CRISIS, POLITICAL INSTITUTIONS, AND POLICY REFORM
The Good, the Bad, and the Ugly

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This paper was written for a session on the political economy of crisis and reform at the Annual World Bank Conference on Development Economics in Oslo, June 2002. In the paper I provide some reflections on crisis and reform, and I relate that to broader concerns about political institutions and their role in fostering good policies both in crisis times and in normal times. I then use the case of Argentina as an illustration.

The main point of the paper is that even though crises might facilitate the introduction of some policy reforms, in general the qualities of the implementation of those policies is very much conditioned by the overall institutional environment of the country, and crises do not necessarily induce changes at this deeper politico-institutional level. The so-called first generation of reforms, sometimes introduced in the context of crises, even though important, were (for the most part) not reforms of the deeper determinants of the qualities of policies.[1]

Let me introduce a hierarchy of rules (i.e., of institutions) for expositional purposes. Policies are rules that regulate, say, the behavior of economic agents; for instance a policy that defines tax bases and tax rates. Let us call those "lower lever rules," belonging to the set RL. Let us call the rules that determine who has the power, under what procedures, to legislate on tax bases and tax rates, intermediate level rules (RM). Finally, let us call high-level rules (RH) those that determine how RM are determined. RH are the deeper politico-institutional rules as reflected in the Constitution, electoral rules, and other related (including informal) practices of the polity. RH together with a number of contextual and

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[*] This paper makes liberal use of some pre-existing accounts of the relation between economic crises and economic reforms, in particular Tommasi and Velasco (1996), Corrales (1998) and Drazen (2000). I thank valuable comments by Robert Barros, Paolo Benedetti, Daniel Heymann, Guillermo Mondino, Valeria Palanza, and seminar participants at CEDI and at the Oslo ABCDE. Special thanks are due to my discussants Jorge Braga de Macedo and Guillermo Perry for excellent comments.

[1] The so-called second-generation reforms contained some un-focused mumbling about institutions and "governance", but do not seem to have induced deeper changes either.

informal elements determine the actual workings of the policymaking system (i.e., is the Judiciary independent, is the bureaucracy professional, are legislators policy-oriented, etc.) For brevity I will use RH (or "deeper institutional determinants") to include the overall functioning of the political system. [2]

Using this language, "the reforms" were reforms in RL (like tax reforms) and RM (like privatization, or granting independence to the central bank). RH rules were for the most part unaffected. I argue in this paper that RHs heavily condition not only the choice of lower Rs but also the details of implementation and effectiveness of those lower level rules. For example, the capacity that the political system has to enforce certain rules, to make intertemporal commitments, is perhaps more important than the "title" of the policy in RM (such as "public enterprises" versus "regulated private utilities.")

I will also argue that, even though the crises identified in the modern economic reform movement might have facilitated introduction of reform with good "titles," it is not obvious that they facilitated good implementation of those reforms and of the subsequent policies. More generally, it is doubtful whether crisis times are likely to foster the introduction of deeper reforms.

In Sections I to III, I provide a brief review of some of the arguments (and implicit assumptions) underlying the received wisdom on crisis and reform. In particular, I try to rationalize some of the main mechanisms of operation of the crisis-reform connection, since some of those mechanisms are a useful language for the points I make later. In Section IV, I suggest some weaknesses of the received crisis-reform wisdom. In Section V, I suggest an alternative approach which focuses on the ability that a polity has of undertaking the political exchanges necessary to instrument good public policies, and at the role that political institutions have as the rules of that game of transactions. In Sections VI and VII, I tentatively apply that approach to one (unfortunately quite topical) case, Argentina.[3]

[2] This is developed in some more detail in Acuña and Tommasi (2000). See also Levy and Spiller (1996).

[3] The Argentine case might be a relevant one because it has been considered a poster child by the Washington establishment throughout the 1990's, and it has recently switched into a basket case (Pastor and Wise, 2001).These days the Argentine case seems to be one of the battlefields in which technical and ideological battles are being fought, often in simplistic and dangerous ways. (The quality of the discussion is not facilitated by the opportunistic behavior of some scholars who try to get their five minutes of fame.)

