linkages; (3) policy and political moves are widely observable; (4) good enforcement technologies (a strong bureaucracy to delegate, or a strong court to arbitrate) are available; (5) the key political exchanges take place in arenas where properties 2.2.1–2.2.4 tend to be satisfied; and (6) the short-run payoffs from noncooperation are not too high.

To explain the characteristics of public policies in specific political systems, we need to look for the observable counterparts of the listing above. These observable counterparts are the workings of political institutions and their determinants in specific countries or time periods. Identifying these variables is a difficult task. It requires immersion in the microdetails²⁵ of politics (and policies) in each case. The abstract listing we provided corresponds to characteristics of the policy-making environment, which in turn will be (in many cases) endogenous (in interrelated ways) to some deeper determinants.²⁵ The type of variables to analyze include key political actors, determinants of their payoffs, institutional veto points, variables determining who holds those institutional veto points at each point in time (related to parameters of stochastic description of the political process), horizons of key political actors and their determinants, institutional features (constitution, budget procedures, informal practices) that facilitate unchecked moves by some actors, independence and strength of the Supreme Court or equivalent, and characteristics of the bureaucracy. As a first step in a broader comparative agenda, we present in the rest of the article our analysis and description of the workings of political institutions and their impact on policy making for the case of Argentina.

3. Political Institutions and the Policy Process in Argentina

In this section we argue that Argentina has a generalized incapacity to implement efficient intertemporal political exchanges and that leads to defective public policies, and we explain the reasons behind that incapacity. In Section 3.1 we provide an overview of why the functioning of the Argentine political system leads to noncooperative policy making. In Sections 3.2–3.6 we explore the main components of that system in more detail.

25. A somewhat similar logic is presented in Cohvey and McCubbins (1995), where they speak of political institutions (structure), politics (conduct), and policy (performance), using an apt industrial organization metaphor.

3.1 Application of the Framework to Argentina

Following the list of elements identified in Section 2.2, we argue that several features of the configuration and workings of political institutions in Argentina are not conducive to effective political compromise and cooperation. First, the constitutional structure (presidential, bicameral, and federal) implies that there are a relatively large number of institutional players in the policy-making game, placing fairly strong demands in terms of the capacity to make agreements. Second, the intertemporal linkages among political actors lead to myopic behavior not conducive to self-enforcement of cooperative agreements. Third, alternative enforcement mechanisms, whether by judicial means or bureaucratic delegation, have been relatively weak. Fourth, the executive has excessive leeway for undertaking unilateral actions that can undo legislative or other agreements. Fifth, key political exchanges do not take place in the legislature, but in other less institutionalized arenas. Finally, the payoffs from noncooperative spot actions are quite high (for instance, in the federal fiscal game). In this section we briefly elaborate on some of these features, and the remaining sections explore them in more detail.

A crucial component for self-enforcement of intertemporal political deals is missing in Argentina. Legislators, key administration officials, bureaucrats, and justices all have had short-term horizons. The shortness of horizons in the Argentine polity is in part a consequence of past institutional instability (the frequent alternation between civilian and military rule from 1930 to 1983), and of the imprint that such instability left on the behavior of Congress, the courts, the bureaucracy, and federal arrangements.²⁶ This myopia, however, is also the result of electoral mechanisms and executive proactive powers that work against having a Congress populated by long-term legislators, weakening what could otherwise be a crucial arena for the discussion and enforcement of political bargains.

Electoral rules in Argentina transfer power away from national legislators and national parties toward provincial party bosses, which leads to transient and “amateur” legislators, given the incentive of the party bosses (and of the legislators) to rotate them.²⁷ The lack of legislators’ incentives to undertake legislative activities, including supervising the bureaucracy or budgetary implementation, has granted the executive ample discretion concerning budgetary design and implementation.²⁸ This discretion, given the heavy financial dependence of the provinces on the center, counterbalances the power given by electoral rules to provincial governors.

26. It also left an imprint on the actions and expectations of nongovernmental actors, which also looms on some current practices—like the focus of lobbying activities on the executive (Acuña 1995; De Riz 1986).

27. See Section 3.2 and for more details, Jones et al. (2001).

28. The capacity for unilateral executive action can also be understood as the result of proactive legislative powers of the President, weak judicial review, and the history of democratic instability. See below.

