Comments

Ernesto Stein: Most of the literature on fiscal federalism, at least the literature written by economists, tends to focus on the immediate causes of the problems observed in the countries studied, such as the rules that govern intergovernmental relations (for example, rules regarding intergovernmental transfers or subnational government borrowing). The approach followed here goes a step further by focusing on the costs of political transactions, suggesting that while these rules may be problematic, they must be seen as the outcome of a broader political game. The approach identifies characteristics of the environment in which this political game takes place as the key determinants of the outcomes of the fiscal federalism system. Policy reform efforts should therefore center on this political transactions environment.

Changing the rules that govern intergovernmental relations, under this approach, would not be sufficient, since the lack of a proper political transactions environment may result in the rules not being enforced. I find this emphasis on the political transactions environment to be very appropriate. Numerous countries have adopted rules that appear to be very reasonable, but they are not enforced or are not effective because of failures in the political environment. The rules for subnational government borrowing in Colombia are a case in point. Colombia has established a system of controls to limit the autonomy of subnational governments to issue new debt. The controls, which are related to indicators of solvency and liquidity, function like traffic lights: if the indicators are in the red light zone, then the government in question loses its borrowing autonomy. In spite of these rules, subnational government debt has increased substantially, and most of the territorial entities in the country are in the red light zone. As a result of the lack of enforcement, Colombia's subnational governments would appear to have as much respect for red lights as do taxi drivers in Bogotá. This suggests that rules alone are not enough. They have to be set in an environment in which they will be effective. For this reason, it is important to emphasize the political transactions environment and, in particular, the key ingredients of the environment that can render it cooperative or uncooperative, which is exactly what the paper does.

Focusing on a single country, however, even if studied in great detail, is not the best way to go about discovering what the key ingredients of the political transactions environment may be. It would be better to undertake a detailed comparison of the institutional structure of a few Latin American countries, which should be similar in a number of dimensions, but different in some of the potentially crucial political dimensions of the political transactions environment (such as, for example, the electoral rules of the national legislature or the degree of legislative turnover). I encourage the authors to move in this direction in future research.

Other countries demonstrate the same types of failures (namely, opportunism, economically inefficient choices, suboptimal policy reform, and underinvestment in capacity), but with very different characteristics with respect to the three aspects of the political transactions environment identified as crucial in the paper: the short-term horizon of legislators (due to high turnover); the relative weakness of legislators vis-à-vis the governors; and the weak horizontal separation of power. Take, for example, the cases of Colombia and Brazil, which are the other most highly decentralized countries in Latin America. Both countries have electoral rules that are very different from those in Argentina. In Brazil, the party leadership has very little power over the careers of legislators, and both countries have a much higher rate of reelection of legislators (close to 50 percent compared to 17 percent for Argentina). Colombia is a unitary country, which should also alter the transactions environment, since it reduces the independence of the subnational units. And yet the two countries have very similar outcomes, with high subnational deficits, overindebtedness, and bailouts. This suggests that they also have an uncooperative transactions environment.

The question, then, is whether the ingredients identified by the authors are really that important. Have other important ingredients of the political transactions environment been overlooked? A comparison of a few countries, rather than the analysis of a single one, would be much more compelling, as it would provide a clearer guide as to which elements of the political transactions environment render that environment uncooperative. Such a comparative study should include a country in which the failures of the fiscal federal system identified for the Argentina case are not widespread.

As mentioned above, the authors identify three aspects of the political transactions environment that they consider important for the uncooperative outcome. But could it be that a combination of these factors actually lessens the problems? It is important to look not only at potentially key ingredients of the political transactions environment, but also at the interaction of some of these ingredients. Hallerberg and von Hagen, for example, find that important features of the budget process (namely, the degree to which it is decentralized) can result in bad fiscal outcomes under some political systems, but not under others.[1]

An interaction that may be particularly important for this paper is the high turnover of legislators and their weakness relative to governors. The authors stress that the high turnover of legislators makes it difficult to strike mutually beneficial intertemporal trades. They also stress, however, that governors play an important role in forming the party lists for the legislature. Now, if governors control the legislators, then perhaps the high turnover is not such a problem, provided the governors serve longer terms. The issue is the turnover rate of governors. The paper does not address this point, but many provinces in Argentina have been controlled by the same powerful families for very long periods. Examples include the Sapag family in Neuquén, the Romeros in Salta, the Romero Feris family in Corrientes, the Rodríguez Saa family in San Luis, the Saadis in Catamarca, and the Menems in La Rioja. Angeloz has also stayed in power a long time in Córdoba, although he is not a member of a family clan. If the tenure of governors is in fact longer than that of legislators, and if governors control legislators, then the scope for mutually beneficial intertemporal trades may be reestablished.

