Existing research has failed to address the impact of subnational politics on economic adjustment. This article attempts to fill this gap by outlining theoretical reasons for anticipating policy divergences across levels of government and by offering three hypotheses to account for variation at the subnational level. The authors explore these ideas on the basis of the Argentine experience. The study traces the impact of subnational policy on Argentine economic adjustment and tests hypotheses about subnational policy variation on the basis of provincial fiscal data. The authors' findings underline the importance of subnational policy choice for national performance and suggest a revised understanding of the role of political competition in the economic adjustment process. The authors find considerable evidence that interactions between party competition and the structure of the public sector shape provincial fiscal performance and thereby condition the capacity for economic adjustment at the national level.

THE SUBNATIONAL POLITICS OF ECONOMIC ADJUSTMENT
Provincial Politics and Fiscal Performance in Argentina

KAREN L. REMMER
ERIK WIBBELS
University of New Mexico

The challenges posed by shifts in the global economy over the past two decades have generated widespread interest in the politics of economic adjustment. What political conditions facilitate economic reform? When do political leaders sacrifice macroeconomic stability to achieve political goals? What accounts for the varied ability of governments to respond effectively to shifting economic constraints and opportunities? A rapidly growing body of empirical research has provided us with a rich array of answers to these questions (e.g., Grindle & Thomas, 1991; Haggard & Kaufman, 1995; Nelson, 1989, 1990; Pierson, 1994; Przeworski, 1991; Remmer, 1993; Waterbury,

AUTHORS' NOTE: *This research is based on work supported by the National Science Foundation under Grant SBR-9809211 and the Institute for Public Policy at the University of New Mexico.*

COMPARATIVE POLITICAL STUDIES, Vol. 33 No. 4, May 2000 419-451

1993; Weyland, 1996). Yet whether drawing upon structural, institutional, or ideational theoretical frameworks, comparativists have tended to limit their search for causal patterns to the national political arena. The central presumption is that the politics of getting macroeconomic policy right revolves around national executives, legislatures, and bureaucracies, rather than state or local governments.

Extant research has consequently neglected the politics of economic reform at the subnational level. The literature on public policy in the United States represents a notable exception (Alt & Lowry, 1994; Baber & Sen, 1986; Clingermayer & Wood, 1995; Poterba, 1994), but the implications of subnational politics for the study of economic adjustment have yet to be explored in broader comparative contexts. Given the size and importance of nations with federal political arrangements and the global trend toward the decentralization of government services, this omission is significant. The politics of economic stabilization and adjustment are complicated numerous times over by the need to trim deficits, privatize public enterprises, restructure financial systems, and introduce related policy changes on a province-by-province (or state-by-state) basis, with the process being further muddled by complex and varied linkages among national, regional, and local governments. Hence, for nations such as Russia, India, Brazil, and Argentina, in which subnational political units account for 40% to 70% of total government spending and up to 70% of the public sector deficit ("Growing Deficits," 1996; Shah, 1994, p. 41; World Bank, 1990a, p. 3), a very significant part of the stabilization and adjustment story has yet to be told.

This study attempts to fill this gap by extending the study of the political economy of adjustment to the subnational level. How do subnational policy decisions impinge upon national reform efforts? Under what conditions do subnational governments respond effectively to increased economic constraints? And what political factors condition adjustment policies at the subnational level? To address these issues, we begin by sketching out the theoretical rationale for expecting major economic policy divergences between national and subnational governments. Having established a basis for understanding the difficulties of coordinating economic reform policies between levels of government, we turn to the question of subnational performance and offer three central hypotheses to account for policy variation at that level. We proceed to explore these ideas on the basis of the Argentine experience, tracing the impact of subnational policy on national economic adjustment over time and testing our hypotheses about subnational policy on the basis of a comparative analysis of provincial fiscal performance. The study focuses explicitly on fiscal performance for the simple reason that maintaining balance in public finances is a prerequisite for price stability. Fiscal discipline is

thus widely recognized as one of the earliest and most important steps in the adjustment process, as well as a continuing policy challenge for countries attempting to realize their full growth potential.

The findings of the study contribute to the existing literature on the politics of economic adjustment by underlining the importance of subnational policy choice for national performance and by suggesting a revised understanding of the policy impact of political competition. Contrary to most prior research, we argue that political competition facilitates adjustment by undermining incentives for the construction and maintenance of large public sectors. We find considerable evidence that interactions between party system competition, dependence on outside revenue sources, and patronage spending shape fiscal performance at the subnational level and thereby condition the capacity for economic adjustment at the national level.

THEORETICAL PERSPECTIVES ON THE POLITICS OF ECONOMIC ADJUSTMENT

Efforts to alter the policy status quo characteristically generate political opposition. According to prior research, however, the politics of economic stabilization and adjustment are particularly problematic. Whereas the costs of economic reform tend to be certain, immediate, and concentrated, the gains may be too long-term, uncertain, and diffuse to mobilize political support (Fernandez & Rodrick, 1991; Nelson, 1993; Pierson, 1994, pp. 8-18; Rodrik, 1994, pp. 61-88). These asymmetries can be exaggerated to the point that reform appears all but theoretically inexplicable, forcing analysts to rely on explanations emphasizing conjunctural factors, such as "outstanding leaders" (Harberger, 1993, p. 343), "coherent economic teams" (Williamson & Haggard, 1994, pp. 579-589), and crisis conditions (Rodrik, 1994; Weyland, 1996). Nevertheless, the conventional wisdom effectively highlights potential tensions between the economic and political rationality of economic reform.

At the national level, these tensions are likely to be mitigated by electoral considerations. Macroeconomic problems, such as high inflation, low growth, and import shortages, can pose political risks for politicians elected by national constituencies. As emphasized by Hunter (1997), "More than any other single political actor, the president is held accountable for the general state of affairs in the country and, by extension, for the failure of key collective goods to be met" (p. 99). Thus, deteriorating economic conditions can create electoral incentives for national political leaders to adopt appropriate economic policies. These incentives are likely to be reinforced by

international economic pressures involving financial carrots and/or threats to withdraw aid, investment, or other support.

At the subnational level, however, neither international pressures nor national electoral imperatives provide much of a motivation for economic reform. Indeed, the structure of incentives shaping the behavior of political actors elected by narrower geographical constituencies is likely to cut in precisely the opposite direction, yielding policies that are perverse from the perspective of national economic adjustment efforts. National legislators may applaud efforts to bring national government expenditures into alignment with revenues, but nevertheless lobby strenuously for increased federal spending in their districts. For governors and state legislators, who stand a further step removed from political responsibility for national policy outcomes and the pressures of the international system, the incentives to participate in national adjustment efforts are even more attenuated. The collective goal of economic stability is unlikely to be advanced by the policies of a single state or province. Even if gains can be achieved through broader cooperation, the incentives to free ride tend to cut against their realization (Prud'homme, 1995; Wildasin, 1997). A collective action problem thus creates incentives for state-level politicians to resist pressures for privatization, budgetary austerity, or other economically correct policies. Regardless of the policies adopted by subnational political units, improved economic conditions can be achieved through sacrifices at the national level. But these sacrifices will have to be unusually heroic in highly decentralized systems. The greater the share of public resources captured by officials elected at the state or local level, the greater the potential for serious leakages in adjustment policy. The clash between the political rationality of economic adjustment policies at the subnational and national levels may thus force national political leaders to adopt policies of overadjustment to compensate for the lack of cooperation at the subnational level.

Within this overall framework of divergent incentives, however, there are strong theoretical reasons for anticipating that the adjustment performance of subnational political units will differ significantly within the framework of a single national system. Three hypotheses linking subnational policy with partisanship, electoral competition, and revenue generation are advanced to account for this variation. Although all three have implications for the study of national adjustment, their central theoretical purpose is to elucidate the sources of policy variation at the subnational level.

The first hypothesis is that the incentives for state or local politicians to cooperate with national government adjustment efforts are influenced by partisanship. Whereas opposition political leaders at all levels of government have something to gain from the failure of national macroeconomic policies,

the perspective of politicians affiliated with the party in power is more likely to be shaped by the prospect of electoral losses. Hence, states or provinces controlled by the party in power at the national level are expected to be more likely to cooperate with national adjustment efforts than other subnational units. Opposition control of subnational government, on the other hand, is likely to result in weak adjustment effort, because politicians will have less incentive to undertake reforms entailing electoral risks.

Second, the more even the balance between contending electoral forces at the state or provincial level, the greater the possibilities for advancing economic reforms. Virtually by definition, stabilization and adjustment programs entail cutbacks in public employment and government largesse. Electoral success, however, is enhanced by the ability of politicians to distribute jobs and favors. Politicians will therefore be unlikely to support adjustment policies, except where access to patronage is equally distributed and conveys no relative partisan disadvantage. Building on the game-theoretic argument of Geddes (1994), it may be assumed that this situation is most likely to be approximated in a competitive two-party system in which the possibilities for a relatively equal and stable distribution of partisan strength are maximized. In contrast, subnational units, in which electoral support is either fragmented among several competing forces or highly concentrated in the hands of a single dominant party, will be unlikely to comply with policies of stabilization, fiscal austerity, or state reform.