Thus the national government depends on the provincial political elites for its legislative agenda, while these depend on the center for financial viability. As we discuss in Section 3.3, a perverse criss-crossing of national and provincial policies and politics further limits the ability to reach cooperative outcomes.

Alternative institutional mechanisms for the enforcement of political agreements are also defective. A professional bureaucracy, well supervised by Congress, could be a channel for enforcement of intertemporal political agreements. Argentina does not have such a bureaucracy. That is due in part to past political instability, but also to the current incentives of key political players. A shortsighted Congress has left the bureaucracy without a long-term principal, and hence hard to motivate. Political appointees, the so-called “parallel bureaucracy,” have then been used to “fill the gap.” These appointees, in turn, rotate very frequently and do not develop norms of cooperation across departments, contributing to the fragmentation and lack of coordination of public policies.²⁹ The Supreme Court has not been a good enforcer either, as it has tended to be “too aligned” with the executive, for reasons that we explain in Section 3.5.

The interaction of the capacity for unilateral moves, history, and the (endogenous) lack of institutionalization of Congress and of legislators’ careers has moved the center of the political scene away from the national legislature and into other arenas. Political bargains take place in executive quarters, in meetings of the president with governors, or occasionally in meetings of national political party leaders. These informal arenas have not been structured for the institutional enforcement of bargains.

In what follows, we bring into focus some of the components of the general picture we have just sketched.

3.2 Career Paths, Weakness of Congress, and the Role of Governors³⁰

As in the United States, Argentina’s political system tends to generate a relatively fragmented polity. It is a federal republic, with a presidential form of government and a bicameral legislature.³¹ The way legislators are elected, however, differs substantially. The members of the Argentine Chamber of Deputies (currently 257) are elected from 24 multimember

29. See Section 3.4, and Bambaci, Spiller, and Tommasi (2001) for further details.

30. This section is based on Jones et al. (2001, 2002).

31. The formal machinery of democracy, elections, and checks and balances operated in Argentina since the first president in 1862 until 1930, the first time that a military coup succeeded in removing a president. Between 1930 and 1983 twelve presidents (both *de jure* and *de facto*) were taken out of office by force. The two dominant parties have been the Partido Justicialista (PJ; the Peronist Party) and the Union Civica Radical (UCR). In addition, other important actors in the chamber are small provincial parties that tend to compete in only one province (where they are either the dominant or the main opposition party).

districts, the 23 provinces, and the federal capital for four-year terms. (One-half of the chamber is renewed every two years, with every district renewing one-half of its legislators.) As in the United States, the 24 provinces send to the national congress a number of deputies in proportion to their populations. The Argentine system, however, tends to strongly over-represent the smaller provinces, through a floor of five deputies per province.³² Deputies are elected from closed party lists using the d'Hondt divisor form of proportional representation. A major difference with the United States is that (intraparty and general) electoral rules have made provincial governors (regional party leaders) powerful actors in national politics.

Legislators in Argentina have high rotation and low tenure rates. Part of that high rotation has come from the high political instability of Argentina in the second half of the twentieth century. High rotation, however, is not all the result of political instability. Twenty years after the return to democratic rule, high rotation still characterizes the Argentine Congress.³³ Looking at the determinants of high rotation, one discovers that it is not the result of voters' rejection. Most legislators simply do not show up on the provincial party list for the next election. Those that do, have a two-thirds probability of being reelected.³⁴ The short tenure of Argentine legislators stems from the fact that those in charge of compiling the lists of candidates (the "*selectorate*") do not reappoint them. Given that electoral districts coincide with provinces, and given the mechanisms of internal candidate selection, this *selectorate* is constituted by provincial party elites.³⁵ Jones et al. (2001) develop and test a game theoretic model

32. Six provinces contain 4% of the population, yet 12% of chamber seats (and 25% of senate seats). In contrast, the province of Buenos Aires accounts for 39% of population, yet possesses 27% of chamber seats (and 4% of senate seats).

33. Since the return to democracy in 1983, turnover rates have always exceeded 40%, with very low reelection rates. (Only 20% of incumbents return to their seats.) Of all the deputies elected from 1983 to 2001, 85% served only one term, 11% two terms, only 4% three or more terms, and only one deputy has lasted from 1983 until the present time. These figures are similar to those of countries (like Costa Rica) with term limits. See Jones et al. (2001).

