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Reassessing the political economy of structural reforms: New lessons from the Argentine experience*

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Introduction

Argentina underwent throughout the 1990's a very intense process of transformation of some of its policies and economic institutions, constituting until very recently "the poster child" for the implementation of the so-called Washington Consensus (see Williamson 1990). Yet, more than a decade later, the experiment arrived to an inflection point, under the effects of a dramatic economic, social and political crisis. It is nowadays common to hear critics of the "pro-market reforms" refer to the Argentine case as irrefutable evidence that such reforms lead to disastrous outcomes not only in terms of inequality and exclusion, but also in terms of aggregate economic performance.

Clearly, the Argentine case presents an important analytical challenge in order to distill lessons about the interactions of economics and politics, and about the interactions of internationally construed reform packages with the idiosyncrasies of domestic political institutions, political practices, and historical heritages.

The reform-cum-Convertibility process achieved some spectacular macroeconomic results in the early part of the 1990s. We are still watching the unfolding of the post-Convertibility economic and political dynamics. It is too early to have very set conclusions about the "final outcome" of the reform process. However, it seems clear that the reform-cum-convertibility process was an attempt to stabilize the economy. As such, it succeeded. It deactivated a high inflation regime installed in the country since the early 70s and finished with fifty years of high inflation in the country.

In the specifics of the reforms, we conjecture that several areas of them (such as trade liberalization, and some transformations of the structure of the public sector) are likely to remain in place. On the other hand, the very negative reading of the reform experience that seems present in public opinion and political discourse, suggests the potential for (at least, partial) revisions in some areas.

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Beyond the broad strokes of what was done and what wasn't, what might stay, what might be reversed, we believe that some aspects of the reform policies were colored and shaped by historical and permanent characteristics of the Argentine polity. A history of ill-resolved distributional conflicts and macroeconomic mismanagement, as well as some characteristics of the political system and policymaking process, cast a long shadow on the policies and outcomes of the period. There are some examples in the Argentine reform experience in which reforms following the standard recipe do not lead to the desired behavioral outcomes because of lack of deeper institutions.

In the real economy, the "long 1990's" have left a modernized productive structure, with substantial heterogeneity. Some firms have been able to bring their operation closer to the international frontier; there has been substantial product and process innovation throughout the decade; and there was a huge increase in exports even under a severe exchange rate appreciation. Nowadays, economic and (to a lesser extent) social indicators show recovery from the crisis. Yet, many relevant economic actors are still in a *wait and see* strategy, and the credibility necessary for adequate intertemporal behavior is not there yet. Also, poverty and income inequality are quite high compared to Argentine historical standards.

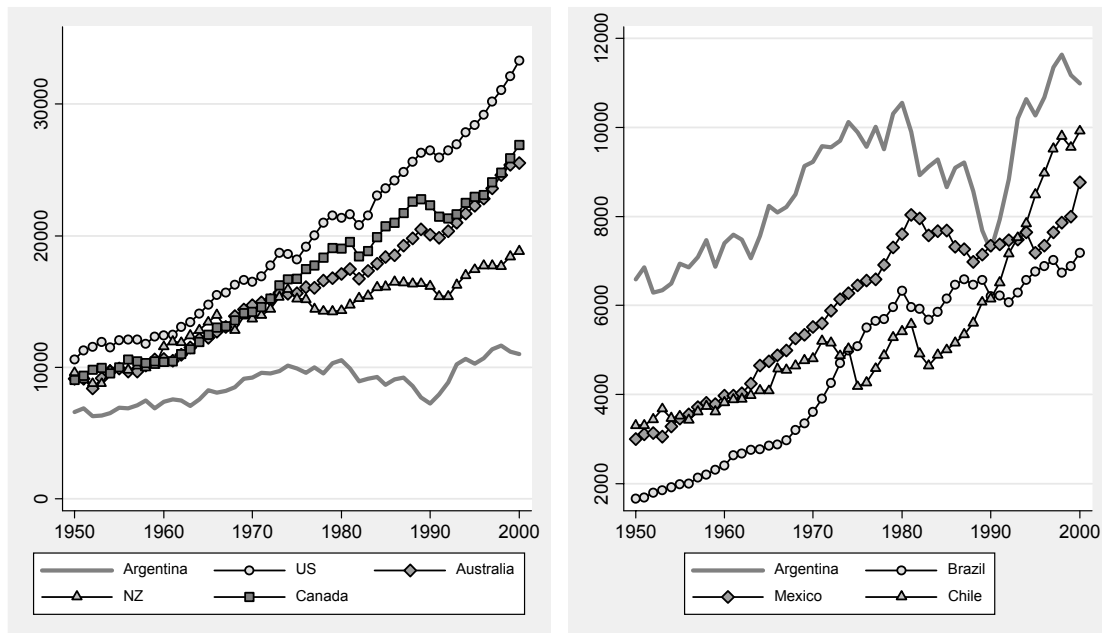
The remaining sections are organized as follows. Section II, "The Political Economy of Reforms in Argentina", constitutes the core of the paper. It aims at answering *why*, *by-whom* and *how* reforms were made in the Argentine case. It contains a synthesis of the historical politico-economic background that led to reforms (*why...*); an analysis of the options, motivations and understanding that lay behind the strategic decision and design of the reforms (*who...*); and an explanation of the logic that characterized the implementation of reforms paying particular attention to, a) the way reforms were presented and legitimized vis à vis society and markets, b) the politico-institutional resources that made possible the reforms, and c) the political steering of the reforms by building coalitions and neutralizing the opposition within the complex realm of political and economic actors affected by the reform process (*how...*). Section III describes some of the main economic and social outcomes of the reform decade. Section IV provides some parting thoughts.

II. The Political Economy of Reforms in Argentina

II. 1. Background: The Road to Structural Reforms

Even though Argentina grew at a reasonable rate up to 1974, the overall performance of the economy during the ISI period was unsatisfactory when put in comparative perspective. As predicted by growth notions of convergence, other poorer Latin American countries were catching up with Argentina. However, Argentina was diverging from more developed countries such as Australia, Canada and the United States, to mention just a few of them (see Figure 1).

Figure 1: GDP per capita, Argentina and Selected Countries



Source: PWT 6.1 – Series in 1996 PPP-adjusted dollars.

In the post-World War II period Argentina adopted an extreme version of the ISI model. Industrialization was promoted using the whole battery of ISI instruments. First, the relation between internal and external prices was distorted to protect the manufacturing sector. This was achieved by building up protectionist barriers via tariff, import quotas, licenses and prohibitions, and by taxing agricultural exports. Second, a complex system of investment incentives (via subsidies and tax exemptions) was also created to promote industry. There were several reimbursement regimes for nontraditional exports. Certain imports were exempted from paying tariffs, and a “buy national” regime was implemented. Third, industrialization was promoted by direct government investment in key industries. And utilities’ user fees were normally set so as to favor industrialization. Finally, interest rates were also regulated and credit was directed to the manufacturing sector.

The Argentine public sector had presented a structural deficit since the 1930s. Up to the hyperinflation process at the end of the 1980s, it had been financed by diverse non-traditional revenue sources. Inflation was systematically high, and the inflation tax played a significant role in financing public expenditures. Another important source of finance for the government was the pay-as-you-go pension system created during this period. Naturally, at the beginning it operated under large surpluses. But from the mid-1970s on, when the number of retired workers began to grow, the system developed a structural deficit that aggravated over time.

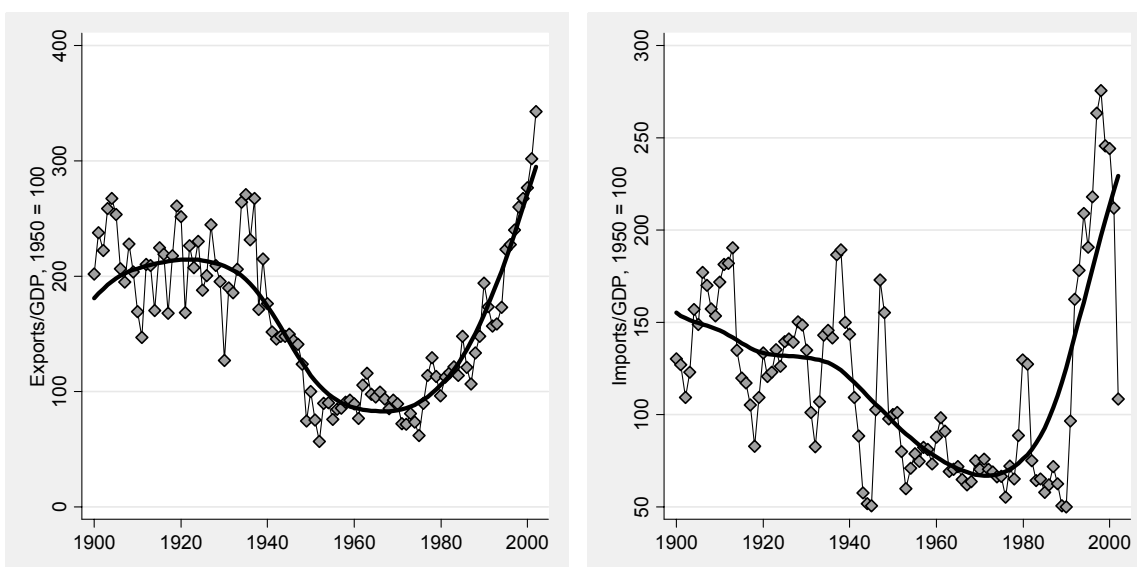
Strong oligopolies developed within the protected manufacturing sector. This and the importance of State enterprises contributed to the development of powerful unions. During the 1940s, pro-labor governments also favored unions, and established a legal system of collective and individual labor legislation. Since then, only one union by economic sector is granted the right to bargain collective agreements and these are legally extended to all workers in that sector of the economy. Later on, granting unions the right to administrate

the workers' health insurance system ("*obras sociales*") provided them with a considerable and enduring source of power (Galiani and Gerchunoff, 2003).

A permanent distributive conflict broke out – between labor and capital, among urban and rural business, and among unions. The State became the arbiter of a conflictive society. This arbitrating role was initially highly discretionary. Thus, every sector tried to establish institutional arrangements to protect their own real incomes, introducing all sorts of rigidities in the economy (Mallon and Sourrouille, 1975; O'Donnell, 1977). Over time, all these protected interests grew into powerful interest groups that opposed any substantial change in the economic system. Even when this system led to severe economic inconsistencies, it was politically very hard to change. Indeed, it took a long protracted economic decline and a number of crises, ending up in a complete collapse of the currency, to generate the space for reform.

Import substitution led to rapid development of the industrial sector. But exports did not expand much, and over time this was at the core of the economic stagnation that marked the eventual collapse of that development model. The imports to GDP ratio contracted continuously over time, until a point in which further decline was not possible (See Figure 2). At this point, the country was extremely vulnerable to external shocks.

Figure 2: Exports and Imports to GDP Ratios at Constant Prices of 1986 Indexes (1950 = 100)



Notes: GDP, Exports and Imports at constant prices of 1986. Index ratios equal 100 in 1950.

Source: CEPAL.

Since the dollar crisis in 1969, fundamental changes in the international context made the ISI-State-led strategy of development outdated. In addition to the fast growth of international trade that started at the end of World War II, financial and productive globalization strengthened. However, no Latin American country showed much ability to adapt to this new reality.

A populist experiment (under President Perón and then his wife) in the early 1970s ended up in economic and political disorder. In 1975, the fiscal deficit reached 15 percent of GDP, the current account deficit reached unprecedented levels and the economy was at

the edge of hyperinflation. A long-lasting consequence of the 1975 spurt of inflation was the consolidation of a *high inflation regime* (Frenkel, 1989).

