

UNRAVELING THE POLITICS OF DECENTRALIZATION: ARGENTINA AND SPAIN IN
COMPARATIVE PERSPECTIVE

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This dissertation explores the politics of fiscal decentralization in comparative perspective. Case studies of Argentina and Spain are used to provide insights into the way that the distribution of institutional and economic resources in multitiered polities shapes the extent to which the policy of transferring revenue and revenue authority to subnational governments can be exploited for political gain. This approach draws attention to the political conditions that inhibit the coordination of fiscal reform efforts between the different levels of government and perpetuate the financing of subnational spending with revenue collected by the national government. This political context undermines national fiscal adjustment efforts and leads to economic catastrophes such as those experienced in Argentina throughout the last two decades. Specifically, this study uses statistical analyses and empirical institutional theory to show how patterns of territorial representation and bargaining strategies hindered revenue decentralization in Argentina but advanced it in Spain.

The research suggests, first, coalition-building goals drive national executives in Argentina to reach out legislators of the opposition by means of allocating larger shares of federal transfers to the provinces the latter belong to. However, all else equal, legislatively overrepresented, i.e. economically marginal and sparsely populated, provinces will be targeted first. Second, the increasing role of regionalist parties in Spanish national politics and their acceptance in joint-policy mechanisms tilts the allocation of chosen federal transfers slightly in

favor of economically developed and densely populated autonomous communities, which are generally governed by regionalist forces. Third, whereas Argentine subnational interests are “locked-in” at the Senate level and intergovernmental negotiations are conducted bilaterally, open-ended institutional arrangements and a relatively impotent senate in Spain boosted the redressing of regional concerns through informal intergovernmental fora and increasing multilateral collaboration. Fourth, such differences in patterns of institutional representation and bargaining strategies explain the paucity of fiscal decentralization in Argentina and its relative progress in Spain.

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PREFACE

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1 Chapter 1: Introduction

What determines the magnitude of decentralization in a country? This question has become highly topical at the light of recent developments in both developed and developing countries that have increased the interest in what might loosely be called “decentralized forms of government”. The preference for decentralization is often articulated by political scientists in terms of its advantages with regard to the transference of powers and functions to lower levels of government. Also, inspired by some economic theories of federalism, devolution of fiscal responsibilities is promoted to bolster economic development and the preservation of markets. Adding to the academic interest in decentralization is the fact that virtually all nations – federal or otherwise – have more than one tier of government, each with its own set of political and fiscal functions. Like democratization and human rights protection, decentralization is often seen as a necessary component of political development. However, despite the emergence of a substantial body of research on the economic and political effects of decentralization, the literature has been more silent on treating decentralization as an outcome to be explained.

In fact, we know very little about the political determinants of decentralization. Implicit in much of the literature is the assumption that federal states are more fiscally and politically decentralized than unitary systems. However, and even if we admit that federalism involves institutional mechanisms that preserve significant and staying powers of subnational units, state structures have limited explanatory value because of their predominantly invariant nature. Not to mention that oftentimes local governments in federal systems (i.e., Austria and Argentina) are worse off than their analogues in unitary countries (i.e., Nordic countries and Colombia) because in the former municipalities tend to be subject to state-level or middle tier of governments, which

by nature are resource maximizers. Moreover, the political praxis of some federal states, like Mexico and Venezuela, is normally more centralized than that of unitary ones. Thus, it becomes apparent that extant taxonomic exercises treating federalism as a way to measure decentralization do not account for the fact that whereas the former entails formal and resilient institutional incentives, the latter is a dynamic phenomenon. Constitutional design and institutional veto points may account for initial levels of decentralization in a country, but they cannot anticipate the degree, patterns, and pace of decentralization.

1.1 Why Decentralization?

The study of decentralization has been high on the agenda of contemporary political science. This should come as no surprise given the fact that nearly all countries worldwide have experimented with one or another type of decentralization project. Their motivations are diverse. First, territorial differentials in economic developments have been identified as causing decentralization. Based on core-periphery analysis, this literature hypothesizes that poor regions would promote decentralization to increase their say in policies that might improve their destiny (Horowitz 1985; Rokkan and Urwin 1983). Another category of explanations suggests that decentralization results from an adverse reaction of societal and governmental actors to economic and political centralization. While in principle there seem to exist no major differences between democratic and authoritarian experiences in this regard, democratization processes invigorate decentralization and coexist with it (Alesina and Spolaore 1997; Nickson 1995; Panizza 1999). Third, one argument asserts that country size and ethno-linguistic heterogeneity are the strongest predictors of decentralization (Oates 1972). Last, decision-makers in developing nations believed that decentralization will quench advanced capitalist countries' concern with

development and good governance. As the confidence in large-scale undertakings eroded, decentralization was congenial with different micro-level projects sponsored by the World Bank, the International Monetary Fund and the European Community/Union (Manor 1999).

Albeit effective in illustrating starting points, these explanations are partial, at best. The hypothesis attributing decentralization to demands from poor regions fails to account for the fact that relatively richer regions (Catalonia, Lombardia, among others) have exerted greater pressure on the center for fiscal and political decentralization (Keating 1988). These better-off regions have exploited their advantageous position to limit redistributive policies that have come about in parallel to state centralization. The explanation focusing on democratization does not fully capture why successive generations of political leaders, both civilians and generals, have sought to shift their countries back and forth along the decentralization continuum. In fact, far-reaching decentralization has occurred under non-elected governments; such as in the cases of Argentina in the 1970s, Brazil in the 1980s and China in the 1990s. Moreover, the democratization *cum* decentralization hypothesis does not tell us much about cases where decentralizing reforms preceded transitions to democracy, as shown by the Brazilian case. Structuralist explanations based on country size and ethnicity fall short of explaining variation in levels of decentralization among comparable countries like Belgium and Switzerland, considering that the former considerably more centralized than the latter (Watts 1999). Last, decisions to decentralize by national governments did not take into account serious reservations in donor agencies about the dangers of decentralization, especially to macroeconomic management (Prud'homme 1995; Tanzi 1996).

1.1.1 The Theoretical Argument

The argument of this dissertation begins with a rather simple observation that decentralization is neither irreversible nor inevitable. It is a process of transformation of political and fiscal relationships between central and subnational governments that inherently involves strategic choices made by politicians. Consistent with this political nature of decentralization, we therefore emphasize the role played by dominant actors in the process. As happens with other policy arenas, presidents and governors may endorse decentralization of authority to bolster their overall position subsequently. What looks oftentimes like a blunt surrendering of power at first glance, becomes much more intelligible when it is juxtaposed with expectations about future gains.

Why, then, would central governments relinquish fiscal authority to lower levels? At least in Latin America, several studies show that decentralization is not so much a goal in itself as a means to an end. In Mexico, major municipal reforms were undertaken during the 1980s at the light of the weakening position of the Institutional Revolutionary Party (PRI) vis-à-vis opposition parties that began to win elections at the state level (Rodriguez 1997: 140-45). Brazilian legislators have passed decentralizing policies oftentimes because state governors, who are powerful political figures controlling the career options of the former at the district level, demanded more fiscal leverage (Souza 1997). President Carlos Menem of Argentina has skillfully launched decentralizing and subsequent re-centralizing reforms that resulted from bilateral negotiations between the national executive and provinces. This means that Menem used fiscal decentralization to play off some of the provinces against each other, favoring those whose governors were willing to support his attempt to compete for re-election (Eaton 2001;

Falletti 2000). This approach of resorting to decentralization as a politically expedient instrument is not foreign to West European experiences as well. Comparative research of Belgium, France, Germany, Italy, Spain, and the United Kingdom shows that pace and forms of fiscal decentralization are basically determined by the structure of partisan competition at the regional level. When regionalist parties compete against each other, demanding further fiscal prerogatives becomes a necessary condition to be seen as a credible representative of state-level interests (Van Houten 1999). Even when top-down styles are more conspicuous, political factors are still decisive. A comparison of the policy and practices of President Reagan and Mrs. Thatcher administrations highlights that, beyond their profound ideological similarities, the former advanced neoliberal prescriptions by adopting the decentralizing New Federalist policy whereas the latter has pushed centralization to unprecedented levels in Britain (Rhodes 1992; Wright 1998: 39). These examples suggest that decentralization processes are highly malleable and are very much dictated by *apriori* expectations of protecting elites' own power positions and policy expediency.

That having been said, while extant research emphasize the impact of specific institutional arrangements on decisions to decentralize or otherwise, the role of contingent and changing scenarios is under-theorized and still remains elusive. We attempt to remedy this deficiency by focusing my analysis beyond formal institutional incentives *per se*. As said, whether the structure of the state is federal or unitary sheds little light on the nature of decentralization, as this is a dynamic feature of both systems. Some studies, however, have addressed this concern by emphasizing the context of “divided government” as the major parameter shaping the evolution of fiscal relations between levels of government. Evidence from US states shows that partisan

configurations in Congress are crucial in shaping fiscal outcomes and their territorial implications (Alt and Lowry 1994; McCubbins 1991). According to this body of scholarship, when control of the executive and legislative branches of government is divided, the party that controls the legislature may support decentralization aiming at restricting budgetary and political power of the chief executive.

However, when data from Argentine provinces are used, it is shown that an expansionary bias in provincial expenditures caused by the detachment of tax and spending decisions is far more influential than divided government (Jones, Sanguinetti and Tommasi 2000). This result is highly unexpected given relatively high levels of party discipline in Argentine legislatures. A parallel case of strong party discipline enforced in the Parliament is Spain (Gunther 1989; Sanchez de Dios 1999), where the incidence of partisan color in legislature on decentralization is eclipsed by the predominance of intergovernmental transfers as the main source of revenues for regional governments (Sole-Vilanoba 1990). Accordingly, a “deficit bias” and its concomitant exacerbation of individualistic and non-cooperative behavior are held to be major driving forces in cross-national processes of fiscal decentralization (Imman and Rubinfeld 1996). This distortion, in turn, denotes a structural limitation of fiscal systems that provides a normative basis for levels of decentralization. While the Argentine and Spanish are just two among many other cases (e.g. Brazil, Germany) in which state-level administrations have every reason to increase their spending, as costs of decentralized provision are borne by other jurisdictions, both deserve independent study because they provide an ideal laboratory to explore the effect of said “race to the bottom” component of fiscal decentralization. This is so because they tackled this predicament differently, despite the presence of strong rent-seeking distributional coalitions at

the subnational level and their sharing potentially significant political variables affecting the unfolding of decentralization. In Argentina, two fiscal pacts (1992 and 1993) negotiated by the national and provincial governments facilitated a partial reversal of fiscal decentralization that took place in the late 1980s. Further, even in policy domains that were formally under the clout of provincial officials such as education, federal authorities preserved a great deal of authority (Murillo 1999). The Spanish experience shows that when certain conditions, such certain level of cross-jurisdictional coordination, are present , it becomes very difficult for central authorities to slow down decentralizing reforms, once these were set in motion.

1.1.1.1 Goals of this Dissertation

In focusing on the Argentine and Spanish experiences with fiscal decentralization, my dissertation seeks to make several contributions. First, it questions the applicability of normative views of fiscal federalism, and their concomitant neglect of the political framework in which fiscal decisions are taken. While the normative literature on fiscal federalism (Tiebout 1956; Buchanan and Musgrave 1999; Oates 1999) is correct in its assessment of the benefits of interregional fiscal competition, it fails to account for the role of bureaucrats and politicians in generating suboptimal fiscal outcomes. In an often cited study, Scharpf (1988) claims that decentralization entails a decision-making system in which no single decision-maker is able to tackle problems alone. This so called “joint decision trap” is held to be a major factor explaining policy deadlock in federal systems like Germany and Switzerland (but, see Peters 1997). This phenomenon, however, has less of an influence in cases where the central government, which controls most tax revenue sources, determines the final amount of transfers that is subject to political bargaining. The Argentine and Spanish cases, accordingly, offer a distinct federal

configuration less conducive to competitive bargaining systems, allowing us to analyze an alternative manner in which decentralization may unfold. Drawing on Scharpf's intuition as to the effect of political interferences in fiscal policies, my study maps out an analytical framework that may explain why and when uncoordinated action between levels of government leads to jurisdictional intrusion and hence to centralizing and decentralizing moves. By providing the empirical details of these developments, this dissertation hopes to provide a building block for a positive theory of decentralization.

Second, this dissertation links the study of decentralization to the literature of institutions and political parties explicitly. For the most part, extant research on parties largely ignores the "territorial dimension" (but, see Ames 1994). This deficiency renders an important gap in our understanding of partisan considerations in intergovernmental fiscal bargaining. The policy of transferring revenue to state governments is by all means a political issue, because the amount of resources granted to subnational governments will determine their viability and success. How politicians approach this arena of political contestation is not divorced from developments in the electoral cycle. In turn, the analytical framework employed in this study suggests that subnational governments' ability to negotiate decentralizing reforms depends on the representation of region-wide parties in legislature, on whether members of the same party govern the central and regional administrations and on partisan distribution of seats in legislature. While controlling for those economic and socio-demographic factors which normative views on fiscal federalism hold as crucial, our explicit inclusion of regional differences in political bargaining power can help us advance toward a political theory of decentralization.

Third, and more implicitly, this dissertation addresses some institutional biases in the comparative study of federalism. The mere existence of formal federal structures does not mean that they are effective in practice. Administrative decentralization in Argentina has not attenuated the centripetal impact of strong mechanisms of centralized control (Botana 1993). For instance, drawing on, and abusing of, a US-like constitutional clause by which the federal government can intervene in its member states to guarantee the republican form of regime, Argentine federal authorities have constrained governors politically by using federal interventions according to their discretion and convenience. By the same token, countries lacking formal federal and full-fledged cooperative institutions may nonetheless animate a system of multiple interacting governments under conditions where subnational administrations make the final decisions in their own sphere of political authority, a parameter which according to Riker (1964) is the most prominent feature of federal systems. The Spanish case is enlightening in this respect because the Constitutional Court has revoked in 1983 the Organic Law for the Harmonization of the Autonomic Process (LOAPA), which established that the national government could enact “basic” legislation and norms in domains reserved for subnational governments, and that in case of discrepancy with regional legislation, national laws would prevail.¹ Let me also just mention how one of the most recently cited and discussed theories of federalism – Weingast’s model of market-preserving federalism – juxtaposes *de facto* federal 18th-century England to the US formal federal system (Weingast 1995) to argue that the legal

¹ There are some studies even arguing that “there are circumstances when the stability of decentralization equilibrium is as robust in unitary as in federal states”. In their article on vertical competition in Italy (i.e., a relatively decentralized yet unitary country), Breton and Fracchini (2003: 58) claim that constitutional arrangements and practices make arbitrary repossessions of powers by the central government unlikely.

system may be neither a necessary nor sufficient condition for the maintenance of a decentralized federal framework. While ignoring self-designated labels can sometimes be analytically misleading, a theoretically-informed use of “functional equivalences” (Dogan and Pelassy 1990: 37-44) may help uncover important patterns of contrasts and similarities in comparative research. Beyond the different regional contexts and governmental structures of Argentina and Spain, the presence and persistence of strong rent-seeking distributional coalitions at the subnational level in these countries yields an appropriate empirical background to study the politics of decentralization.

Finally, the topic of this dissertation zooms in on a problem that is more than of exclusively academic interest. As we write these paragraphs, Argentina is undergoing extreme fiscal difficulties, after several years of economic reforms and growth. Whereas during previous crises the International Monetary Fund (IMF) has in one way or another bailed out irresponsible fiscal behavior of Argentinean decision-makers, this time it has made changes aimed at a radical restructuring of Argentine fiscal coparticipation system the most decisive condition for extending additional loans to Argentina. The IMF stance is well reflected in a recent quote by President Bush saying that, “we are hoping that Argentina will make the necessary reforms, the though decisions necessary to earn the confidence of some of these international financial institutions. The country itself is going to have to make some though calls, starting with reforming the relationship between the provinces and their budgets and the central governments” (The Financial Times, March 21, 2002, p.1).

1.1.1.1.1 A SHORT NOTE ON METHODS

Methodologically, this study attempts to improve on some shortcomings in the literature on decentralization. A large part of extant research is either based on one country studies, which are valuable in providing rich empirical materials but often fail to travel very well cross-nationally (Rodriguez 1997) or on large “*N*” datasets that often times conflate countries that are not reasonably similar, constraining their usefulness as road maps to study decentralization (Davoodi and Zou 1998; Panizza 1999; Garret and Rodden 2000). Furthermore, cross-country studies employ variables such as openness to trade (Fisman and Gatti 2002) and levels of corporatism (Castles 1999) that have little within-country variation, forcing researchers to use average values often based on judgmental calls of data analysts. By studying a more limited, hence controlled, number of cases and using subnational level data, my dissertation renders a research design more propitious to develop “middle range” (LaPalombara 1968) theorizing. Although suggesting that careful attention is needed to avoid “lulling the researcher into a false sense of security”, Peters (1998: 35) claims that a theoretically-informed use of subnational data can be a good antidote to minimize problems of extraneous variance.² Albeit until recently under-utilized in comparative research, with the exception of works on US politics, the use of subnational level statistics increases the number of observations and minimizes the effect of confounding influences derived from structural commonalities at the national level (King, Keohane and Verba 1994: 52, 220).

More specifically, the research design used in this study combines two comparative strategies. On the one hand, it makes use of within-nation comparisons of subnational units in Argentina

² Peters’ cautionary note is exemplified, for instance, by the fact that Southern Spanish Autonomous Communities (AC) like Extremadura, which is one of the poorest in the country, has more in common with Argentine provinces than with AC in northern Spain.

and Spain. There is an extensive literature indicating that this strategy facilitates systematic comparative analysis, controlling for ecological, cultural, and socioeconomic conditions (Key 1949; Lijphart 1971). The other strategy resorts to comparisons of subnational units of non-contiguous nations to minimize the distorting effects of diffusion at the national level. Because subnational units in a country are often interconnected and subjected to parallel political and macroeconomic processes, they can hardly be considered to be independent from one another. This interconnectedness among cases (i.e., “observations”) hinders the accomplishment of independent tests of a theoretical proposition.³

In this spirit, I have constructed two datasets, one for Argentina and the other for Spain, which include a battery of electoral, economic and socio-demographic variables for a time-series analysis. The time-span varies for both countries and it is basically based on data availability. These statistics are triangulated with qualitative information from policy informants and secondary sources that I collected during my dissertation field work in Buenos Aires and Madrid.

³ This dynamics, known as “Galton’s problem”, suggests that subunits drawn from the same political systems are susceptible to diffusion effects (policy, migration, etc.) from which it is hard to sort out causes of variance in political phenomena. While “Galton’s problem” can also involve institutional/policy diffusion across entire regions, such as the pervasiveness of presidentialism in Latin America (Peters 1998: 42) or cross-regional diffusion, epitomized in the adoption of neoliberal reforms in developing nations in the 1980s, comparing subnational units drawn from nations subjected to different regional contexts such Argentina and Spain can maximize independence among cases. For instance, Spain is subjected to regional processes of political and economic integration far more complex and deeper than those affecting Argentina as a member of Mercosur.

1.1.1.1.1 Plan of the Dissertation

The study proceeds in the following way: Chapter 2 uses empirical institutional analysis to assess the effect of patterns of territorial representation on fiscal decentralization policies. It focuses first on legislative-level territorial representation and its effect on intergovernmental fiscal outcomes. Also, it explores the conditions leading to bilateral and multilateral intergovernmental bargaining, which, we will argue are part and parcel of the tension between territorial distribution of political influence and economic resources.

From said theoretical discussion, I distill several hypotheses to explain variation, both spatial and temporal, in the allocation of federal/central government grants to subnational governments in Argentina (chapter 3) and Spain (chapter 4). In these chapters, the dependent variables are not the lump sums grants transferred to their respective regional administrations but, rather, the apportionment of earmarked transfers; in particular, those transfers that are held to be susceptible to high levels of political manipulation by secondary sources and policy informants. After conducting panel corrected standard errors (PCSEs) regression analyses with pooled data from each country, cross-sectional analysis is conducted to explain the inter-regional distribution of transfers. Subsequently, qualitative data are used to unpack the process of decentralization in both countries through more detailed empirical information. These data allow me to pinpoint the impact of different electoral junctures and power configurations more systematically. By just looking at pooled data it is hard to disentangle the effect of strategic considerations on (de) centralizing moves. To illustrate this point let me just refer to an often-cited argument in some literatures on decentralization (Willis, Garman and Haggard 1999) suggesting that, the weaker the central government's position, the more pressed it is to deepen fiscal decentralization and to include a broader group of parties. However, when the Spanish Socialist Party (PSOE) took

power after its landslide victory in the 1982 national elections, it set in motion a decade-long policy of decentralization aiming at the extension of health and education competencies to all regions, regardless of their executive's partisan color. This seemingly paradoxical move was not a mere embrace of decentralizing principles but rather it was party aimed at diluting the political bargaining effect of the Basques and Catalans – both rich, ruled by regionalist parties, and demanding radical policies of decentralization – by integrating other regions in a broad coalition with the national government (Agranoff and Gallarin 1997: 14-15). That is to say, the PSOE “decentralized to deter further decentralization”.

Chapter 5 begins by mapping out the sources of politicization of fiscal decentralization. The main argument set forth in this discussion is that except for those fiscal arrangements that are constitutionally binding (and not coincidentally only few of them are!), national and subnational politicians have a great margin of influence as to whether to enhance or damage decentralization policies. More generally, this chapter shows the importance of including inter-state conflicts and cooperation to explain decentralization processes. This seemingly obvious caveat becomes crucial at the light of bipolar accounts, such as Riker's seminal and pioneering work on federalism, characterizing the conflict as one between a central government, on the one hand, and the constituent state governments *un bloc*, on the other.

Chapter 6 begins with a concluding summary of the dissertation's findings and then turns to the implications of these results. If the theoretical predictions of this study are correct, decentralization may entail more than “preserving markets” or localizing decisions to enhance ethical standards. Decentralization provides dominant political actors a unique opportunity to

“reinvent” fiscal intergovernmental relations to their advantage. Then, can countries escape this apparent subterfuge? Is federalism, insofar as it facilitates political organization at the subnational level, to be blamed? And last, if decentralization policies are no more than elegant ways to dole out politically-motivated side-payments, can they be analyzed using the same theoretical and analytical approaches to explain other policy areas?

Finally, a detailed explanation of the terminology used in this dissertation is provided in Appendix 1. As can be seen above, for instance, “national” and “central” governments are used interchangeably. Also, federations use different term to label their subnational and constituent units. An Argentine “province” is equivalent to an “autonomous community” in Spain, to a Swiss “canton”, and to a US “state”. A full list of terms and detailed information is then offered in said appendix.

1.1.1.1.1.1 Major Findings

This dissertation’s central analytical objective is to find a framework for understanding and explaining the politics of decentralization. The precise field of empirical problems on which we focus to test the conceptual framework is that of politics in the territorial determination of financial resources and fiscal authority in Argentina and Spain. My discussion should provide an understanding of what type of political interferences affect the policy of transferring revenue to subnational governments, and why we should expect to see spatial and temporal variation in the distribution of revenue to lower levels of government. The data analyzed in this study find preliminary support for the central role of federal institutional arrangements and their regional power asymmetries in shaping political strategies and policy outcomes. More specifically, the

main contention of this study is that relative differences in the encapsulation of territorial and partisan interests at the legislative level have a causal impact on intergovernmental bargaining to decide the fate of fiscal decentralization reforms or lack thereof.

In Argentina, the sorting out of fiscal decentralization policies is “locked-in” at the senate level, where peripheral provinces are overrepresented. This balance of power shields the latter from the political hurdles and fiscal responsibilities derived from own-revenue mobilization, it perpetuates fiscal centralization based on intergovernmental transfers, and, ultimately, it engenders a fiscal policy regime based on cooptation and patronage. In turn, this institutional insulation of subnational interests induces resented provincial executives to address redistributive regional concerns bilaterally with the national executive, on a *first-come-first-serve* basis.

A more malleable, open-ended institutional configuration of territorial representation in Spain, however, does not inevitably thwart subnational assertiveness. On the contrary, the combined effect of regionalist-party dominance in fiscally-competent ACs, their increasing influence in the national parliament, and their concomitant acceptance in emerging joint policy-making mechanisms inhibits backward regions’ attempts to preserve the status quo (i.e. revenue centralization). Albeit not entirely keen yet “institutionally” unable to block the moves of richer regions, the latter follow suit. The resulting outcome is increasing multilateral fiscal collaboration and expanding decentralization

Despite the overall significance of our findings, there are several issues that still deserve further attention. First, this dissertation is based on cross-regional research, which is an area of

comparative politics that still remains relatively underdeveloped. Among the several methodological and conceptual issues affecting cross-regional research the “traveling problem” stands out as a major challenge for conducting this type of study. The choice of combining national and subnational levels in Argentina and Spain has eased, to some extent, this issue but problems remain. For instance, there is a risk that these countries may become less comparable over time given their respective regional contexts. While Argentina is associated with MERCOSUR, which acts as a relatively symbolic and poorly institutionalized regional bloc, Spain is influenced by the EU drives to become a “political union” (Sbragia, forthcoming).