34. That conditional reelection rate is lower than the 95% for the United States, but comparable to that of many other countries that have, nonetheless, much higher unconditional reelection rates. See the working paper version for a table with those details.

35. Parties employ three methods of candidate selection: elite arrangement, assembly election, and direct primary. Regardless of which method is used, the provincial-level party leaders are the key players in the nomination process, with the national party leadership and rank-and-file members playing a decidedly secondary role (De Luca, Jones, and Tula, 2002). De Luca, Jones, and Tula (2002) show that the decision to hold a primary depends mostly on whether the party controls the governorship in the province, and on the entrenchment in that position. Strong governors impose their preferred candidates without primaries. The national party leader only plays a role as a mediator in cases of divisions within the local party leadership. Rank-and-file party members are only called upon when not even the national leadership can break the stalemate. Even in those cases, still local party leaders play an important role, since those primaries are clashes of party machines, with the victory

that explains the strategic interaction among local party bosses and incumbent legislators. Local party bosses' objectives are to remain in power within the party and to win local elections. Legislators' objectives are to increase their power, which comes at the expense of challenging local party bosses for their positions. In that environment, local party bosses have an incentive to move legislators away from high-visibility positions (Congress), at the cost of some legislative efficiency. This interaction shapes legislative careers, and helps to explain their brevity. Neither the local party elite nor the legislators have much of an incentive to build a long career in Congress.

These *amateur* legislators are *professional* politicians who, after serving a term in Congress, are moved to other political activities in the party, the province, or in the federal government. Of the 108 deputies in the 1991–95 class, 83% were, as of mid-1998, in other positions strongly influenced by their party ties. Congress is just a temporary stop in their political career.³⁶

These electoral rules limit the incentives of legislators to invest in policy-making capacities. Legislators have little incentive to specialize, to acquire specific policy or legislative expertise, and to develop strong congressional institutions—as a consequence they do not provide strong supervision of the executive or the bureaucracy. Jones et al. (2002) provide evidence on the patterns of legislative committee organization and membership: legislators tend to belong to a large number of committees, and they last less than a legislative period in each committee, even in important ones.

Politics, then, are done at the level of provincial—not national—party leaders (governors, and governors-to-be). Although it would seem that this limits the number of players with veto power, it actually increases it. In a fragmented Congress, each legislator's bargaining power is limited by its ability to be the decisive voter, which is normally low. In an informal assembly of governors, each controlling a substantial number of legislators, each governor may actually have veto power, increasing their bargaining power vis-à-vis the executive.³⁷

going to the machine that is able to mobilize the largest number of voters to the polls (De Luca, Jones, and Tula, 2002; Jones et al., 2001).

36. The weakness of legislators' incentives comes not only from the subnational drag on their careers, but also from some capabilities of the executive to "do policy without Congress" (see Section 3.6). All these factors reinforce each other.

37. We already discussed the fact that national legislators owe allegiance to provincial party leaders. This dependence is strengthened when the leadership in question coincides with provincial government. This is so because provincial executives have both more currencies with which to reward and punish their representatives in the national Congress, and more need to occasionally pull those legislative strings to obtain benefits for the province (see next subsection). The strength of provincial governors was reinforced since 1983 by electoral outcomes. During 1983–99, the legislative contingent of the president's party has oscillated between 45.1% and 51.6% (Molinelli, Palanza, and Sin, 1999:Table 2.121), automatically

3.3 The “Federal” Game

The fact that many professional politicians are more interested in appointments in the provinces (or in the national executive) than in Congress is related to the fact that Congress is not where political goodies (policy influence, money, constituency services, and hence power) are distributed. That is related to the way the federal fiscal system is organized. Provinces undertake a large fraction of total spending, yet a small fraction of taxation.³⁸ Local politicians get a large share of the political benefit of spending and a small fraction of the political cost of taxation.³⁹ That constitutes a core feature of a federal fiscal game, otherwise characterized by a repeated tendency of the central government to bail out provinces that run into financial problems, and a tax-sharing agreement full of rigidities and loopholes that provides poor incentives for fiscal responsibility to the provincial and national governments.⁴⁰

Not only are provinces heavily dependent on “central” monies, but also the mechanisms for covering those needs are open to substantial opportunistic manipulation, occasionally curtailed by fairly rigid and inefficient mechanisms. Unilateral, bilateral, and coalitional opportunism has been common in the allocation of central monies to the provinces. The national executive has had substantial discretion in the geographical allocation of the federal budget. In an attempt to curtail opportunistic incentives and governmental discretion in fund allocation, political actors have tended to increase the rigidity of the Federal Tax Sharing Agreement, reducing the capacity to adjust fiscal policy to changed economic circumstances. An example of such rigidities has been the earmarking of taxes for specific programs with clear regional distributional effects. These features have led to a rigid and convoluted federal tax collection and tax distribution, which has been christened the “Argentine Fiscal Labyrinth.”⁴¹

granting any block of unified votes from one or two provinces veto power over the president’s agenda.