Third, the more tenuous the linkage between subnational spending and taxation, the greater the incentives for patronage spending, public sector expansion, and limited subnational adjustment. The availability of resources that make it possible to spend without incurring the political costs of increased taxation undercut incentives for fiscal belt tightening or other adjustment measures. The standard argument for decentralized fiscal systems is that "by permitting a better fit between the supply of public goods and the preferences of claimants, fiscal federalism tends to make it possible to provide individuals with the quantity and quality of public goods that they want, and will therefore be willing to fund" (Artana, Libonatti, Moskovits, & Salinardi, 1995, p. 78). The argument presupposes a tight nexus between the costs and benefits of providing public goods; but rational political actors will attempt to maximize benefits and export costs to other political jurisdictions. Differential success in this effort is likely, particularly in federal systems. By allocating legislative seats on the basis of territoriality rather than population, such systems characteristically overrepresent citizens from smaller territorial units. Drawing upon this advantage, smaller states or provinces are often able to negotiate advantageous fiscal transfer systems, establishing the basis for inequities among subnational units. The result is likely to be reflected in

widely varying levels of adjustment effort at the subnational level. The more state or provincial political leaders can draw upon a common pool of revenues supplied by other political jurisdictions, the greater the likelihood of bloated public payrolls, overspending, and resistance to economic reform. By the same token, the more subnational leaders are forced to finance government activities through local revenue generation, the greater the incentives for fiscal probity.

The first hypothesis regarding the impact of partisanship on subnational policy is consistent with prior literature on stabilization and adjustment, which links adjustment success with political support, broadly, if often vaguely, defined (e.g., Nelson, 1990, p. 328). The more national reformers can rely on the support and cooperation of politicians at the local level, the greater the prospects for subnational adjustment. For this reason, partisan linkages between politicians at the national and subnational levels may be expected to work in favor of subnational adjustment, thereby contributing to the success of the national reform process. Thus, to the extent that support is operationalized in terms of the partisan loyalties of subnational political leaders, the political logic governing subnational economic adjustment efforts may be seen as compatible with prior research focused on national policy.

The second hypothesis about subnational policy cuts in a different direction and thereby departs significantly from the conventional wisdom about economic reform. Most literature suggests that political strength, whether built on majoritarian electoral victory or authoritarian repression, facilitates economic reform. Hence, in the most ambitious comparative study of adjustment published to date, Haggard and Kaufman (1995) place political support at the center of analysis, arguing that economic adjustment success in their sample of 10 countries has depended upon "political monism" or strong aggregative governing parties. The difficulty is the direction of the causal arrows linking economic performance and government strength. Economic success bolsters government strength, but the presumption that strong governments facing limited opposition are unusually likely to adopt adjustment policies is implausible, as applied to either the national or subnational level. Political incentives for policy changes that reduce patronage opportunities and thereby undercut the political base of incumbents are limited in uncompetitive settings. Politicians from dominant parties have every opportunity and every motive to maintain the status quo and enjoy the assured benefits of distributing patronage. As suggested by Geddes (1994), "For advantaged parties, the dominant strategy will always be to stick with patronage, unless the payoff for voting for reform is remakably high and the future quite certain" (p. 96). Thus, political strength is likely to work against economic adjustment, unless we wish to assume that strong governments tend to be

composed of political heroes or visionaries disposed to self-sacrifice in favor of the collective good.

The second hypothesis presented above thus links variations in subnational policy to the relative equality of government and opposition forces rather than government strength. The weaker and more fragmented the opposition relative to the government, the greater the problems of democratic accountability and the more attenuated the incentives for reforms that diminish patronage opportunities. The underlying logic conforms to Geddes's (1994) analysis of bureaucratic reform. Building on the assumption that access to patronage varies with both past and present electoral success, Geddes argues that reforms reducing the patronage resources of politicians are most likely to occur in two-party systems characterized by relative partisan parity. Not only do such systems generate competitive pressures that create some incentives for politicians to meet citizen demands for public goods; in competitive two-party systems, the time that contending partisan forces have spent in office in the past or can be expected to spend in the future is likely to be more equal than in either uncompetitive or fragmented party systems. The political costs of reducing access to state patronage are thus also distributed more equally than elsewhere, and the possibilities of achieving cooperation favorable to reform are correspondingly greater. In contrast, one-party dominant and highly fractionalized party systems limit the incentives and opportunities for economic reform. In the former, the costs of adjustment are born entirely by the dominant party in exchange for uncertain returns. In the latter, electoral instability combined with the limited probability of parity among multiple parties create asymmetries in the distribution of the costs and benefits of reform. Given the fundamental tension between economic adjustment and patronage opportunities, the argument is of direct relevance to the study of economic reform.

The third hypothesis about variations in subnational policy is rooted in the literature on fiscal federalism, which explores questions related to the optimal assignment of fiscal responsibilities across different levels and units of government (López Murphy, 1995; Musgrave & Musgrave, 1976; Oates, 1972; Stein, 1998). A central insight of this literature relates to the costs of so-called horizontal and vertical imbalances in fiscal transfers, which refer, respectively, to gaps between levels of spending and revenue generation across subnational governmental units and between levels of government. Such imbalances may result in an oversupply of public goods by encouraging political units favored by the transfer system to limit their taxation effort and/or increase government spending. The insight is not only directly relevant to the analysis of subnational adjustment, but suggests more broadly that federal political arrangements may account for important cross-national

differences in economic stabilization and adjustment—differences that to date have received relatively minimal attention.

Despite their diverse theoretical roots, each of the three hypotheses outlined above has significant implications for the spending priorities and fiscal performance of subnational governments. Partisan control, electoral competition, and revenue structure all condition the incentives for subnational politicians to build or maintain patronage networks at the expense of economic adjustment. Consequently, opposition government, uncompetitive or fragmented party systems, and low own-source revenue generation are expected to encourage heavy patronage spending, which, in turn, is expected to contribute to fiscal imbalances and indebtedness at the subnational level. To the extent that patronage spending also strengthens the political bases of opposition to budgetary austerity, the resulting challenge to economic adjustment is likely to prove resistant to change.

Although we explore our central hypotheses at the subnational level, the subsequent analysis is designed not only to elucidate the factors that condition the magnitude of the clash between national and subnational decision makers, but also to test ideas relevant to the study of the political economy of adjustment at the national level. With respect to the latter goal, it should be noted that the methodological advantages of focusing on the subnational, rather than national, level of analysis are considerable. Cross-national studies of national adjustment efforts have generated a richer array of hypotheses to account for the politics of economic adjustment than can be tested with the available set of relevant empirical cases. Hence, it is difficult to sort out the relative significance of variables that have been identified as important for understanding national economic adjustment, including world region (Stallings, 1995), international markets and linkages (Stallings, 1992), hyperinflation (Weyland, 1996), political regime (Sheahan, 1980), presidential leadership capacities (Grindle, 1996), concentrated executive authority (Nelson, 1990, p. 347), and support from international financial institutions (Kahler, 1992). At the subnational level, many of these variables can be held constant. Hence, by working within the framework of a single nation, the subsequent analysis is able to offer fresh insights into the politics of economic adjustment at both the national and subnational levels.

ECONOMIC ADJUSTMENT IN ARGENTINA

The Argentine experience is particularly interesting and important for the study of economic reform. The country has been struggling with acute problems of economic stabilization and adjustment since the 1930s, giving rise to

Table 1
Argentine Economic Performance in Comparative Perspective, 1990-1997

	1990	1996	1997	Average 1991-1996	Regional Average 1991-1996
GDP growth rate	–0.1	3.5	8.0	5.5	3.5
Inflation rate	1,343.9	0.1	–0.1	19.1	313.1
Export growth	29.1	13.4	6.3	12.1	9.9
Investment/GDP	13.7	22.1		20.9	20.6

Source: Economic Commission for Latin America (1992-1997).
Note: GDP = gross domestic product.

a prolonged history of balance of payments crises, inflationary episodes, stop-go economic cycles, and related problems of political instability. These difficulties were far from resolved when the current democratic regime was established under the leadership of Raul Alfonsín in late 1983. Inflation was approaching an annualized rate of 600%, the economy was in its fourth straight year of recession, the public sector deficit exceeded 20% of the gross domestic product (GDP), debt payment obligations accounted for more than 100% of export earnings, and the nation's international reserves were depleted (World Bank, 1985, pp. xxiv-xxv). The Alfonsín administration attempted to address these problems on the basis of heterodox policies, but failed to restore any semblance of macroeconomic stability.

Thus, it was not until the 1990s that Argentina began to grapple effectively with the challenges of economic adjustment. The inauguration of Carlos Menem marks the critical turning point. Under Menem's leadership, the national government moved rapidly to liberalize prices, eliminate subsidies, cut tariffs, reduce budget deficits, and privatize most state-owned enterprises. The resulting gains, which include price stability, the restoration of economic growth, and dramatic increases in capital inflows, define Argentina as one of the more successful adjustment stories in contemporary Latin America. As indicated by Table 1, starting from a relatively dismal base in 1990, the country outperformed the rest of the continent during the 1991-1996 period. This record of success, which also stands out in comparison to other important federalized nations such as India, renders the Argentine experience particularly interesting. To the extent that subnational politics have acted as an important and continuing constraint on national adjustment policies in Argentina, it may be assumed that their impact also warrants serious consideration elsewhere.