Second, this study suggests that fiscal decentralization is subject to the same log-rolls and exchanges that affect any policy arena. Despite prevailing approaches to decentralization that emphasize macro-level processes and phenomena like democratization, liberalization, globalization and others, we find more merit in explanations that focus on the political interests of politicians, regional leaders, and the domestic institutional configuration. Amid considerable attention paid to decentralization in International Financial Institutions (IFI) such as the International Monetary Fund and World Bank reports, national concerns about the distribution of intergovernmental fiscal authority precede these international mostly pro-decentralization voices. In Argentina, which is relatively more exposed to effect of foreign aid conditionality, fiscal decentralization looms large as an important and long-dated topic in discussions about the federal character of its political system. And in Spain, partly due to it higher level of regional embeddedness as an EU member-country, IFI’s policy advice is not decisively consequential. This is not say that international influences do not “matter” but, rather, meant to suggest that it is

necessary to rethink some theoretical and empirical considerations related to our understanding of said influences.

Third, and relatedly, policy recommendation for fiscal reforms in decentralized polities should consider that the timing and sequencing of fiscal and political decentralization reforms are of essence. For instance, the putative fiscal benefits of decentralization to disadvantaged areas are rendered moot, when the amount of transfers to them is dictated by political influence beyond social welfare. In this regard, our study highlights the geographical uneven nature of fiscal reforms and how liberal, efficiency-enhancing decentralization policies can be blocked by the concomitant entrenchment of patronage-ridden, politically-shielded regional enclaves. The Argentine experience suggests that the relationship between the provinces and their budgets and the central government cannot be sorted out from the effect of political institutions and their related regional power asymmetries. If this is correct, institutional reforms in areas such as electoral malapportionment should be contemporaneous, or even precede, fiscal decentralization reforms.

2 Chapter 2: Institutional Sources of Fiscal Decentralization: “The Rules of the Game” and Subnational Politics

In this chapter, we will draw on empirical institutional analysis⁴ and new insights from interest group theory to shed light on the mechanism linking the political determination of transfers and the inter-regional distribution. The first approach will allow us to compare systematically the representation of territorial interests in the Argentine and Spanish Senates, pinpointing how their respective levels of overrepresentation and policy authority shape coalition building in distributive politics. With regard to the latter approach, we draw on Ellen Immergut’s concept of “veto points” to explain why Argentine subnational interests are “locked-in” at the formal legislative level, whereas open-ended institutional arrangements in Spain, unleashed by rapid federalization, made possible the sorting out of regional disputes through informal joint policy-making bodies.

2.1 The Territorial Role of Political Institutions: Representation and Policy Scope of the Senate

2.1.1 The “Puzzle”

In their study of bicameralism, Tsebelis and Money (1997: 33) argue that “in most federal systems the legitimacy of upper houses remains unquestioned and their power unconstrained”. While there is a large kernel of truth in this claim, this section will add some nuances to their statement by illustrating variation in the extent to which the Argentine and Spanish Senates represent subnational interests and in their ability to provide a forum for the different territorial units to debate policies. In the process of showing the formal structural differences of said

⁴ For an insightful review of this analytical perspective, see Peters (1999: 78-96).

bodies, attention is focused on the basis of their composition, how chosen, and their policy scope. These questions about institutional design do not only reflect the formal structure but they also illustrate why political decision-making follows characteristic patterns in different polities. As historical institutionalist approaches contend, “a nation’s electoral system and constitutional structure provide the institutional ‘rules of the game’ in which subsequent political battles are fought (Thelen and Steinmo 1992: 22). Subsequent to comparing these cases, we will show that the Argentine Senate exercises more influence than its Spanish counterpart, but the powerlessness and ostensible policy irrelevance of the latter rendered a “window of opportunity” for the articulation of subnational interests through informal territorial institutions. This point will be analyzed more carefully in the subsequent section addressing the issue of institutional interest representation. The puzzle, then, is to explain why the comparative strengths of the Argentine Senate amounted to a “double-edged sword” whereby, on the one hand, provincial-level actors have numerous opportunities to exert influence on the fate of intergovernmental transfers and, on the other, it locks in the existing politicization of decentralization policies and make the pursuit of fiscal accountability harder. And, why the weaknesses of the Spanish Senate amounted to an institutional facilitator that helped to create alternative fora for fiscal intergovernmental coordination and thus to advance the cause of fiscal federalism in Spain.

2.1.1.1 Representation: *Who and How?*

Unlike lower houses⁵, which are elected directly by a nation's citizens, with equal weight given to each eligible voter, representation in the senate varies in two main dimensions: *who* is represented (i.e. constituent groups) and *how* they are represented (i.e. method of selection). On the first dimension, it is normal to compose the senate in some way that is different from the way in which the low house is chosen (Patterson and Mughan 1999: 10-12). With the exceptions of Italy and Japan, where both houses are chosen on an equal basis, some differentiation between popular and territorial representation exists. The Argentine and Spanish Senates represent geographical constituent unit, which do not exclusively draw on population levels. However, while provinces are the relevant political unit in Argentina, the connection between territory and senate representation in Spain is less clear-cut. Based on a hybrid arrangement that somewhat resembles the German system, representation in the senate is primarily on the basis of sub-regional provinces⁶ (electoral unit), which each have equal representation. These provincial representatives amount to 208 out of a total of 256 senators. The remaining seats are occupied by ACs representatives, with seats distributed on a population-based formula similar to that used in Germany and Austria (Flores Juberías 1999). Secondly, leaving aside those who are *ex-officio* members of a senate⁷, the basic choice is between election and appointment. The former method is the most frequently employed, particularly in federal systems like the United States, Australia, Switzerland and others. However, in some cases, indirect representation precedes the adoption of direct election. While direct elections for the US Senate were introduced in 1913, Argentina has

⁵ We will use the notions of lower house, lower chamber, and chamber of deputies interchangeably.

⁶ Unlike Argentina, provinces in Spain are the political units positioned between the second-tier ACs and municipal government. For more details, see Appendix 1.

⁷ Apart from lifetime appointments in the British House of Lords, the Italian Senate includes a nominal number of Prime Ministerial appointees (Tsebelis and Money 1997: 47).

only adopted direct election of senators after the Constitutional Reform in 1994. In Spain, like the pre-1994 period in Argentina, senators representing ACs are designated by the Autonomous Parliaments, thus indirectly elected.

The above-mentioned differences between the Argentine and Spanish Senates notwithstanding, Lijphart (1999: 207; 211) claims that both countries have an *incongruent* bicameral structure because their respective houses are formally elected by different methods and represent different constituent units. Note that the degree of incongruence is positively associated with senate strength because the latter's capacity of contestation is bolstered when its composition does not mimic the composition of the other house. Nevertheless, it is more appropriate to talk about levels of congruence rather about its presence or absence. Lijphart's approach to congruence as a categorical trait masks important differences among cases. While it is something of a conventional wisdom in the literature about Argentine political institutions that a fully incongruent senate is causally related to this country's strong bicameral structure (Molinelli, Palanza and Sin 1999: 55-58), the same cannot be said of Spain, where almost 82 percent of the senators are elected on the same territorial basis as the members of the national parliament. What is more, and suggesting that the characterization of Spanish bicameralism as *incongruent* is questionable, while senatorial elections in Argentina are staggered, the vast majority of Spanish Senators are elected the same day as the *Diputados* in the lower house. As a result, the partisan composition of the Senate is unrepresentative of that of AC governments, as its electoral system encourages voters to cast a ballot for the same party of government in Madrid.⁸ In brief,

⁸ In this regard, there is an ongoing tension between the miniscule role played by regionalist parties in Senate and their leading role in regional governments (Gunther, Montero and Botella 2004: 121).

Argentine senators are better equipped to represent subnational interests than their Spanish counterparts.

2.1.1.1.1 POLICY SCOPE

Before we proceed to examine the level of policy authority of the senate in both countries, what difference does bicameralism make with respect to fiscal policy performance? Or, put differently, does the fact that revenue-sharing bills are dealt with, or alternatively blocked, at the senate level make any difference in terms of policy outputs? Extant research suggests that bicameralism induces greater fiscal deficits and, more indirectly, precludes economic adjustment. According to Heller (1997), who surveyed 17 unicameral and bicameral democracies from 1965 to 1990, “government budget deficits are higher when policy conflict is built into the budget process, specifically in the form of a bilateral veto game between legislative chambers”. In a similar fashion, Remmer and Wibbels (2000) observe that subnational interests in Argentina are in a pivotal position to offer resistance to national policies of economic adjustment because provinces can make adroit use of territorial representational advantages. However, there is an alternative body of scholarship that explores the possibility of a positive effect of bicameralism on public finances. While this literature is somewhat eclectic in its analytical focus, its common thread is that senatorial intervention in the policy-making process is advantageous insofar as it offers an additional arena of deliberation and fine-tuning of public policies. For instance, Vatter (in Nolte 2002: 18) shows that bicameralism strengthens fiscal decentralization and precludes “over-fishing” at the subnational level. Likewise, Lane and Ersson (in Nolte 2002: 18) claim that “when there is a symmetrically composed two-chamber assembly, then public expenditures tend to be lower and surpluses higher”. So, while the jury is still out to determine the effect of

bicameralism on fiscal outputs, it becomes apparent that senates “matter” in the politics of fiscal federalism.

2.1.1.1.2 THE SENATE AS “VETO PLAYER”

In formulating one of the most seminal analytical frameworks of rational choice theory, Tsebelis (1995: 293) defines veto players as “an individual or collective actor whose agreement is required for a policy decision”. Veto players can be grouped into two major different categories: “partisan” veto players, namely the political parties in the legislature and “institutional” veto players, which include the executive, both legislative houses, and to some extent, the courts, constitutionally required super majorities and referendums. In a nutshell, veto player perspective assesses a problem of collective action, one in which selective incentives must be dispensed in order to guarantee political support for effective governance. More specifically, this approach seeks to pinpoint the conditions for co-opting supporters in the policy process.

So, to what extent are the Argentine and Spanish Senates “veto players”? To respond this question, we will focus on their respective (exclusive) policy competences and how disagreements between both houses are resolved in each country. Argentina in theory follows the US constitutional formula of bicameral “symmetry of policy scope” (Stepan 2001: 345). While symmetry denotes that both houses are equally important and that the consent of both houses is necessary for most important decisions⁹, there are some policy areas in which they have greater prerogatives. The lower house has greater authority in originating money bills, general tax laws,

⁹ However, when disagreement between houses persists, the Argentine Congress resorts to the *navette* system to resolve it. If after several rounds of intercameral exchanges of bill proposals discrepancies cannot be bridged, the originating house has the upper hand and makes the final decision (Tsebelis and Money 1997: 54-55).

troop recruitment and others. The senate, on the other hand, is in charge of approving presidential nominees and advisors, authorize the president to declare a coup d'état in case of foreign military attack and appoint judges that assess federal expenditures. More crucially from the perspective our study, all revenue-sharing bills (including federal transfers) must originate in the senate. Additional senatorial prerogatives can be cited at length, but the encapsulation of fiscal decentralization issues at the Senate level suffice to highlight why this house is the institutional point of reference to uncover the politicization of these issues. This perception of the policy-making scope of the Senate is confirmed by a recent cross-national survey of bicameralism in nine Latin American countries, concluding that Argentina ranks as the most symmetrical bicameral system in the region and thus “the senate is constitutionally equipped to act as an actual ‘*veto player*’ insofar as it can delay lower house legislation at ease and eventually generate legislative paralysis” (Llanos 2002: 21).

We are not the first to point out that the Spanish Senate lacks significant policy-making powers.¹⁰ The Spanish constitution allows autonomic parliaments to propose bills to the national assembly. These bills may be introduced by representatives of the former bodies but, paradoxically, the alleged chamber of territorial representation is bypassed and plays no major role. Beyond scrutiny functions such convening special investigative commissions or forcing ministers to answer questions and pale legislative roles like the responding to bills already discussed and passed the parliament, “the senate has absolutely no voice in the selection and permanence in office of the executive” (Flores Juberías 1999: 287). More crucially, its footing in the territorial policy domain is quite limited as well. While the authorization of cooperation

¹⁰ See, for instance, Aja (1999), Beramendi and Máiz (2004), Börzel (2002), Gunther, Montero and Botella (2004), Solozábal (1996).

agreements between the ACs appears to be an issue that falls within the senate's jurisdiction, its authority is limited to postponing the moment that the lower house is allowed to impose its will on the senate in this issue. In an attempt to revamp the role of the senate as a more territorial chamber, the *Comisión General de las Comunidades Autónomas*, General Committee for the Autonomous Communities, was established in 1994. Despite some positive moves such as opening its doors to representatives of AC governments and debating territorial issues, Eliseo Aja, a leading scholar of Spanish federalism, argues that this committee experiences the same structural limitations the senate does, amounting to a "small senate inside the senate" (Aja 1999: 146).

How does the Spanish Senate compare with its Argentine counterpart in terms of its "veto player" status? While based on the afore-mentioned policy-making powers it does not appear that the Spanish Senate is a "veto player" in its own right until far-reaching institutional reforms take place¹¹, Stepan (2004: 328-329) claims that the senate can potentially become a "veto player" on the basis of the Article 155 of Spanish Constitution. This article establishes that the senate can adopt measures to force regional governments to fulfill their legal/constitutional obligations and prevent them from acting against the "general interest" of Spain. However, and citing Juan Linz's authoritative opinion on Spanish politics, Stepan acknowledges that said article has never been applied because it could only become effective through a federal deposition of the government and military occupation of a recalcitrant AC, leading to an eventual subnational regime breakdown. Hence, we are more inclined to downplay the actual "veto player" potential of the Senate of Spain.

¹¹ On the difficulties to reform the Spanish Senate, see Roller (2002).

2.1.1.1.2.1 “When Effects Become Causes”: Malapportionment¹² and Its Consequences

In federal systems, where territorial representation is juxtaposed to population representation, unequal representation of subnational units is commonplace (Lijphart 1984). Partly as a “built-in” feature of federalism aimed at redressing economic and demographic vulnerability of smaller jurisdictions, these are deliberately (i.e. constitutionally) overrepresented in the Senate.¹³ Consequently, this should hold as well for the Argentine and Spanish upper chambers. Subsequent to illustrating the extent of malapportionment in these cases, we will elaborate analytically why institutional overrepresentation is inextricably linked with distributive policy outputs. While malapportionment in the Spanish Senate is not entirely inconsequential, we will argue that, given its egregious nature and based on the significant policy-making powers of the senate, legislative overrepresentation in Argentina stands out as a decisive independent variable to explain the paucity of fiscal decentralization reforms.

How pervasive is Senate malapportionment in Argentina and Spain? According to the Stepan/Swenden Federal Databank, which uses the Gini Index of Inequality to measure malapportionment¹⁴, Argentina has the world’s highest level of senate overrepresentation.

¹² While the former concept is more commonly used at the micro level (i.e. the votes of some citizens weigh more than the votes of other citizens), overrepresentation is employed to denote institutional apportionment. Some scholars prefer the latter term, because the term malapportionment carries a more distinctive negative connotation (Gibson, Calvo and Falletti 1998: 2). We, however, will use both terms interchangeably.

¹³ Despite that senates are overly more overrepresented, lower chambers are sometimes subject to malapportionment. Both unitary Colombia and New Zealand, which reserve seats for indigenous people on a non-geographic basis, and federal India, where designated casts districts are overrepresented, share a high level of lower house malapportionment (Samuels and Snyder 2001: 658).

¹⁴ For a detailed explanation of the calculation of this index, see Stepan (2001: 344).

Table 1: SENATE OVERREPRESENTATION (Stepan/Swenden data)

Gini Index of Inequality		Percentage of Seats of Best Represented Decile	
Belgium	.015	Belgium	10.8
Austria	.05	Austria	11.9
India	.10	India	15.4
Spain	.31	Spain	23.7
Germany	.32	Germany	24.0
Canada	.34	Australia	28.7
Australia	.36	Canada	33.4
Russia	.43	Russia	35.0
Switzerland	.45	Switzerland	38.4
USA	.49	USA	39.7
Brazil	.52	Brazil	41.3
Argentina	.61	Argentina	44.8
MEAN	.33	MEAN	28.3

Source: Stepan (1997) and own calculations. Higher values denote higher malapportionment.

Table 1, which uses the afore-mentioned databank, also shows how Argentina and Spain fare compared to other ten federal systems. It indicates that Argentina’s figures for the Gini Index and percentage of seats for best represented decile nearly double those of Spain. While Spain has relatively high level of senate overrepresentation compared to similar multinational federations like Belgium and India, its figures are much lower than those for ethnically-diverse Canada and Switzerland. Note that Spain ranks below the mean in both measures. To corroborate whether these results are a function of the dataset used for Table 1, we will triangulate them with data from Samuels and Snyder’s study of comparative malapportionment.¹⁵ Table 2 shows the world’s twenty most overrepresented senates and, confirming the previous analysis, Argentina ranks first. Spain, on the other hand, appears to show a somewhat higher level of

¹⁵ This study uses the Loosemore-Hanby Index of Electoral Disproportionality (*D*), which takes the absolute value of the difference between each district’s seat and population shares. For a more complete explanation, see Samuels and Snyder (2001: 654-655).

malapportionment because it is slightly above the mean value yet short of modifying the pattern of Table 1, as it only outdoes Germany but by a small margin.

Table 2: SENATE OVERREPRESENTATION (SAMUELS/SNYDER DATA)

	<i>MAL_{UC}</i>	Federal		<i>MAL_{UC}</i>	Federal
Czech Rep.	0.0257		Chile	0.3106	
Italy	0.0292		Venezuela	0.3265	Yes
Austria	0.0301	Yes	Russia	0.3346	Yes
Romania	0.0592		Switzerland	0.3448	Yes
India	0.0747	Yes	USA	0.3642	Yes
Japan	0.1224		Bolivia	0.3805	
Poland	0.2029		Brazil	0.4039	Yes
S. Africa	0.2261	Yes	Argentina	0.4852	Yes
Mexico	0.2300	Yes			
Germany	0.2440	Yes			
Spain	0.2853	Yes			
Australia	0.2962	Yes			
MEAN	0.2388				

Source: Samuels and Snyder (2001) and own calculations. Higher values denote higher malapportionment.

Does senate overrepresentation matter? In essence, cross-national evidence suggests that senate’s unequal representation of subnational units shapes legislators’ strategies for pursuing distributive policy agendas. However obvious this argument may appear, a large part of the scholarly work on US legislative politics has downplayed the effect of senate apportionment on coalition building. For instance, Riker’s seminal notion of *minimum-winning* coalitions tells us more about the rules of the game than about asymmetries in the composition of winning coalitions. Drawing on this thesis, formal theory scholars have not paid sufficient heed to the pervasive small-state advantages in the distribution of federal funds (Atlas et al. 1995). Lee and Oppenheimer (in Lee 2000: 59) provide a convincing explanation for this legislative outcome: “Apportionment shapes Senate distributive policy-making for two reasons. First, senators representing small states have

more to gain from procuring a given amount of federal dollars than do senators who represent larger states. A federal grant of \$5 million, for example, has a far greater effect in Wyoming than in California. Such a grant yields greater electoral benefits for senators who represent small states, both in terms of their statewide visibility and the percentage of residents benefited....Second, Senate apportionment affects the incentives of coalition builders in distributive policymaking. The tremendous differences in state population create a unique coalition-building dynamics: All senators' votes are of equal value to the coalition builder, but they are not equal in price". This interpretation is echoed in recent work on Brazilian politics, indicating that malapportionment and clientelism are "two sides of the same coin" (Ames 2001). Further, Mainwaring (1999: 270-271) claims that overrepresentation of poor states helps explain not only pork-barrel politics but also "the disjuncture between Brazil's economic development and the underdevelopment of its political institutions".

As the statistics presented above succinctly suggest, senate malapportionment manifests itself in Argentina more than elsewhere. And its effects are highly axiomatic: virtually no policy coalition can be put together without the support of the regional structures of power of sparsely-populated and economically-underdeveloped provinces. Alike Brazil, "strengthening the financial position" of small provinces affords incumbent national administrations significant political payoffs. Unlike Brazil, and taking aim with Mainwaring's contention, we argue that this "devil's pact" does not lead to institutional decay. On the contrary, it boosts predictability in the intergovernmental rules of the game and, thus, makes "increasing returns processes" more

sustainable.¹⁶ Such inducements, however, create an equilibrium that poses acute problems to feedback processes and consequently foreclose policy reforms to temper the patronage-financed debt spending of Argentine provinces, particularly the small ones.

The combined effect of the scant policymaking powers of the Spanish Senate and its comparatively lower malapportionment levels, which render a more limited “opportunity structure” for small ACs to cajole federal transfers, helps to explain why, in contrast, subnational actors in Spain had to generate alternative means of action and representation.¹⁷ As we will illustrate in the next section, the deficiencies of the Senate engendered a decisional vacuum to be filled by the creation of intergovernmental coordinating agencies like the CPPF and, to a lesser extent, the *Conferencias Sectoriales*, Sectoral Conferences, which are multilateral forums where ACs exchange information with the national administration and among them. The weak institutionalization of the senate and its lack of compensatory representational devices to redress inter-regional gaps have been counterbalanced by a gradual process of “experiential learning” (Olsen and Peters 1996). This open-endedness has imbued intergovernmental relations in Spain with a market-like character, where the fiscal accomplishments and steadfast regionalist leadership of ACs like Catalonia, Baleares, Navarra, and the Basque Country hindered even further any attempt of economically-peripheral ACs to offset their fiscal misfortunes through

¹⁶ In a landmark essay, Pierson (2000) couched the notion of “political increasing returns” to underscore the strong status quo bias generally built into political institutions.

¹⁷ This institutionalist view of the Spanish Senate is matched by ordinary citizens’ perception of the role of this body in the politics of their country. In his study of public opinion in Spain, Lancaster (1997) shows that the senate is the least popular institution.

federal *largesse*. Above and beyond the fiscal revamping of the weak, formal institutional vulnerability opened the door for policy innovation.¹⁸

2.1.1.1.2.1.1.1 The Relational Role of Political Institutions: “The Rules of the Game” and Intergovernmental Instruments of Cooperation

Painting in broad strokes, we can say that Ellen Immergut provides a very satisfying explanation of institutional malleability, which will be analytically applied to uncover differences between the Argentina’s predominantly stagnant regionalism and Spain’s drift to multilateral subnational collaboration. This contrast is the last building bloc in our explanation of the entrenchment of patronage-dependent provincial forces and fiscal decentralization stagnation in Argentina and Spain’s incremental progression to fiscal federalism.

In any political system, the adoption of a new policy deviating from the status quo (e.g. fiscal centralization) requires the agreement of certain political actors. Leaving aside whether a larger number of such political actors is normatively desirable¹⁹, policy change becomes more difficult when these actors proliferate. The necessity to decrease the number of such crucial actors is an issue that both “old” and “new” institutionalisms draw our attention to. From a state-society centered perspective, the notion of corporatism gives preferential treatment²⁰ to state-sponsored societal organized interests, whereas neo-institutionalists (e.g. George Tsebelis) focus more compellingly on the institutional “black box” itself. Implicitly maintaining that these approaches

¹⁸ For an analysis of policy innovation in Argentina, see Keech (1999).

¹⁹ While the modern literature in political science, with Lijphart (1999) as an exception, emphasizes the need of *effective* governance, there is no shortage of arguments on behalf of increasing the number of “veto players”, ranging from Baron de Montesquieu’s theory of separation of powers to John Stuart Mill’s praise of representative government.

²⁰ Or, according to Schmitter (1974), exclusive.

are overly static or mechanistic, Immergut (1992) introduces the notion of “veto points”, which are basically areas of institutional vulnerability, namely, junctures in the policy process where opponents can frustrate policy change. Instead of seeing institutional representation as a rigid end point, the notion of “veto points” suggests that “electoral rules and constitutional structures provide the institutional ‘rules of the game’ in which subsequent political battles are fought” (Thelen and Steinmo 1992: 22). Moreover, this understanding of the policy-making process is also consonant with our previous analysis insofar as the relative differences in policy-making powers of their respective senates and the presence or absence of institutional facilitators for disadvantaged subnational units in Argentina and Spain shape political interactions. Last, this approach is valuable to analyze countries that undergo institutional transformation like Spain and its ongoing process of federalization. Likewise, Argentina has recently experience profound institutional reforms such as the constitutional reform of 1994.²¹

2.1.1.1.2.1.1.2 The “Puzzle”

In this section, we explore the explanatory value of the “veto points” perspective to understand why the mere existence of strong representative institutions of territorial interests does not necessarily mean that they are effective in advancing the horizontal division of powers between the central and regional governments. As shown above, a mighty senate may fall short of becoming an actual arena of intergovernmental exchanges, when subnational units are disproportionately overrepresented. Or put in “veto points” terms, when a highly institutionalized

²¹ This constitutional reform includes: the abolition of the Electoral College and adoption of direct presidential elections, the possibility of re-election for incumbent presidents, political decentralization of the capital city (Buenos Aires) and, more relevant to our subject of study, the introduction of socio-demographic and economic variables, in lieu of fixed coefficients, in the determination of revenue-sharing. Interestingly, from said list of reforms, the latter is the only one that still did not materialize.

political structure of territorial representation such as the Argentine Senate is adjacent to exceedingly malapportioned electoral rules, it will perpetuate existing pathologies in distributive policy. At this juncture, some provinces (i.e. peripheral, transfer-dependent) are motivated to preserve the status quo and other provinces (i.e. metropolitan, more fiscally-proficient) prefer to move away from it. Because the former group of provinces affords the national government a legislative majority at a “convenient” price, distributive policy (i.e. fiscal decentralization) bears out cooptative and patronage-ridden undertones. Of necessity, the latter group of provinces seeks to level out their share and press their case with national authorities. The resulting outcome is bilateral fiscal agreements and incomplete decentralization. By the same token, feeble territorial representation at the senate level does not inevitably thwart subnational assertiveness. In Spain, regionalist-party dominance in fiscally-competent ACs, their increasing influence in the national parliament, and their concomitant acceptance in emerging joint policy-making mechanisms inhibited backward regions’ attempts to preserve the status quo (i.e. revenue centralization). Albeit not entirely keen yet “institutionally” unable to block the moves of richer regions, the latter follow suit. The resulting outcome is increasing multilateral fiscal collaboration and expanding decentralization. These arguments will be illustrated through the narrative of two contrasting experiences: The Argentine Fiscal Federal Pacts and the Spanish Council for Fiscal and Financing Policy of the ACs.