38. Provincial spending amounts to 50% of total consolidated public-sector spending (this figure goes up to almost 70% if we take out the pension system and we focus on “more discretionary” spending). Yet provinces finance only 35% of that spending with own revenues. The rest of their spending is financed out of a common pool of resources, the Federal Tax Sharing Agreement. In a large number of small provinces, the amount coming from this common pool constitutes more than 80% of their funding.

39. Jones, Sanguinetti, and Tommasi (2002) show that voters in Argentina, unlike those in the United States, reward provincial spending at gubernatorial elections. They term that effect “voters as fiscal liberals,” by contrast to the expression “voters as fiscal conservatives,” used by Peltzman (1992) to describe the U.S. case.

40. A more detailed description of the system is provided in Tommasi, Saiegh, and Sanguinetti (2001) and Tommasi (2002). The issue of bailouts is addressed in Nicolini et al. (2002).

41. For example, according to a publication of the Secretariat of Regional Economic Programming, of the national expenditure on social programs, 60% is completely rigid, 32%

The evolution of the federal fiscal system—which in part reflects the noncooperative nature of the federal fiscal game—has been an important factor in the general incapacity of the Argentine polity to strike efficient intertemporal agreements even in policy areas not directly related to federalism. The perverse criss-crossing of federal monies for votes in Congress, as well as the generalized lack of cooperation in Argentine policy making, leads to low-quality policies in areas as diverse as macroeconomic policy, fiscal policy, and social sector policies.⁴²

3.4 A Bureaucracy without a Long-Term Principal⁴³

One possible mechanism for enforcement of intertemporal political agreements is delegation to a relatively independent, yet accountable, bureaucracy. Argentina, however, has not developed such a bureaucracy. Rauch and Evans (1999) rank Argentina in the bottom 5 among 35 developing countries in terms of bureaucratic quality. The lack of any long-term principal can be seen, following Spiller and Urbiztondo (1994), as a key factor behind the lack of a professional bureaucracy. Executives, in almost all presidential systems are transient; in Argentina, Congress is not a long-term principal either, as legislators rotate rapidly and are not particularly motivated to control the administration.⁴⁴

The bureaucracy, as a consequence, faces weak long-term incentives, facilitating shirking and requiring intrusive administrative controls to avoid corruption, further reducing its ability to generate timely and effective policies. Each new executive, unable to motivate (or to fire) the permanent bureaucracy, has nominated large numbers of political appointees, often under much more flexible labor agreements, creating a parallel, transient bureaucracy. The parallel bureaucracy undertakes the same actions as the normal bureaucracy is designed to, but is unable (or unwilling) to undertake. The rotation at the ministerial and secretarial levels implies rotation at the “parallel bureaucracy” as well, limiting the extent of institutional knowledge and the development of cooperation across ministries and secretariats, deepening the heterogeneity in policy quality and the lack of policy coherence.

The parallel bureaucracy is widespread, but difficult to measure. Bambaci, Spiller, and Tommasi (2001) report information for one agency. In that case, the parallel bureaucracy represents well above 50% of total employment, and a larger fraction of the wage bill, as those tend to be

is somehow rigid, and only 7.2% is flexible. See Secretaría de Programación Económica Regional (1999).