The Argentine case is also unusually suggestive with respect to the analysis of tensions between national and subnational policy because of the

institutional arrangements conditioning adjustment efforts in the 1990s. First, under the Convertibility Plan of early 1991, the process of economic stabilization and adjustment in Argentina has pivoted around a currency board arrangement, which fixes the value of the peso to the dollar on a one-to-one ratio and thereby imposes tight constraints on monetary policy. Essentially, the system works like the gold standard, with the monetary base adjusted in accordance with international reserves, precluding the monetization of fiscal deficits and imposing recessionary solutions to the balance of payments problems. The room for economic policy maneuver is thus exceptionally limited in comparison with other countries. Second, the capacity of subnational governments to offer resistance to national policies in Argentina has been constrained by relatively weak federal traditions. Under the Argentine constitution, the federal government enjoys the authority to oust provincial governments—a prerogative exercised on multiple occasions by the Menem administration. Where federal traditions are stronger and/or state officials less constrained by inflexible macroeconomic institutions, the possibilities for conflict between subnational and national policy can be expected to be even greater than in Argentina. Again, the implication is that tensions between provincial and national policies in the Argentine case establish a basis for drawing broader theoretical conclusions about the importance of subnational policies for understanding the political economy of adjustment.

Over the past two decades, Argentina has also participated in the global movement toward the decentralization of services, particularly education, health, and basic infrastructure. Between 1980 and 1994, the federal government's share of total public spending declined from 66% to 55%, whereas provincial spending increased from 28% to 38% (Artana et al., 1995, p. 70). By 1994, the provinces were responsible for more than 90% of public expenditures on primary and secondary education and public housing, 57% on infrastructure and services, 74% on public health, and 50% on public safety and justice (Inter-American Development Bank, 1994). These changes create opportunities for exploring variations in subnational policy performance in a period of increased revenues and responsibilities, thereby establishing a basis for informing broader debates over governmental decentralization.

In addition to these theoretical reasons for studying the Argentine case, the Argentine provinces are sufficiently numerous and diverse to establish the basis for a comparative analysis of adjustment at the subnational level. The 23 provinces range from the highly urbanized and industrialized to the very poor and rural. From a political perspective, the provinces also differ significantly. Traditionally, the majority have been governed by one of the two national parties—the Unión Civica Radical (UCR) and Partido

Justicialista (PJ)—but the structure of political competition at the provincial level varies considerably. Since the restoration of democracy in 1983, provincial parties have gained in importance, challenging the electoral position of national parties in several provinces (Novaro, 1994). In other provinces, the dominance of a single party is pronounced. Finally, the provinces evince major differences in terms of their fiscal performance. Whereas some have followed the national lead, others have been stuck in cycles of violent protest, budgetary imbalances, and ballooning indebtedness. Given the potential for subnational policies to undermine national adjustment efforts and the growing international trend toward fiscal decentralization, understanding these differences is significant not only for the analysis of Argentina, but for politically decentralized systems facing adjustment problems across the developing world (e.g., see Lall & Hofman, 1995; Wallich, 1995; World Bank, 1996b).

THE POLICY DISJUNCTION BETWEEN NATIONAL AND PROVINCIAL ADJUSTMENT

As suggested above, Argentine federalism combines a comparatively high degree of administrative decentralization with strong mechanisms of centralized political control. Provinces elect their own governors and legislatures and have the authority to levy taxes and borrow money; however, they are politically constrained by the power of federal intervention and by traditions of party discipline that allow national party leaders to impose their authority at the district level (Jones, 1997, p. 271). Provincial governments are also fiscally dependent upon the national government to carry out their responsibilities. Under the nation's revenue sharing system, known as *coparticipación*, most taxes are collected by the national government and redistributed to the provinces. The level and terms of these transfers have varied considerably over time, however, constituting a continuing source of political friction between federal and provincial authorities, as well as among the provinces themselves (Sawers, 1996, chap. 11).

The difficulties of agreeing upon a formula for distributing federal funds to the provinces undermined Argentine adjustment efforts during the Alfonsín presidency (1983-1989), which resorted to ad hoc budgetary transfers and subsidized central bank loans to cover the deficits of the provinces. The perverse incentives generated by these arrangements contributed to a dramatic expansion of provincial government employment and to the related emergence of provincial spending as the single largest and fastest growing source of increase in the consolidated public sector deficit (Fundación de

Investigaciones Económicas Latinoamericanas, 1991, p. 78; see also World Bank, 1990a, pp. 60, 194-198). Prior to federal transfers, the provinces were running a fiscal deficit equivalent to 6.2% of GDP in 1986—a figure greater than that of the public sector enterprises and social security system combined. After transfers, the provincial deficit disappeared, but at the expense of transforming a national budget surplus into a fiscal deficit of 4.6% of GDP (World Bank, 1990a, p. viii). According to data collected by the World Bank's 1989 mission, the situation deteriorated further in 1987, when the combined fiscal deficit of the provinces more than doubled (World Bank, 1990b, p. 107).

The process of revenue sharing was finally regularized under an agreement between the federal government and the provinces, which came into effect as Law 23548 in early 1988 (Ministerio de Economía y Obras y Servicios Públicos, 1994). Under this agreement, 57.66% of the revenues raised by all national taxes, with some specific exceptions, were to be transferred automatically to the provinces under a distribution formula highly favorable to the least populous and hence most politically overrepresented provinces (Artana et al., 1995; Kraemer, 1997; World Bank, 1990c, pp. 97-104). Under the auspices of President Menem's stabilization program, these arrangements were renegotiated in 1992 and 1993, when the number and percentage of taxes subject to coparticipation were lowered in exchange for federal agreement to a minimal contribution of 8.9 million pesos, which represented a 50% increase over the amount received by the provinces in 1990. The provinces adhering to the pacts agreed to enhance their revenue efforts, remove distortionary taxes, reform provincial administration, privatize public enterprises and provincial banks, deregulate the provincial economy, and transfer provincial employee pension funds to the national government (Ministerio de Economía y Obras y Servicios Públicos, 1994; World Bank, 1996a, pp. 2, 13). The central features of the 1988 law, however, remained in place, institutionalizing federal revenue sharing on a significantly higher basis than in the past.

Since the late 1980s, the federal government has been collecting more than 80% of public revenues and retaining 55% (World Bank, 1996a, p. 29). The difference has been absorbed by the provinces, which have relied on federal transfers for 55% to 60% of their revenues—a sum roughly equivalent to 5% of GDP (Fundación de Investigaciones Económicas Latinoamericanas, 1995, p. 29; World Bank, 1990a, p. 252, 1996a, pp. 31, 76). Coparticipation funds have accounted for approximately 65% of these federal transfers, with the remainder made up of royalties from mining; automatic, earmarked transfers from the highway development fund (*coparticipacíon vial*); discretionary treasury grants called Aportes del Tesoro Nacional (ATNs), which have

Table 2
Revenues of the Argentine Provinces, 1984/1985-1995 (constant 1995 U.S. dollars)

	1984/1985	1990	1995	Percentage Change 1984/1985-1995
Provincial revenues	5,984	5,532	10,913	82.4
Taxes	4,836	4,524	9,083	87.8
Other	1,148	1,008	1,830	59.5
National revenues	6,014	6,859	13,179	119.1
Coparticipation	4,521	5,676	10,404	130.1
Highway fund	517	146	136	–73.7
Royalties	943	660	640	47.3
Other	33	377	1,999	5,957.6
Capital revenues	95	40	232	144.2
Discretionary federal grants	3,610	1,583	1,995	–44.7
ATN	2,047	80	597	–70.8
Housing fund	1,131	995	793	–29.9
Other	432	507	593	37.3
Total revenues	15,703	14,014	26,320	67.6
Total expenditures[a]	17,227	15,775	29,497	71.2
Overall deficit	(1,525)	(1,761)	(3,178)	108.4
Deficit as percentage revenues	7.2	12.6	12.1	
Deficit as percentage revenues (excluding ATN)	11.2	13.2	14.7	

Sources: World Bank (1991, pp. 174-175; 1992, pp. 87, 93, 99, 199; 1996a, p. 61); International Monetary Fund (1997, p. 857).
Note: ATN = Aportes del Tesoro Nacional. The table includes the federal district of Buenos Aires.
a. Excluding amortization.

been routinely used to cover provincial deficits; and transfers from the National Housing Fund (the Fondo Nacional de la Vivienda [FONAVI]) and similar, smaller funds (World Bank, 1991). The remaining revenues are derived from provincial sources, with provincial taxes on real estate, automobiles, gross sales, and stamp duties accounting for approximately 35% of total provincial revenues.

As indicated by Table 2, the relative share of provincial revenues derived from local and national sources has remained relatively stable since the first 2 years of the Alfonsín administration. Important changes have occurred, however, in the level of resources available to provincial governments. After declining over the course of the 1980s, provincial revenues increased rapidly in the early 1990s in response to the revised revenue-sharing formula, improved revenue performance at the federal level, and renewed economic growth. The gains achieved by the public sector as a whole are reflected in the

consolidated fiscal balance, which rose from a deficit of 2.3% of GDP to a surplus of 1.2% between 1990 and 1993 (World Bank, 1996a, p. 2). The credit for this effort, however, belongs largely to the federal government. At the provincial level, spending more than kept pace with revenue growth after 1992, contributing to a progressively widening gap between revenues and expenditures, growing indebtedness, and renewed problems of fiscal adjustment at the national level.