2.1.1.1.2.1.1.2.1 Bilateral and “Uninstitutionalized” Bargaining: The 1992 and 1993 *Pactos Fiscales* in Argentina

Imagine the following picture: Nearly 100 provincial representatives (governors, vice governors, provincial economy ministers and economic advisors) gather in a dreary building in Buenos Aires city. The *raison d'être* of this gathering is to persuade said representatives to forsake 15

percent of their respective provinces' coparticipated tax revenues to overhaul the then moribund national social security system. Not far from this building, caravans of annoyed pensioners march forcefully into the Congress amid threats of continuing their hunger strikes. Expectedly, and despite these representatives ostensible empathy with the cause of street demonstrators, no agreement can be hammered out.²²

This chaotic background compounded the signature of the 1992 Fiscal Pact at the headquarters of the *Consejo Federal de Inversiones*, CFI, Federal Investment Council.²³ How can said provincial actors be persuaded to cut a deal that would make them less popular in their respective jurisdictions? First, the national government guaranteed provincial transfers of a minimum of US\$ 725 per month. In order to make this arrangement even more “attractive”, Menem “sweetened” this unsettling gridlock through the creation of a special fund to finance fiscal disequilibria in the provinces, made up of revenues that would also be deducted from the automatic FTSA allocations. According to Eaton (1998: 110), “the amount that each province would receive from this fund was determined in one-to-one negotiations with the President. For example, the fact that the Radical governor of Chubut province offered early public support for the pact reflected Chubut’s position as one of the three provinces receiving the largest cut from the disequilibria fund.....Provincial governors who initially criticized the pact but eventually signed it (such as Mario Moine of Entre Ríos) received a smaller cut, and provincial governors who refused to sign (such as Rolando Tauguinás of Chaco) received none of the special funds”. Furthermore, the inter-provincial apportionment of this fiscal disequilibria fund does not deviate

²² For a more complete account of these events, see Falletti (2000: 12).

²³ Originally conceived as an inter-provincial consultative forum in regional development matters, the CFI has turned into a *de facto* branch of the Peronist Party, which typically controls a vast majority of governorships.

from the pattern described in Chapter 3: Santa Cruz, Tierra del Fuego and Chubut (nearly 1.8 percent of total national population) received US\$ 3 million each, whereas Córdoba and Santa Fé (nearly 18 percent of total population) only US\$ 0.5 million each (Falletti 2000: 12).

Encouraged by the apparent success of this deal, Menem arranged a second Fiscal Pact in August 1993. Unlike the previous pact, however, tax reform was the focus of this deal, enhancing its potential fiscally-decentralizing impact. Nevertheless, the provinces did not rush to join this second pact because of its initial stipulation to abolish the provincial turnover tax (Schwartz and Liuskilla 1997: 408). Expectedly, some maneuvers were necessary to cajole reluctant governors. First, the minimum amount set on 1992 was increased to US\$ 745 million a month. Additionally, political guarantees to negotiate the offsetting of claims and debts between the provinces and the central governments were put forward. These benefit packages, however, were only applicable to provinces that agreed to implement the terms of the pact. To avoid further “penalties”, Chaco’s governor this time chose to sign the pact, for which his province had its outstanding debts bailed out (Eaton 1998: 111).²⁴

In brief, we can argue that Argentine bilateralism is a manifestation of cost-shifting tactics for the provinces and divide-and-conquer for the center. The institutional “veto points” in the decision-making process interact with regional economic differentiation, leading to a fiscal policy output that amounts to an “iron law” of the political economy of intergovernmental

²⁴ To illustrate how this exchange of political favors interweaves with institutional prerogatives, Governor Tauguinás, who rules a relatively under-populated province, subsequently supported Menem’s campaign for the Constitutional Reform of 1994. It is noteworthy that the assembly charged with rewriting the constitution was even more skewed than is representation in the senate. Buenos Aires province had one representative for every 109,000 citizens and Tierra del Fuego had one for every 6,000 (Sawers 1996: 96).

relations in Argentina: revenue centralization as a shielding mechanism for economically weak yet politically powerful provinces.

2.1.1.1.2.1.1.2.2 Emerging Multilateral Bargaining: The Spanish Consejo de Política Fiscal y Financiera de las Comunidades Autónomas

Created in 1980, the CPFF is composed of the national Minister of Economy and Finance and his counterpart in each region, and the Minister of Public Administration. It acts as a consultative and discussion body, which concerns itself with the coordination of policy with particular regard to the distribution of national resources to the regions, public investment, the costs of services and public debt. This is the intergovernmental coordination body of highest importance (Huerta Carbonell 1992: 215). The agreements reached within the CPFF, then, form the basis for developing the ACs financing arrangements.

The above having been said, there has been a tendency in the specialized literature to characterize the CPFF as merely symbolic, as a forum guided by a “hierarchical perception of intergovernmental relations, since the minister (i.e. the national Minister of Economy and Finance) calls the conference, chairs it and sets the agenda. This fosters the atmosphere of ‘institutional courtesy’ in the forum, as the ACs have only a very passive role in the discussions” (Grau i Creus 2000: 63). Other scholars have ironically suggested that these meetings amount to “*cooperación por teléfono*”, cooperation by phone (Albertí Rovira 1991: 214). Further, Aja (1999: 227) claims that the CPPF is a mirror image of party politics: When this forum recommended in 1993 the transfer of the 15 percent of the general income taxes to all ACs, Galicia, which is a PP bastion, voted against it and even appealed to the Constitutional Court.

However, it voted in favor of a transfer of the 30 percent of the same tax in 1996 carried out by Aznar's administration.

It is precisely party politics what rendered opportunities to expand the role of CPPF and its *modus operandum*. While admitting that the afore-mentioned tactical behavior of Galicia is very telling, it is noticeable that despite PSOE's participation in the ruling coalitions in Navarra, Aragon, and Asturias did not impede these ACs to support the PP- sponsored 30 percentage reform. Moreover, regionalist party officials, by and large from Catalonia and the Basque Country, advocated deepening revenue decentralization on efficiency as well as on nationalist grounds. For that purpose, they encouraged the formation of mixed technical commission of autonomic and national officials known as *Comisiones Mixtas*, Mixed Commissions, whose multilateral character was somewhat daunting for more transfer-dependent ACs (Ramallo Massanet and Zornoza Pérez 2000). Nonetheless, regionalist party representatives from poorer ACs had a very hard time in articulating regional assertiveness amid hostility to fiscal decentralization moves, so that they gradually moved closer to their more nationalistically-minded counterparts. Exogenous factors such as Europeanization played a role, insofar as regions were endowed with significant resources, including know-how applicable to the sometimes highly technical content of discussions held in the Mixed Commissions.²⁵

²⁵ We disagree, however, with monocausal explanations based on EU influences such as Tanja Börzel's approach. She claims that "while the extension of multilateral intergovernmental cooperation may reflect a certain consolidation of Spanish intergovernmental relations, the functioning of the 16 Euro-effective conferences confirms that the major proposition of this study that multilateral cooperation is the response to Europeanization rather than the result of the consolidation of the State of the Autonomies" (Börzel 2002: 146-47). In addition to supranational-level influences, scholarly discussions about the future of decentralization in Spain were deeply influenced by the German experience and concepts such *Bundestreue* (federal loyalty) are oftentimes made reference to (Aja 1999: 142-43).

In conclusion, in contrast with the cost-sharing strategy of Argentine provinces, Spanish ACs opted to increase collaborative patterns in policy-making, in which representatives of the different levels negotiate their major differences at the program design and implementation stages. Unlike Argentina, the increasing pivotal role played by regionalist parties in national formal and informal fora played a more critical role than the encapsulation of unequal territorial representation at the legislative level. Albeit not entirely stress-free, as some peripheral ACs resisted the pace and nature of reforms, fiscal decentralization in Spain expanded to levels comparable to those of Germany and closer to Switzerland

Summary

The findings of this chapter have implications both for the political science literature on comparative federalism and for the literature on fiscal decentralization in these and other countries. Given research trends in the former literature, some of our findings are surprising. The concept of institutional vulnerability, a byproduct of “veto points” theory, appears to be more useful in explaining the stochastic nature of fiscal decentralization policies than notions of institutional embeddedness. More than the formal rules *per se*, the interaction between institutional structures (e.g. the senate) and political hurdles gives rise to the “rules of the game”. Put simply, overrepresented territories yield political payoffs that afford them “immunity” to revenue decentralization imperatives. In this vein, the “veto points” framework involves different opportunities for influencing political decisions. In assessing how the politics of fiscal decentralization varies in Argentina and Spain, we are able to conclude that institutional “overdevelopment” and the ensuing “locking-in” of a lopsided connection between territorial

overrepresentation and the non-proportional distribution of public funds in the former country propitiates the maintenance of a fiscally-ineffective but politically-desired status quo. And we are also able to conclude that institutional malleability and open-endedness rendered opportunities to regionally-assertive entrepreneurs for claiming further competences, including revenue collection and administration.

This understanding of fiscal decentralization also speaks to a body of scholarship on fiscal federalism that focuses on incentives and goals (e.g. rent-seeking, fiscal performance) without explicitly and systematically identifying the political framework in which fiscal decentralization decisions are taken.²⁶ To address this apparent theoretical gap, our study first identifies two contrasting approaches, one economic and the other political, to explain intergovernmental transfers, test them in Argentina and Spain, and thereafter we move inductively to contextualize the findings of the statistical analysis using qualitative evidence from these countries. To conclude, and borrowing from a recent and enlightening study of federalism by Filippov, Ordeshook and Shvetsova (2004: 138), “fiscal allocations are biased toward certain states or groups of states almost everywhere, because the ability to cater to particular local needs is an essential characteristic and advantage of the federal form”.

²⁶ For a more detailed discussion of this topic, see Chapter 1 of this dissertation.

3 Chapter 3: The Political Significance of Fiscal Decentralization

In both developed and developing countries, there has been a contemporary debate on the nature and merits of decentralization. The collapse of communism and the “crisis” of the welfare state have rekindled serious thinking about the relationship between governance and the appropriate level of devolution of power away from the central state to lower levels of administrative and political authority. Moreover, the growing demand for public services and infrastructure in Third World countries has brought increasing calls for decentralization to develop tailor-made policies in congruence with varying national needs (Rondinelli, McCullough and Johnson 1989). However, and despite the fact that decentralization issues have been on the political front-burner in the last two decades, no single paradigm or theoretical model informs the study and practice of decentralization policies across nations.

On a very general level, decentralization is the transfer of responsibilities and revenue from national government to subnational offices (Rondinelli 1981). This definition suggests that power is being given away through a series of measures and steps meant to eliminate overload at the central level, in which case decentralization denotes a *process* rather than a final or pre-set goal. Despite most studies of decentralization accept a process-oriented perspective, there is no overarching agreement about its goals. This is basically due to the fact that students of decentralization oftentimes confound political and fiscal decentralization. In Europe, there has been a trend to encapsulate types of decentralization under the notion of regionalism and regionalization. Albeit useful to pin down the determinants of regional policy in a era of global political and economic change (i.e, Keating and Loughlin 1997; Le Gales and Lequesne 1998),

this body of research uses indicators of political and fiscal decentralization interchangeably, diminishing their empirical usefulness. Also, frequent regime changes and a strong “centralist tradition” (Veliz 1980) have been long-standing factors inflating the political nature of decentralization in Latin America and downplaying the significance of fiscal power relations. Borrowing from Bird (1993: 208), widely recognized as a leading student of fiscal decentralization, “decentralization seems often to mean whatever the person using the term wants it to mean”.

To remedy this deficiency, we argue that it is important to distinguish between the distribution of political authority, namely the transfer of political power to subnational levels of government, and the organization of fiscal prerogatives, referring to where taxes are raised and public funds spent. The political significance of decentralization becomes apparent as it represents a necessary condition to advance democratization processes in countries with strong legacies of centralist and exclusionary politics. Strengthening local government through civil society participation and municipal elections constituted the dominant theme in the budding cottage industry of academic work on decentralization of the then transitioning democracies (Borja 1987; Gustafson 1990; Nickson 1995; on more developed countries, see Putnam 1993). Albeit valuable in emphasizing the participatory aspects of democracy, these literatures have seldom considered the determinants of such policies, virtually ignoring the role of institutions in uncovering the political logic of decisions by national authorities to decentralize.

Partly due to normative assumptions and some optimism stemming from ongoing episodes of democratization, the “people can do it all” approach assumed that fiscal resources for effective

local governance will flow once local actors will become politically invigorated. Central to all these arguments is the view of decentralization as promoting accountability and political efficacy²⁷, bolstering popular participation and local democracy. From a totally different theoretical perspective, this emphasis on the efficiency gains associated with the decentralization of local decisions to local governments is shared by normative economic theories of federalism. Guided by public choice theory, this body of scholarship put forth by Charles Tiebout, Wallace Oates, and more recently, Barry Weingast, sees decentralization as limiting the ability of government officials to supply local goods on political grounds. This superiority of decentralization, the argument goes, is due to the fact that the principal, i.e. central government, delegates administration and production rights to agents with superior local information. That is to say, more decentralization economizes on communication costs while also leading to a control loss on the part of the principal. Additionally, ordinary citizens can foreshadow their dissatisfaction with local policies by moving to an area where their preferences are fulfilled (“voting with their feet”), enhancing inter-jurisdictional competition. At this juncture, literatures on popular democracy, on the one hand, and international financial institutions, on the other, paradoxically converge.

While both logics linking decentralization to the “small is beautiful” and “voting with the feet” slogans are compelling, they fail to account for the fact that political leaders are, at the very least, as concerned about their power position as they are about public welfare. Despite the fact that both goals are not intrinsically contradictory, we will assume in this study that the former consideration would prevail over the latter. Politicians seek to place power where they can be

²⁷ Political efficacy defined as the extent to which individual citizens feel they can affect political decisions (Almond and Verba 1963).

more confident of controlling it, be it at the center or state level. Moreover, decentralized jurisdictions are less likely to attract high-caliber bureaucrats, since the rewards to local officials will be small in comparison to those at the central level (Tanzi 1996). Accordingly, local bureaucrats oftentimes compensate for this income gap through rent-seeking practices and corruption. The latter practices are further exacerbated by the fact that subnational administrations are less susceptible to public and media scrutiny than the more powerful national office. And from the “demand side”, people living in the periphery of democratizing countries are often assimilated massively into the state payroll, intensifying long-standing loyalties with local politicians and diminishing the probability they will sort themselves into other jurisdictions. Therefore, the persistence of clientelism and patronage practices implies that poor citizens have strong incentives to stay in rather than opting for the “exit” option.

This suggests that neither the civil society approach to decentralization nor normative public choice theories seem to capture the multifaceted nature of decentralization. In emphasizing the role of both vibrant societal actors and benevolent and foresighted actions of national authorities, these assumptions fall short of formulating the more mundane motives behind decentralizing changes. Brennan and Buchanan (1980) have forcefully shown that national politicians have every reason to restrain inter-jurisdictional competition if that furthers their own careers. Furthermore, some literatures on political economy establish that central governments are revenue maximizers that may wish to retain taxes for their own ends (Levi 1988; Weingast 1995). Thus, as decision to decentralize fiscal power entails significant risks, considerations beyond notions of public interest do shape the mindsets of national politicians. This “Leviathan”

assumption about central government behavior suggests that national politicians support decentralization for the same reasons they support any other policy change.

3.1 Why is Fiscal Decentralization Politically Important?

In fact, fiscal arrangements are one of the most politically contested aspects in multitiered systems. In Germany, which is the only federation where fiscal gaps among regions are ameliorated by transfers from richer *Länder* as well as federal government (Gunlicks 2003), “cooperative federalism” has kindled resentment among richer *Länder* against “confiscatory” levels of transfers. This unleashed a significant number of appeals to the federal Constitutional Court and self-serving lawsuits by said *Länder*, especially after reunification (Adelberger 2001). There is additional evidence from cases in which small states play a king-making role. While asymmetries in population, size, and economic power are commonplace in decentralized systems, overrepresentation of states in national governing bodies is a major determinant of fiscal responsibilities and outcomes. Gibson and Calvo (2000) have shown that legislative overrepresentation in Argentina and Brazil produces federal spending distortions in favor of overrepresented territories. Patterns of federal spending reflect overrepresented states’ ability to reproduce their leverage in legislative chambers onto key congressional budgetary committees in the latter country, whereas Argentine national executive directs disproportionate federal funding to small-sized and state-dependent peripheral provinces because these render substantial political payoffs (i.e., legislative support for hard-to-sell economic reforms) from relatively small investments of intergovernmental funds. In Belgium, increasing fiscal autonomy (including tax powers) is strongly associated with the necessity of promoting the visibility and influence of inchoate and recently (circa 1995) established regional governments (Van Houten 1999: 5).

Examples from other federations and rapidly decentralizing countries (i.e., Colombia and Italy) can be cited at length but the above illustrations suffice to show the extent to which fiscal and financial issues give rise to political struggle between central and regional authorities.

Yet, what makes fiscal decentralization particularly susceptible to political manipulation? As argued above, political decentralization is very much at the core of democratization processes, constituting a recurrent and unavoidable outcome. Oftentimes, local elected officials become standard-bearers of transitions processes (Nohlen 1991), and any reversal to their prerogatives stirs public outcry and consternation. In contrast, the unfolding of fiscal reforms and the distribution of federal grants is far less subject to citizen scrutiny and tends to take place in “smoke-filled” rooms²⁸. Particularly so in countries such as Argentina and Spain whose respective intergovernmental fiscal systems are extremely complex even to enlightened bureaucrats (Agranoff and Gallarin 1997: 31-36; Saiegh and Tommasi 1999) However, the fact that elections of local officials have more profound symbolic undertones does not imply that the formulation and allocation of intergovernmental grants is something less of a *political* issue. On the contrary, and as this study attempts to show, when national politicians opt for reforming fiscal power-sharing relations they do so with an eye to territorial patterns of political and electoral support.

²⁸ Additionally, “information-constrained” voters are less inclined to monitor local authorities due to the confounding impact of overlapping authority in decentralized systems (Rodden and Wibbels 2002: 498).

Adding to the above is the fact that fiscal arrangements are only rarely enshrined in laws of constitutional status²⁹. The ensuing rigidity stemming from constitutional mandates not only hinders governments' maneuvering space to respond to fiscal crises in different ways (Cameron 1984; Alvarez, Garrett and Lange 1991) but also affects their ability to attune fiscal policy to changing political environments. Because processes of decentralization often entail significant redrawing of political boundaries and dynamics, renegotiation of agreements becomes necessary. Moreover, some scholars argue that insofar as it promotes different interpretations, constitutional ambiguity ensures the durability of the system (Erk and Gagnon 2000). Yet, this study indicates that mutual trust among the different levels of governance is of essence and that Spain does not meet said requirement. Furthermore, the Achilles heel of the "para-constitutional" nature of these intergovernmental agreements, however, lies in the strategic advantage of a few participants with strong bargaining positions. While this pattern occurs in other decentralized systems like Canada, intergovernmental relations in Argentina and Spain unfold in a framework of low institutionalization and their agenda is set by the political leadership of the governing parties in a largely unmediated manner.

The political nature of fiscal decentralization becomes also evident because there is no widespread agreement among policymakers on how to treat intergovernmental fiscal relations. On the one hand, central authorities offload fiscal functions to subnational governments at the face of budget constraints. However, recent experiences of countries experiencing macroeconomic crises like Argentina and Brazil indicate that central governments have sought to

²⁹ Germany deviates from this "rule" insofar as its Basic Law of 1949 outlines the revenue shares from particular taxes accruing to different government levels and their distribution (Spahn and Föttinger 1997).

re-centralize by imposing fiscal restraints on state governors (Eaton and Dickovick 2003). Let alone that party system changes prompted Alberto Fujimori in Peru and Hugo Chávez in Venezuela to re-centralize.

3.1.1 Conceptualizing the Politicization of Fiscal Decentralization: The Role of Transfers

If the crux of intergovernmental politics lies in the realm of fiscal relations, what aspects are most important in determining the trajectory of these relations? In this section, we investigate the thesis that transfers are a key component of political models of central-regional relations. In considering the effect of transfers on decentralization, it is important to refer to an important body of literature on local budgetary behavior indicating that central funding undermines regional/local fiscal autonomy (Boaden 1970; Dearlove 1973). Autonomy, in this context, denotes the ability of subnational governments to raise tax locally to offset expenditures. More recently, however, it has been suggested that regional leaders may be less motivated to increase the tax burden in their jurisdictions because central government transfers minimize the costs of decentralized provision borne by local taxpayers, which can be financed by a “common pool” of resources collected elsewhere in the economy (Weingast, Shepsle and Johnsen 1981). This view is reinforced by the presence of revenue-sharing arrangements, whereby every time a central government raises taxes to improve its own position, subnational governments receive a corresponding revenue benefit which they are normally free to spend.³⁰

Intergovernmental transfers are the dominant source of revenue for most subnational governments in multitiered systems. Apart from federations like Canada, Switzerland and the

³⁰ According to Thorlakson (2003: 6), “the centralization of public finances is an efficient indicator of the allocation of resources, or power”.

United States, where emphasis is placed on local tax revenue mobilization, other countries have their subnational spending mostly financed by intergovernmental transfers.³¹ These transfers aim also to address fiscal gaps across regions, which are exacerbated by and stem from the insufficient revenue-generating capacity of subnational levels of government to meet their expenditure responsibilities. Adding to the distorting impact of separating taxing and spending powers, namely the “flypaper” effect³², are policies of fiscal decentralization based on unfunded mandates (Roin 1999), or, put simply, deficit-ridden central governments offload their imbalances onto state governments by increasing subnational expenditure without a parallel increase in revenues. These distortions do not only have fiscal significance but also pit the states and federal level against each other, buttressing the political significance of intergovernmental transfers.

More specifically, federal intergovernmental funds comprise general revenue and specific purpose (i.e., conditional) transfers. The former, commonly known as coparticipation or revenue-sharing system, is oftentimes ruled by variables such as population density, developmental gaps, and state own tax collection or alternatively by fixed coefficients over which central and regional powers have limited leverage. In this case, transfers are allocated automatically and are not earmarked for any specific purpose. Hence, the extent of potential politicization of this type of

³¹ Fiscal relations in the EU obscure this characterization, insofar as its budget is financed mainly through upward-oriented grants from its member governments, as opposed to the typical pattern of top-down flows. The European regional policy is one of the few instances in which subnational governments are funded by the “political center” through programs such as the European Fund for Regional Development.

³² Also known as “fiscal illusion”, this effect denotes an underestimation of the costs of locally provided services, resulting in increased demands for local government output. This “inflation” of demands stems from the recipient’s perception that said services are being paid for or heavily subsidized by residents of other localities (Grossman 1990: 313-314).

transfers is nearly negligible because the three afore-mentioned variables have little variance in the short-term and fixed coefficients remain constant, let alone that revenue-sharing is unlikely to be affected by the policy choices and actions of recipient governments. In contrast, conditional transfers are subject to ongoing processes of intergovernmental negotiation, furnishing subnational-level leaders with a maneuvering margin of considerable proportions to extract additional resources from the central administration. By the same token, the center may attempt to manipulate transfers to force subnational authorities to pursue economic policies in tandem with national programs of fiscal adjustment, amounting to a re-centralization of fiscal policies. In Argentina, severe fiscal constraints compelled provincial governments to allow the National Treasury as well as international banks to withhold coparticipation (i.e., unearmarked) income as a collateral for contracting loans. Thus, most provinces are deprived from using coparticipation monies during the first two weeks of the month. To mitigate said stringent conditions, provincial governors were allowed to redirect some of the earmarked (housing, highways, energy, etc.) funds to soothe mushrooming provincial fiscal deficits.³³ Based on discretionary criteria, this change has turned intergovernmental transfers into arenas of political manipulation. Comparable developments transpire in Spain, where Joint Agreements on Investment (*Convenios de Inversión*), the largest conditional intergovernmental transfer, are generally exploited by the central administration to adjust ACs expenditure priorities to national policies of economic stabilization (Monasterio Escudero and Suarez Pandiello 1998: 209).