42. Tommasi (2002) provides some evidence on this issue.

43. This section draws from Bambaci, Spiller, and Tommasi (2001).

44. As Krehbiel (1991) argues, legislators tend to undersupply that kind of public good, an effect that is magnified in Argentina since legislators only attend to provincial party leaders' interests who, in turn, are not particularly interested in the quality of national policy making.

better paid (but shorter-lived) employees than permanent civil servants at similar levels.⁴⁵

3.5 A Friendly Supreme Court

The workings of judicial institutions have direct implications for the feasibility of private contracting, contracting among private and public actors, and arrangements among political agents. We focus here on the latter, emphasizing the role of the Supreme Court as potential enforcer of constitutional and legislative contracts. The Argentine Supreme Court has not been an important enforcer of political agreements in the last several decades. Weak judicial enforcement has been more the result of politics than lack of doctrine. Indeed, Iaryczower, Spiller, and Tommasi (2002) show that a strategic behavioral model similar to the one used to explain the U.S. Supreme Court can explain quite well the behavior of Argentina's Supreme Court justices. Furthermore, the fragmentation of the Argentine polity would suggest that the Argentine court should be a rather strong and independent court. History, however, has implied that some key explanatory variables of the behavior of Argentine Supreme Court justices took very different values than in the U.S. case, leading to a substantially diminished role (Iaryczower, Spiller, and Tommasi, 2002).

In particular, since the mid-1940s, Argentina's Supreme Court justices have historically had very short tenure. Indeed, since then it is one of the Supreme Courts with the shortest average tenure in the world.⁴⁶ Courts whose tenure is very short will naturally tend to be aligned with the sitting government, and hence will not be too strong in their role of judicial

45. Although in principle, national parties could develop a cadre of potential bureaucrats, the fragmented nature of national parties into provincial parties makes such cadre development ineffective as compared to the practice of a parallel bureaucracy composed of individuals highly aligned to the secretary or minister of the moment.

46. From 1960 until the mid-1990s, the average Argentine justice lasted less than four years in the post. The average tenure of Argentine justices is similar to that of Pakistan, Peru, Sri Lanka, the Dominican Republic, and Zambia, countries not associated with long-term stability and the predominance of the rule of law. Iaryczower, Spiller, and Tommasi (2002) show that this is a feature of the last 50 years. After World War I, the Argentine court was on its way to becoming not too distinct from its U.S. counterpart. Since its creation in 1863 until the mid-1920s, the average tenure of the Argentine court systematically increased, reaching the same level as that in the United States. The subsequent political instability drastically reduced the tenure of justices on the bench. The impeachment brought during the first Perón administration against the sitting court members had a lasting impact. Since then, the norm of not manipulating court membership was lost. Several military and civilian presidents, who have alternated in power, got to appoint their own courts. In 1991, the first time since 1946 in which a president might have faced an opposition court, President Menem expanded the court from five to nine members, granting him a "working" judicial majority. Indeed, control over the court was such that since the mid-1940s until the administration of de la Rúa (inaugurated in 1999), no president faced a court with a majority appointed by a political adversary.

review. During a large part of the 20th century—due mostly to de facto governments, but also to the political alignment during the interim democratic spells—executives often had a high level of political alignment in the legislature. This alignment is also a variable leading to a diminished tendency for the court to challenge the government (Iaryczower, Spiller, and Tommasi, 2002).

3.6 Interactions

The sources behind the executive's ability to make unchecked unilateral moves and undo previous agreements are various, including the fact that the Supreme Court has tended to be politically aligned to the president, the lack of a strong and independent bureaucracy, and the "general equilibrium" result that Congress has not built strong technical capacities. The budget process is a further manifestation of this feature. Congress's inability to monitor and control the budget has given the administration substantial budgetary discretion. Indeed, since the beginning of the 20th century, Congress has very often not approved in time the budget sent by the executive—in the high inflation years, often the executive did not even bother to submit a budget. In practice, then, the executive has operated with large budgetary discretion. Even in the low inflation period of the 1990s, while ex ante budgets started being approved in time, ex post control has not been exercised. The so-called *Cuenta de Inversión*, the ex post budget verification process, has not been dealt with promptly enough to be an operational instrument for Congress to verify the fulfillment of the budget contract by the executive.