A top-down disciplinarian military experiment replaced it. At this point, the main objective of economic policy was to reduce inflation. This required eliminating the fiscal deficit and getting rid of wage pressures. A market-oriented program with financial and trade liberalization was implemented. The government attempted to discipline unions (collective bargaining and other union rights were suppressed) and businessmen (through trade liberalization). Over time, both inflation inertia and prevalence of fiscal deficits made the exchange rate system (of preannounced gradual devaluations) unsustainable. Between 1979 and 1981 capital flight amounted to around 20% of GDP, leaving the government, which had absorbed private sector external debt, with a hefty external debt which has conditioned the country's economic performance ever since.¹

Taking over from the military government at this juncture in 1983, President Alfonsín's constitutional government faced the triple threat of coping with mounting external debt arrears, confronting military upheavals related to human rights violations and responding to demands of a population that had just achieved political freedom.²

An important and serious attempt to stabilize the economy, the Austral plan, was implemented in 1985. It was an attempt to combine an 'orthodox' attack on the fundamentals (primarily the elimination of the budget deficit and its monetary financing) with wage, price, and exchange-rate freeze (after an up-front devaluation). All prices, except those in flexible markets, were frozen at their pre-program levels. A new currency was introduced, the austral, and the currency was pegged to the dollar. Wages were set by decree at a level that gave compensation for the previous month's inflation. Finally, to avoid large wealth redistributions due to the unexpected fall of inflation, a currency reform was announced to correct the nominal value of pre-contracted payments.

Despite its initial success, the program faced several problems. Residual inflation triggered a drift in wages sooner rather than later. In addition, in 1986, a large negative shock to the terms of trade of the country severely affected the sustainability of the established structure of relative prices. Thus, just a year after its implementation, price controls were relaxed, unions were allowed to negotiate wages, and a crawling peg on the exchange rate and public-sector prices was reintroduced. More importantly, fiscal policies were not based on solid instruments and the fiscal correction proved only to be transitory.

Yet another attempt to stabilize by pegging the currency to the dollar failed at the end of Alfonsín's government. This time, a massive portfolio shift toward the dollar brought about a devastating hyperinflationary process that caused the anticipated transfer of power from Alfonsín to the Peronist president-elect, Menem.³

Throughout the 1980s the Argentine economy showed its worst performance in the post-World War II period (see Figure 3). Investment and savings collapsed. Per capita GDP

¹ The transfer to the government of an important portion of that debt took place by means of relatively obscure mechanisms such as exchange rate guarantees, swaps and state-issued collateral.

² Indeed, a good part of Alfonsín's energies were devoted to recuperating democratic politics in Argentina.

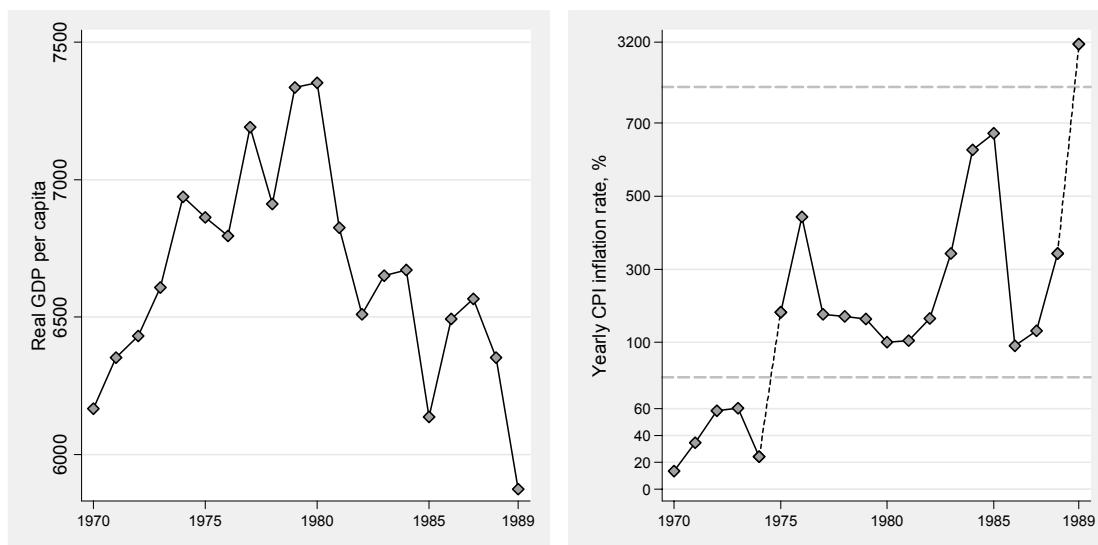
³ The shared beliefs that the economic agents had about Menem's prospective populist policies seem to have been at the core of the portfolio decisions they adopted.

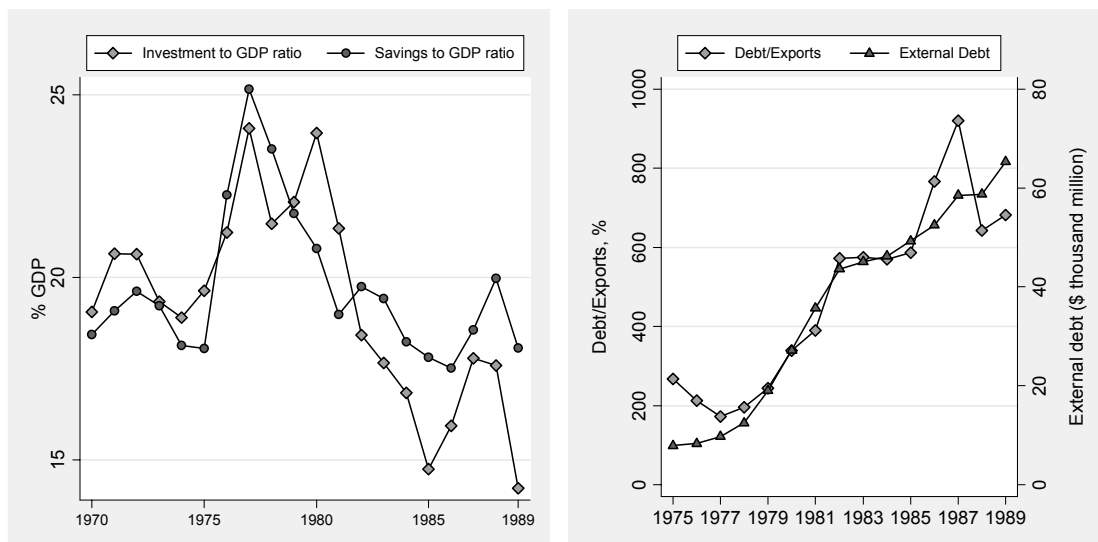
decreased approximately 20 percent between 1980 and 1989. Inflation was above 100% every year except 1986. Both the external debt and the debt to exports ratio rose at an ominous pace (see Figure 3). The dollarization of the economy deepened, increasing its financial fragility. Finally, with maxi-devaluations and disproportionate increases in public prices, the high inflation regime tended to become hyperinflationary.

Stabilization was imperative. When a society has reached this extreme, the alternatives become stark (“stabilize, or else”). The severity of the crises provided for a critical turning point. Although not easy to decide, let alone instrument (as the rest of the paper shows), something had to be done. Contrary to the scenario faced by Alfonsín, who lacked the political space necessary to implement reforms, but at the same time enjoyed a certain degree of freedom to choose alternative courses of action, Menem had more political breathing space, while fewer degrees of freedom to define a course of action.

Thus, it was only after a brutal hyperinflation episode that a comprehensive response to the “slow agony of Peronist Argentina” was formulated. This is how hyperinflation was the inflection point reflecting a long period of deterioration of the old order, and stabilization the cornerstone of the process of designing the reforms (Palermo and Novaro, 1996).

Figure 3: The Performance of the Economy before the Reforms of the early 1990s





Source: Author's elaboration based on Gerchunoff and Llach (2003) and CEPAL.

II. 2. The Reforms

The government of President Menem undertook a process of market-oriented reforms whose speed and breadth process led Argentina to become the poster child of the Washington establishment throughout the 1990's. Menem himself and his party were seen at the time as unlikely characters to undertake market-oriented reforms. In the words of Rodrik (1993), "[i]t is ironic that these reforms were instituted under a Peronist president, Carlos Menem, since Peronism has been virtually synonymous with populism and protectionism. Within a year, Argentine reforms had already gone further than those adopted over a period of decades in the outward-oriented East Asian countries which long served as the example of choice for countries like Argentina." Menem's conversion was a surprise not only when measured against historical based expectations, but also when measured against his (vague but nonetheless populist) campaign statements. Stokes (2001) provides a thorough analysis of the conditions leading to such a difference between campaign statements and policies. In a nutshell, Menem and his staff had come to recognize that market-oriented reforms were the best bet against the ongoing economic disaster, yet they thought they would lose the election if they announced so during the campaign.⁴

Upon entering office in 1989, the government initiated ambitious programs of privatization and trade liberalization. Structural reforms were bundled with stabilization measures; policy decisions in several fronts were taken with an eye to their impact on short-term fiscal needs. Additionally, due to the reputation of the Peronist party, the government had

⁴ See also Cukierman and Tommasi (1998) on the "Nixon goes to China" paradox of populist presidents implementing right wing policies. See, nonetheless our further thoughts with regards to the "Nixon hypothesis" in the concluding section.

to send signals of commitment with the reformist course, what was attempted via a speedy and simultaneous pattern of reform in several fronts.⁵

Despite those efforts, stabilization during the initial period failed, resulting in renewed inflationary episodes in 1990, and the resignation of two Ministers of the Economy. The Convertibility plan of 1991 marks the beginning of the most important stage of reform, which included monetary reform (Convertibility Law and Central Bank independence), fiscal reform (simplification of the tax system and strengthening of the tax collection agency), liberalization of domestic and external markets, and strengthening of the privatization program. The appointment of Domingo Cavallo (and his team) in the Ministry of the Economy brought renewed unity and coherence to the reform effort.

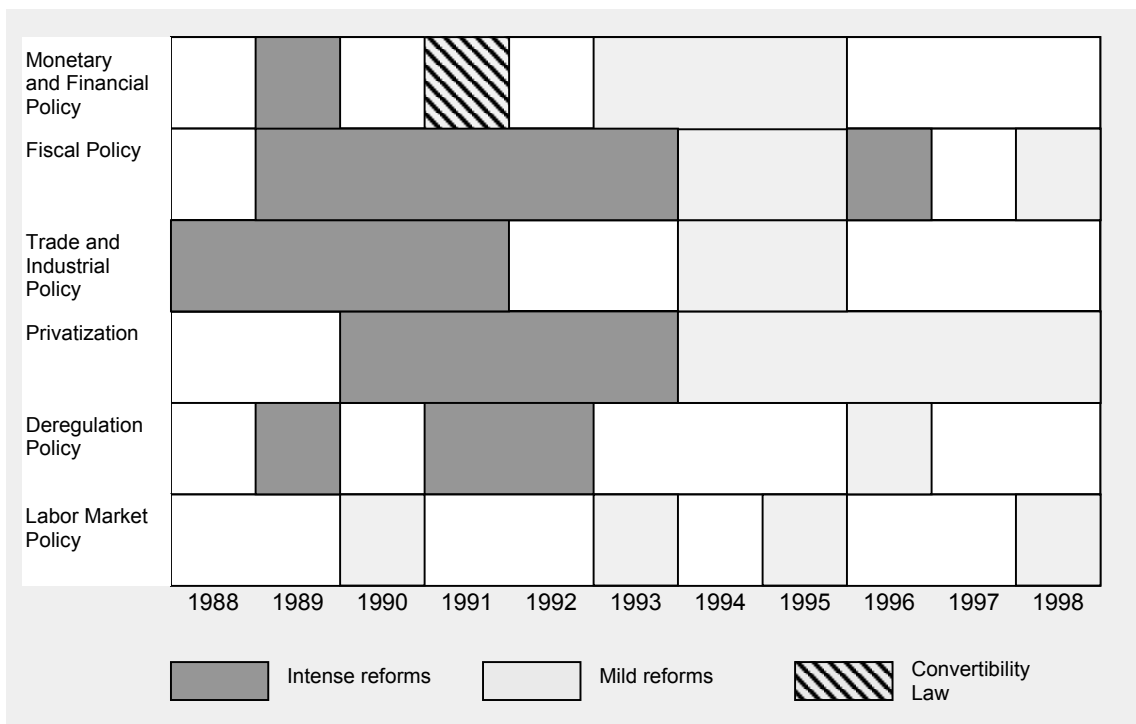
The Annex provides a table summarizing the main reform measures. Figure 4 presents our reading of the intensity of reform by area throughout 1988 to 1998.