³³ For instance, since the mid-1990 the central government has agreed to permit provincial governments to use nearly 50 percent of FONAVI (*Fondo Nacional de Viviendas*, National Housing Fund) funds to cover general expenditure needs (Personal communication with Senior Advisor, *Subsecretaría de Relaciones con Provincias, Ministerio de Economía*, Under Secretariat of Provincial Affairs, July 28, 2001). It is worth mentioning that FONAVI is the largest intergovernmental grant, accounting for roughly 20 percent of the total amount of sharable resources in Argentina.

Focusing on intergovernmental transfers illuminates otherwise cryptic facts about the political nature of fiscal decentralization. As Bird and Vaillancourt (1998: 30) argue, “the design of intergovernmental transfers is always and everywhere an exercise not solely in normative economics but also in political economy”. This is so because looking into the relative shares of revenues and expenditures held by subnational governments, as most studies on decentralization do, gives an incomplete picture of the real degrees of decentralization. A more nuanced and valid measure of regional fiscal autonomy, then, is the share of intergovernmental transfers in total subnational revenue, which taps the segment of subnational finance being determined by central government authorities. Although this indicator applies only to the apportionment between the central and the subnational governments (henceforth, primary distribution) and does not take into account the distribution among subnational governments (henceforth, secondary distribution), it is a useful starting point to establish the comparative context in which Argentina and Spain can be placed. Table 1 confirms that in these two countries there is an acute gap between the political sway of regions and their fiscal autonomy, when compared to a sample of federal and decentralized unitary systems in their respective regions (the U.S. data are used as a “shadow” case of highly decentralized fiscal relations). To illustrate this disparity, we constructed the Index of Fiscal Politicization, in which the magnitude of intergovernmental transfers is weighed up by the level of subnational spending as a proportion of total government spending (see, Table 1, footnote). This index has no fixed range and its substance is more of heuristic than of econometric nature, but its high values denote higher potential for political conflict over fiscal decentralization and lower values otherwise. The rationale for this indicator lies on the stylized fact that high reliance on central government transfers on the revenue side of the equation

combined with increasing subnational expenditure responsibilities exacerbates the zero-sum character of fiscal relations and their political “corrosiveness”. Put differently, the higher the value of this index, the more intergovernmental bargaining will affect the inter-regional distribution of transfers.

Table 3: INTERGOVERNMENTAL FISCAL INDICATORS

	Subnational Fiscal Dependency		Subnational Spending Share		Index of Fiscal Politicization
	<i>Average</i>	<i>St. Dev.</i>	<i>Average</i>	<i>St. Dev.</i>	
Argentina	61.0	4.7	42.7	4.0	1.04
Spain	51.2	18.3	38.0	17.0	0.89
Austria	26.3	3.5	30.8	0.9	0.57
Belgium	58.6	3.3	12.0	1.1	0.71
Brazil	34.4	2.1	37.3	3.8	0.72
Colombia	47.8	4.5	28.1	1.8	0.76
Germany	23.1	2.2	42.7	1.9	0.66
Sweden	24.6	1.9	39.4	3.7	0.64
Switzerland	23.3	1.6	54.4	2.2	0.78
United States	31.1	2.6	44.1	1.9	0.75

Note: Subnational fiscal dependency is the share of intergovernmental transfers to subnational government total revenue. Subnational spending share is the ratio of subnational spending to total government spending. Index of Fiscal Politicization is the standardized summation of the Subnational Fiscal Dependency and Subnational Spending Share indicators. Data are drawn from the IMF’s Government Financial Statistics dataset and Fukasaku and de Mello Jr. (1998). Averages shown are from 1970 to 1995 for most countries.

Against this background, an important theoretical qualification to be introduced here is about the real political significance of decentralized spending. In this regard, the evidence presented above suggests that high levels of subnational spending are not tantamount to regional fiscal sovereignty. Whereas studies using subnational spending as a degree of fiscal decentralization are correct in pointing out that this is one of the best measures available without detailed study of each country (Byskow in Schneider 2003), they fail to grasp that local expenditure is something of a “double-edged sword”. On the one hand, it highlights the amount of government activity that subnational governments undertake, tapping into one of the main aspects of decentralization. On the other, mere expenditure decentralization funded through intergovernmental transfers³⁴ renders local officials subservient to the priorities of the center, with the concomitant rent-seeking effects (Oates 1993). In this context, it is worth emphasizing that while the classic public economics scholarship advocates that transfers are made by “free-handed” central governments to internalize externalities (i.e., interregional fiscal equalization), Rodden (2003: 705-706) correctly argues that, both from an institutional political economy and more realistic perspectives, “intergovernmental grants are not distributed by benevolent central planners, but rather by strategic politicians”. Hence, subnational governments get no “free lunch” when local expenditure is financed with transfers that normally carry political, if not administrative, strings attached. The case of Argentina is very telling insofar as it is not only the most decentralized Latin American country in expenditure terms (Inter-American Development Bank 1997)³⁵ but,

³⁴ Albeit excluded from this discussion, subnational independent borrowing is another important source of finance in multitiered systems, as state governments may borrow aggressively to adjust revenue shortfalls. The political significance of subnational borrowing is equally relevant for developed federations (Sbragia 1996).

³⁵ However, as the World Bank’s report by Burki, Perry and Dillinger (1998:11) claims, “Argentina is arguably one of the most decentralized countries in the region but has essentially the same political and fiscal structure it had before the military intervened in 1976....In contrast,

also, one of the front-runners in Table 1, matching the United States and approaching Switzerland, which have some of the highest levels of decentralized spending in the world. However, the extent of politicization, as measured by our index, is considerably much higher in Argentina, suggesting that transfers are prone to be hijacked by political interests.

What really matters, then, is the sphere over which state officials have autonomy. Ideally, local authorities can have more autonomy over tax bases of their own, but the “common pool” dynamics illustrated above boosts their preference to externalize the founding source (i.e., minimizing own revenue mobilization) to reduce accountability troubles in their electoral jurisdictions.³⁶ Put differently, if the political costs of “self-control” offset administrative and efficiency gains derived from own-revenue mobilization, local authorities will rather choose to maximize “influence”. This sway can be materialized in the determination of the revenue-sharing allocation to be transferred to subnational governments and in the redistribution of transfers among them. With regards to the former, the determination of how much is to be distributed is usually a fixed proportion of central government total revenues, which is more heavily influenced by economic trends such as pro-cyclical effects than by political interferences.³⁷ Furthermore, revenue-sharing arrangements are more commonly set on a tax-by-tax basis, with different coefficients of distribution among levels of government for each tax, rather on the entire pool of central government taxes, as found in Argentina, Brazil, Germany, India, Spain,

Colombia has radically increased the power and responsibilities of subnational units of government”. It is noteworthy that the index of fiscal politicization ranks Argentina much higher than Colombia.

³⁶ Likewise, some public choice scholars go as far as to argue that intergovernmental transfers undercut incentives for fiscal efforts, encouraging the formation of subnational cartels to avoid the discipline of tax competition (Grossman and West in Rodden 2003).

³⁷ Examples of revenue-sharing systems that determine transfers as a proportion of national current revenues may be found in developed and developing countries alike. These include Austria, Brazil, Colombia, India, Japan, Nigeria, Philippines and others (Bird and Vaillancourt 1998: 30).

and others. This scheme, however, is detrimental to subnational governments because it leads the central level over time to tend to increase those taxes which they do not have to share (Ter-Minassian 1997: 11-12).

3.1.1.1 Types of Fiscal Decentralization: A Political Explanation

While state-level authorities have limited capacity to dictate the total volume of revenue-sharing, they have more influence on the primary and secondary distribution of earmarked transfers (Porto 1986). In this regard, decentralization should be seen not only as a game being played between the central government and the regions but also as an issue subject to inter-state conflict.³⁸ The rationale for this analytical strategy stems from the fact that, whereas federal transfers are important to all subnational units, the greater dependence of peripheral regions on the central government alters the parameters used to assess levels of decentralization. This dependency results from the greater share of said disadvantaged regions' budgets subsidized by intergovernmental transfers, compared to metropolitan areas. Thus, while the apportionment of federal transfers to individual metropolitan areas may exceed that for peripheral regions in absolute terms, the purse power granted to the latter is more significant in relative terms. Moreover, in countries traditionally seen as playgrounds of caudillos, dictators and strongmen like Argentina and Spain (Veliz 1980), centralist legacies transpire in the ongoing administrative and political hegemony of Buenos Aires and Madrid, respectively. In turn, this sway endows politically powerful regions with privileged access to fiscal resources, beyond their actual

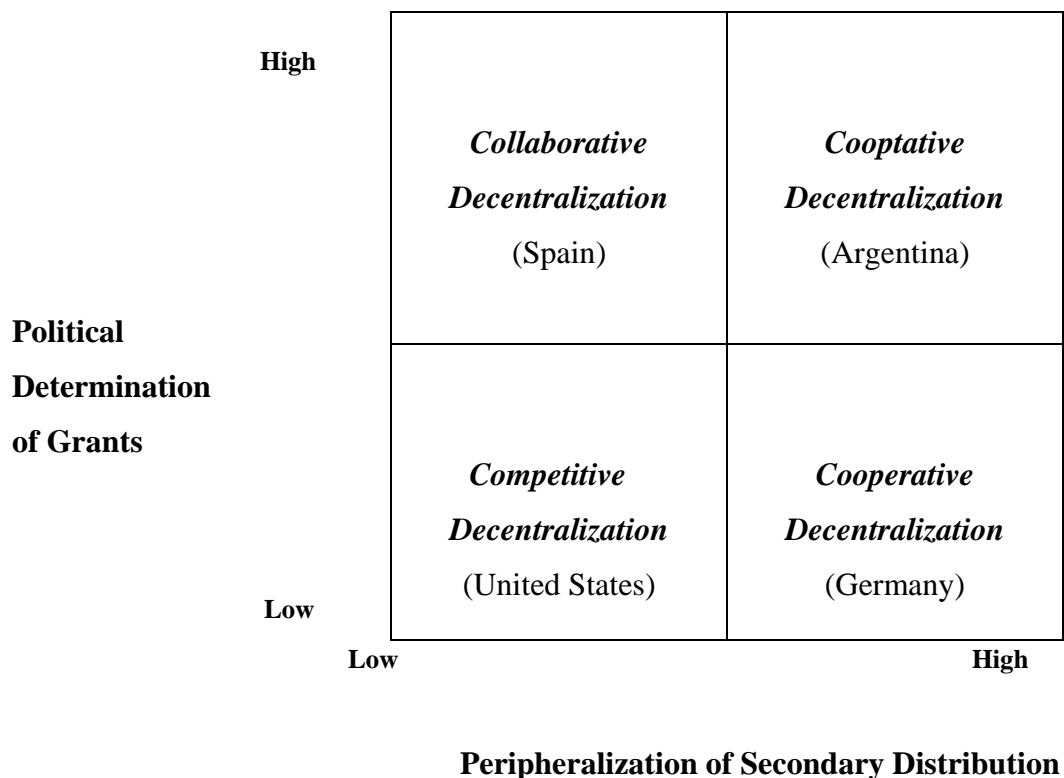
³⁸ Gibson and Falletti (2000) also emphasize the need to integrate inter-provincial conflict into explanations of the institutional centralization in federal systems. The literature on federalism and decentralization, including Riker's seminal theory of federalism, tend to overlook the explanatory role of inter-provincial domination in multitiered systems.

economic capability and despite the concomitant *de facto* separation of national political power from regional economic power.³⁹

Consequently, we argue that the apportionment of federal transfers among subnational units is a most valid and sound indicator of real fiscal decentralization, providing a number of important insights into the political economy of multitiered polities. Furthermore, focusing on the secondary distribution of intergovernmental transfers allows us to knit together the fate of decentralization policies to the maintenance of state patronage. Despite the prevalent view, mostly from international financial institutions, of fiscal decentralization as a potent antidote against rent-seeking behavior, this policy arena renders substantial opportunities to reinforce established clientelist networks in the economically disadvantaged but politically relevant subnational units. In economic terms, this analytical divide between metropolitan and peripheral regions affects substantially the political economy of transfers because higher levels of development and economic prosperity in the former regions will boost their capacity to mobilize revenue locally. Thus, all else equal, transfers in said areas will amount to a smaller fraction of their public budget. However, the extent of peripheralization of transfers is also influenced by the leverage of political factors, as opposed to socio-demographic and economic ones, in the determination of the primary distribution of earmarked transfers. This argument is presented visually in Figure1, which identifies four ideal-typical scenarios of fiscal decentralization.

³⁹ In Argentina, the development of the Pampas region has, from the very beginning, enhanced the economic and administrative clout of city of Buenos Aires, whose ports gave it virtually unchallenged control over trade and customs revenues. The case of Spain bears resemblance in the standing of Madrid as the “center”, notwithstanding the economic strength of Catalonia.

Figure 1: TYPES OF FISCAL DECENTRALIZATION



The horizontal axis measures the extent to which the allocation of federal transfers is tilted to more transfer-dependent subnational units, composing a variable identified as *peripheralization of secondary distribution*. The vertical axis measures the extent to which the total amount of earmarked transfers is politically determined, namely whether the bargaining among politicians and the political ideology of the party in power federally are more decisive than fiscal criteria in said determination, identified as *political determination of grants*. On average, this typology shows that the equalizing and efficiency effects that fiscal decentralization policies aim to

achieve are increased when the determination of transfers fits the lower right quadrant, which corresponds to the *cooperative decentralization* type. The afore-mentioned clause of the German *Grundgesetz* (Constitution) requiring “equivalence of living conditions” implies that inter-regional welfare imperatives prevail over political considerations. Further, poor *Länder* are subsidized by an equalization scheme pursued through direct horizontal redistribution among *Länder*, without participation of the central government (Spahn and Föttinger 1997). Accordingly, constitutionally-determined outcomes prevail. In practice, this translates into what Börzel (2002) describes as “compensation-through-participation”, whereby all *Länder* share the adaptational costs through codetermination in fiscal decision-making. However, if the apportionment of transfers to peripheral regions is a function of the grantee’s ability to deliver votes or legislative support to central government’s policies, grants are more likely to be perceived as contractually established. This scenario, identified in the upper right quadrant as *cooptative decentralization*, is perhaps less desirable from a normatively-oriented fiscal federalism perspective, but it may be appealing to transfers-dependent regions. Note that Argentina has not only one of the world’s most malapportioned senates but also the most malapportioned lower chamber in Latin America (Samuels and Snyder 2001). This overrepresentation renders poor peripheral units politically powerful because these can offer more “political bang for the buck” to the national executive than underrepresented areas. Utility-maximizing central governments prefer to target transfers to disadvantaged regions rather than to more developed constituencies because they obtain substantial political payoffs from smaller investments in “political” spending (Gibson and Calvo 2000).⁴⁰ The correlate of this standpoint

⁴⁰ This conjecture naturally assumes that national political power is more or less equally distributed among constituent units in a politically-decentralized system and that poor and unpopulated units are oftentimes overrepresented in national legislatures of federal systems.

is peripheral subnational governments' keenness to secure a lavish flow of federal transfers, as their political survival hinges upon them to a larger extent than prosperous regions, where both economic clout and organizational resources are more readily available.⁴¹ Thus, this type of decentralization, which is based on institutional resources and their consequential biases, engenders a more predictable and reliable flow of transfer funds to said regions.

The upper left quadrant, however, indicates that political factors can twist transfers toward more developed, metropolitan regions. The rationale underlying this *collaborative*⁴² type of fiscal decentralization is that central governments would reward highly populated, i.e. revenue-rich, subnational units, which are more "regionally assertive" (Van Houten 2000), more likely to develop regionalist political forces and, thus, more prone to advance their region's fiscal autonomy. Partly aimed at rewarding fiscal performance and partly due to the embryonic and evolving nature of fiscal federalism in Spain, the central government started first bilateral consultations and negotiation with Basques and Catalans, which virtually play a gate-keeper role (Aja 1999: 214-15) and gradually incorporated all other regions in multilateral arrangements.

⁴¹ Federations furnish developed regions with channels to assert their economic sway whereby they may circumvent the central state. In Argentina, provinces are constitutionally entitled to establish international trade agreements without interference from the central administration. The Spanish case bears resemblance insofar as AC have access to EU-lead forums such as the Committee of Regions in Brussels. In both instances, better-off regions can exploit more effectively these institutional prerogatives. Organizationally speaking, metropolitan regions have normally a more developed (i.e., more unionized and, thus, susceptible to exacerbate class conflict) workforce than peripheral regions, creating a more contested political environment (Przeworski and Sprague 1986).

⁴² The term *collaborative* is used to denote a lower level of co-decision powers in the formulation and representation of subnational interests than in the more entrenched and institutionalized *cooperative* type. Borrowed from Painter (1998), who couched the former term to portray the Australian intergovernmental policy process, the *collaborative* type involves the creation of joint schemes of administration and authoritative intergovernmental and consultative bodies. In this respect, collaboration is more affected by bilateral dynamics and thus can be seen as a preceding phase to full-fledged cooperation.

Last, transfers can benefit more developed regions, inasmuch as these are “net-payers” (due to the relatively high level of personal income tax generated in their jurisdiction), hence worthy of some sort of compensation for their fiscal contributions. This approach, which is widespread in the United States, shifts emphasis away from redistributive calculus and it prioritizes the removal of distortions in the allocation of federal transfers.⁴³ Identified as *competitive decentralization* in the lower left quadrant, this policy rewards fiscal efforts of competent fiscal contributors and cuts back support for local tax administration in peripheral regions, where it is perceived to generate major revenue bottlenecks. In turn, this type of decentralization hinges on the development and protection of markets (Weingast 1995).

In summary, considering that the territorial impact of federal transfers is gauged in relative terms, as suggested above, transfers that further peripheral subnational governments’ spending power, relative to metropolitan regions, will bring about a type of decentralization that is qualitatively different from one resulting from an advantageous apportionment to metropolitan regions. The major policy-making implication of this crossroads of central government/peripheral areas’ preferences is that a meaningful articulation of subnational interests is precluded, considering the underlying zero-sum game’ character of said distribution of federal transfers. We argue that this competitive environment renders two major structural effects on fiscal decentralization; first, negotiations are based on bilateral bargaining that clearly dilutes the formation of subnational coalitions and, second, intergovernmental negotiation occurs mostly through *ad hoc* meetings between the executive levels of the governing parties, to the

⁴³ In the United States, approximately half of the categorical (i.e. earmarked) grants require matching funds from the state and local governments, regardless of fiscal capacity considerations (Stotsky and Sunley 1997: 371).

detriment of any meaningful parliamentary processes of scrutiny. As it will be more carefully elaborated in chapters 3 and 4, these structural features hinder a redressing of the territorial balance of resources that fiscal decentralization policies are meant to achieve. These effects are more pervasive in Argentina than in Spain, where there has been a shift from confrontation and non-cooperation (between the central government and AC, on the one hand, and among AC, on the other) to a more cooperative approach based on an institutional framework that promotes multilateral cooperation.

3.1.1.1.1 LOOKING AHEAD

This chapter has shown that the design and working of intergovernmental transfers is a most appropriate analytical lense to uncover the political dynamics of fiscal decentralization. Further, we dealt with the sources of politicization of fiscal decentralization policies, suggesting that extant approaches fall short of revealing some ambiguous aspects of these policies. Particularly, the weakness of conventional measures of fiscal decentralization to capture nuanced facts about the inter-state level of conflict and the apparent, yet paradoxical, mutually reinforcing relationship between decentralization and the proliferation of patronage-ridden policy regimes in peripheral regions. What is more, the theory laid out in this chapter suggests that state patronage is not only a likely development but also that it is apparently a causally integral component of the overarching fiscal decentralization policies. This conjecture takes the center stage in the next two chapters, where we use empirical analysis to further investigate this theory in Argentina and Spain, respectively. In specific terms, the core question is what political features and/or institutional incentives of the system determine the afore-described manipulation of intergovernmental financing across subnational jurisdictions. Chief among these features and

incentives are the legislative representation of territorial interests, partisan color of the national executive and governorships, presence of regional-party dominant systems, socio-demographic influences, macroeconomic determinants, which are treated as independent variables. Subsequently, we will trace the paths of fiscal decentralization in Argentina and Spain to flesh out ambiguous, yet important, facts about these trajectories and to account for the causal impact of other political and fiscal influences. This qualitatively-oriented analysis aims to throw some light on particular dynamics that are not captured in the statistical test.

4 Chapter 4: The Politics of Intergovernmental Transfers in Argentina: Time-series and Cross-sectional Analysis

At first glance, Argentina appears to have one of the most decentralized fiscal systems in the world. According to an Inter-American Development Bank Report (1997), provinces spend more than 50 percent of total national and provincial expenditures. Yet, since the 1930s, subnational governments in Argentina have delegated fiscal authority to the federal level, which collects most taxes. This structural imbalance between expenditure and revenue assignments is common among federal systems, inasmuch as revenue-sharing arrangements are commonplace. However, Argentine provinces receive transfers that are, for the most part, substantially larger than own-tax revenues.⁴⁴ These transfers, as already outlined in Chapter 2, are drawn from the revenue-sharing system (*coparticipación* or Federal Tax-Sharing Agreement, FTSA) and other automatic transfers that are earmarked for specific purposes. The levels and parameters of these transfers have varied substantially over time, constituting an ongoing source of political strife between federal and provincial levels authorities and, as we will demonstrate in this chapter, among the provinces themselves.

Argentina's experience with fiscal decentralization stands out as important case for comparative theories about decentralization, as this country underwent processes of democratization and economic liberalization in tandem with decentralizing reforms at different times. Democratic election of subnational offices has unleashed pressure to deepen fiscal decentralization because local authorities sought to maximize control over resources that affect their lot. Additionally,

⁴⁴ By the mid-1980s, subnational administrations (including the municipal level) collected less than 15 percent of the total taxes collected in Argentina (Piffano in Sawers 1996: 218).

democratization sets free institutional factors such as political parties and legislative politics, which are seen as causally linked to decentralization policies (Willis, Garman and Haggard 1999). The effect of economic liberalization, however, is more multifaceted. Eaton (2001: 4) argues that in Argentina is necessary to separate the expenditure and revenue side of the question. On the one hand, liberalization in Argentina boosted expenditure decentralization, be it to pass on unwanted fiscal burden on central government accounts to lower levels or just simply based on the Tieboutian assumption that localized spending is more fiscally efficient. On the other hand, liberalizing, anti-statist plans pushed centralization of revenue, based on the presumption that tax-collection by central government officials is more competent, because this level of government attracts highly trained people through higher salaries (Tanzi 2002: 23). This coexistence of apparently inconsistent trends highlights the extent to which influential theories on the politics of economic liberalization fall short of elucidating the interaction among levels and regions that comprise the Argentine political system.

4.1 The Argentine “Paradox”: Federalism, Political Spending and Fiscal Crises

Argentina in the early years of the twentieth century was one of the most affluent nations in the world. The per capita income was on a par with West European countries such as France and Germany and matched those of Australia and Canada. In contrast, while many economies experienced exceptional growth after the World War II, Argentina has grown erratically, with long periods of stagnation and recession. This economic decay has been attributed to the pursuit of populist macroeconomic policies, which dwindled fiscal imperatives and prioritized the expansion of state capacities (Dornbusch and Edwards 1991).

Despite these gloomy circumstances, Argentina got through several economic crises and managed to overcome unprecedented hyperinflation in the early 1990s by means of policies of economic adjustment that restored Argentina's credibility in world markets. These accomplishments notwithstanding, the financial crisis in 1995 had a profound impact on the evolution of the public provincial sector. Out of 24 provinces, only 4 generated savings to finance investment; the few capital investitures made were financed partly by earmarked transfers (43 percent) and partly by borrowing (World Bank 1996: i). However, and reversing the direction of causality, Argentina presents an interesting case where the imbalances in the intergovernmental relations have contributed directly to macroeconomic collapse. Insulated from international pressures and institutionally powerful, "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 (Remmer and Wibbels 2000: 445).

Under the Argentine Constitution, provinces have the right to borrow and set up their own official banks, thus making the provinces the main locus of spending decisions. While in theory federalism is conducive to fiscal prudence in countries such as the United States (Weingast 1995), it is difficult to ignore that the political sway of Argentine provinces fostered macroeconomic volatility rather than fiscal discipline. Amounting to veto players in economic adjustment policies, regional politicians are institutionally endowed to extract resources from the center with little concern for the potential impact of their economic decisions on the federation as a whole. More specifically, observers of Argentina's political economy have shown that its regime of federal transfers induces an over-spending bias across jurisdictions as each province

tries to overuse the national common source of funds (Jones et al 2000). Adding to the expansionary bias that is being generated by the system of intergovernmental grants are soft budget constraints that manifest themselves in national government's bail outs of regional borrowing and debts. The result is a critically weakened center that resorts to federal transfers to buy off political support but unable to pursue intergovernmental reforms aimed at improving its capacity to provide national public goods. This chapter therefore seeks to analyze the role of subnational politics on the "enigma" of Argentine economic development.