I. The Received Wisdom

In the last couple of decades, the notion that economic crises seem either to facilitate or outright cause economic reforms is part of a new conventional wisdom. Large amounts of ink have been devoted to the subject.[4] Rather than reviewing everything that has been said, I will present below a "stylized account" of the crisis hypothesis.[5] It is worth noting from the start that this conventional wisdom has evolved around some very specific circumstances faced by developing countries in the 1980's and 1990's. Some of that "wisdom" might not be too useful in the near future, under the new circumstances. In particular, it might happen that the possible effects of a crisis before market-oriented reforms have started, are very different from the effects of a crisis when MORs (more or less well executed) are already in course or in place. In addition to the intra-country temporal sequencing of crisis and extant policies, there are global contextual factors that are also different. It is not the same to have a crisis at a point in time in which you come from a closed economy and interventionist policy stance while the Berlin Wall is falling, than to have a crisis after you have instrumented many MORs and the global financial architecture is being scrutinized.[6]

The basic story runs as follows. There is a set of inefficient or inadequate preexisting policies; and the economic situation is very bad and possibly deteriorating rapidly.[7] This is

[4] Bresser Pereira argues that "[w]hen populist leaders in Argentina, Bolivia, Venezuela, Peru and Brazil adopted non-populist policies it was because the crisis in these countries was so deep that even the costs of sticking to populist policies became higher than the costs of adjustment" (1993, p. 57). According to Bates and Krueger "…[i]n all cases, of course, reforms have been undertaken in circumstances in which economic conditions were deteriorating. There is no recorded instance of the beginning of a reform program at a time when economic growth was satisfactory and when the price level and balance of payments situations were stable. Conditions of economic stagnation (and the recognition that it is likely to continue) or continued deterioration are evidently prerequisites for reform efforts" (1993, p. 454). Guillermo de la Dehesa writes "…only when the level of reserves was sufficiently low and/or the current account was in large deficit have necessary economic adjustment and structural reform measures been taken" (1994, p. 137). For more systematic accounts see, for instance, Nelson (1990), Williamson (1994), Tommasi and Velasco (1996), Rodrik (1996), and Corrales (1998). Reflecting on a broader notion of crises (see next footnote), Gourevitch (1989, p. 9) says, "it is the crisis years that put systems under stress. Hard times expose strengths and weaknesses to scrutiny, allowing observers to see relationships that are often blurred in prosperous periods, when good times slake the propensity to contest and challenge. The lean years are times when old relationships crumble and new ones have to be constructed."

[5] I refer to the crisis hypothesis circulating the 1980's and 1990's "Washington Consensus" circles, and related literature, or what Joe Stiglitz has dubbed "the modern reform movement" (Stiglitz 2000, p. 551)." This hypothesis is heir to a long-standing concern in political science about crisis as an independent variable in explaining *policy* and even *political* change. See for instance Binder (1971) and Habermas (1975), as well as Corrales (1998) for a brief introduction.

[6] If we wanted to enter the fray of buzzword creation we might call this the "second round (or generation) of crises" or the "crises of the second stage."

[7] We use "inadequate" as distinct from "inefficient" to capture the notion to be emphasized below that there is no universal set of *right* policies which are always preferable, but rather that good policies are "best responses" to underlying states of the world (including states of knowledge.) See for instance Mukand and Rodrik (2002), Acuña and Tommasi (2000), Cukierman and Tommasi (1998), Spiller and Tommasi (2001), and Lohmann (2000).

supposed to put in motion several mechanisms, that lead to the adoption of substantial policy changes, reforms, in the "*right*" direction. The mechanisms linking crisis to reform that have been put forth in the literature are varied. I review here, in a non-taxonomic way, some of the most common ones. These mechanisms operate over different stages of the policy process, and put their main focus on different actors. Some are complements to each other while other are alternatives.

1. Learning

Economic crises are supposed to contribute to Bayesian learning about the "*right*" model of the world. A period of intense economic disarray leads to a reassessment of the mapping from policies to outcomes,[8] in particular to a realization of how costly some previous policies were. Harberger (1993) writes, "... practitioners go around with a certain world view in their heads. All sorts of crazy things happen – like hyperinflations and huge recessions and wrenching debt or exchange rate crises. All of these ... can occur and still leave seasoned practitioners unruffled, because their worldview already contains sensible explanations for them. Every now and then, however, something happens that does not fit the previous image – something that shakes our Bayesian faith in what we used to think."[9]

The learning view of crises is one of the most important ones. It operates at several levels; the quote by Harberger refers more directly to the technocrats ("practitioners"), but learning does run through the whole process of "social reasoning," involving experts, policymakers, politicians, the media, and the general public. For instance, Williamson and Haggard (1994) write ".. belief in the benefits of economic reform is much less widely held among politicians than among economists, and it is even less widely endorsed by the general public, let alone by the specific interests that stand to lose ..."[10]

This distinction among several "layers" in the information channel is very important to understand several specific aspects of the dynamics of crisis and reform in particular cases.