Macroeconomic stability and economic growth were the immediate results of the above measures. The hard-peg-based stabilization, together with the reappearance of credit, led to a consumption boom, which was important in buying public approval of the new course. At the same time as the economy began to grow, traditional public funds manipulation for electoral purposes reappeared. That fragility became notorious in 1994 when the Tequila crisis hit. At that point, a renewed sense of crisis gave room for the last bout of structural reforms of the Menem administration, which included some poorly designed attempts to increase the flexibility of the labor market, as well as the privatization of some provincial banks and companies. Interestingly, fear of economic instability helped Menem to get reelected in 1995, under the idea that the President and his team were the best pilots in stormy economic waters.⁶

Figure 4: Intensity of reforms by area

⁵ An example of the multiple roles of some reforms is provided by privatization. They were an instrument to improve the efficiency of the economic system, yet they were also used to alleviate short term fiscal needs; and the early and quick privatization of some national symbols (airlines, telephones) helped signal the government's commitment to the new policy direction.

⁶ The Argentine Constitution did not at the time allow the re-election of the President. However, Menem managed to get an agreement with the main opposition party to reform the Constitution.



The second Menem administration (1995-1999), even though maintaining the reform rhetoric, did not make any substantial additional progress, as evidenced in Figure 4. This begs the question of the persistence of the pro-reform incentives in the Executive. We argue that the driving forces behind the initial reforms movement were the hyperinflationary crisis and the general agreement in society on the need to stabilize the economy. Once this goal had been achieved, any new reform initiative had to be justified in its own terms. New reforms lacked the generalized support that they had enjoyed during the first Menem administration – when they had been perceived to be the solution to fifty years of high inflation. At the same time, they needed to deactivate political opposition from groups who would be overall losers. In addition, “the next frontier” of reforms required going against precisely the core of the coalition that had enabled the previous set of reforms. The reforms that were eventually put in place, even though a substantial achievement by Argentine standards, fell short of the Washington Consensus benchmark.

II. 3. The Reform Decision within the Executive

A successful reform requires the emergence, within the government, of a pro-reform actor, which in turn needs to mobilize support (resolving collective action problems), and to neutralize opposition. All of these “steps” are conditioned by historical circumstances and by the institutional framework in which the process takes place.

In this section we shed some light on the incentives that led President Menem to enact reforms. We argue that the crisis experienced by Argentina towards the end of the 1980’s forced the President to embark in actions leading to economic stabilization, a collective

good whose relative importance rose in this context.⁷ As the only political actor in the Argentine institutional framework that is elected by a nationwide constituency, the National Executive is the institutional actor with more “encompassing” interests, and hence the most likely actor to possibly initiate such reforms. But why did Menem embark in such a reform process?

The literature on structural reforms has pointed out the relevance of socio-economic crisis to bring about the conditions that in some polities might increase the feasibility of structural reform. The Argentine case seems to confirm this assumption. The Peronist leadership, an unlikely actor to lead pro-market structural reforms, concluded just before taking office that, given the nature and intensity of the Argentine socio-economic crisis at that time (1989), it had no choice but to embark in deep pro-market process of reform. Thus, structural reforms in Argentina appeared primarily as an instrument for the stabilization of an unwieldy macroeconomic situation.

II.4. Structural Reforms as a Stabilization Device

At the onset of the Menem administration, it was urgent to restore macroeconomic stability. This required satisfying the perceived intertemporal budget constraint of the government without relying much, if at all, on the inflation tax. It was also critical to restore economic growth, which seemed to require the elimination of the severe inefficiencies in resource allocation prevalent in the economy. Most economists agreed that the widespread intervention of the state in the economy needed to be reduced, and that the economy needed to integrate into the world.

The stabilization of the economy was not an easy task. Given history, a complete turnaround of expectations was called for. It was necessary to introduce a radical change in the strategy and political action regarding current and future deficits – binding enough for it to result generally credible. Stabilization also required a comprehensive policy package aimed to force a sudden change in the forms of behavior developed during the high-inflation regime era.

Economic agents faced deep uncertainty. Would the government be able to stabilize the economy? Would this stabilization be sustainable? Which reforms would eventually be implemented? At what cost? What would the short-run monetary and fiscal policies be? What would they be in the medium- and long-run? More deeply, what would the new rules of the game be? Many institutional arrangements in society exist in order to reduce this type of uncertainty and to provide reliability to social and economic interactions. For a variety of reasons, Argentina did not provide those “certainties” at the beginning of the reform period; in a sense, the overall reform strategy (with its cornerstone in Convertibility) was an attempt to provide more certainty to economic planning.

On top of the technical complexity of the task, the new Menem administration entered government in 1989 lacking any credibility as to its ability to soundly manage the economy. In order to *signal* a credible shift in policy, the government adopted as its economic

⁷ This is consistent with Rodrik (1994)'s notion that the likelihood of a reform is a function of the ratio of net social gain to net reallocation (redistribution). In times like those of Argentina in the early 1990's, efficiency gains from halting hyperinflation were large enough to swamp many distributive considerations (see also Mondino et al, 1996).

program a package including the entire list of first-generation reforms. In addition, this program of structural reforms was seen as the strategy for restoring economic growth after two decades of stagnation. However, the stabilization process did not unfold as a predetermined program. It had a general logic, but in the specifics it was historically contingent.

The consistency condition that the stream of revenues should finance the normal stream of spending does not dictate a particular composition of the flows. The government focused on improving tax collection, reducing subsidies and reducing the drag on fiscal accounts produced by public sector enterprises (in fact even using the proceeds from privatization in order to balance the budget). Public expenditures were seen as being already too low and quite rigid.

In order to enhance economic efficiency, the government also relied on trade and financial liberalization, deregulation of markets and privatization of public enterprises. In addition, in view of the fact that the government had entered a *de facto* moratorium of the services of its external debt in 1988, a debt renegotiation was needed, to make clear what commitments the government would honor and what relief it would be able to obtain. The government made it plain that this was one of its policy priorities.

The literature on economic reforms is rich in discussions about the speed and sequencing of market liberalization (Tommasi and Velasco, 1996). Structural reforms in Argentina impressed the world because of their speed and scope. In a few years, the government substantially improved its fiscal performance, liberalized trade, opened up to foreign direct investment, reformed its pension system, privatized most state companies, liberalized the financial system and legislated a world-class bankruptcy law. Thus, all these reforms were bundled together and adopted at once. The structural reform package was also the stabilization program and *vice versa*. This was done not without haste. It is certainly not the same to privatize public firms with several objectives – i.e. to finance the government, to signal the government type and to restore efficiency and investment – than to privatize just to enhance efficiency (Galiani and Petrecolla, 2000).

Although the government attempted to stabilize the economy by changing the expectations and behavior of economic agents by means of a wide program of structural reforms, economic performance was at first disappointing. In fact, the government reached the verge of hyperinflation twice before it adopted a new stabilization program based on the convertibility law. Convertibility tried to provide a framework for contractual and investment decisions by restricting monetary policies and validating the widespread use of the dollar as a unit of account for domestic transactions. The common view was that such measures were necessary to induce the emergence of credit markets. This, in turn, would make it possible to take advantage of large growth possibilities left unexploited in an unfavorable macroeconomic environment.

BOX

Convertibility

The market-oriented reform package in Argentina became associated in the public eye and in the political discourse with a particular stabilization device / monetary regime, the Convertibility system, to the point that the demise of Convertibility in 2001/2002 opened a big question mark on the future path of the economy, the polity, and the reforms.

As stated in the text, Convertibility was a crucial factor not only for macroeconomic stabilization, but because it was deeply intertwined with the overall reform effort, not only economically, but also politically. A full analysis of the origin, dynamics and demise of Convertibility cannot be presented here. (See for instance Galiani, Heymann and Tommasi, 2003a and 2003b, for one such attempt). We devote this box to synthesize a few points relevant for our argument in the text.

The hyperinflationary experience of the 80s led to a general recognition of the costs that high inflation and the lack of a framework for contractual and investment decisions had inflicted on the economy. Convertibility tried to provide such a framework by restricting monetary policies and validating the widespread use of the dollar as a unit of denomination for domestic transactions. The common view was that such measures were necessary to induce the emergence of credit markets. This, in turn, would make it possible to take advantage of large growth possibilities left unexploited in an unfavorable macroeconomic environment and would enhance the performance of a large set of economic reforms put into place. However, the Argentine experiment with convertibility ended in collapse.

Two arguments are often encountered in the explanation of that collapse: that fiscal policies were inconsistent with the fixed exchange rate (implying that the political system was incapable of adjusting itself to the discipline of budget constraints and let the public debt grow along an explosive path), and that the convertibility regime induced a sustained overvaluation of the currency, and thus was bound to end in a collapse. There are elements of truth in both arguments, but they are incomplete, and cannot paint the full picture by themselves.

A coherent explanation of the Argentine crisis must take into account the interaction between wealth perceptions and the decisions of government and private agents. The dynamics of both fiscal accounts and the real exchange rate have to be placed in the context of the expectations that domestic and foreign agents had about the future path of the economy. In an economy where the “fundamental” configuration of incentives and opportunities can change substantially over short periods, agents have a problem in projecting a growth trend in their incomes. This, we believe, was a relevant issue in the Argentine economy during the nineties. Agents could entertain the belief that an economy with considerable resources, after reforming its policies and solving such a major and long-standing problem as high inflation, would allow residents to sustain much higher spending, on the basis of improved growth prospects. The contractual system developed under convertibility was consistent with those beliefs, since the use of the dollar as a unit of denomination presumed that incomes could be maintained in terms of that unit. But it was vulnerable to macroeconomic contingencies such as large movements in the real exchange rate. Towards the end of convertibility, strong doubts developed about the solvency of many agents.

Under the conditions prevailing in the aftermath of the 1995 financial crisis, and with no major changes in the evolution of macroeconomic variables up to that point – rapid growth rates, historically high terms of trade, and low international interest rates – no major fiscal risks could be foreseen. However, trade and current account balances showed a worrisome deterioration (see Cetrángolo et al, 1997). After the Asian and Russian financial crises, the appreciation of the dollar, and the Brazilian devaluation, a similar exercise showed that the trade-off between fiscal and external balance was insurmountable (see Galiani et al, 2003a).

Thus, reliability and predictability were built upon hard rules, which consequently lacked flexibility and ultimately broke down brutally. The cornerstone of the new institutional arrangement was the Convertibility Law adopted in 1991.⁸ Convertibility was, in the Argentina of the 1990s, much more than a monetary institution. It also shaped fiscal policies and provided the basis for an elaborate system of contracts. This clearly signified a break with the past in an economy where, say, private mortgage loans had been a rarity for decades. Over time the government became more and more committed to the fixed exchange rate in several ways. Since alternative mechanisms for gaining policy credibility did not arise, strict adherence to the existing monetary rule remained identified with stability (see Galiani et al 2003a). Over time, the development of extremely high costs for exiting convertibility provided a self-sustaining system of shared beliefs about future economic and policy actions.