4.1.1 Understanding the Role of Political and Economic Factors in Argentine Intergovernmental Relations

The task of this case study is to examine the political and economic underpinnings of fiscal decentralization in Argentina, paying special attention to the distribution of intergovernmental transfers. This case study shows that the political tinkering behind fiscal decentralization policies can be grasped more precisely when we examine the distribution of seemingly small-scale grants. Previous studies have used the history of Argentine FTSA to explore for evidence of the relative effect of economic and political factors on fiscal decentralization (Eaton 2001). However, while FTSA funds are not earmarked and local politicians can use them to build independent patronage networks, the bulk of money was given out on a formula or fixed coefficients basis. Further, after the 1973 restructuring of revenue sharing, FTSA increasingly lost ground (in relative terms) to other revenue-sharing funds that target specific purposes.⁴⁵ In this vein, this case study will focus on three intergovernmental transfers programs, FONAVI (*Fondo Nacional de la Vivienda*, National Housing Fund), FEDEI (*Fondo de Desarrollo*

⁴⁵ Although FTSA allocations, which are automatic, have been subject to periodical revisions based on political calculations (Saiegh and Tommassi 1999), there is some preliminary empirical evidence on the limited significance of FTSA as a determinant of actual levels of fiscal decentralization in Argentina (Gordin forthcoming).

Eléctrico del Interior, Electricity Investment Development Fund), and ATN (*Aportes del Tesoro Nacional*, National Treasury Contributions). This case selection is based on the fact that these funds are based on discretionary transfers, as opposed to automatic ones that are less vulnerable to political influence. However, while FONAVI and FEDEI are ideally allocated with the purpose of financing housing construction and electricity provision infrastructure respectively, ATN is used to fill financing gaps, thus is based on discretionary criteria both in the determination of the total amount to be transferred and unconditional with respect to allocation. Focusing on these funds, therefore, allows us to analyze the effect of explanatory political and economic factors on subnational funds apportionment under diverse transfer regimes.

4.1.1.1 FONAVI

Established in 1972 with the explicit purpose of financing underprivileged social sectors to defray costs to acquire housing and finance small-scale housing construction, FONAVI is the most important revenue-sharing fund after FTSA, accounting for roughly 20 percent, on average, of the total sharable resources. Over time, this fund underwent significant budgetary expansion, much larger than that experienced by comparable transfer programs in Argentina. According to FIEL (1993: 159), while FTSA experienced nearly 100 percent increase in the total transfers to provincial governments from 1974 to 1990, FONAVI underwent almost a 400 percent increase throughout the same period of time. This expansion of FONAVI suggests that both central and provincial administrations favor this fund over automatic transfers, considering that both levels prefer to have more influence over apportionment.⁴⁶

⁴⁶ Personal communication with a Senior Advisor, *Subsecretaria de Relaciones con Provincias*, *Ministerio de Economía*, Under Secretariat of Provincial Affairs, July 28, 2001.

In general terms, the incidence of FONAVI funds on the overall level of house construction is very high, particularly, but not exclusively, in poor provinces (INDEC 1994). These funds are lent to the provinces, which then onlend funds through provincial housing organizations to needy individuals to bankroll housing construction. It is noteworthy that while FONAVI resources have to be paid back in principle, the income recovered from outstanding housing loans has only been between 2 and 4 percent in 1978-1993 (World Bank 1993: 128). Adding to this low repayment levels, Schwartz and Liuskilla (1997: 403) argue that “FONAVI does not reach the very poor, and, in fact, it has evolved into a mechanism for subsidizing middle-class housing”. This apparent unruly background hints that there might be other aspects of FONAVI that make it more subservient to political and regional influence than to its ostensible goal.⁴⁷

4.1.1.1.1 FEDEI

Created in 1960, FEDEI operates as a subsidy, which is not repayable to the federal government, to provinces to organize cooperatives to promote and organize electrification public works. These cooperatives undertake works mostly in rural area, which are distant from power distribution grids and away from major urban centers that normally receive electricity services from major providers. Considering that FEDEI-related cooperatives supply almost 20 percent of the total national provision of electricity, its incidence on the energy sector is considerable (Ambito Financiero, April 15, 1999). Beyond its valuable social function, FEDEI is driven by

⁴⁷ Lopez Murphy and Moskovits (1999: 127) claim that the mechanism of federal transfers in Argentina leads to moral hazard for local officials and, more specifically, “when funds are transferred for specific programmes (e.g. conditional transfers such as FONAVI or other health or education programmes) get diverted to general funds and then are spent in other, politically profitable ways (e.g. temporary jobs for potential supporters or simply deficit reduction). The central government cannot immediately detect if this has an effect on local government’s housing, health or education budget, nor can it legally prevent it unless legally or constitutionally authorized”.

pork-barreling priorities set by provincial governments, which have the last word in the distribution criteria. The cooperative structure, whose organization is highly impromptu and informal, opens further opportunities for clientelist practices through public contracts that oftentimes are awarded to governor's "friends". Further, despite the fact that provinces have ample discretionary authorities to set FEDEI priorities, there is no shortage of conflicts among provinces from overlapping jurisdictions. For instance, neighboring Córdoba and San Luis are interconnected but bitter disputes took place because the latter province had its FEDEI cooperatives bearing much higher costs. In Santa Cruz, which was the only province unconnected from the national electricity network until recently, FEDEI transfers have been consistently high, ranking among the most critical revenue transfers to that province. These outlay differentials are not divorced from governors' ability to negotiate with the federal government their share of FEDEI.⁴⁸

4.1.1.1.1.1 ATN

Drawing its mandate from the article 67 of the Argentine National Constitution of 1853, ATN is the oldest intergovernmental transfer fund. Until the establishment of FTSA in 1935, ATN were the sole transfer avenue from the central government to provinces (Cetrangolo and Jimenez 1997: 9). This datum has more than historical significance, and it highlights the discretionary character that the Argentine "Founding Fathers" have conferred to this country's intergovernmental fiscal system.⁴⁹ In terms of governance, this means that the Ministry of

⁴⁸ Personal communication with a former *Subsecretario de Relaciones Fiscales con Provincias, Ministerio de Economía*, Under Secretary of Provincial Affairs, July 30, 2001.

⁴⁹ Article 67 (paragraph 8) establishes that, de "acordar subsidios del Tesoro Nacional a las provincias cuyas rentas no alcancen, segun sus presupuestos, a cubrir sus gastos ordinaries", i.e.

Interior, which is in charge of allocating ATN, has had free hands to determine the allocation of funds to provincial administrations. While ATN allocations are consistently smaller than FONAVI transfers, oftentimes the former fund constituted the main avenue to channel transfers to the provinces. As Schwartz and Liuskilla (1997: 403) claim, “particularly in the early 1980s, when the funds channeled through the coparticipation arrangement were reduced via pre-coparticipation arrangements, the provinces began to rely more heavily on discretionary ATN transfers to fill financing gaps. In 1983, for example, ATN transfers exceeded coparticipation transfers by 75 percent”. Furthermore, the share of provincial revenues coming from ATN transfers has grown by an annual average of 30 percent between 1991 and 1995, accounting for 3.8 percent of total transfers to provinces in 1995 (World Bank 1996, Vol. 1: 34).

This seemingly insignificant figure suggests that ATN are a small portion of total transfers. However, ATN transfers represent a large share of the revenue for some selected provinces. Even though the Debt Crisis in 1982 has caused to increase the amount of ATN transfers to all provinces, peripheral provinces experienced an increase of 140 percent compared to a 17 percent increase in economically-advanced provinces (Porto 1986: 23). What is more, in one notorious extreme case, the province of La Rioja, ATN transfers have accounted, in selected years, for over 40 percent of the provincial government resources (World Bank 1996, Vol. 1: 66).⁵⁰ In Cordoba, a more developed yet similarly deficit-ridden province, ATN funds amounted only to 2.6 percent

“ATN will be transferred to provinces whose revenue is insufficient, based on their own budgetary forecasts, to offset ordinary expenses” (Anales de Legislación Argentina 1977: 10-11).

⁵⁰ It is noteworthy that La Rioja has reached this 40 percent in the 1990s, right after former President Carlos Menem, who achieved national standing as a populist governor of this province, won the 1989 presidential elections. Throughout the 1980s, ATN transfers accounted, on average, only for 6 percent of total provincial resources in La Rioja (Cetrángolo and Jimenez 1997: 30).

of total provincial resources during the 1990s, a period in which this province was so indebted that almost 40 percent of its *coparticipación* funds were retained to pay debt service. This inter-provincial gap, which is at odds with ATN's alleged goal of assisting ALL indebted provinces, becomes even more apparent when we observe that, during the 1990s, La Rioja attracted almost 50 percent of the total amount of ATN allocated to all provinces, whereas Cordoba has been allocated only 1.4 percent throughout the same period (Subsecretaría de Programación Regional 1998).

Last, it is very telling that the agency in charge of managing ATN is the Ministry of Interior, whose *modus operandum* is highly political, compared to more technocratic (and germane to fiscal imperatives) offices such as the Ministry of Finance or Economics. Also, extraordinary political events may have a significant effect on ATN distribution. For instance, after the province of Corrientes was intervened by the central government in 1992, there has been a steep increase in ATN funding to said province, from 3.1 percent of total ATN allocations in 1991 to 15.4 percent in 1993. Likewise, the intervention of Santiago del Estero in 1993 entailed an increase from 1.2 percent in 1992 to almost 6 percent in 1994 (Cetrángolo and Jimenez 1997: 31).⁵¹ This suggests that ATN may be oftentimes be used as a politically-expedient tool by central government authorities to enhance support or encourage compliance at the face of unilateral and authoritarian moves such as said interventions.

⁵¹ Further, considering that there are 24 ATN-hungry provinces in Argentina, the relative weight of these percentage increases becomes more palpable.

4.1.1.1.1.1 The Empirical Analysis

In this section, we assess the explanatory power of the typology of fiscal decentralization laid out in the previous chapter by means of statistical analysis and insights from policy informants and secondary sources. The first task is to examine the extent to which FONAVI and ATN allocations are politically determined, confronting two competing views about intergovernmental transfers.⁵² One explanation emphasizes the traditional neoclassical approach to federal-subnational fiscal relations and the alternative model suggests that transfers are contingent on the political fortunes and current political vulnerability of each level of government. For that purpose, regression analysis is used to account for cross-subnational and diachronic variation in the distribution of intergovernmental transfers, using macroeconomic, socio-demographic and political indicators as explanatory factors. The second part lays out the circumstances and details of the inter-provincial distribution of federal transfers, using cross-sectional analysis of FEDEI allocations in 1995. This year, as we will show more thoroughly later, amounts to a “critical juncture” in the federal-provincial fiscal relations, following the fall of the Convertibility Plan, the Mexican (“Tequila”) crisis, and two Federal Fiscal Pacts (1992 and 1993).

4.1.1.1.1.1.1 Benevolent Central Planners or Strategic Politicians?: The Determination of Federal Transfers, Argentine Style

The theoretical framework for this analysis consists of a set of hypotheses positing relationships among these independent variables and the subnational allocations of FONAVI and ATN

⁵² In this analysis, we exclude FEDEI because it has been subjected to numerous changes since its creation, affecting the consistency of its time-series. However, FEDEI provides the most appropriate empirical indicator to analyze the cross-section distribution in the 1995 crisis, as it was put through intense media and oversight scrutiny based on its salient capital-intensive character (Zapata 1998).

grants.⁵³ This dependent variable measures the annual apportionment of these funds to provincial administrations from 1972 to 2000. This time frame does not relate to any theoretical consideration and is dictated by the availability of comparable and uniform data for only these years. That having been said, this is the longest time-series ever used to study the unfolding of fiscal decentralization in Argentina.⁵⁴ In the case of FONAVI, a variable to analyze the extent to which these transfers are actually used for housing assistance purposes is included. In this vein, we have collected census data on the total yearly amount of new houses built that are financed by public monies.⁵⁵ Ideally, there should be a significant positive correlation between the amount of FONAVI transfers to a province and the total amount of publicly subsidized new houses built in that province in the corresponding year.⁵⁶ Appendix 2 provides a list of data sources used to compile all variables.

We have chosen to test the hypotheses using pooled time-series regression analysis, which is the most appropriate technique for capturing variation across and within panels (Wonnacot and Wonnacot 1979) while using an estimator that recognizes the potential errors attributable to panels of subnational financial data. Chief among them is the statistical problem of serial correlation because budget allocations for one year are only *incrementally* different from previous years, so that the independence of observations requirement does not hold. Further, considering the data used in this analysis are unbalanced (i.e. a small numbers of years are

⁵³ We specifically look at the secondary distribution of grants because the central government is not a recipient of these funds

⁵⁴ Previous studies use small data sets with cross-section averages for only 5 years (Stein 1998) or time-series for a period of 12 years (Rezk 1998).

⁵⁵ Because there is no alternative or competing national housing fund, we can confidently associate FONAVI to this census information.

⁵⁶ Funds are usually channeled before works, so, as we will see thereafter in the statistical analysis, it is necessary to lag this effect.

missing), we use STATA software, which provides a command (“xtpcse”) that employs an algorithm to estimate unbalanced data. An additional advantage of using regression models with panel-corrected standard errors is that they prevent cross-sectional heteroskedasticity⁵⁷ without substantially diminishing degrees of freedom. Last, given the reasonably large number of cross-section units (24 provinces), it is not necessary to include a matrix of case dummies.⁵⁸ As we use pooled data, the unit of analysis is province/year.

Competing Hypotheses

1) The Economic Context

The traditional economic policy view of intergovernmental transfers is that such grants are made to enhance macroeconomic efficiency and fiscal equalization among provinces (Gramlich 1977; Oates 1972). This approach sees central government agents as “benevolent” insofar as they prioritize the advancement of public welfare over their private (i.e. political and utility-maximizing) interest. In principle, government seeks to offset externalities and other market imperfections, thus it aims to match grants to jurisdictional needs and capabilities. This section, therefore, explores the ways in which these imperatives may come to be crucial in determining cross-provincial variation in the distribution of transfers.

⁵⁷ Regression analysis is biased when all the error processes do not have the same variance (i.e. heteroskedasticity).

⁵⁸ Commonly used to analyze pooled time-series data, least squares dummy variable (LSDV) regression is useful only when cross-temporal variances and covariances significantly exceed cross-spatial ones (Hicks 1994: 179).

HYPOTHESIS 1: Provinces with higher population share will receive larger amounts of FONAVI transfers than less populated provinces. However, the former will not necessarily receive larger amounts of ATN transfers than the latter.

The distribution of funds across provinces is determined using various indicators reflecting the evolution of the demand for public services. Population is then a critical consideration in this regard. Further, population needs to be included in this analysis because is the crucial factor for allocating the amount of legislators in the low chamber representing each province, thus it indirectly affects the ebb and flow of transfers. Basically a demand-driven program, FONAVI is directly affected by population figures. While there is apparently a linear and positive relationship between FONAVI allocations and housing needs, it can be argued that other macroeconomic conditions affect this relationship. For instance, provincial unemployment levels are relevant because individuals who have no income are unlikely to take on mortgage commitments and would probably reside in rented housing. Hence, we should control for the impact of unemployment, which it will be subsequently analyzed in the next hypothesis. However, ATN are allocated to help provinces with a wide range of fiscal difficulties, thus populations may not be among the ultimate factors. Also, preliminary evidence (1973-84) on ATN transfers indicates that these contributions have been far more redistributive toward the underdeveloped provinces, some of them with low population density and some not (CECE 1997: 153). This variable is measured using population figures based on available census data.

HYPOTHESIS 2: Provinces with high levels of unemployment will seek to offset their disadvantaged position with higher transfers of FONAVI and ATN funds

As indicated above, unemployment is included to control for the existence of an active counter-cyclical fiscal policy, which might be at the core of demands for greater intergovernmental transfers. Considering that levels of unemployment tend to diverge dramatically across Argentine provinces⁵⁹, it is important to see whether they demarcate the manner in which FONAVI and ATN transfers are doled out. Unemployment is measured as the provincial unemployment rate in percentages.

HYPOTHESIS 3: Provinces with higher geographical GDP will receive higher FONAVI transfers. However, the former provinces will not necessarily receive higher ATN transfers.

Provincial own revenue is usually positively related to the value of the regional economic capacity, generally measured in terms of gross domestic product (GDP). The availability of relatively reliable data on regional GDP allows us to test the impact of this variable on the distribution of intergovernmental transfers. Previous work on fiscal performance of Argentine provinces shows that energy consumption, a factor often used as a proxy for economic development, does not have any significant effect on provincial public sector spending (Jones et al 2000). However, provincial economic capacity bolsters demand for housing, thus we expect a significant relationship between provincial GDP and FONAVI transfers. In the case of FONAVI, considering that provincial debt stock is at variance with GDP (Jimenez and Devoto 2002: 231),

⁵⁹ For instance, the unemployment rate (1995, randomly selected) in Mendoza is 6.7 percent compared to a 19.2 percent in Tucuman (INDEC).

we do not anticipate any significant effect. Geographical GDP is measured as the per capita provincial GDP converted into Pesos, June 1995.

2) The Political Context

Arguments under this rubric hold that utility-maximizing politicians will use intergovernmental transfers to advance their own private (political) interests, thus questions of efficiency and social welfare are surface phenomena. Instead, one must understand the incentives politicians at all levels of government face and the resulting political relationships between national and subnational politicians. These incentives stem from electoral institutions, party competition, and most fundamentally, coalition-building. That is, intergovernmental bargaining in the political market takes the center stage.

HYPOTHESIS 5: Provinces where the governor is from the same party as the president will have lower transfers of FONAVI and ATN transfers than provinces where the governor is a member of the opposition.

In a widely cited study, Riker and Schaps (1957) argued that if the executive officials of the central and constituent governments are controlled by the same party, then they might be expected to attenuate the level of conflict within a federation by enhancing centralizing moves. In turn, whether governors belong to a political party which is similar or different to that of the president is a major influence in the unfolding of intergovernmental fiscal relations. In the Argentine context, governorships are by far the most important office at the provincial level and the way in which negotiations between the national and provincial executives evolves is seen as

determinant of decentralizing policies (Falletti 2000; Jones et al 2000). Further, considering that many policies of the central government that require legislation to give them effect involve a coalition that is broader than the members of the incumbent party alone, presidents seek to captivate the other parties' governors support. The latter, largely unaffected by incumbent's intra-party rules and the effect of legislative party discipline, are likely to behave in an opportunistic manner, trying to extract higher transfer payments from the national government than governors from the president's party would. Partisan disharmony is assessed using a dummy variable indicating whether the provincial governor belongs to a party that is different of that of the president.

HYPOTHESIS 6: Presidents facing divided government at the provincial level will be more likely to increase the level of FONAVI and ATN transfers to the provinces controlled by the opposition.

Drawing heavily on evidence from US states, a body of scholarship has concluded that while several political and institutional factors affect budgetary outcomes, the absence of simultaneous same-party majorities in executive and legislative branches of government⁶⁰ is a decisive influence in fiscal policies (Alt and Lowry 1994; McCubbins 1991). This factor, known as divided government, refers to those cases in which the executive is unable to rely on a solid contingent in the legislature approving his/her policy proposals. Divided government is a widespread political phenomenon that affects a wide range of political systems (Ecuador, Mexico, France, Finland, Poland, Denmark and others) and it acquires particular relevance in

⁶⁰ This characterization is borrowed from Elgie (2001: 2), who provides one of the most comprehensive analyses of divided government in comparative perspective.

Argentina, where relatively high levels of party discipline furnish the national executive with coercive resources ⁶¹ to induce copartisan legislators to behave in line with national fiscal objectives (Jones 1997). Divided government is measured at the provincial level, as the percentage of deputies who do not belong to the president's party.⁶² It should be noted that there is significant variation in the legislative structures across Argentine provinces because some provinces have bicameral legislatures (e.g. Buenos Aires, Córdoba, Entre Ríos) and others have unicameral ones (e.g. La Pampa, San Juan, Neuquén). Adding to this wide gamut of institutional designs is the confounding effect of provincial constitutions that regulate the balance of powers between houses differently. As a result, we code all provinces as unicameral, just adding up the total number of legislators in both houses when the province is bicameral.

HYPOTHESIS 7: Provinces where the governor is representing a regional party will have a significant larger proportion of FONAVI and ATN transfers than provinces ruled by other parties

While two-party presidentialism has been the hallmark of Argentine national politics throughout the last century, provincial parties became meaningful actors at the subnational level. This development is crucial for understanding the evolution of intergovernmental transfers given the

⁶¹ These resources stem primarily from the fact that the national executive is the most important figure in its respective party, having considerable influence over the candidate nomination process mainly due to the use of closed-party lists to elect legislators in Argentina.

⁶² Previous studies used a dummy variable to classify divided government based on a 50 percent majority threshold (Alt and Lowry 1994). This operationalization, however, is suitable for a US-like bipartisan composition of the legislature. In Argentina, provincial parties are significant forces at the subnational legislative level (e.g. Corrientes, Chaco, Jujuy, Neuquén, Salta, San Juan, San Luis), thus a stronger multiparty composition is better captured by using percentages rather than dichotomous values.

fact that some regions have regional-party dominant systems providing them advantages over regions with higher levels of electoral volatility. Previous research has shown that, with few exceptions, national politicians have used fiscal transfers to strengthen the allegiance of provincial party leaders (Gibson 1996; Remmer and Wibbels 2000). This patronage-driven mechanism derives from provincial parties' fewer opportunities to obtain discretionary resources than their mainstream challengers at the regional level. In many respects, it is not too far-fetched to argue that long-standing dominance of provincial bosses on regional politics has translated into lavish transfers to their respective regions to the detriment of provinces more susceptible to electoral manipulation. In a country where governors act as agents of the president (Snow 1971), such channeling of financial support to provincial parties-dominated regions seems to be a price worth being paid. This variable is measured using a dummy variable indicating whether the provincial executive is controlled by a provincial party.

Table 4: DETERMINANTS OF FONAVI TRANSFERS: PANEL-CORRECTED REGRESSION RESULTS

Independent Variables	z	p < .05
Intercept	-1.04	0.297
Population	1.10	0.270
Unemployment	1.08	0.281
Geographical GDP	2.07	0.039
House Building	- 1.18	0.237
Provincial Party Governor	0.70	0.487
Divided Government	1.69	0.090
Partisan Disharmony	-0.87	0.386
FONAVI _{t-1}	10.31	0.000

Note: $N = 294$. The dependent variable is yearly changes in the evolution of FONAVI transfers to provinces from 1972 to 2000. $R^2 = 0.91$. Wald Chi2 = 470.66 (prob > chi2 = 0.000). Entries are panel-corrected standardized coefficients.

Table 5: DETERMINANTS OF ATN TRANSFERS: PANEL-CORRECTED REGRESSION RESULTS

Independent Variables	z	p < .05
Intercept	-0.61	0.542
Population	3.26	0.001
Unemployment	2.88	0.004
Geographical GDP	-0.75	0.452
Provincial Party Governor	0.53	0.593
Divided Government	3.05	0.002
Partisan Disharmony	-2.12	0.034

Note: $N = 215$. The dependent variable is yearly changes in the evolution of ATN transfers to provinces from 1972 to 2000. $R^2 = 0.45$. Wald Chi2 = 28.41 (prob > chi2 = 0.000). Entries are panel-corrected standardized coefficients.

Tables 1 and 2 present the coefficients of the equations estimating FONAVI and ATN transfers to provinces, respectively. For the FONAVI regression, it was necessary to include the lagged value of the dependent variable due to problems of serial correlation.⁶³ Before we proceed to discuss the findings for each political factor, it becomes apparent that partisan considerations are major shaping influences in the unfolding of these transfers, as they withstand the inclusion of decisive socio-demographic and economic variables. If in fact grants are doled out to address equity and/or efficiency issues, political factors should not be so conspicuously present. Also, as suggested earlier in this chapter, the statistical insignificance of the House Building variable denotes a meaningful margin for political manipulation of funds. Beyond providing preliminary evidence to advance a political theory of decentralization, these general findings challenge the basic postulates of the normative theory of intergovernmental transfers and its emphasis on fiscal equity and efficiency as key building blocs (Oates 1972). The major stylized fact emerging from this analysis is that economic imperatives are necessary but, by all means, *not sufficient*

⁶³ This inclusion has inflated the R^2 of the equation, which should be then interpreted cautiously.

conditions to account for variation in FONAVI and ATN transfers at the light of the consistent and significant effect of the divided government factor. This strong and consistent relationship between partisan and legislative variables and the ability of provincial governments to increase their share of federal funds corresponds with preliminary evidence offered by Willis et al (1999), who argue that party system factors define levels of fiscal decentralization in Latin America.

All in all, the specification of the fiscal federalism variables used here does not capture the realities of all intergovernmental transfer programs in Argentina, as it emerges from our empirical analysis. In the case of FONAVI, geographical GDP is the only statistically significant variable, whose positive sign is indicative of a lack of redistributive concerns in FONAVI allocations. However, this relationship is feasible insofar as house building is, all else equal, likely to be enhanced in wealthier provinces. Conversely, ATN allocations appear to be far more redistributive toward peripheral and underdeveloped provinces of the interior than have been other intergovernmental transfers. The positive and statistically significant sign of the unemployment variable shows that provinces with higher unemployment rates will obtain higher ATN apportionments. As for population, the positive sign indicates that although less populated provinces enjoy stronger representation in congress, they do not get a better deal because ATN are channeled by the executive.