[8] This is a very important point. The facts that nobody understands completely the (possible) effects of policies on outcomes, that this mapping is stochastic, and that there are various asymmetries of information about it, lead to a series of policymaking and political gimmicks and tactics that are one of the core elements of the policymaking process. The tendency to oversimplify complex messages, and to bundle together policy reforms that are not necessarily inseparable from a technical point of view, are a consequence of this imperfect knowledge and have important implications for the path of future policies in political equilibria in which politicians construct messages attempting to differentiate themselves from supposedly bad policies.

[9] Bruno (1993, p. 190) describes the Argentine reform process of the early 1990's as the outcome of "a painful and protracted collective learning process." He adds, furthermore, that "[i]t is doubtful, considering the experiences of various countries that we have encountered so far, and given the complexity of Argentina's situation, whether any shortcuts are possible in this process."

[10] Note that the Williamson (1994) volume from which the quote is taken is a clear exponent of the most prevalent views on reform at the time. Notice the use of the generic expression "economic reform" to refer to a rather specific set of policies in the direction of market opening and liberalization (on this, see also Stiglitz 2000). Nelson (1997) is an interesting paper that explores some of the complexities in deriving generic propositions about (trade) reform, and that also emphasizes the asymmetries in understanding and argumenting about such complex processes. See also Lohmann (2000), who emphasizes the different degrees of understanding of the details of monetary policy by different audiences.

For instance, the "Nixon goes to China" effect by which left-leaning politicians have been able to carry through market oriented reforms has been related to their superior ability to communicate the advantages of such policies to some constituencies (Cukierman and Tommasi, 1998a and 1998b). Also, the media can play an important role in building up public opinion with regards to the diagnostic of a crisis and the possible remedies. Oversimplification of messages and coarsening of information are not uncommon, and possibly quite risky; for instance the bundling of several market-oriented reforms in the process going forward might now backfire, as politicians and the public might blame the overall package for undesirable outcomes.

2. Special Politics

"In extreme cases, such as Poland in 1989, the crisis of the ancien regime may be so profound as to create an opening for what Leszek Balcerowitz calls "extraordinary politics" – a widespread willingness to suspend the usual political rules. These worst of times give rise to the best of opportunities for those who understand the need for fundamental economic reform" (Williamson 1994.) "Reform will be easier where the opposition is discredited and disorganized (or repressed)" (Nelson, 1990, 335).

This line of reasoning contains several "branches," some emphasizing temporary reallocation of institutional power (for example in delegation from Congress to the executive), others emphasizing temporary or permanent reallocation of effective power among underlying interest groups, or (in connection to the informational point above) reallocation of space in public debate.

2.1. Delegation

Several reform episodes included instances in which, for instance, Congress delegated to the Executive some unusual legislative prerogatives. (See the description in Keeler, 1993). Crises create a sense of urgency. *Something* needs to be done soon, for the crisis requires an urgent resolution, creating room for "special politics" for a period of time. In that context, Rodrik (1994) emphasizes the agenda-setting role of reformist governments.[11]

2.2. The Opposition is Weakened or Muted

Oftentimes reform efforts at times of crisis come associated with reconfigurations of dominant coalitions, in such a way that the (core of the) reform coalition is able to (actively) mute the opposition. (The classic war of attrition reform model of Alesina and

[11] Using the language of procedural rules in legislatures (Kiewiet and McCubbins 1991, Krehbiel 1991), the logic of delegation in crises situations can be understood as a switch from "open rule" to "closed rule." It also relates to the standard constitutional practice of granting presidents "emergency powers." (For more on the logic of delegation see Epstein and O'Halloran (1999). Of course this delegation has several downsides (see for instance O'Donnell 1994b), that could have a negative impact on the quality of the reforms undertaken in criss scenarios, as we will stress below.

Drazen (1991) can be seen as formalizing what might lay behind the weakening of those who oppose *a particular way of* instrumenting adjustment and reform.)

This notion somentimes comes bundled with learning-type arguments. In many policy decisions, the public goods / efficiency /valence dimensions come intertwined with distributive struggles. Particular groups (say, industrialists) build arguments buttressing policies that protect them. When things are going really badly, and somehow an image has related those poor outcomes to some pre-existing policies, those advocating such policies tend to loose ground in the public debate, and hence supporting such policies becomes less attractive for politicians. (For instance Krueger [1993] argues that economic crises undermine the supporters of the status quo, rendering politics as usual no longer sustainable.) In the other direction,

3. "Cooperation Becomes an Equilibrium"