Convertibility also served as a way of keeping political support to the structural reform process alive. One of the reasons why these reforms had usually been postponed during the 1980s was the belief that they would impose severe costs on society. However, in the favorable context for the emerging markets of the international financial markets of the 1990s, the framework created by convertibility allowed the emergence of credit, which enlarged the consumption and investment opportunities of many agents, including the government itself, and contributed to the growth in economic activity. Convertibility (like the Austral plan in its time) rewarded the government in the legislative elections of 1991 and 1993 and led to the re-election of the president by a large margin in 1995. The consumption boom of 1992-1993 was surely behind the excellent legislative election made by the Peronist party in 1993 when they even won for the first time in the always-adverse Federal district. The large number of people who had contracted dollar debts, and those who feared a return of high inflation if convertibility was abandoned, created a very strong constituency against devaluation. Indeed, during the financial crisis of 1995, previous to the presidential elections, the authorities used as their main electoral argument that they had ended hyperinflation and that they constituted the only political force that would maintain convertibility (Starr, 1999).

The Box above provides a brief account of the dynamics of Convertibility.

II. 5. Politico-Institutional Resources for Reform

In the Argentine case, the partisan distribution, the delegation of legislative faculties to the Executive, and its control over the Supreme Court, as well as the use of certain resources of doubtful constitutionality, enabled the Executive to concentrate political power. In this section we address the distribution of institutional power during the first (1989-1995) and second (1995-1999) Menem administrations, and the delegation mechanisms that took place at the onset of his first mandate.

Distribution of institutional power

The electoral results throughout Menem's presidency were favorable to his party (Table 1,a), conferring Menem an ample mandate at the onset of his first administration, and

⁸ The Argentine currency was made convertible to the US dollar by law, and the Central Bank was mandated to reduce its monetary policy to the management of a currency board. Thus, the monetary base had to be backed by assets denominated in foreign currencies, mainly issued abroad.

further reinvigorating the reformist course later on. Favorable electoral results were mirrored in the resulting distribution of institutional power (Table 1, b, c, and d). This power composition implied that several of the pivotal political negotiations were with actors within the Peronist party (PJ), a point that we explore below.

Table 1. Electoral Results and Partisan Composition during Menem's Government

a. Electoral Results, 1989-1997

Political Party	1989	1991	1993	1994	1995	1997
	% (b)	% (a)	% (a)	% (c)	% (b)	% (a)
Peronist Party (PJ)	47	40	43	39	50	36
UCR	33	29	30	20	17	7
Center-right and Provincial Parties	12	16	18	12	1	9
Center-Left Parties	7	10	3	17	31	6
Alianza (UCR+Frepasso)	-	-	-	-	-	36
Others	2	4	6	12	2	

(a) Legislative elections; (b) Legislative and presidential elections; (c) Elections for Constitutional Assembly.

b. Partisan Composition of the Chamber of Deputies 1987-1999

Political Party	Deputy Periods					
	1987-89	1989-91	1991-93	1993-95	1995-97	1997-99
	%	%	%	%	%	%
Peronist Party (PJ)	43	50	50	50	52	47
Unión Cívica Radical	46	37	33	33	27	26
Center-Right Provincial P.	6	7	9	9	8	11
Other Parties	5	6	5	8	12	16

c. Partisan Composition of the Senate, 1986-1998

Political Party	Senate Periods			
	1986-89	1989-92	1992-95	1995-98
	%	%	%	%
Peronist Party (PJ)	47	54	62	56
Unión Cívica Radical	39	30/29	23	29
Provincial Parties & Others	15	15/17	15	15

d. Partisan Composition of Provincial Governorships, 1987-1999

Political Party	Gubernatorial Periods		
	1987-91	1991-95	1995-97
	%	%	%
Peronist Party (PJ)	77	61	61
Union Cívica Radical	9	17	22
Provincial Parties	14	22	17

The favorable partisan composition at key institutional nodes was furthered by a law that increased the number of members of the Supreme Court from 5 to 9. Through this device Menem was allowed to appoint four judges (with agreement of the Senate). Then, when one of the Ministers of the Court resigned in protest, Menem was granted the opportunity

for a fifth appointment. In addition, Menem resorted to the use of two types of legislative instruments of (until the 1994 Constitutional reform) dubious constitutionality: the decrees of “necessity and urgency” (DNU’s) and the line-item veto, in a way that far exceeded the historical record.

Delegation mechanisms

An additional effect of the economic crisis was to trigger a series of “delegation” patterns; in particular, a political agreement to move ahead the presidential succession in 1989, and two laws by which the Executive was conferred with ample margins for defining the details of reform policies.

The economic crisis helped to forge a political agreement between the two major parties, the Radical party (the outgoing administration) and the Peronist party, to move forward the presidential succession in order to deal with the crisis. President Alfonsín (1983-1989) resigned, Menem agreed to take office five months before originally scheduled, and in exchange the radical party committed to give legislative support to the new administration.

Soon after Menem became president (in July 1989), Congress delegated to the Executive vast legislative powers through *Ley 23.696 de Emergencia Económica* (Economic Emergency Law) and *Ley 23.697 de Reforma del Estado* (State Reform Law). The first of these laws meant to dismantle most of the institutions related to the state-centered, inward-looking development model: subsidies, industrial promotion regimes, etc. The second one conferred vast powers on the executive to define the details of the reform policies, including the privatization of state-owned enterprises.

In sum, the partisan distribution of institutional power coupled with these delegation patterns allowed the Executive to jump institutional hurdles for the initiation of structural reforms. Yet, this did not completely numb relevant political and institutional actors.

II. 6. The Political Steering of the Reforms: Dealing with the Relevant Actors

Contrary to what much of the literature on the political economy of reforms in Argentina asserts, the reform process was not carried out by an Executive power in isolation of social, political and institutional actors. Rather, reforms were the product of a series of transactions between the Executive and some key actors at every step of the process. In this subsection we present the relevant actors with whom the Executive “dealt” in order to advance the reformist course.

The reformist administration was clever in manipulating both *electoral* and *policy* coalition-making throughout the reforming period. Having been elected by a coalition of traditional peronist sources with the center left, it governed and was reelected with a coalition of traditional peronist sources (with changed weights within that coalition) with the center right. The latter was taken into account not only as an electoral source but, mostly, because of its ties with business and international actors whose “economic” support was necessary.⁹

⁹ This strategy was also related to the signaling to international financial actors, which provided crucial funding and opinion-making support for the reform process.

Menem's administration made clever use of its institutional and fiscal resources to obtain the support of the politically important backward provinces; it gave selective benefits to some unions and union leaders while debilitating the overall labor movement; it was able to gain the support of important business actors through a mix of general policies and specific deals. In the rest of this section we deal with some of the main actors in turn. We begin with several actors whose key role is in the electoral/governmental arena (parties, provincial governments, voters), and then we refer to other (mostly corporate) actors who operate mainly in other arenas (conflict resolution, opinion making, the economy).¹⁰

In this section, we implicitly use a theory in which an agenda-setting executive needs a given level of support for his reform package, and insures it by "buying" the necessary number of "votes". We can think of the executive as facing a price schedule for votes in favor of the policies that it is trying to implement. The spot price to be paid will depend, among other things, on the intertemporal political linkages between the President and each relevant actor. Cheapest votes (probably price zero, or even negative) will be those of actors who directly benefit from the reform package. From the actors who do not benefit from the package, the cheapest votes will come from those legislators with whom there are credible intertemporal reward mechanisms. These mechanisms will include future appointments in the executive or in the party. Legislators from the same party will be first in line, legislators from small independent parties will come second, and legislators from the main opposition party/parties will be the most expensive. The spot currency used to buy votes might include outright bribery, policy benefits to the relevant constituency, or exemptions sparing reforms costly to the relevant constituency.

Which votes are actually purchased out of this schedule will depend on the rules of the game (for instance, the required majority), and on the actual composition of the legislature and other relevant institutional positions at the time of the reform. In the Argentine case under Menem, it turns out that the pivotal votes were some in the Peronist party (from provincial blocks and from union-related actors) as well as some of the small provincial parties. We look at these actors in turn.

The Peronist Party

Due to the above-mentioned partisan distribution of institutional power, the Peronist party had a high leverage on the legislative process, becoming the fundamental veto player at the time of approving reforms (Corrales, 2000). When referring to the Peronist party as a fundamental political actor, we are basically concerned with its two major historical "constituencies": provinces and trade unions, which we analyze in later subsections.

Menem's Peronist credentials facilitated the achievement of the acquiescence of popular sectors.¹¹ Yet, there was a major disruption in the party since the policies Menem was propounding constituted a dramatic break with the populist policies Peronism traditionally embodied. This break produced resistance and criticism inside the party. Both the intellectual efforts devoted to "rebuild" the Peronist identity as well as the concessions

¹⁰ The military were no longer an important actor by the time of reform partly because Menem's administration managed to subordinate this actor to constitutional rule. For a detailed account of these dynamics see Acuña (2005).

¹¹ This "Nixon goes to China" effect is analyzed in Cukierman and Tommasi 1998 and 1998b. See also the discussion in the concluding section below.

used to construct support helped moderate these tensions.¹² Menem's 'conversion' to neo-liberal policies created discrepancies between the government and official legislators which lead to schisms in the Peronist block of the Deputy's Chamber. Pro-government deputies took part in arduous discussion prior to approving legislation regarding reform of the state. Eventually, under pressure from the executive, the package was approved. Nevertheless, a dissident faction of Peronist deputies was formed, the so-called "Group of Eight."¹³

In contrast to the notion of an insulated, all-powerful executive, between 1992 and 1994 Congress modified around 46% of legislative initiatives of the president. The Executive managed to tackle these discrepancies through the extensive use of "Decrees of Necessity and Urgency" and vetoes that strengthened his bargaining position in the legislature, through political transactions with provincial and small national parties, and through concessions in policy design.

Menem was also challenged by other peronist figures calling for a "return to the sources of Peronist doctrine." He counteracted the reaction within party ranks in several ways. He engaged in public debate arguing that given the extreme crisis, there were no alternatives, and that the room for maneuver was very limited. Also, over time he filled party leadership with individuals close to the executive, displaying considerable pragmatism in choosing candidates for elections. Whenever non-Peronists were likely to win an election or support the government's economic course, the executive did not hesitate to incorporate them. Even Peronists with little party experience were nominated as candidates. Of course, the success of the economic policy strengthened this strategy. Moreover, resistance from his own party yielded with the progressive acquisition of new members, co-opted from center-right parties (especially UCD).

Center-right parties

The government's resolute implementation of market-oriented reforms implied some realignments within the party system. The convergence of the Peronists with the rightist UCD led to an important shift in the UCD electorate toward support for Menem's policies. Peronists and the UCD reached formal alliances in some districts, such as the Federal Capital. And UCD specialists and professionals held government positions including secretariats in the ministry of the interior, provincial offices, and management of firms being privatized. (UCD, as had happened to most of its conservative predecessors, pretty much disappeared after this experiment).

The opposition: the Radical Party

The Radical party faced the Menem administration from a weak position, deriving from the disastrous end of the Alfonsín government, which transferred power to Menem 5 months early in 1989. The party agreed not to oppose any legislative initiatives originating in the Executive during the six months before the newly elected Congress was in place. The

¹² Levitsky (2003) provides an insightful analysis of the internal process of Peronist adaptation to the new policies.