The Convertibility Law of 1991 prohibited the financing of provincial deficits through provincial banks or Central Bank emissions. Nevertheless, provincial borrowing continued largely unconstrained during the 1990s through loans against anticipated coparticipation funds, delayed payments to suppliers, salary and pension arrears, and the issuance of provincial script—a device tantamount to currency emission and thus fundamentally threatening to the national adjustment effort. By the end of 1995, the provinces had accumulated a total debt of approximately $15 billion or $430 per capita—higher than the average figure of $400 prevailing at the state level in the United States (World Bank, 1996a, p. ii). Adding amortization payments to the total expenditures reported in Table 2, provincial financing needs at the end of Menem's first term in office equaled 19% of total revenues—a sum approximately equal to 2% of national GDP. If discretionary federal transfers designed to cover deficit spending are eliminated from the balance sheet, the picture is markedly worse.

The success of Argentine adjustment effort of the early 1990s was thus achieved through policies of overadjustment at the national level that compensated for public sector expansion and financial fragilities at the provincial level. These fragilities became manifest in 1995, when the Argentine GDP declined more than 4% in response to the "tequila effect" (Fundación de Investigactiones Económicas Latinoamericanas, 1995; see also Cavallo, 1997, pp. 213-228). Faced with unanticipated revenue shortfalls and credit shortages, provincial authorities were forced to resort to the expansion of the floating debt, sales of assets, and emergency expenditure cutbacks. Public employees took to the streets in protest, provoking a series of riots and violent clashes with police and paramilitary troops in the provinces that dramatically underlined the social costs and political vulnerabilities of the Menem adjustment program ("New Riots," 1995).

Public sector employment figures reflect the divergence in national and provincial policies. After increasing approximately 25% between 1983 and 1990, the number of civil servants in the national public administration was cut dramatically from 835,485 in 1990 to 190,414 in 1994 (Instituto Nacional de Estadísticas y Censos, 1995, p. 479; World Bank, 1993, p. 308). At the provincial level, the trend was diametrically the opposite. After expanding 40%

between 1983 and 1990, provincial public sector employment may be estimated to have increased by an additional 77% between 1990 and 1995—a period marked by one of the most intense stabilization efforts in Argentine history (World Bank, 1993, pp. 129, 308, 1996a, p. 51). Although this estimate may well be inflated by ghost workers, double employment, and other problems associated with inadequate provincial record-keeping systems, provincial spending patterns also point to a sustained growth in provincial government employment. Whereas capital spending at the provincial level dropped from U.S.$4.6 billion to U.S.$2.1 billion over the course of the 1980s (World Bank, 1993, p. 129), personnel expenditures increased significantly. By 1990, spending associated with wage and public employment policies accounted for nearly two thirds of all provincial expenditures (World Bank, 1993, p. 129). The provincial wage bill continued to grow at an average annual rate of 14.2% between 1991 and 1994, increasing a total of 41% in real terms (World Bank, 1996a, p. 61).

The costs of provincial fiscal policies for the Argentine adjustment effort have not gone unnoticed by the international financial community. The World Bank (1990a) issued a special report on Argentine provincial finances that emphasized the importance of fiscal adjustment at all levels of government. In unusually strong language, the report asserted that "the necessity of bringing irresponsible provincial deficits under control is of utmost and urgent concern" (p. viii). Six years later, after the Convertibility Plan had restored macroeconomic stability to the economy, another World Bank report on provincial finances outlined the severe fiscal crisis facing the provinces and again warned that "provincial fiscal adjustment is urgent" (1996a, p. ix). A 1997 International Monetary Fund (IMF) mission to Argentina likewise expressed concern about spiraling provincial spending, noting that in April of that year provincial governments managed to spend 21% more than in the same month of the previous year ("Social Protests," 1997).

Despite these external pressures, the gap separating national and provincial policy has remained a central feature of Argentine political economy. As of mid-1998, the provinces were collectively pressing the federal government to guarantee their increased spending levels by raising the budgetary floor established by the Pacto Fiscal of 1993 from $740 million to $900 million per month ("Las Provincias Condicionan," 1998). Concommitantly, national authorities were announcing U.S.$1 billion in cuts from the federal budget to reduce the public sector deficit and insulate Argentina from turmoil in global financial markets.[1] The political costs of this policy divergence

1. See, for example, "El Gobierno Corta" (1998), "Menem Fails" (1998), and "Menem y De la Rúa Pidieron Austeridad" (1998).

have been borne by the national government, which is charged with responsibility for the overall state of the economy. Unemployment, which approached 20% during the 1995 crisis and remained high in its wake, has represented a particularly intractable political problem—the number one concern of the Argentine electorate as it delivered a major electoral defeat to the government in the 1997 interim congressional elections (Centro de Estudios para La Nueva Mayoría, 1997; see also "The *Wall Street Journal* Americas poll," 1998).

VARIATIONS IN ECONOMIC ADJUSTMENT AT THE PROVINCIAL LEVEL

The decentralization of public services does not adequately explain the worsening fiscal condition and growing indebtedness of the provinces. Between 1983 and 1990, provincial employment grew as rapidly in areas not affected by decentralization as in health and education, for which substantial responsibility was transferred from the central government to the provinces (World Bank, 1990a, p. 61, 1996a, p. 7). The increases in provincial expenditures that occurred after 1990 were also well above the estimated cost of the new administrative functions assigned to the provinces (World Bank, 1996a, pp. 46-47). Perhaps most telling of all, however, is the wide variation that exists in provincial responses to common federal policies.

Within the framework of the national trend toward administrative decentralization, the rate of expansion of public sector employment, deficit spending, and indebtedness has varied considerably across the provinces. Between 1991 and 1995, provinces such as Buenos Aires and La Pampa managed to maintain relatively balanced budgets, whereas the fiscal situation in others (including La Rioja, Río Negro, and San Juan) deteriorated significantly. These differences speak to the importance of politics at the provincial level, where the public sector has traditionally been noted less for efficient service delivery than for high levels of politicization, the absence of merit appointment and promotion criteria, and the prevalence of political appointments down through the lowest levels of the bureaucracy (World Bank, 1990a, p. 62).

Although heavily oriented toward the study of expenditure and revenue levels, prior research on fiscal policy in the Argentine provinces provides a useful starting point for analyzing these subnational variations. The main finding of this literature is relatively straightforward and unsurprising: Levels of provincial spending and revenue generation vary with provincial wealth and intergovernmental transfers. Hence, drawing on recent World Bank data (1996a, pp. 10, 37, 75), we estimate that per capita federal transfers

and provincial GDP explain .807% of the variance in provincial revenue levels in 1995, as assessed on the basis of adjusted R^2 ($n = 23$). Not surprisingly, per capita provincial expenditures in turn are highly correlated with per capita revenues ($r = .969$). Detailed analyses of provincial finances indicate that these relationships hold up for the 1983-1995 period as a whole (Sanguinetti & Tommasi, 1997).

From the perspective of understanding the problems of stabilization and adjustment, perhaps the most important conclusion that can be drawn from this research is that intergovernmental transfers generate differences in expenditure patterns across the provinces, encouraging those favored by the prevailing distribution formula to spend more than their counterparts. As of 1995, the so-called low density provinces (Chubut, La Pampa, Neuquén, Río Negro, Santa Cruz, and Tierra del Fuego), which contain approximately 5% of the total national population, received 14.6% of federal transfers or $1,158 per capita. In contrast, the four largest and most developed provinces (Buenos Aires, Córdoba, Mendoza, and Santa Fe) plus the Muncipality of Buenos Aires received only $277 per capita in transfer funds (World Bank, 1996a, p. 37). These differences establish the basis for significant variations in spending capacity, marked at one extreme by Santa Cruz, one of the smallest but by no means the poorest province, which spent $4,237 per inhabitant in 1995; and at the other the large Province of Buenos Aires, which spent only $595 per capita.

As emphasized by Sawers's (1996, pp. 217-253) research, the transfer of funds from the more prosperous pampean provinces to the interior of the country is not new; nor are its costs, which lead to public sector expansion in selected provinces at the expense of the nation as a whole. No defensible set of redistributive policy goals is served by these distortions (Fundación de Investigaciones Económicas Latinoamericanas, 1991, p. 295). For example, drawing upon published data (World Bank, 1996a, pp. 10, 37), we find that the correlation between per capita federal transfers and per capita provincial GDP in 1995 is statistically insignificant (–.21). Per capita federal transfers are also unrelated to the proportion of provincial inhabitants living in poverty (Artana et al., 1995; Kraemer, 1997). What does count is population: The current revenue transfer system is characterized by a negative correlation between provincial population and total federal transfers, reflecting the disproportionate political weight achieved by the overrepresentation of small provinces within the Argentine federal system of governance.

The resulting differences in the relative sizes of the provincial public sectors have important implications for the process of economic adjustment. As suggested previously, the extensive patronage opportunities created by bloated public sectors provide politicians and their clienteles with strong

motives for resisting national pressures for economic reform. As theorized by Stigler and others, the more concentrated the costs of policy change, the greater the political opposition (Nelson, 1990; Noll, 1983; Stigler, 1971). In the Argentine provinces, where salaries absorb roughly 60% of current revenues, the costs of adjustment are most immediately and obviously borne by unionized public sector workers. Since the early 1990s, attempts to cut provincial budgets have resulted in recurrent outbreaks of protest and political violence.[2] But defensive reaction on the part of public employees is arguably only part of the problem. Where up to one third of the provincial workforce is either employed by the government or supported by state pensions, the prosperity of the private sector also revolves around public spending. Thus, the higher the level of spending on public sector wages, the more the calculus regarding the political costs and benefits of adjustment is likely to be weighted against reform. The findings of prior research linking spending decisions with federal transfer levels thus dovetail into our hypothesis linking the political incentives for provincial adjustment with the relative degree of reliance on own-source revenues.