Turning first to our partisan disharmony variable, Riker and Schaps' intuition does not provide a solid ground to fully explain FONAVI transfers, at the light of its statistical insignificance. While in a previous study it is shown that when governorships are ruled by opposition parties, the overall amount of (total) federal funds transferred to the provinces increases considerably

(Gordin, forthcoming)⁶⁴, partisan disharmony appears to be a much weaker predictor of the inter-provincial distribution of such funds. The overall amount of FONAVI transfers hinges on bilateral bargaining between the central government and each province precluding the coordination of strategies among governors, regardless of their partisan color.⁶⁵ Said bilateral bargaining generates a *zero-sum* game dynamics among governors and bolsters the territorial aspects of interest representation and bargaining *vis-à-vis* partisan interests. Moreover, the “catch-all” nature of Argentina’s mainstream parties, the Peronist Party and the UCR, leads to intra-party confrontations because these parties embrace quite distinct factions.⁶⁶ As a result, and despite some scholars have noted the “executive” nature of Argentine federalism (Pirez 1986; Porto 1996), partisan disharmony between the national and provincial level does not capture the diversity of political interactions affecting FONAVI transfers and appears to subside to provincial-level politics. On the other hand, a “reverse” effect of the partisan disharmony variable is a strong predictor of ATN allocations, namely provinces whose governorships are ruled by the national incumbent party are favored. The above-mentioned advantaged status of La Rioja exemplifies very clearly this finding. Partisan interests gain preeminence because ATN

⁶⁴ In this analysis, the dependent variable is the evolution of the main federal intergovernmental funds transferred to all provinces, excluding the FTSA.

⁶⁵ The Housing Committee in Argentine Congress is the main arena where FONAVI appropriations are negotiated. Considering that governors are extremely influential in the determination of committee chairmanships (Jones et al. 2002: 666-667), and that the Argentine legislators are provincially party-centered (as the locus of nominations is at the provincial level), national partisan interests fall short of determining FONAVI outcomes and territorially-based party interests prevail.

⁶⁶ Borrowing from Eaton (2002: 287), “Whether provincial party leaders support the national party leadership is largely a function of factional disputes within the party. Factions typically take shape as provincial party leaders cluster around the various governors jockeying for support as the party’s next presidential standard bearer. In President Menem’s second term, for example, different brands of intra-party opposition to his leadership were organized by Governors Eduardo Duhalde of Buenos Aires, Nestor Kirchner of Santa Cruz, and Arturo Lafalla of Mendoza”.

funds are allocated by the highly centralized Ministry of Interior, which is an agency known to resort to a “stick and carrots” strategy to sort out intergovernmental conflict.⁶⁷

Substantiating the works of scholars questioning O’Donnell’s thesis of delegative (i.e. executive-dominated) democracy (Eaton 2002; Jones 2001), we found that legislative politics in Argentina, at least with regard to intergovernmental transfers, “matter”. In both tables, the divided government variable is statistically significant and carries the expected sign, which indicates that, as Garman et al (2001: 210) have found in their study of fiscal decentralization in Latin America, “under divided government, legislators will be attentive to checking the powers of the president, including her control of resources, and will seek to channel resources to their copartisans at the subnational level”. While the significance of this finding for the case of FONAVI was somewhat expected, considering that the Housing Congressional Committee is the main decision-making arena, its relevance for ATN allocations needs further clarification. First, there is an apparent contradiction between the partisan encapsulation at the executive level, where governors who belong to the president’s are favored, and the parallel rewarding of provinces represented by legislators of the opposition parties. However, the concurrence of these two strategies maximizes support-building, and the highly discretionary character of ATN transfers permits presidents and, by extension, the Minister of Interior a high degree of strategic flexibility, while still maintaining a solid base of support. In this regard, it is noteworthy that during Alfonsín’s presidency (1983-

⁶⁷ The Ministry of Interior is also a decisive actor in federal interventions to provinces. Cetrangolo and Jimenez (1997: 30-31) argue that the Ministry of Interior “compensates” federally-intervened provinces by increasing their ATN allocations in the years right after interventions. Given the intermittent (and mostly variable) episodes of interventions, we cannot use this information for statistical analysis.

1989), which is the period when ATN virtually substituted FTSA transfers⁶⁸, there was some deviation from this pattern insofar as both Peronist governors and senators were disproportionately rewarded by Alfonsín. While it is beyond the scope of this data analysis, it is important to point out that there are different gradations in the divided government phenomenon. For instance, there is a significant difference between a situation where the president's party controls only one house or none (Alt and Lowry 1994). In the case of Alfonsín, when divided government intensified, following his party defeat at the 1987 mid-term elections, he lost the ability to build Peronist support in congress following the increased leverage of this party to legislate a return to automatic revenue-sharing procedures.

Regarding the political influence of a governorship controlled by a regionalist party, we found no support for the hypothesized effect in Argentina, as this variable is statistically insignificant for FONAVI and ATN transfers. One possible explanation for this finding stems from the ideological orientation of Argentine provincial parties, mostly clustered at the center-right and thus closer to the Peronist Party. In the last 10 years covered in this study, provincial parties have massively supported the candidacy of Carlos Menem and his subsequent attempt to cut down 15 percent in the primary distribution of FTSA to the provinces to finance the proposed nationalization of the social security system. An additional cause of this seemingly minor role played by the provincial parties' czars stems from their progressive ambitions (Schlesinger 1966), insofar as provincial governorships in Argentina are strategic springboards to attain national

⁶⁸ Throughout these years, the incumbent UCR only held a majority in the lower house, and only until 1987, when Peronism assumed the majority of this chamber. Peronists exploited a constitutional clause that all revenue-sharing bills must originate in the National Senate and blocked the passing of badly needed revenue-sharing law reforms. Alfonsín manipulated this legislative vacuum by resorting to ATN transfers to compensate for provincial fiscal shortfalls.

leverage, buttressing their prospects to run in subsequent presidential elections as candidates. In this light, governors from provincial parties seek to cast a fiscally-responsible image and conceal, to the extent possible their clientelist and opportunistic streak.⁶⁹

4.1.1.1.1.1.1.1 “And the Last Shall Come First”: The Inter-Provincial Distribution of Intergovernmental Transfers

The preceding results for FONAVI and ATN apportionment are consistent with the so-called politico-economic “partisan model” of elected officials from competing parties, who safeguard their political destiny through public provision. Significant as these first findings are, they are only a building bloc to test the typology outlined in Chapter 2. Having revealed that the political determination of transfers is consistently high, it is necessary now to examine whether transfer-dependent provinces are rewarded compared to provinces with higher fiscal capacity. For that purpose, we will use cross-section analysis of transfers to provinces in 1995.⁷⁰ This year epitomizes the beginning of a period in which provincial administrations were pushed to modernize their public administrations systems, reform the structure of provincial taxes, and, more importantly, improve their own-resource mobilization. Accordingly, this is the time when the federal government was expected to grapple effectively with the challenges of provincial

⁶⁹ Personal communication with Juan Carlos Pezoa (former *Subsecretario de Relaciones Fiscales con Provincias, Ministerio de Economía*, Under Secretary of Provincial Affairs, July 30, 2001.

⁷⁰ An alternative approach to focusing on 1995 is to use cross-section averages for the period 1990-1995 (Gibson and Calvo 2000, Stein 1998), which is a critical period of fiscal adjustment following the introduction of the Convertibility Plan that paved the way for the restoration of macroeconomic stability at the national level. However, we believe that although provincial fiscal performance has been consistently poor throughout these years, the incentives to overspend and/or undertax have been at variance following the introduction of the Fiscal Pacts in 1992 and 1993.

fiscal adjustment, providing an ideal counterfactual laboratory to map out the extent of peripheralization of inter-provincial transfer distributions.

- 1995: An Illustrative Case-Study

The analysis of the inter-provincial distribution of federal funds in 1995 offers an interesting case to examine the extent to which economically disadvantaged provinces can tilt their share of transfers at a time when financial imperatives were expected to reduce subnational fiscal autonomy. This year amounts to a “critical juncture”⁷¹ that was expected to reduce the maneuvering margin of poor provinces to retain a lion share of federal transfers, providing a useful testing ground of extreme fiscal conditions. More specifically, this year represents a crossroad of the beginning of the demise of the Convertibility Plan, the Mexican Crisis in late 1994, and the lagging effects of the 1992 and 1993 Fiscal Pacts.

The Convertibility Plan: Seen as the only remedy to curb hyperinflation, the 1991 Convertibility law forbid the Central Bank from using the money supply to finance the public deficit, and money creation was permitted only to the extent that international (i.e. US dollars) reserves were increased. While this plan help to increase provincial revenue, expenditures quickly accommodated and provincial deficits grew from 0.2 percent of GPD in 1992 to 1.2 percent in 1995 (World Bank 1996: 2).⁷² This overall unsustainable level of debt has not swayed provinces’

⁷¹ Collier and Collier (1991: 29-30) define critical juncture “as a period of significant change, which typically occurs in distinct ways in different countries (or in other units of analysis) and which is hypothesized to produce distinct legacies”.

⁷² Provinces have historically benefited from agricultural exports income, but their export capabilities were severely curbed given the ensuing parity of the Argentine peso to the US dollar mandated by the Convertibility Law, which made Argentine exports unreasonably expensive and thus uncompetitive.

attempts to resort to financing operations such as borrowing from their official banks⁷³ and issuing “coupons” in lieu of wage payments.

The “Tequila” Effect: The above-mentioned weaknesses of the new monetary regime were underscored after the Mexican crisis in late 1994. Following the collapse of the Mexican currency, Argentina’s monetary base shrank sharply (almost a 20 percent, a reduction comparable to that experienced by the United States in the 1929 crisis). This resulted in numerous deposit losses that threatened to bankrupt the provincial banks. To avoid massive defaults, many provincial banks, mostly from peripheral provinces, were privatized, amounting to a (re) centralization of intergovernmental fiscal relations (Eaton and Dickovick 2004: 97).⁷⁴

The 1992 and 1993 Fiscal Pacts: Touted as potential watersheds in the reform of fiscal federalism in Argentina, the *Pactos Fiscales* were negotiated bilaterally with provincial governors to reduce provincial revenue shares and the transfer of key expenditures responsibilities (education, health, and housing) without the corresponding revenue resources. In a nutshell, President Menem sought to replace the automatic (i.e. decentralizing) distribution criteria for FTSA funds legislated in 1987 with selectively induced benefits to compliant

⁷³ The Argentine Constitution of 1853 endows provinces with the right to borrow in international financial markets and establish their own official banks.

⁷⁴ The fact that privatization of provincial central banks centralizes further the powers of the monetary authority (controlled by the federal government) raises interesting paradoxes about fiscal decentralization policies. This relationship is somewhat ironic insofar as decentralized choice of central banks seeks to insulate them from direct participation by the citizenry, while, in most cases, decentralized choice is praised because it rather enhances citizen participation. Also, privatization is, intuitively and coarsely speaking, thought to lead to deregulation and thus seen as a decentralizing measure. However, the above-mentioned seemingly controversial connection is consistent with Karl Polany’s claim that deregulation of markets leads to centralization of political authority and oversight (Sbragia 2000).

governors. In 1992, they negotiated to reroute 15 percent of the revenues slated to be transferred to provincial governments toward the national social security system, which was on the verge of bankruptcy. To offset this concession, provinces obtained transfers with a minimum amount guaranteed. Defiant provinces (e.g. Entre Ríos, Chaco, Jujuy) were selectively punished with no payments, until they gave in. Echoing the political-ridden character of this pact, Menem signed a second fiscal pact in 1993 with governors aimed at deregulating and reducing/eliminating provincial taxes that affect enterprise and employment costs. This move was a “token of appreciation” to the business sector, to limit the autonomy of the governors to set their own tax bases and fine-tune the provincial tax systems to mirror the neoliberal reforms Menem had implemented at the national level.⁷⁵ Facing seven governors refusing to sign, selective debt relief and, mostly, federal infrastructure investments were used by the national government to marshal subnational support. In summary, beyond the nature of the issues addressed in each fiscal pact, a recurrent thread in Menem’s moves has been to weaken coordination among provinces and deepen federal controls over subnational revenue to preclude provincial expansion of public spending and thus strengthening their own patronage networks.

Based on this sketch of the fiscal scene in 1995, and its concomitant constraints on inter-provincial capacity to join ranks and oppose the federal executive’s moves, what kind of provinces succeeded in attracting a larger share of federal transfers? In order to respond this question, we investigate the distribution of FEDEI transfers to provinces in said year. As argued previously, a cross-section model is more appropriate to zoom in on the context set out above. For this analysis, we will add a variable to measure transfer-dependency that taps into the Index

⁷⁵ Personal communication with Prof. Alberto Porto, *Universidad de La Plata*, July 25, 2001.

of Fiscal Politicization used in Chapter 2 but measured at the subnational level instead. For this purpose, we will use an indicator of provincial financial capacity, which is the revenue/expenditure flexibility variable and operationalized as the provincially-generated revenue as a percentage of total revenue.⁷⁶ This, in turn, will be our approach to uncover the extent of peripheralization in the distribution of transfers and our main independent variable. Based on our previous time-series findings and qualitative evidence presented above, we expect this factor to be negatively associated with federal transfers, which is to say, poorer provinces will receive a higher share of funds. Further, the equation to estimate this model will include all the statistically-significant variables in the pooled time-series analysis, which will function as control variables.⁷⁷

Thus we estimate the following model:

$$\text{FEDEI} = B_0 + b_1 \text{Population} + b_2 \text{Unemployment} + b_3 \text{Revenue/Expenditure Flexibility} \\ + b_4 \text{Divided Government} + b_5 \text{Partisan Disharmony} + e$$

Table 6: THE DETERMINANTS OF FEDEI TRANSFERS: RESULTS OF CROSS-SECTION ANALYSIS

Independent Variables	Coefficient	t
Intercept	1.367	6.111
Population	.192	.787
Unemployment	-.060	-.187
Revenue/Expenditure Flexibility	-.561**	-1.808
Divided Government	-.272	-.781
Partisan Disharmony	.046	.095

** Significant at the 0.08 level (2-tailed test)

Note: N = 24. The dependent variable is the evolution of FEDEI transfers to provinces in 1995. $R^2 = 0.29$. Entries are standardized coefficients.

⁷⁶ The source of data used for this variable is the 1996 World Bank's Argentina Provincial Finances Study.

⁷⁷ We exclude geographical GDP because it is strongly correlated (about 60 percent and statistically significant) with the revenue/expenditure factor and thus induces to multicollinearity.

The results are reported in Table 3. The support in favor of the peripheralization is strong and the coefficient for the revenue/expenditure flexibility variable is large and carries the expected sign. Its level of statistical significance is somewhat below the ideal level, but is nonetheless acceptable given its closeness to the .05 level and because it emerges as the only significant relevant factor.⁷⁸ This trend is further illustrated in Chart 1, where it becomes apparent that the actual inter-provincial distribution fits the regression line. However, and despite the pronounced downward slope of the actual inter-provincial distribution, we can see that there is a sudden increase in FEDEI transfers contrary to the expected direction. To tease out what really account for this inconsistency and identify what province/s are included, Chart 2 presents a scatter plot where it is clear that there is one outlier, the province of Salta. This is an interesting case, insofar as Salta's fiscal situation is stable and it ranks among the best performers in debt service (World Bank 1996). But, on the other hand, Salta is a relatively socially-underdeveloped province⁷⁹ and its territory, and hence its energy needs, is considerably larger than other provinces with similar developmental traits. In political terms, it is noteworthy that while the Peronist Party has consistently controlled Salta's governorship for decades, the *Partido Renovador de Salta* (Salta's Innovation Party), a center-right provincial party known as a "hard-to-buy" party, won the governorship elections in 1991 and controlled the province until the end of 1995. It is possible,

⁷⁸ To examine whether this relatively low significance level is a function of the N of this sample (i.e. 24 provinces), we simulated an increase in N size by using the "weight cases" function in SPSS. This N increase is weighted by the ratio between the number of provinces in Argentina and the number of states in the United States. The latter case is a comparable federation, which, given its relatively high number of subnational units, provides a realistic yardstick to "artificially" expand the number of observations. It turns out that that the revenue/expenditure flexibility variable maintains the largest coefficient in the sample, the appropriate sign, and its significance level comes near to $p < .01$.

⁷⁹ Salta's poverty index (i.e. percentage of households with Unsatisfied Basic Needs) for 1995 is 37.1 percent well above the national average of 19.9 percent for that year (INDEC 1997).

then, that some combination of socio-demographic and political factors has skewed FEDEI transfers to Salta beyond fiscal consideration, but this still remains a question to be investigated in future studies.

Figure 2: CURVE FIT

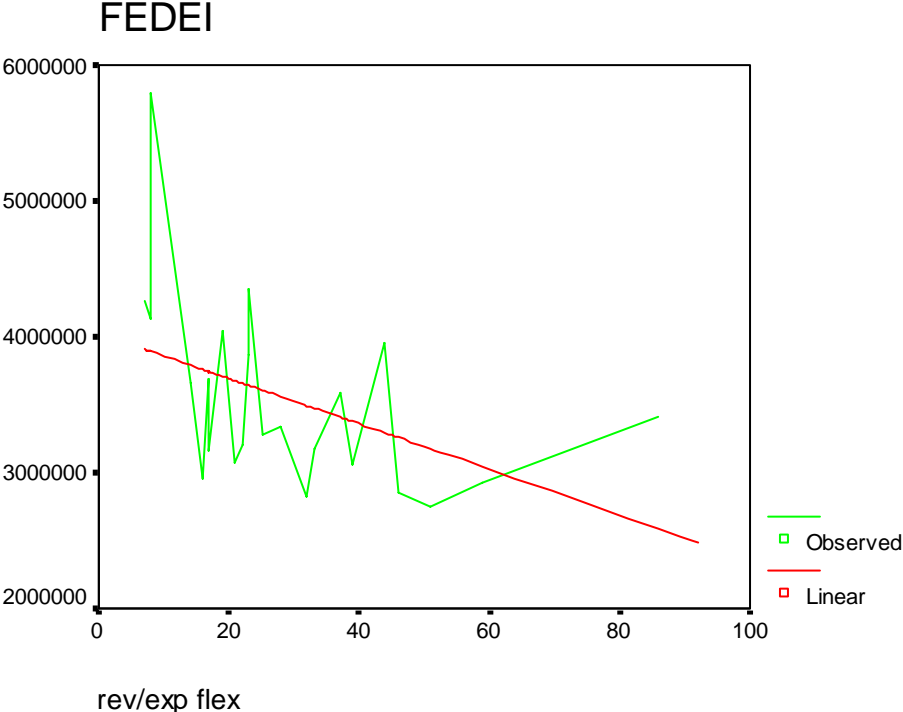
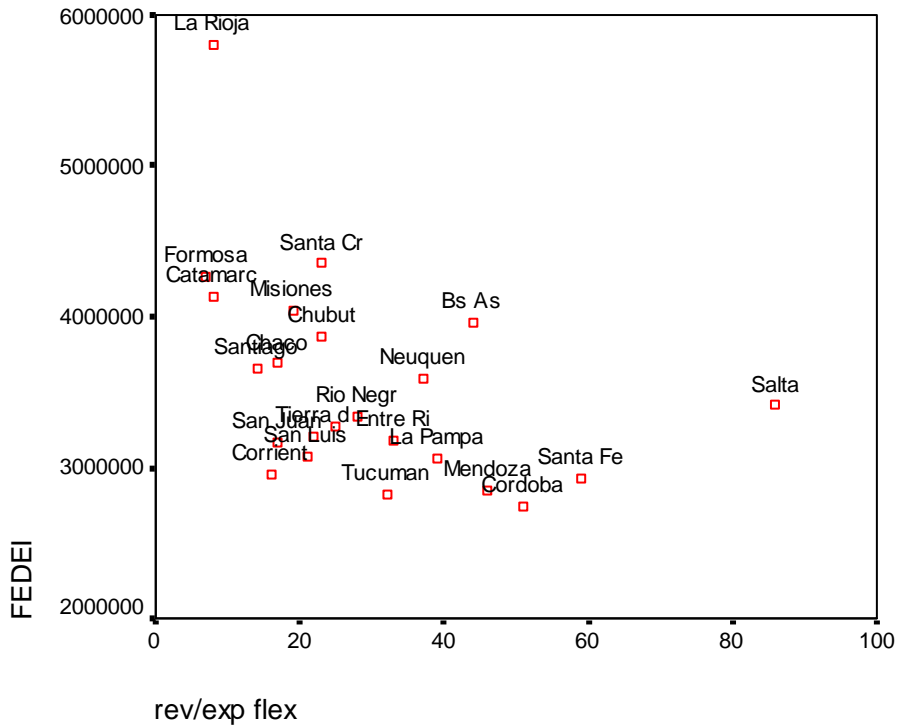


Figure 3: RELATIONSHIP BETWEEN FEDEI ALLOCATIONS AND PROVINCIAL TRANSFER DEPENDENCE



These preliminary findings are consistent with historical records about the secondary distribution of intergovernmental transfers. Using data from 1935 to 1994, Rezk (1998: 225, 231) shows that ever since revenue-sharing was implemented for the first time in 1935 a gradual trend in favor of poorer provinces is conspicuous. While high-revenue provinces like Buenos Aires, Santa Fé, and Córdoba experienced a decrease of 24 percent, low-revenue provinces were benefited with an increase of 21 percent. Likewise, Sawers (1996: 245) argues that “in 1900, when federal assistance was minimal, the most advanced provinces (Buenos Aires, Córdoba, Santa Fé, and Mendoza) spent five times per capita what the most backward provinces spent (La Rioja, Catamarca, Corrientes, Jujuy, Misiones, Chaco, Santiago, and Formosa). By 1960, they were spending roughly the same amount per capita. By the mid-1980s, the poorest provinces were spending almost twice what the most prosperous provinces spent on each citizen”. The political

correlate of this redirecting of economic resources toward the development of backward provinces is the historical alliance among elites from poor provinces and a strong and autonomous central government to prevent one province's (i.e. Buenos Aires) dominating the others in Argentina. This intersection of interests was formalized through the creation of institutions such as the Senate and the Electoral College that elected the president (Botana 1996: 243). More crucially, provincial governments moved to the institutional center stage, playing an important role in deciding who gets sent to Congress. National senators are chosen by provincial legislatures, not by popular vote.⁸⁰ Thus, control over provincial governments means control over the national senate and veto power over fiscal decentralization legislation.

This brief narrative highlights that while legislative politics, and more specifically divided government, is directly linked to the geography of fiscal transfers, territorial interests have historically played a decisive role in the crafting of political institutions in Argentina. This suggests that both layers of analysis appear to be mutually endogenously determined. Disappointing as this afterthought may be to a pursuit of causal analysis, it nonetheless foreshadows some inherent hurdles in any conceptualization of the politics of decentralization. Borrowing from Samuel Beer's Presidential Address to the American Political Science Association in 1977, "more important than any shifts of power or function between levels of government has been the emergence of new arenas of mutual influence among levels of government" (Beer 1978: 9).

⁸⁰ Following the 1994 Constitutional reform, Senators are currently elected by popular vote.

Summary

What remains of our explanatory typology of fiscal decentralization? The answer must be that the political determination of transfers appears to be associated to the extent of peripheralization of the inter-provincial distribution of funds. In this vein, the Argentine case looms close to what we characterized as *cooptative* decentralization. This type of decentralization, however, goes well beyond the realm of private patron-client relationships and it thrives in the public sphere, more specifically in legislative institutions where decisions about revenue-sharing bills and policies are made. However, what is the trigger mechanism? In our analysis, it is shown that partisan interests lurked underneath the ability of economically disadvantaged yet politically powerful provinces to attract a lion share of federal transfers beyond economic and social welfare considerations. Accordingly, we argue that a large part of the answer lies in territorial over-representation in the national legislature, particularly in the senate. Part of the argument has already been made – coalition-building goals drove presidents to reach out legislators of the opposition by means of allocating larger shares of federal transfers to the provinces the latter belong to. Subsequently, in Chapter 5, we will return to this topic, showing that the Argentine Senate ranks as one of the world’s most malapportioned chambers. Second, bilateral bargaining between the president and governors on a “first-come, first-serve” basis creates a structural institutional imbalance and constitutes a constant source of inter-provincial conflict. Then, we will discuss how these institutional traits link the two explanatory axes of our fiscal decentralization typology.

5 Chapter 5: The Politics of Intergovernmental Transfers in Spain: Time-series and Cross-sectional Analysis

The political and administrative map of Spain is now radically different from what it was less than thirty years ago. The authoritarian and centralized machinery of the Franco regime was replaced by a federal structure in which the powers of the state are shared with seventeen newly created autonomous communities (henceforth, AC), each endowed with its own president (i.e. governor), parliament and high court of justice.⁸¹ A characteristic of the devolutionary process since 1978 has been the granting to each region its own degree of autonomy adapted to its particular situation and resulting from political compromises between the national government and the regional leadership (Watts 1999: 38). Whereas the political dimension of this process has not generated significant asymmetries, this “multispeed” regional dynamics manifests itself in the creation of a hybrid intergovernmental fiscal system. One group of regional governments, including Navarra and the Basque Country⁸², Catalonia, Comunidad Valenciana, Andalusia, Galicia, and the Canary Islands (the so-called Article 151 ACs) has a wide range of fiscal competencies, comprising regional control of education and health. A second group, which includes all other ACs, (under Article 143 of the Constitution) has a more restricted range of competences but it preserved the constitutional right to assume further responsibilities. This

⁸¹ Paradoxically, Spain is not a federation in name. Among the reasons accounting for the reluctance to include the notion of federalism explicitly in the drafting of the post-Franco 1978 Constitution is the apprehension of the *Unión de Centro Democrático*, (UCD) Union of the Democratic Center - namely the party that steered the democratic transition – to encourage radical nationalism in Catalonia and the Basque Country. Federalism is a highly controversial concept in the Spanish public discourse because it brings to mind some of the conflicts that triggered the Civil War in the 1930s.