¹³ It is interesting to note that all the legislators departing the Peronist block were from the two major districts: the city and the province of Buenos Aires. These districts tend to be the ones that supply most of the few legislators who are more ideological, more visible, and more focused on national policy. Legislators from the vast majority of peripheral provinces tend to respond mostly to provincial governments, and in general only need to be "bought" with provincial spoils in order to support whatever national policies the executive might be pushing.

Menem administration passed the fundamental legal structure of the reform during these first six months of green light in Congress: *Ley 23.696 de Emergencia Económica* (Economic Emergency Law) and *Ley 23.697 de Reforma del Estado* (State Reform Law).

Notwithstanding their partial success since 1991 in reasserting their opposition role, the Radicals were neutralized by two governmental strategies. First, the government effectively controlled Congress through its majority in the Senate and its ability to forge alliances with center-right and provincial parties in the Chamber of Deputies, alliances that were occasionally necessary in the face of weak party discipline among Peronist deputies. Second, when other measures were of no avail, the government resorted to the activist use of the executive decree powers, a course of action that exacerbated tensions with Radicalism.

Menem's policies also had repercussions within the ranks of the Radical party. Before Alfonsín's resignation the UCR already showed internal tensions between the president and Eduardo Angeloz (the candidate for the 1989 elections). In the first years of the Menem administration a schism emerged between Alfonsín, who maintained a critical posture toward the Menem administration on the one hand, and Angeloz, governor of Córdoba province, who supported the government. The convergence of Angeloz with the Menem administration was such that Angeloz was offered a cabinet position, which he eventually declined. At the UCR party convention of October 1990, these internal differences erupted, with delegates backing Angeloz walking out after a sharp confrontation over the content of the party's platform.

During the first years of the first Menem administration, the Radical party remained divided over how to confront the Peronist government. One faction questioned the economic policies but offered no viable alternative. Linked to former president Alfonsín, this faction had still to face the political costs of leaving a legacy of hyperinflation and the decision to accelerate the transfer of power to Peronism. Other groups attempted to compete with Peronism for power at the regional level, but they did not question the logic of the overall economic policy.

Ideologically divided and electorally weaker than PJ, the radical opposition was rather mild. Moreover, when UCR resumed its opposition role by 1991, the Peronist predominance in both Houses, its alliance with center-right legislators and the president's frequent use of executive decrees, implied that the UCR's neutralization was relatively easy. The political strength (weakness, rather) of the main opposition party, far from a major obstacle, was reflected in the agreement between Menem and Alfonsín (1993 Pact of Olivos) to launch the process of constitutional reform giving Menem the chance to be re-elected for a second term.

The Provinces

The Peronist machinery in the provinces constitutes one of the fundamental electoral pillars of the party. Argentine federalism confers a high degree of political and institutional power to the provinces, especially as veto players in the national arena (Spiller and Tommasi 2003, and references there). In this sense, it is possible to trace, throughout the reform period, a strong reformist impetus at the national level that contrasts with the scarce advances at provincial levels.

Gibson and Calvo (2000) show that the territorial organization of the electoral coalition – to the extent that poor and under-populated provinces received special treatments to

generate legislative support to sustain the reformist agenda – was an important element in the successful implementation of reforms. Peronism historically encompassed two distinctive and regionally based coalitions: a “metropolitan” coalition, which gave support to the party’s development strategies, and a “peripheral” coalition, which carried the burden of generating electoral majorities. The metropolitan coalition is of very high economic importance, but carries less political weight in Congress given the notable mal-apportionment of seats. Thus, Menem decided to have the metropolitan coalition shoulder the full blow of adjustment costs, while he speared the peripheral coalition through several concessions in tax benefits and by allowing the subsistence of interventionist and populist enclaves.

National legislators in Argentina tend to act as agents of provincial governments, rather than national policymakers.¹⁴ Small “peripheral” provinces have had special importance in general, and especially within the Peronist coalition. The general importance of small provinces is the result of their overrepresentation in the National Congress.¹⁵ These provinces have an institutional representation that far exceeds their population and their economic importance.¹⁶ In the period of market-oriented reforms, the peripheral regions held 83% of Senate seats and 52% of Chamber of Deputies seats. During this period, the Peronist Party (PJ) had the majority of seats in the Senate, but not in the Lower Chamber (the President chose to present his bills through the Senate). Despite the general agreement attained with the main opposition party (UCR) – which guaranteed the PJ would always have the required quorum in Congress – Menem faced several obstacles when he tried to pass his reform projects. The way out of the gridlock was to buy the support of independent provincial parties.¹⁷

This institutional overrepresentation, together with the “subnational drag” on legislators’ incentives, meant that no national legislative coalition could be put together without the support of the regional structures of power in the periphery. The need to buy this support affected the eventual outcome of the reform process in several ways. The burden of the costs of reform was shouldered predominantly by the metropolitan constituency. The reforms were timed and instrumented in a fashion that did imply earlier and heavier hits on the central provinces, as well as differential benefits in favor of peripheral provinces.¹⁸

¹⁴ This is primarily a consequence of the electoral system (provinces are the electoral districts where party lists are drawn). See the details of the provincial nature of legislators careers in Jones et al (2002) and (2001).

¹⁵ Stepan (1999) utilizes three indicators of malapportionment across twelve modern federal democracies, and in all the indicators Argentina is the worst case.

¹⁶ The bulk of the Argentine economy is concentrated in a few districts: the city and the province of Buenos Aires, plus the provinces of Santa Fe, Córdoba, and Mendoza concentrate almost 80% of economic activity and 70% of the population.

¹⁷ Palanza and Sin (1996) document the strategies behind these exchanges. Provincial party legislators tended to start the negotiations by opposing the Executive’s proposals, but came around in favor in the final voting. Examples of legislation sanctioned thanks to the aid provided by provincial parties are, among others, law 23809 (Privatization of Altos Hornos Zapla), law 23871 (Fiscal Reform), law 23897 (Payment of Oil royalties), 24154 (Transformation of YPF – the later privatized oil company).

¹⁸ Tommasi (2002) provides empirical evidence on the details of this strategy. It is worth noting that even though many peripheral provinces did suffer some economic costs from trade liberalizations (and from some of the privatizations), provincial governors did not oppose those measures as long as there were some compensations in the form of resources that they themselves could distribute through their political machines (Spiller and Tommasi 2003b and Jones, Sanguinetti and Tommasi, 2002).

The Electorate

To see the way the electorate was handled in the strategy of the reformist government, it is useful to divide it into two groups. With regards to the electorate in the peripheral provinces, Menem built alliances with the (almost feudal) leaders of those provinces, through a series of handouts that they administered internally in order to maintain their traditional clientelistic networks.

The electoral support of an important part of metropolitan voters (irrelevant for the Senate, mildly relevant for the Chamber of Deputies, crucial for presidential elections) was achieved via the successful stabilizing effect of Convertibility. This lent popular support to the center-right governing coalition, fostering a solid electoral coalition that would start dismembering itself only in the last years of the decade.

The Unions

Restructuring of the populist metropolitan coalition involved picking winners and losers within the business community (see next sub-section) and the labor movement. In part the success of the reform process involved the division of the labor movement and the co-optation of certain sectors to prevent unified labor opposition to economic reform. Menem's credentials also proved to be an asset during the implementation of this strategy.

In 1989, Menem deepened divisions within the unions, precipitating a fracture that diminished their bargaining power. The policy succeeded through the administration of "carrots and sticks". Unions opposing the reforms were punished; unions supporting the reforms were brought on board via "new economic businesses" and through rewards to some leaders with government positions (Murillo, 1997). Menem treated unions supporting him favorably when it came to wage negotiations and the transfer of welfare funds from the social security agency to individual union funds. The government provided some incentives like early retirement programs, re-training programs, and workers' ownership of stock (10% of total) in privatizations affecting large public enterprises (telephones, petroleum, gas, and electricity). In several cases, privatization opened up new lucrative business opportunities for unions, as they were allowed to set up companies managing the shares transferred to workers.

The stick was used to break strikes of defiant unions by invoking the new legislation, enforced by decree in 1990, regulating the right to strike; the administration adopted massive layoffs affecting employees who had participated in strikes regarded as illegal in the telephone, railway, and oil companies between 1990 and 1991.

By 1992, many union leaders who had initially opposed Menem's state-shrinking policies understood that the process was irreversible and it was politically wise to jump on the President's bandwagon before it was too late.

Unions' new tolerant attitude to the reforms was evidenced by the decrease in their activism compared with the levels reached during the Alfonsín administration. The number of general strikes decreased from 13 during the Alfonsín administration to two in the first Menem term and 5 in the second. Furthermore, there was a reduction in the average

number of people participating in each strike.¹⁹ In exchange for their non conflictive behavior, the government agreed to maintain their sources of power – the regulation of collective bargaining and “*Obras Sociales*”²⁰ – in spite of the constant decrease in unions’ representation in the legislature.²¹ This is at the core of the explanation for the lack of completion of labor reform.

Business

Business actors, at the most aggregate level, i.e., as owners of capital, tend to be naturally supportive of measures that weaken trade union, shrink the State, and privatize public services. At that level, the efforts of the government had mainly to build credibility for those policies. At a more sectoral level, there were several business actors threatened by specific measures.

In the delicate fiscal situation of the 1989 economic crisis, reactions from business leaders could determine the success or failure of economic policy. Menem’s political background generated distrust among most domestic and international businessmen and investors. This forced him to overreact in sending signals to turn credible his reformist intentions. The initial signals of commitment to the new reform path were the privatization of firms like the national airline and telecommunication companies; the invitation to influential economic groups traditionally opposed to the Peronist party to take part in the government;²² and the alignment of foreign policy with the US.

The administration faced some dilemmas in its relationship with specific business sectors. The industrial sector was going to be reluctant to support trade liberalization policies, since such policies would generate competition from international products. Also, privatization policies implied a cost to many of the firms that were privileged suppliers of the state-owned companies, while also affecting business as a consumer of state-subsidized public services. The government followed vis a vis different business sectors a strategy similar to the one dealing with partisan actors: ignore the weak, weaken those that you can, and buy the support of the strong.

Among “the weak / weakened” we would include traditionally protected industries, like textiles, electronics and auto-parts. Even though they were hurt by reform, by that time

¹⁹ There was also a change on the main motivations behind strikes. During Alfonsín’s presidency the protests were mainly related to wage levels and economic policy, whereas during Menem’s presidency, they were related to labor policy and unemployment.

²⁰ *Obras Sociales*, union-administered welfare organizations (very important in the health market), are the main source of financing of unions. That is the reason why a profound health reform has not taken place.

²¹ The number of deputies with ties to unions decreased from 35 in 1983-85 to 10 in 1993-95 and 14 in 1997-99. They concentrated mostly in the labor legislation committee.

²² Menem included in his first cabinet a representative of a powerful holding as Minister of the Economy. The strategy consisted in establishing a close relationship with a particular holding, Bunge & Born (in the Peronist imaginary, a symbol of the “oligarchy” with interests incompatible with those of the “people and the nation”), instead of dealing with representatives of business associations – as had been the Peronist tradition and as former radical president Alfonsín had unsuccessfully attempted.

they had lost collective action capacity.²³ Furthermore, the government furthered their collective weaknesses by providing strong incentives to negotiate individual solutions to each particular sector.²⁴

Intermediate cases were those industries, such as pharmaceuticals, that had a better (“economic”) capacity to adapt to the new set of rules. In those cases, the government showed its determination to speed up and/or increase the opening of the economy, forcing them to acquiesce politically and adjust economically.