To the extent that prior research has explored the political roots of policy differences among the provinces, the major findings echo those of the literature on the United States. Budgetary institutions (including borrowing restrictions), divided government, and presidential party control of provincial governments have all been found to influence provincial expenditures and deficits (Sanguinetti & Tommasi, 1997). What remains unclear is the relative importance of these factors for understanding cross-sectional variations in adjustment effort in the critical 1991-1995 period, as distinct from year-to-year shifts over the 1983-1995 period as a whole. Also open to question is the relationship of these factors to other influences on provincial spending, especially the structure of party competition and dependence on own-source revenues. Our theoretical framework privileges the latter two variables for two major reasons. First, we assume that the motivation for politicians to adopt budgetary institutions that insulate policy formation from political pressures varies with the relative degree of provincial dependence on own-source revenues and the structure of party competition. The closer the relationship between government spending and taxation, the greater the incentives for sound fiscal management. Evenly balanced party competition also creates incentives for politicians to adopt reforms that undermine

2. See, for example, "And Now, Merge the Provinces" (1990); "Provinces Revolt" (1994); "Will Rosario Be the Next" (1994); "Argentina Provincial" (1994); "The Challenge" (1995); "It Was Not the Feared" (1995); "'Extortion' Forces Angeloz" (1995); "New Riots" (1995); "Riots" (1995); "Rio Negro Sounds" (1995); "Steep Warning" (1995); "The Downslide" (1995);

clientelistic, patronage-based politics and supply voters with cleaner and more efficient government (Fox, 1996; Geddes, 1994). Second, we assume that the possibilities for the election of governors from nonpresidential parties, as well as divided government at the subnational level, are not randomly distributed but shaped by the underlying pattern of party competition within a province. One-sided electoral contests can insulate provincial politics from broader national trends and influences, as in the one-party South, thereby strengthening opportunities for the election of governors from nonpresidential parties. The same may be said of provincial parties, which also establish the basis for fragmented party systems and increase prospects for divided government.

To explore these and related sets of issues, the subsequent analysis focuses on variations in Argentine provincial policy performance, with emphasis on the critical 1991-1995 adjustment period. The first year of this period saw the introduction of the Convertibility Plan, which paved the way for the restoration of macroeconomic stability at the national level. By 1995, however, which is the latest year for which systematic provincial data are available, it had become evident that adjustment success at the national level masked serious and growing fiscal disequilibria in many provinces.

Given the limitations of available data, we focus explicitly on variations in the relative magnitude of patronage spending, budgetary imbalances, and indebtedness in 1995 using four indicators of provincial policy. The first is personnel spending as a percentage of provincial revenues in 1995, which is designed to assess the priority placed on patronage in the allocation of provincial resources. Our theoretical framework suggests that partisanship, revenue structure, and electoral competition will shape the incentives for provincial politicians to resist economic adjustment in favor of patronage spending. Because patronage in the Argentine provinces has historically been distributed via public sector jobs (Sawers, 1996; World Bank, 1991, 1993), we focus explicitly on personnel spending. We expect high levels of patronage spending, in turn, to be reflected in provincial fiscal performance, measured on the basis of three different indicators: (a) the 1995 provincial operating balance (current revenues minus current expenditures minus amortization) expressed as a percentage of current revenues, (b) the 1995 current balance (current revenues minus current expenditures) expressed as a percentage of current revenues, and (c) the 1995 per capita provincial debt. All of the financial data used in the analysis have been drawn from the World Bank (1990a, 1996a). Political data are drawn from Fraga (1989, 1992, 1995).

Table 3 maps out the major differences among the Argentine provinces in terms of budgetary performance over the course of the 1991-1995 period.

Table 3
Provincial Operating Balances, 1991-1995 (millions of pesos)

Province	1991	1992	1993	1994	1995
Buenos Aires	–418	549	263	112	81
Córdoba	–114	–55	–343	–228	–389
Mendoza	45	36	–34	–117	–128
Santa Fe	–58	109	42	103	–116
Entre Ríos	–74	–44	–100	–93	–239
Salta	–95	–112	–148	–72	–111
San Juan	–20	25	–79	–232	–185
San Luis	58	65	66	46	63
T. Fuego	–46	–23	–14	–76	–118
Tucumán	7	2	–16	–69	–184
Chubut	–58	–51	–125	–122	–151
La Pampa	43	38	25	9	48
La Neuquén	0	–6	–134	–61	–68
Río Negro	–13	–20	–374	–121	–330
Santa Cruz	–42	12	–24	–10	–104
Catamarca	–41	–22	–73	–121	–90
Chaco	10	–34	–82	–80	–165
Corrientes	2	–70	–86	–194	–123
Formosa	–76	–28	–157	–240	–324
Jujuy	–102	31	–115	–101	–181
La Rioja	–95	–132	–161	–177	–293
Misiones	20	–7	–87	–58	–98
Santiago de E.	12	–7	–110	–135	–70
Total	–1,055	258	–1,866	–2,035	–3,275

Source: World Bank (1996a, I p. 65).
Note: Operating deficit is defined as current savings (current revenues minus current expenditures) less amortization.

After registering a major improvement in 1992, the fiscal situation of most provinces steadily deteriorated. Whereas nine started out the adjustment period with positive operating balances, by 1995 that number had been reduced to three. Within the framework of these broader trends, Buenos Aires, Santa Fe, Salta, San Luis, and La Pampa managed to maintain or even improve their fiscal situation. Others, most notably the presidential province of La Rioja, failed to cooperate with the national adjustment program and allowed their operating deficits to mount to levels equivalent to 50% or more of current revenues. Difficulties on the revenue side of the equation were only partially responsible. Total provincial expenditures increased 38.9% in real terms between 1991 and 1995.

These pronounced variations in provincial budgetary performance strongly reflect the structure of public expenditures and revenues. In accordance with theoretical expectation, the lower the proportion of revenues derived from provincial sources at the start of the adjustment program, the less the fiscal adjustment effort as measured in terms of the 1995 provincial operating balance relative to current revenues. On the expenditure side, the greater the level of personnel spending in 1995 relative to current revenues, the lower the relative size of the operating balance. Building on our hypothesis regarding revenue sources, we postulate that these two phenomena are closely related, such that the greater the degree of dependence on national revenues, the greater the tendency for provincial authorities to resist economic adjustment in favor of the maintenance or expansion of public payrolls. Indeed, we find that the wage and revenue variables are highly correlated (in 1995, $r = -.70$). To cope with the resulting problems of collinearity and endogeneity, as well as to address as directly as possible the contribution of patronage to provincial fiscal disequilibria, we model the relationships linking provincial fiscal performance with public sector revenue and expenditure structure as follows:

$$\text{WAGES95} = b_0 + b_1\text{OWNREV90} + b_2\text{COMP} + b_3\text{RADGOV} + e$$

$$\text{FISCAL PERFORMANCE95} = b_0 + b_1\text{WAGES95} + e,$$

where WAGES95 is the ratio of provincial wage expenditures to current revenues in 1995, OWNREV90 is the percentage of total revenues derived from provincial as opposed to federal sources in 1990, COMP or competitiveness is the percentage vote received by provincial governors elected for the 1991-1995 period measured in consistently negative terms as distance from the 50th percentile, and RADGOV is a dummy variable identifying governors as members of the Radical opposition party. To estimate the second equation, we rely on the three indicators of provincial fiscal performance described above: the provincial current balance, the provincial operating balance, and the 1995 per capita provincial debt.

Taken together, the two equations are designed to explore our three hypotheses linking variations in provincial fiscal performance with the incentives and opportunities for politicians to supply political patronage rather than conform with national adjustment policies. The first independent variable in the wage equation is designed to assess our hypothesis linking adjustment with the structure of public revenues. To avoid introducing additional problems of endogeneity, the own-source revenue variable is lagged back to 1990, the year before the initiation of the Convertibility Plan. The

logic behind the creation of the indicator of competitiveness is also relatively uncomplicated: We expect that the more equally votes are distributed between two major parties, the greater the prospects for reform. By the same logic, governors elected with fragile pluralities or overwhelming majorities are expected to be equally unlikely to initiate policies that threaten provincial patronage bases. The competitiveness variable ranges from a high of –.02% for the province of Entre Ríos to –28.78% for La Rioja. It should be emphasized that the indicator does not exaggerate partisan strength at the expense of fragmentation. Factoring in the relative strength of all competing parties on the basis of the Molinar index of party fragmentation (Molinar, 1991) and measuring the resulting distance from a perfect two-party system yields a nearly identical, albeit far more complicated and less transparent, index (r = .87). The final variable in the model, RADGOV, is designed to assess the extent to which opposition provinces represent major bastions of resistance to federal adjustment efforts.

RESULTS

To address problems associated with endogeneity, the statistical analysis relies on a relatively straightforward application of two-stage least squares regression. The analysis draws upon the instrumental-variables method, in which the instrument is the predicted value of the endogenous variable—in this instance, the wage variable (see Johnston, 1984; Pagan, 1986). The results, with respect to the relative burden of wage expenditures, are displayed in Table 4.