With regard to the policy recommendations, I sympathize with the federal fiscal institution proposed in the paper. No set of rules regarding intergovernmental relations should be cast in stone. Situations change, so the system has to be flexible enough to respond appropriately to changes. A federal fiscal institution such as the one proposed here, in which both the central government and the provinces are represented and which has solid backing from a strong, somewhat autonomous technical department, would play an important role in this regard. There is quite a jump, however, between the policy recommendations and the rest of the paper. The authors need to more clearly justify their focus on the federal fiscal institution.

1. Hallerberg and von Hagen (1999).

Before discussing the federal fiscal institution, they should first discuss some policy recommendations that more closely match the problems identified in the political transactions environment. They should then explain to the readers that an alternative to some of these policies (or a complement to others, perhaps) is to create a different venue for intergovernmental dealings, which sidesteps some of the problems identified above.

Mauricio Cárdenas: Decentralization is now under intense scrutiny in Latin America. Early fascination with fiscal federalism has been replaced with a more critical assessment, partly because countries have experienced a tension between the objectives of macroeconomic stability, on the one hand, and political and fiscal decentralization, on the other. Reform proposals, however, generally focus on designing new institutions that improve the outcome of decentralization, rather than advocating a return to more centralized fiscal and political structures.

In that spirit, the paper by Mariano Tomassi, Sebastián Saiegh, and Pablo Sanguinetti is an important contribution. They start by characterizing fiscal federalism in Argentina as inefficient and subject to "all sorts of perverse incentives." According to the authors, the critical aspects are the following:

—Large vertical fiscal imbalance. Provincial expenditures require transfers from the national government (57 percent of the centrally collected taxes). At the same time, the revenue-sharing rules are convoluted, combining fixed-sum transfers, minimum transfer guarantees, and special provisions that benefit the central government by reducing the tax-sharing pool.

—High deficits, high indebtedness, and procyclical finances in provincial governments. In several cases, the federal government has intervened by bailing out the provinces with unsustainable finances.

—Inefficiencies in taxation. Poor local and national tax collection combined with special provisions that reduce (or eliminate) national taxes in certain regions. In addition, taxation is increasingly based on nonshared taxes, such as payroll taxes, which may be inefficient.

—Inefficiencies in the provision of public goods. The system of transfers does not respond to changes in the costs associated with supplying those goods to a targeted population. The rules do not provide incentive mechanisms that reward efficiency in the use of transfers.

After explaining these features as the outcome of political transactions, the authors propose an institutional reform to address the shortcomings of the current scheme. In their words, the rules of the political game do not facilitate cooperative intertemporal exchanges between national and subnational governments, resulting in inefficient policies. The proposed agenda therefore centers on changing the way political transactions take place.

My comments focus on three aspects of the paper. First, I discuss the authors' characterization of the Argentine fiscal federalism. Second, I examine the arguments they use to explain the key aspects of that characterization. Finally, I comment on their recommendations, mainly the creation of a new set of institutions.

My first point is related to their description of the main features of the federal system in Argentina. Not all the elements in their list of stylized facts can be considered proof of inefficiencies in the system. Take, for example, the existence of large vertical fiscal imbalances or the fact that subnational fiscal imbalances explain a large part of the consolidated fiscal imbalance. These characteristics are inherent in systems with centrally collected taxes and a high degree of expenditure decentralization. The authors also attribute the inefficiencies in taxation (for example, poor tax collection) to the existence of a federal fiscal system. One could argue that other factors, different from the ones mentioned in the paper, play a more significant role in explaining the inefficiencies of tax collection in Argentina.

In my opinion, what is peculiar about the Argentine case is the way in which revenues are transferred from the national government to the provinces. The paper indicates that the rules defining the system of transfers have changed frequently and do not follow clear-cut criteria. Transfers have therefore become almost discretionary and arbitrary. This poses interesting questions. What explains the complex evolution in the system of transfers that created such a fiscal labyrinth? What are the consequences of those rules? How should they be changed? This is really what deserves attention.