The (economically and politically) strongest business groups were the industrial conglomerates strengthened during the 1976-1983 military dictatorship, which saw their interests affected by the shrinkage of the state. Even though these groups were horizontally diversified and had export capacity, they used to depend heavily on their profits as (over-priced) state suppliers. These groups were a real threat, since they could shape an alliance with other sectors building upon a “nationalistic” speech in defense of the state. The government strategy to neutralize the potential reaction of these conglomerates was to barter their loss of earnings as state suppliers by their appropriation via privatization of the state-owned companies that were placed in monopolistic or oligopolistic positions (especially providers of public services, made even more attractive by the peso-dollar parity). This strategy was very successful²⁵. Although not all large former suppliers of the state attained similar benefits in the process of privatization, those that ended up suffering absolute losses in the competition for the appropriation of state-owned firms did not constitute a sufficiently powerful group for their reaction to complicate the government strategy.

Politically, the government maintained a similar strategy as the one displayed with some unions, namely, exchanging “favors” accompanied by threats of sanctions in the event of not reaching a solution to the conflicts with the business sectors that were affected by the plan as producers. The overall result of the reforms was a strong consolidation of the local industrial conglomerates to the detriment of the smaller, less horizontally diversified industrial companies that had to pay the costs of the liberalization of trade and the privatization of state-owned companies.

International Actors

²³ They used to group around the once powerful CGE (a corporatist business counterpart to CGT, the central trade union), which by the early 1990s was already weak and thus had no capacity for sustaining significant opposition to the government.

²⁴ According to Viguera (1999), rather than isolating trade policy from political pressures (as was the case with monetary policy and the Central Bank) the government kept these decisions in the scope of the Ministry of Economy, where each sector, in a non-cooperative manner, lobbied for favorable treatment. The “accommodating” response of these sectors is well encapsulated in a statement by the president of the Unión Industrial Argentina, Israel Mahler: “The level of deterioration of the productive sector showed by the fact that the production per capita in industry is now almost 40 percent lower than in 1970, definitively influenced toward setting aside confrontational attitudes that would lead us nowhere” (La Nación, September 1 1991, part 3^a, page 1).

²⁵ By way of illustration, *Pérez-Companc* participated in the privatizations of EnTel (telecommunications), SEGBA (electricity), YPF (oil), Gas del Estado (gas), and national roads; *Techint* participated in the privatizations of EnTel, YPF, SOMISA (steel), SEGBA, Gas del Estado, national railways and roads. Moreover, in the aftermath of privatizations the energy market was concentrated in the hands of these few economic conglomerates.

The US government was a key international actor to assure the right environment for the reforms. In order to include this government as one of the supporting actors for the reforms, Menem's strategy was to establish a close alliance with the US by radically shifting long-standing Argentine positions in the international arena. As part of this new foreign policy, Argentina did not condemn the US invasion to Panama, withdrew from the Non-aligned Movement, dismantled the Condor Missile project – a major interest of the US at that time (Acuña and Smith, 1994b) –, sent troops to the first Gulf War, signed the Tlatelolco Treaty, and sustained a voting behavior almost identical to the US in different international fora.

The consistent international support from the US government, the EEC, the IMF, the IDB, and the World Bank was instrumental in boosting the credibility of the administration's reform program at home. For instance, in July 1997, the IMF decided to enhance Argentina's credit line because of the country's "good governance" record. On the other hand, privatizations, for example, played a key role in Argentina's ability to enter the Brady Plan.²⁶

III. The Effects of the Reforms

After a decade of market oriented reforms, what can be concluded in terms of their impact on economic outcomes? This is a very difficult, but important, question. First, it is always very hard to nail down the effect of macroeconomic interventions. Confounding the impact of reforms with other secular trends and with other simultaneous interventions tends to be pervasive in these cases. Second, and in particular in the Argentina case, disentangling the effect of the reforms from those of the stabilization based on convertibility is simply not possible. There is no way to assess the counterfactual of what would have happened if the reforms had been implemented without adopting convertibility. Thus, in this section, we just provide a descriptive analysis of some key economic variables, whose ups and downs nevertheless were associated by all political actors to the reforms-cum-convertibility package.²⁷

Taking a broad and long perspective, and recognizing the starting point of the Argentine economy in the late 1980's, "the Reforms" seem to have been (in broad strokes) a movement in the right direction. Several "overall" outcomes were successful (if measured against reasonable counterfactuals).

In our view, the main achievement has been on the inflation front. After decades of high inflation, Argentina's inflation has been in the single digits, with the exception of 2002 (in which the exchange rate multiplied by four after convertibility was abandoned.) This substantial and so far permanent removal of inflation has had significant microeconomic effects.

The aggregate performance of the economy also improved substantially, reverting a long declining trend (Figure 5), although this is obscured when the collapse of convertibility is

²⁶ Argentina's entry into the Brady Plan meant that the country received a discount of 35%, or \$10 billion, on its foreign debt and a rescheduling of the remaining outstanding debt. In addition, the IMF, World Bank and IDB provided special loans exceeding \$5 billion to finance the reforms.

²⁷ Hence, the causal statements in the section should not be taken literally, but interpreted as conjectures.

taken into account. During the 90s, the GDP per capita grew at 3 percent, twice the rate of growth of the world economy and 50 percent more than that of Latin America. However, when the crisis period is incorporated, the economy only grew at 1.5 percent per year, which is a substantially better performance than the one obtained during the 80s, but it is similar to the one achieved in the 70s (Table 2).

Figure 5: GDP per capita, 1980-2004

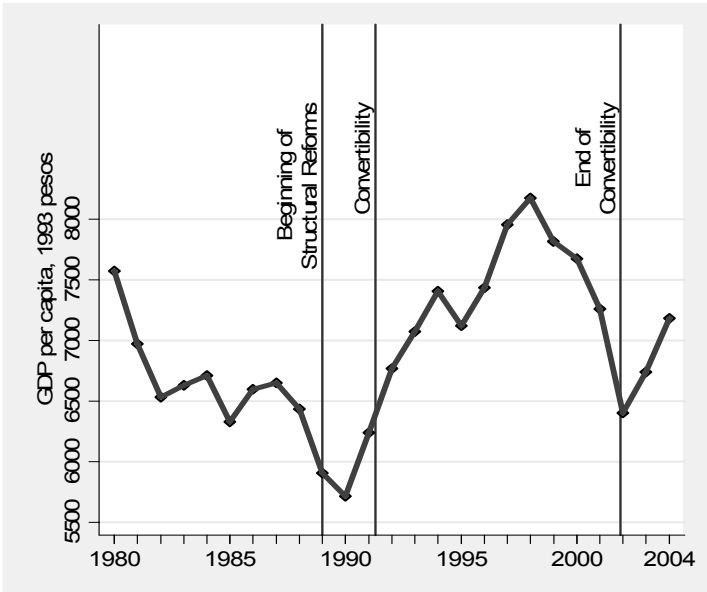


Table 2

**GDP per capita growth
- Annualized rate (%) -**

	Period			
	70's	80's	90's	90-04
Argentina	1.73	-2.24	3.13	1.50
Latin America	1.60	-1.02	2.09	3.06
World	2.35	1.60	1.61	2.89

Source: Author's elaboration based on Penn World Tables, Llach and Gerchunoff (2003) and INDEC.

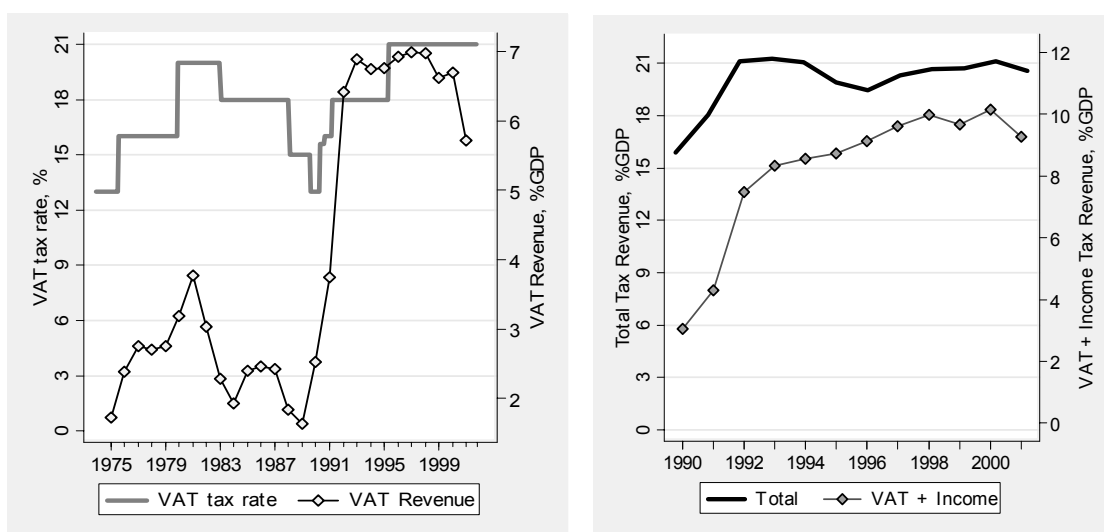
Trade liberalization was also very successful. Starting in the early 80s, and partially responding to the opening of the mid-70s, exports to GDP almost tripled (Figure 2). This process continued in the aftermath of the convertibility crisis. The growth of exports was a necessary condition to reinstate economic growth in the country after the demise of the import substitution strategy adopted in the post-world period. During the 90s, there were also significant gains in the productive efficiency of the economy – see Galiani et al (2002) for the privatized firms, and Chudnovsky et al (2004) for the manufacturing sector.

There were also substantial improvements on the fiscal front. Up until the end of the eighties, the deficit (including inflationary tax revenue but not privatization income) was around 6 percent of GDP. During the nineties, the primary result was balanced. Under convertibility, Argentina undeniably achieved the best fiscal results in 40 years.

At the beginning of Convertibility, government spending was quite low and increasingly inelastic. A high share of government spending was devoted to wages and social security payments. Furthermore, a large share of resources was automatically transferred to the provinces, adding to the rigidity of the fiscal accounts. This rigidity in government spending implied that most of the action in terms of fiscal adjustment had to rely on the use of tax instruments.

Tax reform largely followed the consensus on tax policies for developing countries (see, among others, Harberger, 1993). The value added tax was generalized and tax collection improved. Figure 6 shows how the effectiveness of the collection of the VAT increased substantially during the early years of the reform. A similar improvement occurred in income taxes. In all, tax collection from income taxes and the VAT increased from about 3 percent of GDP in 1990 to about 10 percent of GDP by 1998, more than accounting for the overall increase in government resources (see Figure 6). Several years later, the 2001 crisis showed that this improvement was permanent, and that efforts made during the decade to strengthen convertibility with a consistent fiscal policy are behind the stability achieved after its demise.

Figure 6



Source: Cetrángolo and Jiménez (2003).

Nevertheless, the fiscal retrenchment proved insufficient²⁸ and, finally, the government defaulted on its debt.