The main finding is that evenly balanced political competition and lesser dependence on federal transfers reduce the propensity toward bloated public sector payrolls. The coefficients for opposition control are also marginally significant, but only at the .07 level. The results not only offer a relatively complete explanation for the relative magnitude of provincial wage burdens as assessed in terms of adjusted R^2, but also stand up to diagnostic tests for outliers, omitted variables, and heteroskedasticity. Adding per capita provincial GDP, which is not significantly correlated with any of the independent variables, does not significantly change the reported results, nor does provincial population. Additional testing also indicates that the results are not an artifact of the index of competition. Adding the total vote of the two leading parties to the equation to control for party fragmentation does not significantly alter the estimates. A curvilinear model specification using the percentage vote of the winning gubernatorial candidate, together with that same

Table 4
Provincial Wage Expenditures as a Function of Revenue Structure, Party Competition, and Partisanship

Variable	Model 1	Model 2	Model 3	Model 4
Intercept	75.250****	79.566****	74.319****	74.551****
	(4.359)	(7.468)	(4.886)	(4.547)
OWNREV90	–45.732***	–39.989**	–43.792***	–44.325***
	(13.254)	(5.988)	(14.328)	(14.023)
COMP	–1.504****	–1.455****	–1.457****	–1.467****
	(0.288)	(0.300)	(0.292)	(0.298)
RADGOV	9.143*	8.496*		8.179
	(4.800)	(4.945)		(5.082)
ININDEX		–0.216		
		(0.301)		
PRESGOV			6.008	
			(3.842)	
DIVGOV				2.911
				(4.373)
F	18.91****	13.95****	17.59****	13.88****
Adjusted R^2	.710	.702	.694	.701

Note: $N = 23$. Entries are unstandardized regression coefficients, and standard errors are in parentheses. Dependent variable is 1995 wage expenditures as a percentage of current revenues. *$p = .10$. **$p = .05$. ***$p = .01$. ****$p = .001$.

variable exponentiated, similarly suggests that departures from partisan parity work against economic adjustment.[3]

Given the small number of cases, there is limited room to assess competing hypotheses about provincial fiscal performance. We have, however, tested for the relevance of three variables identified in prior research as potentially important for understanding Argentine fiscal policy: provincial budgetary institutions (ININDEX), presidential party control of provincial governorships (PRESGOV), and divided provincial government (DIVGOV). Provincial budgetary institutions are measured on a scale ranging from 15 to 45, as reported in Sanguinetti and Tommasi (1997, p. 45).[4] The other in-

"Eyes on Unrest" (1995); "Social Protests" (1997); and "Unrest Erupts" (1997). See also Sawers (1996, p. 33).

3. As anticipated, the relationship between winning party strength and wage spending resembles a "U," with the coefficient for the winning gubernatorial vote negative and statistically significant at the .000 level, and the coefficient for the winning vote exponentiated positive and also statistically significant at the .000 level. As assessed in terms of adjusted *R*, the overall fit of the model including the RADGOV and OWNREV variables is .757 with *F* equal to 18.09.

4. The scale assigns values of 0 to 10 to provinces on eight institutional dimensions: the capacity of provincial legislatures to increase the spending levels proposed in the governor's

dicators are dummy variables, measured on the basis of outcomes in the 1991 gubernatorial elections or, in the case of DIVGOV, on the basis of both 1991 and 1993 elections. Provinces in which different parties controlled the governorship and legislature either between 1991-1993 or 1993-1995 are coded as instances of divided government.

Our findings, with respect to these competing explanations of provincial fiscal performance, are completely negative. Despite being prominently featured in recent Inter-American Bank studies (Inter-American Development Bank, 1997, p. 175; Sanguinetti & Tommasi, 1997), provincial institutions do not enhance our basic model. The reason is that the institutional index is highly correlated with provincial revenue structure (for 1995, $r = .70$). Because provincial revenue structure is shaped by the federal revenue-sharing formula, the correlation between ININDEX and OWNREV90 clearly suggests that budgetary institutions are a consequence, rather than a cause, of the relative dependence upon own-source revenues. Provinces that are obliged to raise a high proportion of their own revenues have more incentive to adopt institutions that encourage fiscal prudence. Accordingly, we dismiss the relevance of provincial rules and organs of budgetary control as a significant independent variable within the framework of our model. Substituting the presidential governorship variables for the RADGOV indicator used in our model also yields statistically insignificant results. Moreover, the sign is diametrically the opposite of the predicted direction. Likewise, divided government adds nothing to the model, either with or without the dummy variable for Radical governorships.[5]

Turning to our second equation for fiscal performance, we present three sets of estimates for current deficits as a percentage of current revenues, operating deficits as a percentage of current revenues, and per capita debt. The results for the two deficit indicators correspond to the equation for Model 1 defined in Table 4. To estimate per capita indebtedness, however, we have added per capita provincial income for 1995 to the equation to control for variations in the capacity of wealthier provinces to incur greater debt.

The main finding is that the coefficient for the instrumental wage variable (i.e., the predicted value of the wage variable) is significant across Table 5,

---

budget, the independence of provincial authorities from fiscal auditing agencies, constitutional provisions promoting specific economic activities, rules governing budgets lacking legislative approval at the start of the fiscal year, borrowing restrictions at the provincial level, borrowing restrictions at the municipal level, tax-sharing agreements between provincial governments and municipalities, and provincial pension systems.

Table 5
Provincial Fiscal Adjustment as a Function of Expenditure Structure

Variable	Current Balance	Operating Balance	Per Capita Debt
Intercept	86.641****	89.424****	–922.07***
	(11.814)	(16.578)	(327.462)
WAGES95	–1.395****	–1.572****	22.663****
	(0.155)	(0.218)	(0.209)
PCGDP			–3.646***
			(1.241)
F	80.64****	52.04****	19.35****
Adjusted R^2	.846	.766	.673

Note: $N = 23$. Entries are unstandardized regression coefficients, and standard errors are in parentheses. Dependent variables are the current operating balance as a percentage of current revenues in 1995, the operating balance (current balance minus amortization) as a percentage of current revenues in 1995, and per capita provincial debt in 1995. WAGES95 is an instrumental variable generated by regressing 1995 wage expenditures as a percentage of current revenues on all exogenous variables in the system.
***$p = .01$. ****$p = .001$.

emphasizing the importance of the link between patronage and provincial fiscal performance. Whether measured in terms of current balance, operating balance, or per capita indebtedness, high wage expenditures are associated with limited adjustment. As indicated by the *F* statistic and adjusted R^2, the fit of the model is also impressive for all three of our indicators. Unexpectedly, we find a negative linkage between per capita debt and income, which suggests unusual adjustment problems in the poorer provinces; however, per capita income is not related to either of the other two indicators of fiscal performance.

Given problems of autocorrelation and the relatively truncated nature of the 1991-1995 time period, significant statistical gains cannot be achieved through estimation on the basis of pooled cross-sectional time series data. Even after transforming the current balance variable into a percentage figure (current balance as a percentage of current revenues), for example, the correlation between current balance in 1991 and 1995 is .814. Thus, after introducing lagged values to control for autocorrelation problems, the time series is basically reduced to a cross-sectional data set. Nevertheless, it may be noted that the results reported above remain stable if the basic equations are estimated using averaged data for wages and fiscal balance for the 1991-1995 period as a whole. Likewise, the results remain virtually identical if we add the lagged value of the dependent variable to the two basic equations to estimate change over the course of the 1991-1995 time period.

CONCLUSION

Most evidence about the politics of economic adjustment has been drawn from the study of national policy formation. Central emphasis has been placed on the political strength and autonomy of national executives and on the role of economic pressures in generating the political bases for adjustment programs. For the study of the process of national policy innovation, this combined emphasis makes some sense; however, understanding the problems of sustaining adjustment policies over time calls for a broader perspective that takes into account politics at the subnational level. Leadership and conjunctural factors may also be relevant at this level, but the political incentives and opportunities shaping policy decisions differ from those operating in the national arena. Insulated from international pressures and elected by relatively narrow geographical constituencies, state and local politicians cannot be expected automatically to cooperate with national programs of economic adjustment.

To address the problem of understanding subnational policy choice, we develop and test a theoretical model of adjustment that emphasizes interactions between political competitiveness and the structure of the public sector. Drawing upon evidence for the Argentine provinces, our findings show that adjustment performance varies with the resources devoted to the maintenance of subnational patronage networks. The size of the provincial public sector, in turn, is negatively linked with evenly balanced party competition and dependence upon local revenue generation. The tighter the nexus between the costs and benefits of subnational government, the more muted the tendency toward public sector expansion. Likewise, the more the electoral environment departs from the extremes of fragmented or hegemonic competition, the less the relative burden of patronage. To a lesser extent, national opposition party leadership of provincial governments also matters. Contrary to prior research, however, we find no evidence that subnational policy performance varies with presidential party control, divided government, or budgetary institutions.

Three central conclusions having significant implications for the study of economic stabilization and adjustment may be drawn from the analysis. First, and most important, subnational politics matter. Especially in political systems characterized by federalized states and decentralized government spending, the possibilities for slippage between national adjustment programs and subnational policy implementation are enormous. As the Argentine experience concretely demonstrates, even relatively successful national adjustment efforts may be undermined by contradictions between local and

national policy. Attempting to rebuild their partisan networks in the wake of the transition to democracy, recalcitrant provincial authorities in Argentina have protected and even expanded their patronage bases at the expense of national economic adjustment, forcing the federal government to adopt policies of overadjustment that have generated high unemployment, severe political tensions, and major electoral losses for the governing party. Subnational politicians in Argentina have thus demonstrated a capacity not only to mire their own governmental units in debt and mismanagement, but collectively to threaten the adjustment policies of the nation as a whole. The experience emphasizes the political complexity of economic reform and the related need for additional research on subnational economic adjustment.