⁸² Known as *Fuero* (i.e. forum) ACs, the Basque Country and Navarra were set apart from all other regions in that they could collect most taxes in exchange for payment of an annual percentage (the *cupo*) to the national government. This system of finance allows to restore some historical charters of the two ACs.

open-endedness allowed all ACs to expand their policymaking authority and resources over time. For instance, the share of ACs of total national spending increased from 0.1 in 1979 to 23.9 percent in 1997, while in the same period of time the central government moved down from 88 to 63.8 percent (Dirección General de Coordinación con las Haciendas Autonómicas 1999).⁸³ Likewise, as a result of “autonomous pacts” between the two major political parties, the *Partido Socialista Obrero Español*, Spanish Socialist Workers Party (PSOE) and the *Partido Popular*, Popular Party (PP), in the 1990’s additional powers have been transferred to all ACs so that they are almost on a par with the “fast-track” group.

However, the level of revenue decentralization is comparable to that of Argentina, since the central government still collects about 80 percent of tax revenue (Bosch Roca 1992: 108). With the exceptions of Navarra and the Basque Country, ACs are primarily financed by tax-sharing grants. The dependence of the ACs on intergovernmental transfers is illustrated by the fact that on the 1990s these transfers represented, on average, about 72 percent of the total revenue of the ACs (Ministerio de Hacienda 2003).

The largest subvention is the *Porcentaje de Participación en Impuestos no Cedidos*, or General Revenue Sharing (PPI)⁸⁴, which is unconditional and aimed at guaranteeing the financing of public services with a volume of transfers to cover the difference between the *coste efectivo* (actual cost) and the revenues actually obtained from the ceded taxes. Unlike the Argentine FTSA, this transfer is ruled by varying coefficients that prioritize population and territorial size,

⁸³ This level of expenditure decentralization is much higher than that we can find in federal countries with similar economic and political set-up like Belgium (about 12 percent), matching Austria, and slightly below Germany and the United States (Watts 1999: 47).

⁸⁴ Although the conditional grant for the financing of health services is almost equally large, we exclude it from this analysis because it is only doled out to the fast-track ACs.

but it shares with the former a significantly lower potential of political manipulation than other grants (Monasterio Escudero and Suarez Pandiello 1998). Among the conditional grants the *Fondo de Compensación Interterritorial*, Interterritorial Compensation Fund (FCI) looms large as the most important redistributive fund to reduce disparities among regions through mainly investment projects. While at the time of its creation this fund was designed to support public investment in all regions, in 1990 it was revised to be a purely redistributive grant and several ACs were excluded from it (García-Mila and McGuire 2001). When Spain joined the European Community in 1986, the regions also benefited from the *Fondo Europeo de Desarrollo Regional*, European Fund for Regional Development (FEDER) to attenuate inter-territorial wealth gaps.

Despite the prevailing wisdom that subnational governments in Spain are capable to bypass Madrid and have an important bearing on Brussels' decision on structural funds (Allen 1996, Dudek 2001), Börzel (2002: 106) convincingly shows that the central government has traditionally been reluctant to involve the regions in the implementation of EU policies. Further, the central state has limited the effect of Europeanization on intergovernmental fiscal relations by ensuring that the Spanish funding programs outdo the European funds in their magnitude. For instance, the European Regional Development Fund (ERDF), which is the largest EU funding program after agricultural assistance, is only a fraction of the FCI. From 1982 to 1993, whereas the ERDF amounted to a 24 percent of the total structural (national and EU), the FCI constituted a 59 percent of the total (García-Milá and McGuire 2001: 284). This uneven distribution resulted in a redistribution of power between the central and autonomic governments to the detriment of the latter. However, in mapping the secondary distribution, we will see how that some ACs succeeded to resist centralizing moves of the center more than others.

5.1 The Empirical Analysis

This chapter zooms in on the evolution of the other two conditional (i.e. earmarked) transfer programs, that alike the case-studies used to examine the Argentina case, are based on discretionary determination. The first is *Subvenciones Gestionadas*, Subsidies (SG), which is funding provided by the central government for various policy goals mainly aimed at financing welfare schemes by the regional Ministries of Labor and Social Security. On average, this sector, combined with Education and Science, captures nearly 99 percent of the total amount of subsidies, enhancing its fiscal and political significance (Ministerio de Economía y Hacienda 1995: 84-85). In practical terms, this type of assistance is intended to support deficit-ridden regional administrations, but in principle is open to all ACs. The second, known as *Convenios de Inversión*, Joint Investment Agreements (CI), is mainly used to increase the stock of capital necessary for the provision of public services with spillover effects⁸⁵, but also to compensate for deficiencies in certain services transferred to the regions. While smaller than the above-mentioned transfer programs, the latter two have experienced an increase of almost a 30 percent during the 1990s (Banco de España 1999).

5.1.1 Benevolent Central Planners or Strategic Politicians?: The Determination of Federal Transfers, *Spanish Style*

The general thrust of this part is to estimate the impact of political factors at the subnational level by regressing the same sets of efficiency/equity and electoral/institutional variables we used to analyze the Argentine case on SG and CI transfers. We will analyze the extent to which federal transfers are politically determined, namely the Y axis of the typology laid out in chapter 2. To

⁸⁵ For instance, these include environment, housing, agriculture, public safety, and tourism.

avoid repetition, the same caveats and rationalization for methodological issues set forth previously for the Argentine case apply here. Likewise, the same arguments advanced to substantiate the hypotheses apply, however we will contextualize them with evidence and data from Spain. Particularly, there are important institutional differences in the functioning of the legislatures of these countries, such as the weak role of the Spanish Senate that is more often regarded as an “institutional courtesy” than a body where subnational representatives have a meaningful say in national policymaking (Colomer 2002: 199; Roller 2002).⁸⁶ Further, it is important to point out that decentralization of public powers occurred only after the 1978 Spanish Constitution was put in effect. In turn, the creation of the seventeen ACs took five years to materialize, as the last Autonomy Statutes were passed in 1983. As a result, longitudinal data to examine the politics of fiscal decentralization in Spain are more limited in the amount of years that can be used in time-series analysis. That said, pooling these data allows us to overcome that limitation so that statistical analysis can still be accomplished. The unit of analysis is an AC in a given year.

Dependent Variable

The approach to identify our measure of fiscal decentralization will be the yearly changes in the evolution of SG and CI transfers from 1986 to 1998, which are the only years available for consistent and systematic analysis. Again, these two transfers programs are chosen because they are the largest pieces of sharable resources available in Spain, in which discretionary criteria plays a significant role. To control for the impact of inflation, we have converted all years to 1992 Pesetas. As mentioned earlier with regard to Argentina, inflation, albeit much more

⁸⁶ We will elaborate further on this point and provide the empirical details subsequently.

moderate in Spain, affects levels of apportionment to a large extent. However, our explanatory models do not focus on monetary effects on fiscal decentralization and thus inflation *per se* is not of interest. Unlike the case of FONAVI in Argentina, it is not possible to gather data on policy performance (i.e. housing building) to examine whether transfers were used for earmarked purposes or not given that these grants cut across many activity sectors. It remains for future study and further data collection efforts to tease out more precisely these details. Appendix 2 provides a list of data sources used to compile all variables.

Independent Variables

While there is a relatively significant concentration of the national population in only a few ACs, Spain does not have a significantly skewed inter-regional population distribution.⁸⁷ Further, regions enjoying high levels of economic development do not belong to a single population category, as the largest population shares are those of Andalusia and Catalonia, the former the poorest AC and the latter very rich. Still, population-related issues have been controversial. For instance, when the financing arrangements for 1987-1991 were debated, it was proposed that subsidies for education would be based on population distributions that would exclude individuals older than 22 years. This factor favored the rapidly demographically-growing Andalusia but it was prejudicial to Catalonia. Given that the latter was a necessary coalition partner for the then ruling PSOE, whereas the former was a “safe constituency” and that Catalonia plays a strategic role in Spain’s economy accounting for about the 16 percent of the national GDP, the central government decided to adopt a formulae that includes the total

⁸⁷ While the inter-regional distribution of population in Argentina is very unbalanced, with only the provinces of Buenos Aires and Córdoba accounting for almost 40 percent of the national population, Spain’s inter-regional disparities in population density do not deviate from those in EU countries of comparable size (Castells 2001).

population. Thus, population has been high in the discussions about fiscal decentralization in Spain. We will also hypothesize in this case study a positive relationship between population shares and the amount of SG and CI transfers to ACs. This variable is measured using population figures based on available census data.

Since the 1970s the Spanish economy has proved unable to create employment at a fast rate enough to bring more than temporary reductions in the unemployment rate. In turn, Spain experienced an increase in unemployment levels from 2.5 percent in 1973 to 22.7 percent in 1993 (Hamann 1997: 120). The PSOE's labor market policies not only attracted opprobrium from the unions but they also increased conflict among ACs. García-Milà and McGuire (2001) argue that the central government resorted to development funds such as the FCI to tone down unemployment tensions. However, they found that transfers did not improve but rather deteriorated job creation in recipient ACs. This datum notwithstanding, and changing the direction of causality, it is also important to examine the extent to which counter-cyclical pressures are play in Spain in the determination of federal transfers. Therefore, we will conjecture that ACs with higher unemployment rates will attract higher transfers of SG and CI. Unemployment is measures as the AC unemployment rate in percentages.

As hypothesized in the Argentine case, geographical GDP may affect the allocation of intergovernmental transfers. There are important differences in terms of GDP across ACs, largely reflecting the high concentration of economic activity in two ACs, Catalonia and Madrid, which jointly represent more than 35 percent of the total GDP produced in Spain. That said, Castells (2001: 191) claims that "comparison with other European countries shows that Spain is

not a country with strong regional imbalances; on the contrary, it has smaller imbalance indexes than most of the other large European countries". In turn, we expect that geographical GDP will be negatively correlated in the case of SG because of its considerable welfare module, but not for CI, where the public infrastructure component is more prominent. Geographical GDP is measured as the per capita AC GDP converted into Pesetas, 1992.

Turning to the political variables, partisan disharmony between the executive of the central and subnational governments stands out as a potentially important factor to explain intergovernmental fiscal relations in Spain. Pacts among elites were commonplace in Spanish transition to democracy (Gunther and Higley 1990; Karl and Schmitter 1991), facilitating a gradual and stable democratization but, more decisively from the standpoint of this section, bolstering decision making from "above". This attempt to accommodate intergovernmental relations is a perennial one among federation and it essentially consists of relations between elected and appointed first-rank officials of the two levels of government.⁸⁸ Table 1, however, shows that throughout the last two decades, the party elected to government in most of the ACs has been the same party elected to national government. More precisely, for the period 1983-1999, on average, only 38 percent of the seventeen AC presidents belonged to the opposition party. This suggests that Spanish Prime Ministers could benefit from ample majorities in high-level meeting forums such as the *Consejo de Política Fiscal y Financiera de las Comunidades Autónomas*, (CPFF) Council for Fiscal and Financial Planning, where negotiations on SG and CI allocations take place. As a result, we do not anticipate any significant effect of the partisan disharmony on the distribution of these funds.

⁸⁸ Students of federalism, mainly from Canada, have couched this dynamics as the keystone component of "executive federalism" (Smiley 1980; Wiltshire 1980).

Table 7: Parties in Central and AC Governments 1983-1999

	1983-87	1987-91	1991-96	1996-99
Party in central government (CG)	PSOE	PSOE	PSOE	PP
AC governments of the same party as that in CG	12	9	9	10
AC governments of the main opposition party (OP)	3	4	4	3
<i>Percentage of AC presidents of the OP whose party is not in central government</i>	25	47	47	33

Source: Own elaboration based on Grau I Creus (2000).

While the PSOE held a majority of seats in the national parliament from 1982 to 1993, allowing the then Prime Minister Felipe Gonzales to govern freely, in 1989 it lost a recount challenge to *Izquierda Unida*, IU, United Left (formerly the Spanish Communist Party), losing half of its seats and thus facing a minority government until 1996. Additionally, considering the fact that, following the transition to democracy, no single party enjoyed an absolute majority of seats in the parliament, legislative party power has been diffused and open to bargain. Borrowing from Peters (1997: 69), “this need to bargain and form a coalition means that, in essence, the coalition is a form of divided government”. Thus, “minority governments are the unambiguous parliamentary equivalent of divided governments in presidential regimes” (Elgie 2001: 6). As a

result, and mirroring what we hypothesized in the Argentine context, the weaker the central government's party position in parliament, the more pressed it is to include a broader group of parties. This need to reach out political opponents is boosted by staggered regional elections in the Basque Country, Catalonia, Galicia, and Andalusia, where opposition parties, mainly regionally-based, have greater opportunities to introduce new issues onto the political agenda. And because the party controlling the majority of seats in the regional legislature appoints the AC president, the prime minister must pay serious heed to these subnational elections. Hence, we expect a positive relationship between divided government and transfers allocation. Divided government is measured at the subnational level, as the percentage of deputies who do not belong to the Prime Minister's party. Unlike Argentina, all ACs have unicameral legislatures, facilitating the codification of data.

Considering that the transition to democracy in Spain is inseparably linked to territorial decentralization, regionalist parties⁸⁹ benefited from a significant opportunity structure to attract an increasing amount of attention (Pallares, Montero, and Llera 1997). In turn, regionalist parties have had an important impact on political developments in Spain, not just at the autonomy level, but also at the center. In a party system subject to a high level of electoral volatility⁹⁰, these parties have attained hegemonic status in some ACs (*Convergència i Unió*,

⁸⁹ Some scholars claim that regionalist parties in Spain should be classified as non state- wide parties wide because these parties circumscribe their activities over a territory smaller than the national territory (Pallarés and Keating 2003). Others prefer the most general notion of nationalist (Hernandez Bravo 1989). Elsewhere, I argue that these parties should be identified as ethnoregionalist because their demands for regional-level policy making authority stem from, and are articulated through, ethnic and identity factors (Gordin 2001)

⁹⁰ Flying in the face of the highly influential *freezing* (i.e. stabilization) thesis about electoral realignments in Western Europe espoused by Stein Rokkan, the ruling UCD “suffered perhaps the most important electoral defeat ever experienced by a political force in Western Europe;

CiU, in Catalonia, *Partido Nacionalista Vasco*, PNV, in the Basque Country) and decisively important in others (*Coalición Canaria*, CC, in the Canary Islands, *Bloque Nacionalista Galego*, BNG, in Galicia). Further, regionalist parties profit from their strategic intermediate ideological position in the left-right continuum; in fact, mainstream parties prefer to negotiate support for national policy outcomes (i.e. budgets) with regionalist parties more than with other national parties, because regionalist party leaders are willing to support national policies with minimal amendment in exchange for transfers of policy-making authority to the AC governments (Heller 2002). This king-maker role endows regionalist parties with considerable opportunities to tilt the allocation of federal transfers to their jurisdictions, so we will assume a positive relationship between regionalist party control of an AC and the corresponding share of SG and CI transfers.⁹¹ This variable is measured using a dummy variable indicating whether the AC executive is controlled by a regionalist party.

indeed, its vote share decreased from 35 to 7% and its representation in Congress went from 168 seats to a mere dozen” (Gunther, Sani and Shabad in Montabes 1994: 15). Hopkin (1999) provides a very vivid account of the meteoric rise and fall of the UCD in the 1980s.

⁹¹ An additional effect of the territorialization of politics in Spain after the death of Franco has been that the strong presence of regionalist parties has blocked the emergence of other contenders in the party system. For instance, green parties and right-wing neopopulist parties, increasingly popular in other West European nations, are insignificant players in the Spanish party system.

Table 8: DETERMINANTS OF SUBVENCIONES GESTIONADAS: PANEL-CORRECTED REGRESSION RESULTS

Independent Variables	z	p<.05
Intercept	1.98	0.048
Population	2.62	0.009
Unemployment	2.51	0.012
Geographical GDP	7.76	0.000
Regionalist Party President	2.73	0.006
Divided Government	-3.21	0.001
Partisan Disharmony	-0.90	0.366

Note: $N = 167$. The dependent variable is yearly changes in the evolution of Subvenciones Gestionadas transfers to ACs from 1986-1998. $R^2 = 0.64$. Wald Chi2 = 115.27 (prob > chi2 = 0.000). Entries are panel-corrected standardized coefficients.

Table 9: DETERMINANTS OF CONVENIOS DE INVERSION: PANEL-CORRECTED REGRESSION RESULTS

Independent Variables	z	p<.05
Intercept	2.08	0.037
Population	8.12	0.000
Unemployment	-0.41	0.680
Geographical GDP	-0.75	0.455
Regionalist Party President	1.67	0.095
Divided Government	-1.15	0.251
Partisan Disharmony	-0.87	0.384

Note: $N = 200$. The dependent variable is yearly changes in the evolution of Convenios de Inversión transfers to ACs from 1986-1998. $R^2 = 0.30$. Wald Chi2 = 89.06 (prob > chi2 = 0.000). Entries are panel-corrected standardized coefficients

Tables 2 and 3 display the results for the SG and CI models. It seems that in most respects, both models perform reasonably well. It appears, however, that political variables have less to offer in understanding intergovernmental fiscal relations in Spain than in Argentina. Except for the

regionalist party president variable, partisan-institutional parameters do a poor job in predicting transfer allocations because partisan disharmony is not statistically significant in both models and divided government is only significant in the SG model but carrying the opposite sign. At first glance, these findings suggest that, other things equal, the distribution of selective incentives to local bosses in Spain is more politically expedient than building legislative support. Albeit contradicting the hypothesized effect, the negative sign of the divided government factor should be interpreted at the light of certain legislative and electoral dynamics that affect the distributional strategies of the main national parties differently. While the PSOE's parliamentary party turnover has been relatively normal, the rate of PP turnover has been higher because many of its MPs had gone to take part in regional bureaucracies.⁹² Furthermore, partisan control of both legislative houses by the PSOE from 1982 to 1993 has not been related to decentralizing trends. Boix (1998) study of public investment in the ACs made by the PSOE convincingly shows that state spending was territorially biased toward Andalusia and Extremadura, which were the AC where the PSOE had its strongest electoral support.⁹³ Put differently, coalition interests subsided to partisan interests, diminishing the explanatory power of the divided government variable.

Conversely, according to our data, regionalist party presidencies are consistently successful in luring federal transfers to their ACs. If, as Ames (2001: 24) claims, "without a question, political support is exchanged for government jobs and public works in every society", regionalist parties

⁹² Personal communication with a Diputado PP (Comunidad Valenciana, February 10, 2002.

⁹³ In this regard, Hopkin (2001: 128) argues that "the most emblematic example of this was the establishment of Spain's first high-speed rail link (the *AVE*) between Madrid and the Socialist bastion Sevilla (Andalusia's most populated province and capital, *note in parenthesis is not in original*), rather than the more obvious link between the capital and Barcelona".

can take additional advantage of increasing transfers to their respective ACs, because, in regional voters' mind, pork-barreling is inherently intertwined with regionally defined appeals to increase spending powers.⁹⁴ Questions of public spending and services, and more generally policy outputs, take on a regional face and become the “flesh and blood” of center-regional conflicts. It remains to be seen, however, what factors make these parties more successful in some ACs than others, which is an issue we will address in the next section of this chapter.

We turn now to the estimation of the efficiency/equity variables. In the SG model, these factors provide an adequate empirical explanation of the determination of transfers. Thus, the ostensible welfare goals of this transfer program are reflected in its elasticity in respect to demographic and unemployment considerations. However, we find no support for the hypothesized effect of geographical GDP, which has a positive sign, namely, that richer ACs attract higher shares of transfers. This finding is questionable because in a redistributive-oriented program availability of resources should undercut the levels of transfers relative to more economically-constrained scenarios. Table 3 shows, on the other hand, that CI transfers are less vulnerable to equalization imperatives. Both macroeconomic and counter-cyclical factors fall short of accounting for variations in this grant program. Considering that these agreements consist mostly of public works projects, “distributive” politics (Lowi 1964) calculations lessen the impact of fiscal expediency calculations, so these preliminary findings should come as no surprise. More conclusively, population looms large as the most important socio-demographic variable in both

⁹⁴ Van Houten (2000) explored this possibility more systematically across Western Europe and he found that regionalist leaders try to claim credit for their support for fiscal autonomy. When these leaders compete against national parties, his argument goes, incentives for mobilizing broad support are large, and demanding revenue powers is unwieldy. On the other hand, if they compete against other regional parties, demanding taxing powers amounts to a “credibility ribbon” to represent regional interests.

transfer programs and it is positively signed. What is more, population is the most significant and strong factor in the equation estimating CI allocations. In other words, discretionary federal transfers in Spain favor larger, i.e. more densely populated, ACs.

5.1.1.1 The Limits to Redistribution: The Inter-AC Distribution of Intergovernmental Transfers in Spain

Now that the factors thrusting the political determination of discretionary intergovernmental transfers have been described, it is time to examine whether transfer-dependency in Spain leads also to larger grants. We have argued that both theoretically and empirically that the best way to assess the geographical underpinnings of these transfers is with a static, cross-section model. Accordingly, we will focus on the inter-AC distribution of the above-analyzed programs in 1994. This year, of course, is not chosen randomly and its selection is based on the convergence of major policy changes and significant shifts in the relationship between the central and the subnational governments. Chief among these changes are the landslide defeat of the PSOE in the general 1993 elections and its resulting (and unexpected) effect in the development of Spanish fiscal federalism. That is, the inclusion of the Catalan CiU in the PSOE-led minority government increasingly fragmented the national state's control over fiscal policy, allowing *all* other ACs to increase the share of autonomously collected resources, thus setting the ground for the inchoate policy of *corresponsabilidad fiscal* (autonomic fiscal accountability).

-“Café para todos” (coffee for everybody): The 1993 Elections, Fiscal Authority Transfer and its Demonstration Effects

The results of the general elections in 1993 ushered in a radical change in the ruling coalition makeup. Abruptly weakened and 17 seats short of a majority, the PSOE had to choose between including the former Communists or the Catalan nationalists. Albeit reluctant to unleash a dramatic federalization in Spain, the PSOE opted for the latter group because the IU opposed European integration and the liberalization of labor markets, two central pillars of the PSOE's political agenda (Maravall 1999: 154-97). This opened a “window of opportunity” for the CiU, which eager to emulate the Basque and Navarese *fuero* system, succeeded in persuading the central government to cede 15 percent of the general income taxes to the Catalan government. Even with some ACs opposing the implementation of this reform in their jurisdiction⁹⁵, this formula was extended to all ACs. In many respects, this development shows that while “front-runners” like the Basque Country and Catalonia sought to expand their own autonomy, and despite that regional bosses in poorer regions were interested in preserving the political benefits of “fiscal illusion”, the moves of the “front-runners” dialectically interacted with an “evening out” of competences across all autonomic administrations and thus strengthened the principle of fiscal accountability in Spain. Colomer (1999: 47) argues that “the creation of 17 autonomous communities has had the unintended consequence of promoting strong rivalry among them, even when they are governed by members of the same party. Most autonomous governments have ceaselessly requested increasing financial transfers and legal powers from the central

⁹⁵ For instance, Galicia and other poorer regions were aware that this reform would benefit wealthier regions, given their greater tax-generating capacity. Put coarsely, their argument was that this tax reform was a “camouflaged” transfer to the richer ACs. In the case of Galicia, it is not entirely clear whether they opposed this move substantively or, rather, their PP's controlled *Xunta* (autonomic government, in Galician) opposed it purely due to partisan calculations.

government in order to approach the level of the Basques and the Catalans. Meanwhile, the latter governments try to maintain a distance from the rest of the communities in order to enhance their own difference. This game, usually known as ‘comparative grievance’, has produced more regional competition and much higher levels of decentralization of the Spanish state than was expected before the constitutional compromise was implemented”⁹⁶

Despite the sweeping opposition of three ACs with poor revenue-generating capacity (i.e. Andalusia, Castille La Mancha, and Extremadura), the tax autonomy of the regional governments was built up and a new financing system was agreed upon, leading to a reassignment of tax powers. Until the mid-90s, there were several tax assignments (wealth, gambling, stamp, etc.) whose yield was ceded to ACs, but no significant decision-making powers were at play. In turn, the power to regulate tax brackets, tax rates, and some other benefits were conferred on the ACs. Subsequently, the central government and the ACs agreed to broaden the scope of the ceded taxes and the 15 percent share of ACs on income tax was increased to a 33 percent (Ruiz Almendral 2003). What began as a central government’s move to quench Catalonia’s aspirations of self-determination and autonomy, it soon turned into an “inductive allocation of powers” (Moreno in Agranoff and Ramos Gallarín 1997: 38) whereby all regions had both incentives and multiple opportunities to expand their fiscal policymaking authority. Uneasy as these development appeared at first to economically-backward and ostensibly looser ACs, it nevertheless became more difficult for them to sabotage the pace of change.