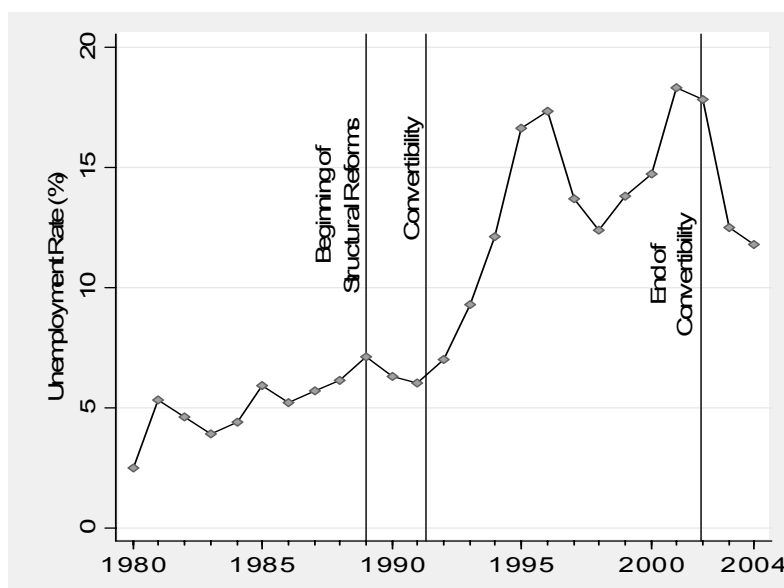
Tax pressure in Argentina is still too low. It was below 22 percent of GDP by the end of the 90s, while it was above 30 percent in Brazil and Uruguay, and between 35 and 40 percent

²⁸ To a large extent, the budget deficit in Menem's second term grew out of reductions on labor taxes and the privatization of social security.

in most developed countries. Argentina still needs to broaden its tax base if she is to improve the quality of her supply of public goods.

Unfortunately, income distribution not only did not improve during the 90s but got much worse. A particularly negative outcome of the period was the substantial increase in unemployment (see Figure 7). First, note that unemployment increased steadily during the 80s. This trend was in part related to a large secular increase in female labor supply, which continued during the 90s. Nevertheless, during the 90s, unemployment soared. Many commentators have adjudicated this to the structural reforms of the 90s – privatization and trade liberalization – but the evidence is not that clear cut. Only approximately 4 percentage points of the jump in unemployment during the 90s can be directly adjudicated to the massive layoffs associated to the privatized firms and the manufacturing sector that was also shedding labor. But it is arguable that these laid off individuals were not going to be unemployed for 10 years – as they have not been. This is not to say that the reforms only had a small impact on unemployment, but it highlights the impossibility of adjudicating to them the large jump in unemployment observed during most of the 90s. Since 1995, there have been a series of severe shocks to unemployment that kept it above 10 percent ever since (Figure 7). These severe shocks to employment can be adjudicated mostly to the rigidity of the monetary system. Under convertibility, all shocks were mostly absorbed through quantity adjustments instead of price adjustments.

Figure 7: Unemployment Rate, 1980-2004

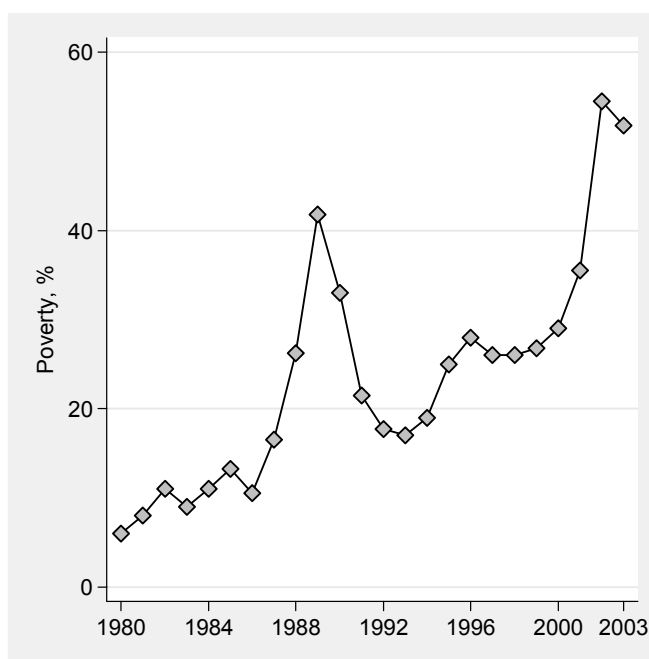


Related to the increase in unemployment, there was a substantial increase in inequality and poverty (see Figure 8), particularly since 1995. Both poverty and inequality were at the historical maximums at the time convertibility collapsed. However, both indicators were growing fast well before the 90s. Just as an example, note that the poverty index in 1998

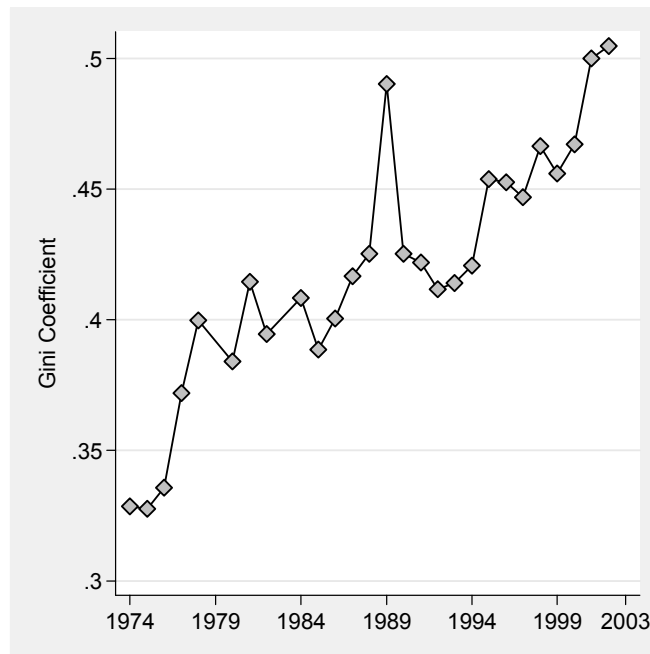
was quite close to its value in 1988.²⁹ In any event, the worse outcome related to poverty is not whether it is higher or lower than in 1988. It is that now it has been above 20% for almost 20 years, which makes poverty one of the most serious problems to be faced by the Argentine society in the years to come. Income inequality has significantly increased since the 70s. Consider, for example, the Gini coefficient for the distribution of household income in Greater Buenos Aires. It climbed from 0.32 in 1974 to 0.52 in 2003. Inequality greatly increased in the second half of the 70s, remained stable in the first half of the 80s and substantially increased during the macroeconomic crisis of the late 80s. After stabilization, inequality went down, although it did not reach the pre-crisis levels. The 90s were again times of increasing inequality: The Gini climbed 6 points from 1992 to 1998. The recent macroeconomic crisis of 2001-2002 pushed the Gini another 4 points up.

The increase in unemployment, poverty and inequality, and the association of these events to the economic model adopted, severely mined the public support for the economic program. Although the public opinion was never in favor of abandoning convertibility until the depression of 2001, its support was seriously reduced during the long recession that started in 1998.

Figure 8: Poverty and Inequality



²⁹ Certainly, GDP per capita in 1998 was at its historical pick and, hence, one would have expected poverty to be lower than in 1988. But the increase in unemployment and inequality prevented poverty to decrease in the second part of the nineties.



Note: Top Panel, poverty headcount ration. Source Gasparini (2003). Bottom Panel: Gini coefficient for household income per equivalent adult, with parameter of household economies of scale set at 0.5.
Authors' calculations from Permanent household survey.

To wrap up this section, we have a few words on public perception of the costs and benefits of the reforms. Overall, public sentiment towards the whole reform process is fairly negative. For instance, as of 2003, Argentine citizens rank among the least supportive of “privatizations” in Latin America (Lora, Panizza, and Quispe-Agnoli, 2003), even though privatizations have in general been welfare improving, in some cases, even for the poor (see, for example, Galiani et al, 2005). This overly negative impression is probably a mix of the association of some of these measures with governmental corruption (Lora et al, 2003), as well as with the political strategies in the construction of the post-Convertibility political coalitions, which have successfully managed to further conflate in the public’s mind the 2001-2002 crisis with the overall reform package.

IV. Parting Thoughts

In this paper we summarize the experience of market-oriented reforms in Argentina during the 1990s. In a context of economic chaos following several decades of fiscally irresponsible and inward looking economic policies, a pragmatic incoming executive decided to “follow the international wave” and embarked in a broad reform process, along the lines of the so-called Washington consensus. The executive was able to build a governing coalition that put together economic sectors benefiting from the reforms with some of the traditional clientelistic Peronist networks.

One of the most salient features of the Argentine case was the bundling of measures such as privatization, trade liberalization and de-regulation, with a particular stabilization devise,

the monetary regime of Convertibility. We argue in this paper that convertibility played a key role both politically and economically, given the peculiar inflation history of Argentina, and its impact on the contractual basis of the economy.³⁰

Argentina has done clear progress on some important fronts in the last decades. In 1983 it returned to democracy, and it has remained there ever since, even through deep crises like the 2001-2002 one. It also seems conventional wisdom even among political leaders nowadays that high inflation is not good politics, and that in order to avoid high inflation, care on the fiscal end seems necessary. The reform process also left behind a relatively modernized business sector, a more open economy, as well as some clear improvements in infrastructure.

The economy still has many unresolved problems, and the social situation has deteriorated throughout the reform decade. Argentina is still a country that does not seem able to steer a clear direction, unlike some of its neighbors like Chile or Brazil.³¹ Even though not the direct focus of this paper, we believe that some of Argentina's unresolved problems relate to the inability of the polity to produce credible policies sustained by more cooperative political behavior.³² Convertibility was an institutional shortcut towards the building of more adequate "deep institutions" but it does not seem to have worked.

We close the paper with ten speculative remarks related to the conventional wisdom about "the political economy of reform."

First, even though in this paper we seem to provide some evidence that "crises lead to reform", we believe that a narrow reading of that statement is misleading. Crises do not necessarily lead to better policies or even to policies in any particular direction. Crises are more likely to be necessary to trigger reforms in polities that have a poor capacity for (less costly) collective learning and to solve collective action problems. More importantly, crises do not seem the best time for the gradual and profound building of deep institutions, which need time to develop, which are fundamental to deliver credible, yet adaptable, policies over time. The type of solutions that tend to be adopted in some crisis situations, like the Convertibility regime in Argentina, do not generally provide the most adequate starting point for the building of good adaptive institutions.

Second, another usual "maxim" in the reform folklore is that *"left-wing governments are more likely to successfully implement reforms because they are more credible"*. One of the authors of this paper is one of the authors credited in the literature for the development of that hypothesis. We believe the hypothesis is theoretically relevant and practically relevant in some situations. Although some of that literature was partly motivated by examples like that of Menem in Argentina, a deeper reading of the case suggests that such was only a small portion of the story in this particular case. The ability of Menem to maneuver the reforms with the traditional constituencies of Peronism is more related to the management of clientelistic political machineries than on the additional credibility lent to the necessity of

³⁰ We refer the readers to Galiani et al (2003b) for a more detailed analysis of the process of convertibility, and for a critique of the naïve interpretations that see convertibility as "the mistake" in the Argentine reform process (such as Williamson, 2003). The Box synthesizes some of the main arguments.

³¹ Compare for instance the volatility and quality of international policymaking in Argentina vis a vis its main neighbors – Spiller and Tommasi, forthcoming, Chapter 4.

³² Some of those issues are raised in Spiller and Tommasi (2003b), in Tommasi (2004) and in Acuña and Tommasi (2000).

reform by his Peronist credentials.³³ The disastrous pre-existing situation was a stronger source of information about the need for some change.

Third, in the paper we look in a rather disaggregated manner at the way “winners” and “losers” were handled politically. This implicitly states that, contrary to some naïve renderings of the political economy of reforms, the implementation (and sustainability) of market-oriented reforms does not depend on their Pareto-improving nature, but on political configurations in which losers do not have effective power to mobilize against implementation (or for reversal).³⁴

Fourth, it should be evident that the set of actors participating in the specific processes of reform is not limited to socio-economic actors. In our case, while the neutralization of powerful actors (such as the military) was a key precondition for the implementation of privatizations this was not a major issue in relationship to trade liberalization. This confirms the need to disaggregate the analysis at the level of specific reforms if we are to understand the aggregate political game of the structural reform process.