There are many actors that participate in the policy process. The preexisting inefficient policies can be seen as the outcome of a non-cooperative outcome in the policymaking game. This decentralized equilibrium is likely to come about in the absence of some encompassing institutional setup that would enforce cooperation.[12]

The connection with crisis comes through some mechanism by which a very low current or expected future value from the status quo policies (a crisis) induces political players to change their actions towards more cooperative play. One rendering of that story is asymmetric as in Alesina and Drazen (1991) where one group concedes and pays most of the cost of adjustment; another account is more symmetric, with all actors choosing more cooperative play, as in Mondino et al (1996) and Velasco (1998).[13]

4. Risk-Taking Behavior

Using prospect theory, Weyland (1996) argues that economic crises (worsening fiscal deficits, sharp external imbalances, or exploding inflation) place presidents in the "domain of losses," and thus more inclined to adopt risky policies. Although Weyland focuses on the chief executive, the logic can apply to multiple layers of the policymaking process, including also public opinion and even technocrats (Cavallo in 2001?).

[12] This account is quite close to the view of policymaking and reform that I will push later in the paper.

[13] The converse of the cooperation argument is one (for instance by Tornell, 1995) in which the reduction in economic rents brought about by an economic crisis destroys the previous "cohabitational equilibrium" among rent-seeking groups. Rather than cooperate with one another in exploiting rents and blocking reforms, rent-seeking groups turn against each other; some of them even siding with the executive and accepting the costs of reform in order to inflict losses on other groups. This is somewhat similar to the break up of oligopolistic cooperation depending on the expected dynamics of aggregate demand. Other views see reform as the outcome of a switch to a different game; a point to which I will come back.

II. Some Clarifications

The quick listing presented above suggests several points that require more precision in order to operationalize "the crisis hypothesis." First of all, it is not clear whether the role of crisis should be seen as "necessary," "sufficient," or simply "facilitating" reform (Drazen, 2000, p. 445). Second, it is not clear whether we are referring to "economic" crises in a somewhat narrow sense, or whether we include full blown political and social crises, all of which sometimes come together.[14] Even restricting us to a narrower definition, what is the threshold to declare a crisis? In a sense, "crisis is mental state" related to country-specific aspiration levels, somewhat hard to implement empirically.[15]

Also, the varied accounts sometimes do not take care to distinguish different possible origins of crises (and/or the interpretation of the origin of the crisis being made). Is it the outcome of the endogenous deterioration induced by the pre-existing misguided policies (Argentina 1990)? Is it the outcome of savage exogenous shocks that hit a polity that has approximately sound policies (Argentina 1994)? Is it largely induced by an "endogenous" break up of confidence of economic actors on the sustainability of the (right or wrong) extant policies (perhaps Argentina 2001)? These three possible reasons for having a crisis - bad policies, bad luck, or bad institutions- might lead to different types of political responses.

In the next section, we will take the easiest and most benign interpretation with regards to all the concerns of the last two paragraphs. We use the hypothesis that crisis are a "facilitating" factor for reform. (Williamson and Haggard, 1994, p. 565: "Crisis is clearly neither a necessary nor a sufficient condition to initiate reform. It has nevertheless often played a critical role in stimulating reform.") We concentrate on "economic" crises, and we identify a crisis with a deterioration of status quo welfare, which is associated with prevailing policies. Yet, as we will see below, the "crisis & reform" story still contains many "ifs."

III. Crisis, Reform, and Living Happily Everafter

In this section I provide a stylized account of the steps involved in a crisis & reform story with a happy ending.

1. There is a set of well-identified (inefficient) preexisting policies.
2. The *economic* situation deteriorates substantially.

[14] Where by "economic" we encompass the narrower definition of "social," poverty, unemployment and the like, not the total rupture of the social contract that characterizes deeper political crises.
[15] For some implementation see Lora (1997) and (2000).

3. The deterioration, the crisis, is perceived to be caused by the preexisting policies; either because they were always inadequate, or because they are inadequate to handle some new states of the world.[16]
4. There is a clear set of *"right"* prescriptions that can take care of the problem
5. There is an adequate "social learning" of 3 & 4.
6. It becomes incentive compatible for an agenda-setting leader to act on that.[17]
7. The leader has the political capacity to "play" the reforms through the political process. (related to *special politics* above)
8. The reforms are sustained throughout the multiple stages of the policy process.
9. Details are dealt with properly (or are unimportant.)
10. Economic agents (rather soon) believe in the stability of the new set of policies and react accordingly.
11. Hence, economic outcomes turn out rather well.
12. It is sustained politically, and there are no major economic setbacks.
13. The End of History.