The unilateral power of the executive has also been based on some constitutional capacities and practices amounting to proactive legislative powers of the president. These practices have evolved partly out of the political instability that has tended to focus on the executive processes that in a more stable environment would have drifted toward the legislature. They are also the result of some explicit constitutional capacities and constitutional lacunae,⁴⁷ including the fact that the president is endowed with the capacity to "regulate" the laws from Congress, and the practice of issuing Decrees of Need and Urgency (Carey and Shugart, 1998; Molinelli, Palanza, and Sin, 1999).⁴⁸

The interaction of the capacity for unilateral moves, historical carryovers, and the (endogenous) lack of institutionalization of Congress and of legislative careers has moved the center of the political scene away from Congress and the bureaucracy toward unilateral and multilateral interactions among the national executive and provincial political elites, especially

47. As well as their interpretation—in turn, related to the relative weakness of the Supreme Court.

48. Table 3.2 of Shugart and Haggard (2001) ranks the Argentine president highest in terms of his presidential powers over legislation in a sample of 23 presidential democracies.

provincial governors. Given the provincial bases of party power, this has been a game of 25 or 49 players (or more if we count the provincial parties proper). This large number of key veto players interacting in an essentially “institutionless” arena has led to noncooperative outcomes and to public policies with the undesirable features described in the introduction.

4. Conclusion

In this article we have provided a framework for looking at the characteristics of public policies and at their institutional determinants. The framework emphasizes intertemporal considerations and the “transactional” features of policies. As a first step toward a comparative logic, we have applied the framework to shed light on politics and policies in Argentina.

Public policy in Argentina has a dual characteristic: over some issues it exhibits excess volatility, while over other issues it is too rigid. In general it lacks credibility and coherence. We trace the reasons for such characteristics to the workings of political institutions. We identify some key features of the institutional environment that do not promote intertemporal political agreements: a legislature uninterested in legislative activities, a bureaucracy with no long-term objectives, a judiciary that has often been aligned with the executive, a federal system that grants provinces little incentives for fiscal responsibility, and an executive with excessive leeway for unilateral moves. These features, which can be traced back to basic constitutional and electoral rules, as well as to the history of democratic instability, have increased the number of key players, limited their political horizons, and moved politics away from institutionalized arenas, increasing the difficulty to reach cooperative outcomes among policy decision makers.

The next step in the agenda is to make progress in the comparative analysis of political institutions and of policy outcomes. Toward that goal, one of the main messages of the article is that attention has to be paid to several interrelated political arenas, and that some of the generalizations in the literature (such as presidential-parliamentary, federal-unitary) need substantial refinement.⁴⁹ We argue that the particular incentives of key political players in Argentina are the combined result of its electoral rules (including intraparty selection methods), some features of its federal structure and fiscal arrangements, some proactive powers of the president, as well as the history of military interruptions and their legacy. The interrelation among these factors (often not considered in broad cross-national comparisons) is crucial to understand the current performance of Argentina’s polity.

49. We are obviously not the first authors that go beyond these “macro” political features. Among others, see the recent comparative volumes by Shugart and Carey (1992), Cowhey and McCubbins (1995), and Haggard and McCubbins (2001).

These interrelations have to be taken into account also if one ventures into giving advice on institutional reform. We are reluctant to go too far in making this type of recommendation, given the slow dynamics of institutional change in response to institutional engineering, “general-equilibrium” interrelations, and political-economy considerations applied to institutional reform. For instance, we believe that limiting discretionary powers of the executive would be desirable, yet that isolated reform would, in the short-term, give power to a Congress populated by amateurs with little incentive to develop high-quality national policies. Other reforms that we would consider beneficial, such as reducing the dependence of national legislators on provincial party bosses, seem politically unlikely given the incentives of the current power brokers.

Appendix: A Simple Model of Political Cooperation and Public Policy⁵⁰

Imagine a game between two players or “groups,” $i = A, B$. Each player tries to minimize

$$\sum_{t=0}^{\infty} \delta^t E[L_i(y_t, \theta_t)],$$

where $\delta \in [0, 1]$ is a (common) discount factor measuring “patience” and $L_i(\cdot)$ is a loss function which depends on the “collectively” chosen policy y and the economic shock θ , identically and independently distributed over time, with $E(\theta) = 0$. For simplicity, let

$$L_i(y_t, \theta_t) = [y_t - (y_i + \theta_t)]^2.$$

The fact that $y_A \neq y_B$ captures the elements of conflict, while the fact that everybody’s preferred policy responds in the same direction to the economic shock θ , captures the idea of common interest, or economic efficiency. Assume that $y_B = -y_A > 0$.

In each period, after the random shock θ_t is realized, the policy y_t is decided through a collective choice mechanism. Also assume that the recognition rule, $\mu_t = i$, generates an equal probability that each player $i \in \{A, B\}$ be the one-period dictator ($\mu_t = i$ implies that player i decides y_t in period t). That is,⁵¹

$$\mu_t = i, \quad i \in \{A, B\} \text{ with a probability of } 0.5$$

Assume furthermore that there is an initial period (zero) in which, by unanimity, players can make some agreements.