Fifth, specific structural reforms are nested games. In this sense, the logic of support and opposition of the different actors should be understood as a function of the aggregate result of expected costs and benefits brought about by the different specific reforms. Namely, an actor negatively affected by a given reform (such as trade liberalization) can be part of its supporting alliance due to the expected benefits in another specific reform (such as privatizations). In this sense, we conclude that when reforms are implemented simultaneously they allow exchanges to take place at a relatively low risk for the potential opposition, thus turning the aggregate reform process more feasible.

Sixth, when structural reforms take place in newly emerged democracies, the reform games are also inevitably nested with games that are central for the democratic regime, games that determine conditions of feasibility for the reforms. A clear example of this is the way the tensions among civilian rulers and the military developed during the 1980's in Argentina and also the way the resolution of this conflict affected the development of the privatization game.³⁵

Seventh, for some of the reforms, the above mentioned “nested” character includes games with strategic foreign counterparts and events. In the Argentine case, three examples of this are:

- a) when the support of key actors both in the phase of power building as well as during the implementation of the reforms, such as the U.S. government, depend on exchanges related to geopolitical matters (such as the abandonment of the project of the missile “Cóndor” or the disaffiliation from the “non-aligned” movement by the Menem government as a sign of commitment to a new and close alliance with the U.S.);

³³ This is related to the fact that Peronism has become more of a technology for mobilization than a programmatic “left-wing” party, if it ever was. (See also Levitsky, 2003).

³⁴ For a more detailed discussion on this matter, see Acuña and Smith 1994a.

³⁵ It is noteworthy that the first phase of reforms implemented during the 1976-83 military regime included an important effort aimed at trade liberalization, but did not include significant processes of privatization due to the military veto. This did not allow for crossed exchanges and, thus, made the reform process less likely to pass through.

- b) when the impact of the reforms does not depend solely on domestic dynamics but, by definition, result from a relationship with strategic foreign economic counterparts (such is the case with trade liberalization and its impact over exports: this impact will be radically different if the U.S. and France maintain or vary their own degree of trade liberalization related to Argentine export goods, such as agricultural products).
- c) when the impact of the reforms cannot be assessed independently of foreign shocks (our study argues that it is impossible to understand the impact of the reforms without incorporating the effects of the Mexican and Russian crises, of the Brazilian devaluation and of the intense slowdown of the world economy in 2001).

Eighth, the highest level of the political game shows that the governing coalitions are as important as the electoral coalitions necessary to have access to government, and that these two might show profound differences. In this sense the Argentine experience clearly shows a shift when the electoral majority of the peronist–center-left alliance turns into a peronist–center-right majoritarian support for the process of reforms. Moreover, in a context where a deep re-definition of the supporting alliance for the reforms takes place, public opinion and the mass media play a major role in creating the conditions to turn the newly emerged governing (pro-reform) coalition into a successful electoral coalition for the subsequent elections.

Ninth, as for the interrelation of general and partial equilibria, from our analysis emerges what we could term *the Argentine paradox*: the Argentine democratic process demonstrates that it is possible to achieve long-term stability at the level of the political regime (i.e. the democratic game) while simultaneously showing high degrees of political instability at lower institutional levels (i.e. the presidency, government ministries, rules related to the monetary regime and some privatizations, etc.). The Argentine case also shows that lower-level rules and economic processes (for example, trade liberalization) can acquire important degrees of autonomy and stability vis à vis the high degrees of uncertainty characteristic of the encompassing institutional framework.

Tenth, finally, at this point of our conclusions it should be clear that the impact of structural reforms cannot be assessed in narrow economic terms. The Argentine case shows that the weakness of its governmental institutions to sustain the intertemporal exchanges necessary to resolve problems of coordination and contradiction of interests in an efficient, effective and legitimate way, is at the core of the logic of reforms and, more broadly, at the core of its needs. In this context, the original promise of the Washington decalogue that more market and less government would bring about better politics and economics was simply wrong. Economics cannot be understood or reformed independently of the political conditions in which they operate, and the government plays a central role in strengthening or weakening the capacities of these conditions.

In a nutshell, good governmental institutions allow bad policies to be redefined, while bad governments cannot even assure that good policies will be maintained. Conceptually, the “Washington” notion of first and second generation reforms, got the order wrong.

Annex

Year	Monetary and Financial Policy	Fiscal Policy	Trade and Industrial Policy	Privatization	Deregulation Policy	Labor Market Policy
1989	Elimination of currency restrictions on transactions. Debt rescheduling program.	VAT generalized and rate reduced (15% to 13.5%). Reduction in income tax rates. Temporary tax on assets levied. Tax on financial operations.	Suspension of subsidies, industrial promotion, mining promotion. Raise in public utility prices. Promotional regimes in Tierra del Fuego were not affected. Import tariff reform. Reduction of maximum tariff to 30% by the end of the year. Quantitative restrictions were removed for more than half the goods in the quota list. Average tariff is reduced to 21%, and tariff dispersion falls. Temporary suspension of tax refunds for exports. Raise in export duties.	State companies audited. Legal framework for privatization of State-owned enterprises is established.	Price controls eliminated for goods and services. Economic Emergency Law removed prior approval requisite for Foreign Investment.	
1990	Bonex Plan. Banks' terms deposits are repaid in external government bonds.	Tax on corporate assets is raised. Taxes on capital and net worth are repealed. VAT is raised to 15.6%, and its base is expanded. Integrated budget for State companies. Reduction in the number of areas of Central Administration.	Import tariffs were reduced. Reduced dispersion. Overall, the average tariff fell to 17%. Specific tariffs were gradually removed. Export refunds were reinstated Initial Mercosur talks.	Telephones. Airlines. Petrochemicals. Air, oil and roads concessions.		
1991	Convertibility Law. Reform of private companies securities law.	State debt law. VAT increased to 18%. Introduction of a tax on personal assets. Nation/Provinces Agreement: transfer of services.	Five different tariff levels, set according to the stage of the production process where the imported good was used. The average tariff was lowered to 12%, while tariff dispersion grew. A special regime for temporary inputs, which paid no tariff, was put in place. Most export taxes were eliminated, while refunds were lowered. A special regime for the automobile industry was created. Its main feature was a compensated trade regime for local manufacturers Mercosur Treaty.	Telephone company's stock sale. Association deals and concessions for oil extraction. Railway concessions.	Deregulation of internal trade of goods and services. All restrictions to supply of goods and services not related to national defense, internal security or public utilities were abolished. Official wage schedules not present in collective bargaining agreements were also eliminated. Entry to professional activities was liberalized. State preferential policies for domestic suppliers were lifted. Deregulated activities included the insurance market, medicine retail distribution and medicine imports. State regulatory entities were dissolved.	Employment law introduced several fix-term contracts and it constitutes the first attempt to flexibilize the Argentine labor market. Introduced fixed term contracts and special training contracts for young workers. It also created the unemployment benefit system.
1992	Central Bank Charter. Establishes Central Bank autarchy.	Extended Facilities agreement with IMF. Extension of VAT's base.	Import Reform. The maximum tariff was reduced to 20%. The statistics tax rate was raised,	Gas transport and distribution. Railway concessions. Passenger and freight lines.	Ports Law. It authorized the creation of private ports, as well as the transfer to the provinces	

	Financial Regulation Law. Authorization to constitute reserve requirements in dollars. Deposit Insurance abolished in December. Basle Capital Requirements adopted.	Increase in income tax rate. Nation/Provinces Agreement: Tax sharing. Guaranteed minimum monthly transfers to provinces. Debt with pensioners is regularized.	exempting capital goods and temporary imports. Quantitative restrictions were almost completely eliminated, with the exception of the automobile industry. Export refunds were increased. The tax on traditional exports was eliminated. A special regime, with higher refund rates, was in place in Tierra del Fuego. Advance in Mercosur preferential system. Industrial promotion regimes were hardened, imposing greater accountability and more severe punishments. Reduced restrictions on investment in mining projects. The ban on foreign investment in frontier areas –where most mineral deposits are located – is lifted. So is the prior approval requirement for all mining investments – which applied both to foreign and domestic projects. Finally, it removed transport restrictions and taxes on mineral exports.	Water supply. Electricity supply. Iron and steel companies.	and privatization of existing national ports. Deregulation of medium and long-distance bus services.	
1993	Brady Plan. Prohibition of deposits for periods shorter than 30 days. Mutual Funds Law. New Securitization rules.	Nation/Provinces Agreement: Tax structure coordination. Income tax modifications. New scale for rates on individual earnings. Tax on corporate assets repealed. Reform of social security system is sanctioned. Creates a private savings funds system to coexist with a public "pay as you go" system.	Placement of anti-dumping measures. Specific import tariffs (mainly those on textiles and steel) were raised. Tax free zones regime.	YPF (oil and energy company). Hydroelectric and thermal plants. Electricity transmission. Railway and subway concessions.	Foreign Investment further liberalized – treated on a par with domestic investment.	
1994	Financial Entities Law: Equal treatment for domestic and foreign capital. Capital Requirements raised in December.	Reduction in employer payroll taxes. New social security system in place.	Agreement for the Mercosur Common External Tariff.	Power plants. Electricity distribution. Gas transport and distribution stock sale.		
1995	Central Bank Charter is modified: Grants the Central Bank greater authority over banks. Bank capitalization fiduciary fund, to aid financial institutions with liquidity problems. Provisioning Requirements are Raised. Introduction of Liquidity	Increase in VAT rate to 21%. Personal assets tax lowered. Income and Personal assets tax base extended. Partial and transitory elimination of the reduction in employer payroll taxes.	Mercosur operational. Common External Tariff is enacted. Export refunds were redefined for exports outside Mercosur, and gradually reduced for intra-Mercosur trades. Raise in import tariffs.	Power plants. Brachia Blanca petrochemical.		Flexibilization law generalized the set of fix-term contracts regulated in 1991 by law 24.013. It also introduced a trial period of up to six months.

	Requirements. Deposit Insurance (Limited, fully funded).					
1996	Financial Entities Law: Sets forth the legal framework applicable to assets and liabilities of liquidated financial institutions. Market Risk Capital Requirements.	Expansion of income tax base. Raise in tax on liquid fuels and gas. Modification of family allowances regime. Reduction of employer payroll taxes. Customs authority (DGA) and the federal tax collection agency (DGI) were merged.	Suspension of refunds to the production of capital goods. Mercosur-Bolivia and Mercosur-Chile treaties.	Provincial banks.	Obras Sociales deregulation – employees could choose a service provider other than their labor union.	Modifications to the Accidents and Professional sickness regime. Establishment of an insurance system.
1997	Liquidity requirements for banks were raised, as well as capital requirements. Reserves for risky credits are raised. BASIC criteria introduced.			National Post Office.		
1998	Mercosur: Rules for the operation of banks from one country in the market of another.	Tax Reform: reduction in social security taxes, reduction of VAT rate to half (from 21% to 10.5%) for basic foodstuffs, VAT exemptions eliminated, raise in internal taxes, income tax rate raised to 35%. Creation of tax on interest payments by firms.	Tariffs and statistics tax unified.	Airports. Transfer mechanism for nuclear power plants. Congressional approval to sell Banco Hipotecario Nacional.		Elimination of promoted contracts. Substantial reduction of severance payment for short tenure employment relationships. Increase in the degree of centralization prevalent in collective bargaining.
1999	Introduction of Capital Requirements for Exposure to Interest Rate Risk.					
2000						Decentralization of collective bargaining.

Source: Author's elaboration based on Berlinski (1998), Calomiris and Powell (2000), Chudnovsky and López (2001), Galiani and Gerchunoff (2003), Heymann (2000), Rojo and Hoberman (1994), and laws and decrees.

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