Second, the findings of this study suggest that most prior research has misspecified the relationship between political competition and economic adjustment. An early body of literature on the politics of economic reform staked out a strong theoretical position linking successful stabilization and adjustment with authoritarian government. By emphasizing the importance of such issues as political monism, strong electoral support, limited political opposition, state autonomy, and executive strength, subsequent research has left us with a diluted version of the same formula (Callaghy, 1990; Conaghan & Malloy, 1995; Haggard & Kaufman, 1995, p. 163; Killick, 1995). The implicit argument is the more the ruling formula resembles authoritarianism, the greater the opportunities for adjustment. Building on Geddes's (1994) insights into the importance of political incentives, our analysis suggests just the opposite: Electorally dominant parties facing limited competition lower the odds of economic adjustment. Because this reverse formula is grounded in a logic applicable to national as well as subnational politics and is supported with systematic empirical evidence, it warrants more extensive and rigorous testing.

Third, our analysis also departs from the conventional wisdom about the politics of economic adjustment by virtue of its emphasis on the structure of the public sector. The challenges confronting reformers in different contexts are presumably not equal. In addressing this issue, prior research has emphasized the relative strength of state reformers and opposition in society at large. In contrast, our theoretical framework privileges the incentives for reform that are created by the relative dependence of subnational government on own-source revenues and the related propensity toward increased public-sector employment. Although the case base is limited, we find significant support for our model. Concommitantly, our research indicates that issues that have been at the center of the debate over the politics of adjustment, including divided government and budgetary rules, are either unimportant

when examined within the framework of a model that addresses the structure of the public sector or, as in the case of political competition, related to adjustment outcomes by virtue of their impact on the public sector.

These inconsistencies with prior research are theoretically suggestive in several ways. Inter alia they point to the use of focusing research, both at the subnational and national level, on the obstacles to reform generated by the structure of the public sector rather than society at large. For the analysis of national economic adjustment, particularly intriguing are the links between own-revenue generation and adjustment performance. The prevailing assumption is that international financial support buttresses national adjustment efforts. This assumption can be questioned on the basis of the same logic underpinning our analysis. Relevant empirical examples include Costa Rica, Dominican Republic, and Haiti—all high per capita recipients of international aid and remittances with long histories of inconsistent or failed adjustment. Such experiences point to the possible use of reconceptualizing the impact of external support along the same lines as national to subnational transfers.

In addition, the analysis of subnational policy performance has cautionary implications for the global process of decentralization, which has been transforming the administrative structures of less industrialized and emerging market nations. Adopting the perspective of analysts at the Inter-American Development Bank and other international financial institutions (Inter-American Development Bank, 1997; López Murphy, 1995; Winkler, 1994), Argentine officials expected that decentralizing responsibilities to the provinces would result in more efficient and responsive service delivery. Instead, in many provinces, capital investment ceased, debt accumulated, and increased transfers of federal revenues were used to expand public sector wages and employment. This experience emphasizes the potential perils of decentralization and the importance of analyzing the political conditions necessary for the realization of efficiency gains. Not only does decentralization exacerbate coordination problems but, as emphasized by this study, the promise of increased accountability for the provision of efficient services may be undercut by either highly uncompetitive or fragmented political processes at the local level and the lack of a close nexus between the costs and benefits of government services. Technocratic remedies, including administrative training systems and rules designed to limit discretionality, do not begin to address these difficulties.

Finally, this analysis demonstrates that subnational research can be useful for exploring issues of broad significance to the field of comparative politics. The importance of cross-national research is incontestable, but the

difficulties of drawing valid inferences about causality across small *n* studies cannot be underestimated. Particularly in studying issues such as the political economy of adjustment across widely disparate sets of countries, analysts may succeed in avoiding the shoals of theoretical banality only to founder in a sea of unreplicable results and ad hoc generalizations. Generalizing from the subnational to the national is not without its own perils, but by reducing the obstacles to the development of comparable measurement instruments and parsimonious theoretical models, subnational comparisons alleviate two of the most fundamental problems of comparative research. As illustrated by this study, the relationship between variables such as economic adjustment and political competition, which are difficult to pin down on the basis of broad cross-national comparisons, may be effectively explored at the subnational level, establishing the basis for a more complete understanding of the politics of economic adjustment.

REFERENCES

Alt, James E., & Lowry, Robert C. (1994, December). Divided government, fiscal institutions, and budget deficits: Evidence from the states. *American Political Science Review*, *88*, 811-828.

And now, merge the provinces; central bank chief says eight are no longer viable. (1990, November 15). *Latin American Weekly Report*, p. 9.

Argentina provincial protests. (1994, June 16). *Latin American Weekly Report*, p. 264.

Artana, Daniel, Libonatti, Oscar, Moskovits, Cynthia, & Salinardi, Mario. (1995). Argentina. In Ricardo López Murphy (Ed.), *Fiscal decentralization in Latin America* (pp. 59-136). Washington, DC: Inter-American Development Bank.

Baber, William R., & Sen, Pradyot. (1986). The political process and the use of debt financing by state government. *Public Choice*, *48*, 201-215.

Callaghy, Thomas. (1990). Lost between state and market: The politics of economic adjustment in Ghana, Zambia, and Nigeria. In Joan M. Nelson (Ed.), *Economic crisis and policy choice: The politics of adjustment in the third world* (pp. 257-319). Princeton, NJ: Princeton University Press.

Cavallo, Domingo. (1997). *El peso de la verdad: Un impulso a la transparencia en la Argentina de los 90* [The weight of the truth: An impulse toward transparency in the Argentina of the 90s]. Buenos Aires, Argentina: Planeta.

Centro de Estudios para La Nueva Mayoría. (1997, October). *La Alianza UCR-Frepaso*. Mimeo.

The challenge of the provinces. (1995, June 15). *Latin American Weekly Report*, p. 260.

Clingermayer, James C., & Wood, B. Dan. (1995, March). Disentangling patterns of state debt financing. *American Political Science Review*, *89*, 108-120.

Conaghan, Catherine M., & Malloy, James M. (1995). *Unsettling statecraft: Democracy and neoliberalism in the Central Andes*. Pittsburgh, PA: University of Pittsburgh Press.

The downslide is getting steeper. (1995, November 16). *Latin American Weekly Report*, p. 527.

Economic Commission for Latin America. (1992-1997). *Preliminary overview of the economy of Latin America and the Caribbean*. Santiago, Chile: United Nations.

El gobierno corta gastos frente a la crisis asiática [The government cuts expenditures in response to the Asian crisis]. (1998, June 17). *La Nación*, p. 1.

"Extortion" forces Angeloz to resign. (1995, July 20). *Latin American Weekly Report*, p. 323.

Eyes on unrest in northern Jujuy. (1995, December 14). *Latin American Weekly Report*, p. 568.

Fernandez, Raquel, & Rodrick, Dani. (1991, December). Resistance to reform: Status quo bias in the presence of individual-specific uncertainty. *American Economic Review*, *81*, 1146-1155.

Fox, Jonathan. (1996). National electoral choices in rural Mexico. In Laura Randall (Ed.), *Reforming Mexico's agrarian reform* (pp. 185-210). New York: M. E. Sharpe.

Fraga, Rosendo. (1989). *Argentina en las urnas, 1916-1989* [Argentina at the polls, 1916-1989]. Buenos Aires, Argentina: Editorial Centro de Estudios Unión para la Nueva Mayoría.

Fraga, Rosendo. (1992). *Argentina en las urnas, 1931-1991* [Argentina at the polls, 1931-1991]. Buenos Aires, Argentina: Editorial Centro de Estudios Unión para la Nueva Mayoría.

Fraga, Rosendo. (1995). *Aregentina en las urnas, 1916-1994* [Argentina at the polls, 1916-1994]. Buenos Aires, Argentina: Editorial Centro de Estudios Unión para la Nueva Mayoría.

Fundación de Investigaciones Económicas Latinoamericanas. (1991). *El sistema impositivo argentino* [The Argentine tax system]. Buenos Aires, Argentina: Ediciones Manantial.

Fundación de Investigaciones Económicas Latinoamericanas. (1995). La convertibilidad y las crisis provinciales [Convertability and the provincial crisis]. *FIDE: Coyuntura y Desarrollo*, *202*, 27-37.

Geddes, Barbara. (1994). *Politician's dilemma: Building state capacity in Latin America*. Berkeley: University of California Press.

Grindle, Merilee, & Thomas, John W. (1991). *Public choices and policy change: The political economy of reform in developing countries*. Baltimore: Johns Hopkins.

Grindle, Merilee S. (1996). *Challenging the state: Crisis and innovation in Latin America and Africa*. New York: Cambridge University Press.

Growing deficits alarm markets. (1996, November 7). *Latin American Weekly Report*, p. 512.

Haggard, Stephan, & Kaufman, Robert R. (1995). *The political economy of democratic transitions*. Princeton, NJ: Princeton University Press.

Harberger, Arnold C. (1993, May). Secrets of success: A handful of heroes. *American Economic Review*, *83*, 343-350.