50. This model is a simplification of Saporiti, Spiller, and Tommasi (2002).

51. This is a very simplified version of several richer collective decision-making mechanisms, such as those in Alesina (1988), Baron and Ferejohn (1989), and Dixit, Grossman, and Gul (2000).

We start defining a first-best utilitarian benchmark as

$$\min \sum_{t=0}^{\infty} \delta^t E[L_A(y_t, \theta_t) + L_B(y_t, \theta_t)].$$

Given our assumptions, Equation (4) simplifies to

$$\min \sum_{t=0}^{\infty} \delta^t E(y_t - \theta_t)^2,$$

so that the first-best policy is $y_t = y^*(\theta_t) = \theta_t$ for all t . This result indicates that the first-best policy is a function of the realization of economic shocks, but independent of the realization of political shocks.

We analyze now the solution to the noncooperative game. The one-shot Nash equilibrium has $y_t = y_{\mu_i} + \theta_t$. That is, each political player implements his or her most desired policy, ignoring the interest of others. Turning to the repeated game, the infinite repetition of one-shot Nash is always an equilibrium. We define V^N as the present value of expected loss for each player from the infinite repetition of the one shot Nash equilibrium. Then we have that

$$V^N = \frac{1}{2} [0 + (2y_B)^2] + \delta V^N = \frac{2y_B^2}{1 - \delta}.$$

To simplify the analysis we focus now on the possibility of the most cooperative behavior being supported by the punishment strategy of permanent reversion to noncooperation [as in Dixit, Grossman, and Gul (2000) and Dixit (2001)]. This is the strategy (S1) for both i :

$$y_1^i = y^*(\theta_1) = \theta_1$$

$$y_t^i = \begin{cases} y_t^* = \theta_t & \text{if } y_\tau = \theta_\tau \quad \forall \tau < t \\ y_i + \theta_t & \text{otherwise.} \end{cases}$$

The payoff along the equilibrium path of cooperation is

$$V^* = \frac{y_B^2}{1 - \delta}$$

for both players, which coincides with the value of the loss function in the first best. In order to verify whether this strategy pair constitutes an equilibrium, we have to consider the value of an opportunistic deviation to $y_{\mu_i} + \theta_t$. Such deviation would move the game to noncooperation forever, leading to the value

$$V^D = 0 + \delta V^N = \frac{\delta}{1 - \delta} 2y_B^2.$$

Comparing the loss functions V^* and V^D , we can conclude that cooperation can be sustained iff $\delta \geq 1/2$. The first-best can be attained then for δ large enough, that is, when players have long horizons.

Consider now what might transpire in the previous stage of the game, what we call the contracting moment. The features of the resulting policies will depend on the set of feasible contracts. Assume that agreements can be enforced, but that the realization of economic shocks is not verifiable. In that case, it will not be possible to sign contracts that prescribe (economic) state-contingent contracts. On the other hand, the parties can agree on simple “rules.” In our example, it can be shown that the best such rule is to set $y_t = 0$ for all t . This will deliver an expected loss of

$$V^0 = \sum_{t=0}^{\infty} \delta^t E(y_B + \theta_t)^2 = \frac{y_B^2 + \text{var}(\theta)}{1 - \delta}.$$

This outcome is inferior to the first best for both players, that is, $V^0 > V^*$. (Remember that we are dealing with *loss* functions.) The discretionary cooperative equilibrium is preferable to a rigid rule. Thus, whenever the repeated game delivers cooperation, a rigid rule will not be utilized. Comparing the rigid rule to the noncooperative case, we have that $V^N > V^0$ iff $(y_B)^2 > \text{var}(\theta)$. This implies that when the parties have a limited capacity to self-enforce cooperative agreements (i.e., when δ is low), rigid policy rules (not responsive to the economic environment) will be chosen iff the conflict of interest (y_B) is large compared to the volatility of the economic environment ($\text{var}(\theta)$). Thus we find that when there is a low capacity to enforce intertemporal political exchanges, depending on the extent of the distributive conflict as related to the nature of economic volatility, we may observe highly volatile political agreements or highly inflexible policies.

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