This highly stylized fable is obviously subject to several caveats. In the next section I raise some of those considerations, which are relevant for the later discussion.

IV. What is Wrong with the Fairytale?

The typical account of crisis and reform implicitly focuses on one-shot policy implementation. In reality, policies are complex objects, with multiple stages, and taking reform to full fruition is a process involving multiple actors through multiple stages of the policy process, requiring specific responses from economic and social agents, and hence requiring several forms of cooperation and requiring positive beliefs on the durability of the policy. That is, policies require a lot more than a magical moment of special politics in order to produce effective results. Furthermore, wonderful ideas might be poorly implemented, and it is not clear that the public or the political system will be able to tell the difference. And, of course, there is not a universal set of "right" policies.

The last point has two elements. (i) On the one hand, policies are contingent responses to underlying states of the world; what might work at one point in time in a given country, might not work in a different place or in the same place at other points in time. (ii) Furthermore, one has to go beyond the "title" of the policy into the details of its implementation.

Starting from (ii) and in relation to point 9 in the previous section, *wonderful ideas* might be poorly implemented. More generally, (within reasonable bounds) what really matters is not the broad definition of a policy stance, but the details of implementation. For instance, Rodrik (1995) analyzes six countries that implemented "the same policy," export

[16] We clean up from the "bad management" interpretation, in which case interpreters, but not necessarily the music, might be changed. This relates to a point I will emphasize below: policies are more than their "titles," sometimes the details of implementation matter even more than the broad policy definition (Rodrik, 1995).

[17] The order of these steps is not necessarily chronological. Social learning might be induced by leadership, or more generally by "elite domination" (Zaller 1992, Chapter 12).

subsidization, but with widely varying degrees of success.[18] Rodrik relates success to features such as the consistency with which the policy was implemented, which office was in charge, how this was bundled or not with other policy objectives, and how predictable the future of the policy was.[19] This latter point highlights the fact that policies depend upon the expectations and beliefs of economic (and social) agents for their success.

Some of my own (mostly indirect) involvement with fiscal issues in Latin America suggests that the success of tax policies is much more a question of accountants, lawyers, and political will, than of the "optimal-taxation" advice of economists. Also, studying the process of "decentralization of education" (a beautiful Washington-sponsored policy title) one finds enormous variations in performance depending on many implementation details and on contextual variables (see for instance Tommasi 2002, section IV).

Coming to (i), the fact that there are no universally valid policy recipes is a point that was somewhat forgotten during the "reform epic" of the 80's and 90's. Recent work has, rightly, started to emphasize the importance of "home-grown" development strategies (see for instance North 1994, Evans 2001, and Pistor 2000).[20] As emphasized in Mukand and Rodrik (2002), there is a tendency for countries to "imitate too quickly" formulas that have been successful elsewhere. Even though not the explicit focus of Mukand and Rodrik, I believe that part of the explanation has to do with the informational issues emphasized in Section I.*1*. here. The mappings between policies and outcomes are complex objects to apprehend, as illustrated by the debates among professional economists on the impact of trade liberalization on growth (Srinivasan and Bhagwati, 1999, Edwards, 1998, Rodríguez and Rodrik, 1999), or on poverty reduction (Kanbur, 2001). People (economic agents, politicians, policymakers) use mental shortcuts in order to organize the information of the world around them.[21] That is the reason why the statement "it worked in New Zealand" seems to carry a lot more weight in selling an idea to a politician or to the public, than a complex multivariate analysis which specifies the dependence of optimal policy responses on a large number of difficult-to-assess variables. These tendencies seem to be more pronounced in the general public than in politicians, in politicians than in "policy experts," and in policy experts than in academics specialized in the subject matter.

[18] Murillo (2002) explains the variety of policies undertaken under the privatization title in Latin America, and their political determinants.

[19] Some of these policy features are the same identified in a more generic approach to public policies in Spiller and Tommasi (2001). See also Cox and McCubbins (2001) and Sabatier (1999). Certainly we would benefit from better (theoretically focused) studies of the determinants of the effectiveness of polices.

[20] In the words of North (1994, p. 8) "economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy because of different informal norms and enforcement. The implication is that transferring the formal political and economic rules of successful Western economies to third-world and Eastern European economies is not a sufficient condition for good economic performance." Acuña and Tommasi (2000) make similar points with emphasis on the match between the policies (RL) or lower-level institutional reforms (RM) with the higher-level institutional endowment of the country (RH).

[21] For a more detailed elaboration of the notion of "mental models," see Denzau and North (1994). They argue that ideologies are the shared framework of mental models that groups of individuals possess that provide both an interpretation of the environment and a prescription as to how that environment should be structured.