Hunter, Wendy. (1997). *Eroding military influence in Brazil: Politicians against soldiers*. Chapel Hill: University of North Carolina Press.

Instituto Nacional de Estadísticas y Censos. (1995). *Statistical yearbook: Republic of Argentina*. Buenos Aires, Argentina: Author.

Inter-American Development Bank. (1994). *La descentralización fiscal en América Latina* (Working Paper No. 184). Washington, DC: Author.

Inter-American Development Bank. (1997). *Latin America after a decade of reforms*. Washington, DC: Author.

International Monetary Fund. (1997). *International financial statistics yearbook*. Washington, DC: Author.

It was not the feared "social explosion," but unrest in Córdoba unnerved many. (1995, July 6). *Latin American Weekly Report*, p. 289.

Johnston, J. (1984). *Econometric methods* (3rd ed.). New York: McGraw-Hill.

Jones, Mark. (1997). Evaluating Argentina's presidential democracy. In Scott Mainwaring & Matthew Soberg Shugart (Eds.), *Presidentialism and democracy in Latin America* (pp. 259-299). New York: Cambridge University Press.

Kahler, Miles. (1992). External influence, conditionality, and the politics of adjustment. In Stephan Haggard & Robert R. Kaufman (Eds.), *The politics of economic adjustment* (pp. 89-136). Princeton, NJ: Princeton University Press.

Killick, Tony. (1995). Relevance, meaning and determinants of flexibility. In Tony Killick (Ed.), *The flexible economy: Causes and consequences of the adaptability of national economies* (pp. 1-33). London: Routledge.

Kraemer, Moritz. (1997). *Intergovernmental transfers and political representation: Evidence from Argentina, Brazil and Mexico* (Working Paper No. 345). Washington, DC: Inter-American Development Bank.

Lall, Rajiv, & Hofman, Bert. (1995). Decentralization and the government deficit in China. In Jayanta Roy (Ed.), *Macroeconomic management and fiscal decentralization* (pp. 195-220). Washington, DC: World Bank.

Las provincias condicionan la reforma impositiva [The provinces condition tax reform]. (1998, May 19-25). *La Nación*, p. 6.

López Murphy, Ricardo. (Ed.). (1995). *Fiscal decentralization in Latin America*. Washington, DC: Inter-American Development Bank.

Menem fails to break new ground. (1998, June 24). *Wall Street Journal*, p. A12.

Menem y de la rúa pidieron austeridad [Menem and de la rua ask for austerity]. (1998, June 23-29). *La Nación*, pp. 1, 6.

Ministerio de Economía y Obras y Servicios Públicos. 1994. *Cambios estructurales en la relación nación provincias* [Structural changes in national provincial relations]. Buenos Aires, Argentina: Lugar Editorial.

Molinar, Juan. (1991, December). Counting the number of parties: An alternative index. *American Political Science Review*, *85*, 1383-1391.

Musgrave, Richard A., & Musgrave, Peggy B. (1976). *Public finance in theory and practice* (2nd ed.). New York: McGraw-Hill.

Nelson, Joan. (Ed.). (1989). *Fragile coalitions: The politics of economic adjustment*. New Brunswick, NJ: Transaction Books.

Nelson, Joan. (Ed.). (1990). *Economic crisis and policy choice: The politics of adjustment in the third world*. Princeton, NJ: Princeton University Press.

Nelson, Joan M. (1993, April). The politics of economic transformation: Is third world experience relevant to Eastern Europe? *World Politics*, *45*, 433-463.

New riots underline social vulnerability. (1995, August 10). *Latin American Weekly Report*, p. 358.

Noll, Roger G. (1983). The political foundations of regulatory policy. *Zeitschrift fur die Gesamte Staatswissenshart*, *139*, 377-404.

Novaro, Markos. (1994). Pilotos de tormentas: Crisis de representación y personalización de la política en Argentina (1989-1993) [Pilots of storms: The crisis of representation and personalization in the politics of Argentina]. Buenos Aires, Argentina: Letra Buena.

Oates, Wallace E. (1972). *Fiscal federalism*. New York: Harcourt Brace Jovanovich.

Pagan, Adrian. (1986). Two stage and related estimations and their applications. *Review of Economic Studies*, *53*, 517-538.

Pierson, Paul. (1994). *Dismantling the welfare state: Reagan, Thatcher, and the politics of retrenchment*. New York: Cambridge University Press.

Poterba, James M. (1994, August). State responses to fiscal crisis: The effects of budgetary institutions and politics. *Journal of Political Economy*, *102*, 799-821.

Provinces revolt against reform. (1994, January 13). *Latin American Weekly Report*, p. 3.

Prud'homme, Rémy. (1995). The dangers of decentralization. *World Bank Observer*, *10*, 201-220.

Przeworski, Adam. (1991). *Democracy and the market: Political and economic reforms in Eastern Europe and Latin America*. New York: Cambridge University Press.

Remmer, Karen. (1993, June). The political economy of elections in Latin America, 1980-1991. *American Political Science Review*, *87*, 393-407.

Río Negro sounds new warning. (1995, October 12). *Latin American Weekly Report*, p. 466.

Riots. (1995, October 5). *Latin American Weekly Report*, p. 456.

Rodrik, Dani. (1994). The rush to free trade in the developing world: Why so late? Why now? Will it last? In Stephan Haggard & Steven B. Webb (Eds.), *Voting for reform: Democracy, political liberalization, and economic adjustment* (pp. 61-88). Washington, DC: World Bank.

Sanguinetti, Pablo, & Tommasi, Mariano. (1997). *Los determinantes económicos e institucionales de los déficts en los presupuestos provinciales: Argentina 1983-1996* [The economic and institutional determinants of deficits in provincial budgets: Argentina 1983-1996] [Mimeo]. Washington, DC: Banco Interamericano de Desarrollo.

Sawers, Larry. (1996). *The other Argentina*. Boulder, CO: Westview.

Shah, Anwar. (1994). *The reform of intergovernmental fiscal relations in developing and emerging market economies*. Washington, DC: World Bank.

Sheahan, John. (1980, January). Market-oriented policies and political repression in Latin America. *Economic Development and Cultural Change*, *28*, 267-291.

Social protests continue to spread. (1997, May 20). *Latin American Weekly Report*, pp. 232-233.

Stallings, Barbara. (1992). International influence on economic policy: Debt, stabilization, and structural reform. In Stephan Haggard & Robert R. Kaufman (Eds.), *The politics of economic adjustment* (pp. 41-88). Princeton, NJ: Princeton University Press.

Stallings, Barbara. (1995). *Global change, regional response*. New York: Cambridge University Press.

Steep warning for Menem (and the UCR) in the latest round of elections. (1995, October 19). *Latin American Weekly Report*, p. 469.

Stein, Ernesto. (1998). *Fiscal decentralization and government size in Latin America* (Working Paper No. 368). Washington, DC: Inter-American Development Bank.

Stigler, George. (1971, Spring). The theory of economic regulation. *Bell Journal of Economics and Management Science*, *2*, 3-21.

Unrest erupts in Argentina over austerity. (1997, May 22). *New York Times*, p. A3.

The *Wall Street Journal* Americas poll. (1998, April 16). *Wall Street Journal Interactive Edition*.

Wallich, Christine I. (1995). Russia's dilemma of fiscal federalism. In Jayanta Roy (Ed.), *Macroeconomic management and fiscal decentralization* (pp. 103-123). Washington, DC: World Bank.

Waterbury, John. (1993). *Exposed to innumerable delusions: Public enterprise and state power in Egypt, India, Mexico and Turkey*. New York: Cambridge University Press.

Weyland, Kurt. (1996). Risk taking in Latin American economic restructuring: Lessons from prospect theory. *International Studies Quarterly*, *40*, 185-208.

Wildasin, David E. (1997). *Fiscal aspects of evolving federations*. Cambridge, MA: Cambridge University Press.

Will Rosario be the next to blow up? (1994, February 10). *Latin American Weekly Report*, p. 57.

Williamson, John, & Haggard, Stephan. (1994). The political conditions for economic reform. In John Williamson (Ed.), *The political economy of policy reform* (pp. 525-596). Washington, DC: Institute for International Economics.

Winkler, Donald R. (1994). *The design and administration of intergovernmental transfers: Fiscal decentralization in Latin America* (World Bank Discussion Papers No. 235). Washington, DC: World Bank.

World Bank. (1985). *Argentina: Economic memorandum* (Vol. 1). Washington, DC: Author.
World Bank. (1990a). *Argentina: Provincial government finances*. Washington, DC: Author.
World Bank. (1990b). *Argentina: Reforms for price stability and growth*. Washington, DC: Author.
World Bank. (1990c). *Argentina: Tax policy for stabilization and economic recovery*. Washington, DC: Author.
World Bank. (1992). *Argentina: Towards a new federalism* [Mimeo]. Washington, DC: Author.
World Bank. (1993). *Argentina: From insolvency to growth*. Washington, DC: Author.
World Bank. (1996a). *Argentina: Provincial finances study: Selected issues in fiscal federalism* (2 vols.). Washington, DC: Author.
World Bank. (1996b). *India: Five years of stabilization and reform and the challenges ahead*. Washington, DC: Author.

Karen L. Remmer is a professor of political science at the University of New Mexico and an associate editor of the Latin American Research Review. *Her publications include* Military Rule in Latin America.

Erik Wibbels is a Ph.D. candidate at the University of New Mexico, currently completing his dissertation on federalism and economic adjustment.