⁹⁶ This amounts to something of a “bitter pill” for Catalonia and its quest for regional distinctiveness (Personal communication with a Consejero (Senior Advisor), *Banco de España*, February 5, 2002.

These new developments and constraints notwithstanding, the jury is still out to determine what ACs succeeded in attracting a larger share of federal transfers. To respond this question, we investigate the distribution of SG and CI transfers among ACs in 1994. Echoing our analysis of the Argentine case, revenue/expenditure flexibility will be our approach to uncover the extent of peripheralization in the distribution of transfers and our main independent variable. Unlike Argentina, however, the time-series analysis in Spain does not provide robust evidence of a negative relationship between transfer dependency and grants allocations; let alone that the “all for one and one for all” dynamics portrayed above does not bode any significant maneuvering space for transfer-dependent ACs to increase their shares beyond reasonable levels. Therefore, we do not expect revenue/expenditure flexibility to be a major determinant in the cross-sectional analysis. Further, the equation to estimate this model will include all the statistically-significant variables in the pooled time-series analysis, which will function as control variables.⁹⁷

Thus we estimate the following models:

$$\text{Subvenciones Gestionadas} = B_0 + b_1 \text{Population} + b_2 \text{Unemployment} + b_3 \text{Revenue/Expenditure Flexibility} + b_4 \text{Divided Government} + b_5 \text{Regionalist Party Presidency} + e$$

$$\text{Convenios de Inversion} = B_0 + b_1 \text{Population} + b_2 \text{Revenue/Expenditure Flexibility} + b_3 \text{Regionalist Party Presidency} + e$$

⁹⁷ Unlike in Argentina’s analysis, we include geographical GDP because its Pearson correlation with the revenue/expenditure factor is not statistically significant.

Table 10: THE DETERMINANTS OF SUBVENCIONES GESTIONADAS: RESULTS OF CROSS-SECTION ANALYSIS

Independent Variables	Coefficient	t
Intercept	0.899	.565
Population	1.474**	2.341
Geographical GDP	-.549	-.946
Unemployment	-.150	-.736
Revenue/Expenditure Flexibility	-.061	-.338
Divided Government	-.072	-.380
Regionalist Party Presidency	.124	.623

** Significant at the 0.04 level (2-tailed test)

Note: N = 17. The dependent variable is the evolution of SG transfers to ACs in 1994.

$R^2 = 0.78$. Entries are standardized coefficients.

Table 11: THE DETERMINANTS OF CONVENIOS DE INVERSION: RESULTS OF CROSS-SECTION ANALYSIS

Independent Variables	Coefficient	t
Intercept	.687	-.168
Population	.877**	6.555
Revenue/Expenditure Flexibility	-.013	-.093
Regionalist Party System	-.009	-.066

** Significant at the 0.00 level (2-tailed test)

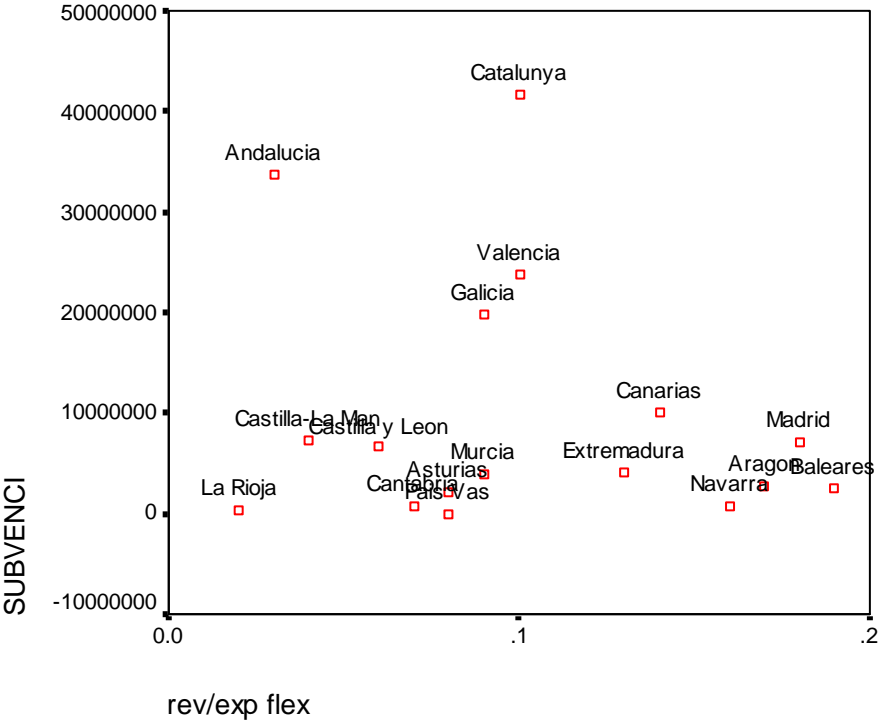
Note: N = 17. The dependent variable is the evolution of CI transfers to ACs in 1994.

$R^2 = 0.76$. Entries are standardized coefficients

Table 3 and 4 display the results for the SG and CI models, respectively. First, our variable of interest, revenue/expenditure flexibility, is not significant, thus transfer- dependent ACs unwilling to shoulder the political burden of having to raise taxes locally are not rewarded. Charts 1 and 2 illustrate clearly the lack of a well-defined distribution of ACs when these are plotted over the respective federal transfers and the revenue/expenditure flexibility axes. Note that the only significant variable is population, and because it has positive sign there is little

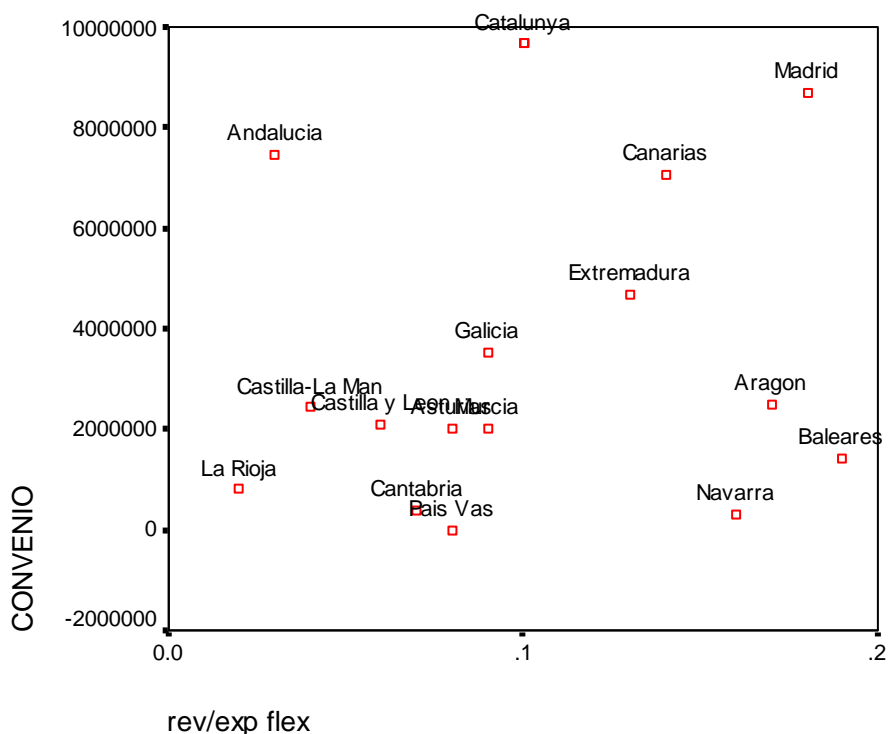
room to infer any important effect of political or fiscal imbalances factors. This suggests that when we control for these influences, population is the most important predictor of the inter-regional distribution of intergovernmental transfers, as transpires from our data. Considering that population is usually included to capture any scale economies in the provision of publicly supplied goods and services, our finding points to the preeminence of socio-demographic imperatives in the inter-AC distribution of transfers.⁹⁸

Figure 3: RELATIONSHIP BETWEEN SUBVENCIONES GESTIONADAS AND AC TRANSFER DEPENDENCE



⁹⁸ To corroborate whether these results hold when the number of observations is increased, we used the same method applied to the analysis of the Argentine case in Chapter 3 (see footnote 35 for full explanation of method). The sign and significance of variables remained unchanged after this simulation.

Figure 4: RELATIONSHIP BETWEEN CONVENIOS DE INVERSION AND AC TRANSFER DEPENDENCE



In order to gain a more nuanced insight into the determinants of peripheralization of inter-AC transfer allocation, Charts 1 and 2 display a somewhat similar spatial distribution in both transfer programs. Beyond the limited explanatory power of the revenue/expenditure flexibility variable, it appears that Catalonia has benefited most. It is also noticeable that Andalusia has performed consistently high in both programs and Madrid did well in one of them. Despite the fact that Andalusia and Madrid have relatively similar shares of total national population to that of Catalonia⁹⁹, the latter has been disproportionately blessed by the central government's need of votes in the national parliament. The above-described pivotal position of CiU, beginning in 1993 but remaining as an enduring fact in Spain's electoral landscape throughout the 1990s (Pallarès 1999), and its steady hegemony in its respective regional government have undoubtedly been at

⁹⁹ The average values for the 1990s are as follows: Andalusia with about 18, Madrid with 13, and Catalonia with 16 percent, respectively (Fundación BBV 1999).

play. Catalonia's pole position in the above charts is matched by parallel accomplishments such as control over new competences within its territory, including ports and traffic control, police and jail system, tax breaks for small business, authority over EU funds in their jurisdiction, and assumption of the Catalan AC deficits in health care delivery. In addition to these new competences and bail outs, Montero (2001: 159) claims that "using the distribution of spending on 'reindustrialization' policies to forge its parliamentary alliance with the Catalonians, the PSOE granted Pujol (Catalonia's perennial regional leader and President, *note in parentheses is not in original*) an array of new resources and authority. Spending on projects in Catalonia jumped from an average of 12 percent in the 1991-94 period to 48 percent, while Madrid's share fell from 62 to 34 percent. No other region's share exceeded 4.5 percent, and most suffered declines". The list of benefits continues, including support for ailing industries such subsidizing the state-run SEAT-Volkswagen factory in Barcelona, a city with a very high concentration of blue-collar workers who were crucial for PSOE's electoral fate. When the PP took power in 1996, Catalonia kept accruing additional "trophies" such as authority transfer to land use, autonomic representation in Spanish delegations to the EU and others. This suggests that while population shares loom large as an important factor, patronage politics played a significant role in the distribution of federal transfers.

Nonetheless, Catalonia's comparative advantages should be understood as part of the uneven territorial nature of the politics of fiscal decentralization in Spain. While it is tempting to portray said advantages as an archetypal case of pork-barreling distribution and coalition politics, it is important to bear in mind that the patchwork of subnational policy regimes in Spain is becoming more uniform in those areas of fiscal policy where "front-runners" like Catalonia, and the

Basque Country in some respects, have shown a greater ability to increase authority within their own regions and greater ability to use own tax revenues at the margin. This explains why other ACs like Canary Islands and Valencia pursued lobby pressure on the central government to catch up with Basques, Navarese and Catalan achievements and why laggards such as Extremadura, Castille La Mancha, and, to a lesser extent, Andalusia proved unable to boycott increasing inter-AC cooperation in the area of fiscal federalism. Borrowing from Hall (1992), Spain's open-ended institutional federal structure and its concomitant periodic bargaining over competences facilitated policy learning among regional elites and a subsequent "paradigm shift" from financial autonomy (i.e. regional spending power) to fiscal autonomy (i.e. regional revenue-generating powers).¹⁰⁰ Put differently, Spain gradually moved from "consumption" to "market-preserving" federalism.

Moreover, Catalonia's CiU is perhaps the most pragmatically-oriented regionalist party in Spain. Lying somewhere between a "catch-all" and "pressure group" strategic stance, the CiU has paid lip service to Catalans' quest for an independent state but its main approach has been to resort to nationalism as its defining element (Marcet 1994). However, far from advocating an organic conception of nationalism, CiU has resorted to *Catalanismo* in a mostly populist fashion and as an electoral identifying badge. This is corroborated by evidence drawn from the Manifesto Research Group data, which shows that the CiU is more likely to cooperate with either the PSOE or the PP than other regionalist parties (Heller 2002: 664). Accordingly, CiU has been able to affect national policy to a larger extent than competitor regionalist forces. However, the policy

¹⁰⁰ While other authors who drew on the policy learning approach have stressed the effect of the South European neighbors (Rico 1996) or Europeanization (Borzel 2002) on Spain's regional decentralization, we focus on the domestic level influences.

learning effect may have been at play in partisan politics as well, because, except for the Basque regionalists, most other regionalist parties have articulated a more pragmatic outlook and thus contribute to political integration in a decentralized state (Pallarès, Montero and Llera 1997: 167).¹⁰¹ A more latent yet crucial development has been the acceptance of regionalist parties as important actors not only at the legislative level but also as decisive players in joint policy-making bodies such as the CPFF, regular meetings of the national and autonomous education ministers, and the Intergovernmental Council on Health Matters. The institutionalization of regular interactions between national and regionalist parties' leaders has led the latter to accept multilateral cooperation. In other words, while regionalist parties still remain "second-order" political forces at the legislative level, they nonetheless discovered informal means to pool their strategic resources. This development will take the center stage in Chapter 5, where we will show how the weaknesses of territorial legislative representation have shifted the locus of regionalist parties' action from the senate to the above-mentioned joint co-operative bodies.

Summary

In Spain, the political determination of transfers appears also to be associated to the extent of peripheralization of the inter-provincial distribution of funds. Unlike Argentina, partisan influences are conspicuous in more informal institutional settings, as a weak senate renders their influence more redundant in legislative politics. Adding to this, transfer-dependent, peripheral ACs are not as successful as their Argentine counterparts in attracting a lion share of federal

¹⁰¹ Gibbons (1999: 26) claims that "in terms of their broad strategies, regional and nationalist parties have tended, to some extent, to copy each other. This was illustrated during the Second Republic as, one after another, the historic nationalities sought autonomous status... 'autonomy fever' spread across the land-mass of Spain in the late 1970s and early 1980s, when regional consciousness even surfaced in areas of Spain such as Extremadura and Murcia, not known previously to have had any special claims to regional separateness".

transfers beyond fiscal and socio-demographic considerations. The increasing accommodation of regionalist parties' interests in joint decision-making bodies, where inchoate notions of fiscal accountability are gradually gaining more favor than economic rent-seeking, hinders the ability of economically disadvantaged yet politically relevant ACs to form fiscally-regressive distributional coalitions. In terms of our explanatory typology, Spain is then closer to the *collaborative* type of fiscal decentralization, because the level of peripheralization in the inter-AC distribution of transfers is lower than in Argentina, yet partisan factors are still relevant and noticeable in the determination of grants. Accordingly, we argue that the strong presence of regionalist parties in mostly economically prosperous ACs has played an important role in preventing “over-fishing” of intergovernmental transfers by poorer ACs.

6 Chapter 6: Conclusions and Implications

This concluding chapter undertakes two tasks. First, its starting point is a brief summary of the dissertation's major findings. It begins by arguing that the findings challenge dominant approaches in the field of fiscal federalism, which see national government as benevolent planners and subnational governments as entities promoting interregional fiscal competition. Rather, we found that the political framework in which decentralization occurs is an endogenous influence that accounts for cross-national and cross-state variation in fiscal decentralization policy outputs. The second objective is to highlight the counter-intuitive nature of some of said findings, puts them in the context of broader discussions in comparative politics and it finally addresses issues related to future research in decentralization.

This dissertation has made the case that a good part of the fate of fiscal decentralization policies stem from tension between the territorial distribution of political resources and the territorial distribution of economic structure. Interregional economic asymmetries, which manifest themselves in the degree of transfer-dependency of subnational governments, intertwine with political asymmetries derived from legislative overrepresentation of territorial units and intergovernmental bargaining strategies. That is, poorly populated, mostly economically disadvantaged and thus transfer-dependent regions, which are less likely to engender regionalist party representation, can bring into play their political overrepresentation to shield themselves from unwanted reforms to increase their fiscal autonomy. In this institutional environment, richer regions are unable to spur inter-regional cooperation to deepen decentralization because poor jurisdictions are more fiscally vulnerable to the national center's attempts to negotiate bilaterally. On the other hand, when legislative overrepresentation is less pervasive, economically powerful

and thus self-financing regions, where regionalist party dominance is more widespread, exert pressure to deepen fiscal decentralization and co-responsibility. In this milieu, richer regions are more capable to obstruct poorer regions' attempts to interfere with fiscal decentralization and horizontal, multilateral negotiations are increasingly advanced.

The effect of said regional power asymmetries on the allocation of revenue and revenue authority is mediated by three major influences: the entrenchment of regionalist party-dominant systems, levels of overrepresentation and policy scope of the senate, and the ability of subnational governments to develop horizontal cooperation in bargaining with central government officials. In Argentina, where regionalist political forces are coopted by mainstream political parties, territorial representation takes place in an overrepresented and policy-powerful senate, and the national gov't negotiates bilaterally with provincial administrations, transfer-dependent, peripheral provinces, reluctant to deepen revenue decentralization, become king-makers and fiscal decentralization is hindered. In contrast, the Spanish case shows that, when regionalist forces, mostly controlling richer ACs, are vibrant, the Senate is a relatively policy-impotent and not extremely overrepresented institution, and ACs are increasingly involved in horizontal collaboration to negotiate multilaterally with Madrid, transfer-self sufficient ACs play a king-maker role and revenue decentralization is gradually advanced. This theoretical framework therefore allows us to show that countries such as Argentina and Spain, which initiated processes of fiscal decentralization with similar structural conditions insofar as their respective regional governments have significant expenditure responsibilities and low level of revenue authority, can attain different levels of revenue decentralization over time.

It is noteworthy that the same institutional problems that preclude the advancement of fiscal decentralization are also associated with national fiscal crises. Argentina, a country whose policies of economic adjustment in the early 1990s have won it international acclaim, has proved unable to restructure its federal system to address severe imbalances in the intergovernmental fiscal relations. The overall unsustainable level of subnational debt and the limiting authority of the center to rein in fiscal discipline lurked underneath Argentina's foreign debt default - the world's largest – and the premature fall of De La Rúa's elected government in December 2001. Federalism and its concomitant institutional protection of the autonomy of subnational units can at times have perverse effects on macroeconomic performance. Despite federalism's ostensible "market-preserving" quality, deadlocked and malfunctioning federal institutions can lead to economic catastrophes.

These findings rejoin the existing literature on federalism and decentralization, while at the same time highlighting more unforeseen and counter-intuitive aspects of the subject theme and thus providing more precise insights. For example, coalition-building goals drive presidents in Argentina to reach out legislators of the opposition by means of allocating larger shares of federal transfers to the provinces the latter belong to. This strategy is intelligible insofar as presidents, who count on copartisan legislators' support due to relatively high levels of party discipline, seek to extend the scope of their policy coalitions in congress. However, favoring opposition forces over copartisan forces may have the unexpected effect of damaging partisan interests because targeting greater transfers to opposition bulwarks bolster their political bases and their capacity to more effectively challenge the ruling party in future elections. This finding thus suggests that short-term policy coalition-building goals may hurt mid and long-term partisan

interests. At the same time, this conclusion indicates that an alternative model of “rationality” to address intergovernmental party concerns may be at play, in which case we need to rethink theories of party systems in multitiered systems.¹⁰²

Similarly, this study shows that the presence of formal governmental structures to represent territorial interests does not necessarily mean they are effective in practice. A highly “institutionalized” senate in Argentina shields the political and economic interests of poorly-developed, yet politically powerful, provinces. As these provinces are coopted in the legislative process at a more “convenient” price than metropolitan regions, regional asymmetries in the allocation of revenue and revenue authority are sustained over time. A far less “institutionalized” chamber of territorial representation and a more malleable and open-ended institutional configuration in Spain prevents backward regions to exploit institutional devices to block fiscal decentralization. What is more, this institutional malleability has facilitated the emergence of alternative policy-making mechanisms where multilateral subnational coordination is facilitated and fiscal decentralization further expanded. Therefore, formal federal polities, which are normally based on strong bicameralism, can at times be less effective than more loose, yet decentralizing unitary systems in deepening fiscal decentralization. This finding complicates the validity of held views about the positive association between political federalism and fiscal decentralization.

In focusing on the tension between the territorial distribution of political resources and the territorial distribution of economic structure, another implication also poses daunting challenges

¹⁰² I am grateful to William Keech for reminding me of this possibility.

to the fiscal federalism scholarship. This tension exacerbates the politicization of intergovernmental fiscal relations and, what is more, it becomes palpable in the mutually-reinforcing relationship between decentralization and regionalized patronage. While the conventional wisdom in the subject that sees distributive politics as a mere residual issue, namely that it plays no role in the determination of fiscal decentralization reforms or, ever worse, that patronage is doomed to wither away once fiscal decentralization evolves, exactly the contrary is argued in this study. The policy of transferring revenue and revenue authority to subnational governments not only renders possible the entrenchment of patronage-ridden regional enclaves but, also, the latter can exploit institutional and political opportunities to sabotage fiscal decentralization projects.

More broadly, this dissertation indicates a new direction for research in comparative politics. Despite the obvious hindrances for conducting cross-regional studies, subnational-level analysis is an effective antidote because it allows to comparing cross-national units while holding the national political culture and regional context constant. Observers of decentralization have developed a rich literature in their efforts to account for reforms that eliminate fiscal policy distortions but these works come from isolated research on a handful of countries that are analyzed individually. To the degree that subnational governments are responsible for significant portions of total public spending (and, as we sought to illustrate in this study, in charge of increasing revenue authorities), research in comparative federalism must include comparison of subnational-level units. Further, and without denying the potential confounding effect of regional contexts, important lessons can be drawn from analyzing countries such as Brazil and Germany,

whose respective subnational governments face similar incentives to overuse national revenue and institutional rules of the game comparable to those of Argentina and Spain.

In closing, this study provides useful insights to map out the trajectory of fiscal decentralization changes, highlighting the role of territorially-based policy coalitions and inter-state level conflict. It does not, however, solve all heretofore unmeasured aspects of fiscal decentralization, or decentralization more generally, nor does it tell the reader whether Argentina is more or less “decentralized” than Spain. Important as these questions may be, it remains for future research efforts to refine some empirical and econometric dimensions of the analysis. My hope is that the issues raised in this study will serve as a useful starting point for more systematic efforts to understand the political roots of subnational fiscal politics.

APPENDIX A

A Conceptual Clarification of Intergovernmental Jurisdictions and Terminology

In this dissertation, we assume that intergovernmental relations develop on a two-tier basis: *The central government and the second-tier constituent units*. This means that the tier-level political units, commonly identified as “local government”, “municipality”, “county” and the like are not included in the analysis. In Daniel Elazar’s words, “in most federal systems, the essential bargain is between a general government and state governments or their equivalents” (Elazar 1987: 187). Considering that the intergovernmental transfers analyzed in this study are allocated to second-tier authorities, which subsequently and by mean of different formula channel funds to the local level, we focus on the relationship between the first two tiers. When we refer to the *central government*, we will use this term with the following tantamount expressions: *national government, federal government, and center*.

Given the wide variety of federal system, it should not be surprising that there different terns are used to name the second-tier, subnational levels. As follows, we provide a list of “functional equivalents” and their national origin:

Autonomous Communities: Spain

Emirates: United Arab Emirates

Provinces: Argentina, Canada, Pakistan, South Africa, Yugoslavia

States: Australia, Brazil, Ethiopia, India, Malaysia, Mexico, Micronesia, Nigeria, Unites States, Venezuela

Länder: Austria, Germany

Cantons: Switzerland

Regions: Belgium

Republics: Russian Federation

State-Members: European Union (?)

Islands: Comoro Islands, St. Kitts and Nevis

APPENDIX B

Data and Sources

<i>Variables</i>	<i>Source</i>
<i>Dependent</i>	
FONAVI	MECON, <i>Ejecución Presupuestaria</i> FEDEI
ATN	MECON, <i>Ejecución Presupuestaria</i>
Subvenciones Gestionadas	MECON, <i>Ejecución Presupuestaria</i>
Convenios de Inversión	Ministerio de Economía y Hacienda Ministerio de Economía y Hacienda
<i>Independent</i>	
Population (Argentina)	INDEC, <i>Censo</i>
Population (Spain)	INE, <i>Encuesta de Población Activa</i>
Unemployment (Argentina)	INDEC, <i>Anuario Estadístico</i>
Unemployment (Spain)	INE
Geographical GDP (Argentina)	Elías (1996)
Geographical GDP (Spain)	BBV
House Building	INDEC, <i>Edificación</i>
Divided Government (Argentina)	Fraga (1995), Molinelli, Palanza, and Sin (1999)
Divided Government (Spain).	Anuario El País
Partisan Disharmony (Argentina)	Fraga (1995), Molinelli, Palanza, and Sin (1999)
Partisan Disharmony (Spain)	Anuario El País
Provincial Party Governor	Fraga (1995), Molinelli, Palanza, and Sin (1999)
Regionalist Party President	Anuario El País

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