This multi-layered imperfect knowledge about what the exact impacts of policies are (or, even more, are likely to be) in turn opens the door for manipulation, bundling, oversimplification and outright lying in policymaking games (Tommasi and Velasco, 1996). Some of the bundling and overselling played during the market-oriented reform epic might backfire in a second round of crises, in which sensible policies might be rejected by the polity because they have been (unnecessarily) bundled with other policies which might have failed. The degree to which such things happen, in turn, might be a function of the institutional determinants of the qualities of that "public space of policy making" (Nelson and Tommasi, 2001).

Putting together (i) and (ii), if a "good idea" is poorly implemented, it is not clear that the public or the political system will be able to tell the difference – i.e. that the "right" social learning will take place. In that sense, crises could lead to right reforms (the good), no reform (the bad), or wrong reforms (the ugly).[22] Adding the fact that (good or bad) reforms could also take place "in normal times," we have a two-by-three matrix of possible connections between crisis and reform, depicted in Table 1, which will be useful later.

<Table 1>

Another point that needs more careful consideration is the notion of special politics (*delegation, muted opposition*, etc.) The fact that reforms are instrumented under those forced circumstances impinges some special characteristics to the type of reform that could emerge. These "negative special politics" do not seem the most adequate process in order to instrument deeper institutional reforms. The fact that a series of strategic tricks are used might have a negative impact on the quality of resulting reforms (as it will be illustrated in the Argentine case). This is even more important once we recognize the multi-stage nature of policy processes; points 8, 9, 10, 11 and 12 of the fairytale, and not just 7, do matter.

Furthermore, there is a sense in which crises are the worst conditions for the enactment of good collective choices. As O'Donnell (1994) argues, using the example of hyperinflation crises, "in the context of this crisis it becomes rational for everyone to act 1) at highly disaggregated levels ...; 2) with extremely short time horizons; and 3) with the assumptions that everyone else will do the same. A gigantic, national level Prisoner's Dilemma emerges .... The primary basic phenomenon is generalized de-solidarization.... For players of this game, broad, long-run economic policies, negotiated and implemented with the participation of highly aggregated interest associations, are not important." (O'Donnell, 1994, 170). Even though O'Donnell focuses on individual *economic* behavior, much of what he says could be applied to *political* behavior. That is to say that crises are perhaps the worst of times to generate the conditions for the deliberative construction of bargains and consensus that are necessary to sustain quality policies and solid institutional reforms. This capacity for constructing intertemporal cooperation is, beyond the state of crisis or normalcy, heavily affected by the political institutions of the country, the institutional environment (RH).[23]

[22] The latter again could relate to learning in reverse, with adequate policies wrongly assigned guilt for poor outcomes.
[23] Also, the likelihood of falling into crises could depend on the quality of the underlying institutions.

This brings us to the final point we want to re-emphasize in this section: many aspects of reforms have temporal dimensions that require substantial intertemporal cooperation. These intertemporal dimensions are the political analogy of the intertemporal characteristics of transactions in Transaction Cost Economics, and as in TCE, are a crucial entry point for the role of institutions, in this case *political* institutions. Applying such logic to the policy process, we enter the realm of Transaction Cost Politics, which can be encapsulated by thinking of a political version of the Coase Theorem. If reforms are so good, how come it is so hard to implement them? The answer has to include the (transaction) costs of enforcing the necessary intertemporal compensations.[24] The next section takes us in the direction of transaction cost politics.

V. Institutions and Policy (and Policy Reform)

The reforms usually depicted in the reform epic are policy reforms (RL) and intermediate level institutional reforms (RM). The central point of the paper is that what really matters are some deep aspects of the workings of political institutions (RH), which condition not only broad policy choices (including "reforms"), but more importantly the effectiveness of policy implementation.

What determines a society's capacity to adjust its policies in the face of changed circumstances or in the face of the failure of previous policies? What determines the ability of a society to sustain policies long enough to create an environment of credibility and hence to elicit the adequate responses from economic agents? More generally, what determines the capacity of a society to decide and instrument effective polices both in crisis times and in more normal times?[25]

One good entry point to answering that question is provided by Rodrik (2000). His answer would be "democracy," or more precisely "participatory politics" or even more precisely "social cooperation." Rodrik emphasizes three channels by which "democracy" fosters better policies: 1) deliberation, 2) rules that prevent "too much redistribution," and 3) *procedural rules that facilitate intertemporal cooperation* (my wording.)