The paper explains the main features of Argentina's federalism as the outcome of political transactions between the national and subnational governments. The analytical framework is a repeated game with economic and political shocks, in which the optimal policies are irresponsive to the latter. The argument is that certain exogenous factors do not facilitate cooperation, such that the outcome of the game is characterized by opportunism, economic inefficiency, impossibility of reform, and underinvestment.

The paper includes a very interesting discussion on intergovernmental politics in Argentina. The political environment is described as one in which it is hard to reach intergovernmental agreements that coordinate the actions of the different actors. More important, whenever those agreements are possible, their enforceability is severely limited. This is the result of Argentina's history of political and economic instability, which has prevented national and subnational governments from building institutions that facilitate cooperation. As in other democracies, Congress would be a natural institution for negotiating and enforcing the agreements between the competing actors. The executive branch of the subnational governments is more powerful than the legislature, however, because of the short-term horizon of legislators (associated with their high turnover) and the dominant role of governors in forming the lists of congressional candidates. The authors also argue that the lack of specialization among legislators further increases the de facto power of the executive branch, especially in budgetary matters. Moreover, governments have frequently deviated from what has been decided in Congress, without judicial implications. In my view, all this indicates that political reform should be oriented toward fixing a dysfunctional legislative branch.

Essentially, the paper's main explanation of the problems associated with federalism in Argentina is twofold. First, the key actors in intergovernmental relations are the president and the governors. Second, efficient intertemporal deals are rare, institutionally unstable, and easily reversed. This explanation leads me to a second set of comments. The authors do not elaborate on why the president (who can run for reelection) and the governors (who normally seek higher office) are not interested in trades that can have long-term positive payoffs. The question is no longer whether legislators are unspecialized and shortsighted, but whether the president and the governors are affected by the long-term consequences of their decisions.

A second point in relation to the explanation provided in the paper is that countries with very different institutional arrangements show similar features. Take, for example, the case of Colombia, which is not a federation but has a very decentralized political and fiscal structure. The stylized facts are quite similar to the ones described in the paper: large fiscal imbalances and indebtedness, a recurrent need for the national government to bail out local governments, and the impossibility of reform and cooperation. The institutional arrangement is just the opposite, however: a powerful Congress made of politicians with constituencies and agendas that are predominantly local, lower congressional turnover rates than in Argentina, weak governors who carry no decisionmaking capacity, an absence of party discipline, and effective judicial enforcement of the rules that frame decentralization.

An alternative theory may better explain Argentina's case while also encompassing countries with different institutional arrangements but similar outcomes. The tragedy-of-the-commons literature offers an interesting possibility. Think of the centrally collected pool of taxes as an overextended, inadequately priced common resource. Governors, mayors, members of congress, and others all lobby for additional transfers whose benefits they can internalize, at a cost to society as a whole.[1] Cárdenas and Partow model this setting; they show that rules are preferred to discretion when there are many competing groups, as in the case of provinces.[2] In contrast, if fewer actors are involved, it may be possible to push out the frontier of feasible combinations of flexibility and credibility by delegating authority to an autonomous agency.[3] Rigid rules may be the only feasible solution to the commons problem when the fiscal structure is not unitary. The major cost of this solution, however, is the total loss of flexibility.

Finally, the recommendations of the paper emphasize the need for a broad-based institutional reform. Among other aspects, the proposed reform includes the creation of a new institution that would enforce a new revenue-sharing system and become the "formal arena in which issues of fiscal federalism could be decided." In other words, this institution would replace Congress as the proper channel for intergovernmental agreements, and it would reduce the ex post discretion of the executive branch of the national government. This new political body would be made up of representatives of the national and subnational governments. I doubt, however, that this new arrangement would produce more efficient results. The critical element is to replace the transfers labyrinth with a clear set of rules that embody the efficiency and redistributive criteria. Under the current structure, Congress is unlikely to enact the necessary constitutional and legal changes that would clarify the rules of the game. This points to the need to reform Congress, together with the judicial institutions that can enforce the new rules. Without these reforms, a new institution, dominated by the president and the governors and based on discretion and flexibility, will rapidly mimic the current conditions.

1. See, for example, Tornell and Velasco (1992).

2. Cárdenas and Partow (1998).

3. On the tension between credibility and flexibility and its implications for institutional design, see Levy and Spiller (1994).

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