I believe that Rodrik's answer is basically right, but a little too "macro", too general in its depiction of political institutions. It would be nice to be able to develop more microanalytics of the effect of political institutions on policy processes, so that we can

[24] Once again, Rodrik is the author who has opened that door in the application to policy reform. The closing sentences of his 1996 overview article are: "Because distributional issues are at the heart of the literature discussed here, we need more progress on understanding why institutions for compensating losers from reform are not more common. There are very few papers where the difficulties of compensation are made endogenous to the analytical framework. This makes the literature somewhat incomplete in its diagnosis of the issues. It also opens up a natural avenue for future research." (Rodrik, 1996, p. 39)

[25] It can also be argued that oftentimes the likelihood of a given polity facing a crisis depends in part on its institutions and on (the more permanent and generic features of) its resulting policies. I illustrate this point in the Argentine case below.

move beyond telling a dictatorship "you should become a democracy." What exactly determines the ability of generating these more cooperative societal outcomes that are necessary to sustain effective policies? The answer, I believe, lies in the ("general equilibrium") interactions of several specific details affecting the workings of the political system.[26]

Here I suggest one possible way of looking at the connection between some detailed aspects of political institutions and the resulting features of public policies, and below I apply it to the Argentine case. The framework, called a "transactions approach to public policy" in Spiller and Tommasi (2001), is an elaboration of previous work on transaction cost economics and its application to politics.[27]

Transaction cost economics, as developed by Williamson (1979, 1985 and 1991) and others, attempts to understand economic organization, taking *economic* transactions as the unit of analysis. Characteristics of the institutional environment (such as the workings of the Judiciary) are taken as given, and a deep analysis of the features of different economic transactions is undertaken. This micro-analytical approach to transactions endogenizes (explains) the governance structures that support those transactions (distribution of ownership, contracts, etc.). In Levy and Spiller (1996), the institutional characteristics of countries vary, and the features of the (now *political*) transaction, the regulation of utilities, are held constant. In those cases, the governance structure of that particular transaction between "the government" and "the firm" is endogenized to the features of each institutional environment. The approach suggested here is, in a sense, a generalization and deepening of Levy and Spiller (1996). We argue that the politico-institutional environment of a country, together with the underlying features of the policy issues at stake, will determine the governance structure for each *political* transaction. These endogenously derived features of political transactions are, indeed, the characteristics of public policies.[28]

Public policies are the outcome of intertemporal transactions among political actors who hold power at different points in time. If the equilibrium of that intertemporal policy game is cooperative, first best policies could be implemented. First best policies possess a number of features, such as stability throughout different administrations, adaptability to changing economic and social circumstances (i.e., capacity to instrument reforms),

[26] For brevity I will focus on formal political institutions, which are certainly very important, but by no means the unique determinant of societal outcomes. In particular, the main socioeconomic cleavages, and the way they are articulated (or not) via formal political institutions, are crucial aspects that need to be studied. More generally, beyond "formal political institutions of government," we should include the nature of cleavages, corporatist actors, public opinion, social actors, social capital, etc. Yet, the nuts and bolts of (professional) politics and its determinants are a very relevant entry point.

[27] North (1990) and Dixit (1996) have labeled *transaction-cost politics* the use of transaction-cost reasoning to think about politics. While North and Dixit emphasize transactions among citizens and politicians, I emphasize here transactions among politicians. Related work in political science includes Weingast and Marshall (1988), Moe (1990a and 1990b), Moe and Caldwell (1994), Epstein and O' Halloran (1999), and Haggard and McCubbins (2001).

[28] To be more precise, the features of those political transactions are either itself characteristics of policies (for instance when fixing a fairly rigid policy rule), or are the determinants of those characteristics (for instance when delegating to an agency with a particular structure).

coordination across policymaking units, sufficient degrees of investment in policymaking capacity, etc.

Whether policies (and processes) with such desirable properties emerge, will depend on whether the political institutions (RH) underlying the policy process lead to cooperative behavior or not. In order to answer that question, it is necessary to enter a detailed investigation of the determinants of political cooperation in each polity. I will briefly sketch those details for the Argentine case. As an intermediate step, let me suggest the type of elements pertaining to the (abstract) description of a policymaking game that one needs to match to observed characteristics of the workings of political institutions:

Payoffs of the stage game: as in oligopoly games in industrial organization, "market" variables will determine the difference between the payoff from cooperation and the payoff from non-cooperation. This will vary from issue to issue, and within issue with the distribution of policy preferences (cleavages) and with policy technologies. (This relates to the "structural factors" referred to in footnote 26).

Number of political actors with power over a given decision: the larger the number of players, the smaller the set of other parameters for which cooperation obtains.

Length of the horizons / patience of key political actors: the likelihood of cooperation increases with the players' horizons.

Intertemporal linkages among key political actors: the intertemporal pattern of interactions among specific individuals in formal political positions (legislators, governors, bureaucrats) matters for developing cooperative outcomes.

Characteristics of the arenas where key political actors undertake their exchanges: the complex intertemporal exchanges required for the implementation of effective public policies could be facilitated by the existence of institutionalized exchange arenas.[29]

Timing and observability of moves: cooperation is harder to sustain if there is plenty of room for unilateral moves which are hard to observe or hard to verify.

Availability of enforcement technologies: needless to say, the availability of enforcement technologies facilitates cooperation. Such technologies might include the Courts as enforcers of political contracts (Constitutions, laws, etc), or a professional and independent bureaucracy on to which the implementation of political agreements could be delegated.

[29] The landmark in the literature is the depiction of the U.S. Congress by Weingast and Marshall (1988).

VI. The Argentine Case as an Illustration of Crisis, Institutions, and Reform

Argentina, due to its history and to the workings of its political institutions (its high-level institutional endowment, RH), is a polity in which cooperative intertemporal agreements are very hard to realize. Because of this, even the reform process of the 1990s took very idiosyncratic characteristics. These characteristics, on top of the maintained incapacity to strike the intertemporal agreements necessary to implement good policies, together with several shocks to which the system was unable to adjust, lead to the (largely endogenous) crisis that is still unfolding at the time of this writing. From the point of view of this diagnostic, it is not very likely that the magic of "Crisis, Reform, and Living Happily Everafter" will operate this time in the Argentine case.

In this section I take a detour and describe briefly the workings of political institutions, of the policy process and of public policies in Argentina (applying the framework of analysis summarized in section V.) I argue that some very undesirable properties of public policies in Argentina are the outcome of a generalized incapacity to realize efficient intertemporal political transactions. That incapacity, in turn, is conditioned by the high-level institutional endowment of the country (RH). In section VII, I combine those characteristics with some of the specifics of the 1990's in order to understand Argentina's trajectory from crisis to reform to crisis again.

In Spiller and Tommasi (2001) and Bambaci, Spiller and Tommasi (2001) we characterize public policies in Argentina as having the following features: (i) public policies in Argentina are oftentimes too volatile, being changed too easily with (sometimes minor) changes in political winds; (ii) oftentimes, precisely to avoid that opportunistic volatility, rigid mechanisms are put in place to instrument long term policies (illustrated by the Convertibility example); (iii) there is poor coordination among different governmental units operating over interrelated policy arenas (among levels of government in the federal structure, among departments within a given level, among subnational governments); (iv) some welfare enhancing reforms are not instrumented; and (v) there is underinvestment in capacity building for improving public policies.

All of the above features, in turn, could be explained as the non-cooperative outcome of an intertemporal policy game with conflict of interests and alternation in power. (Formal versions of this statement are provided in Saporiti, Spiller and Tommasi, 2002, and in an application to federal fiscal games in Tommasi, Saiegh and Sanguinetti, 2001). Non-cooperative equilibrium play leads enacting coalitions and individual policy makers to behave opportunistically. (Individual opportunism leads to poor coordination). To protect themselves from such opportunism, actors embed rigidities into policies, restraining not only opportunistic actions, but also efficient adjustments –those two elements cannot be separated due to the necessary incompleteness of legislative contracts. Closer to the main focus of this paper, most relevant reforms have an intertemporal path of implementation which is open to opportunistic moves, and the anticipation of such future moves, often derails reform efforts from the very start. Finally, in an environment of weak political property rights, actors (legislators, subnational politicians, bureaucrats) do not invest in capacities that could lead to better policies.

Having established the defective properties of Argentine public policies, and having argued that such properties could be explained as the non-cooperative outcome of a policymaking game, the next step is to explore why is it the case that non-cooperation is the outcome of such game. Or, in other words, we need to describe which is exactly the political game played to build public policies in Argentina.[30]

To do that we can use the abstract elements conducive to more or less cooperation in the intertemporal policy game hinted in the previous section. Argentina is a federal country, with a Presidentialist and Bicameral structure in its federal ("national") government. This leads to a naturally fragmented political system (a fragmentation increased by electoral mechanisms), in which several actors have to agree in order to instrument policy (changes). Such "large N" would require that several other institutional features be aligned in particular ways in order to facilitate effective policymaking. Unfortunately, these other "variables" have taken the wrong values in Argentina.

For historical plus constitutional reasons (including electoral rules broadly defined,)[31] key political actors have tended to have short horizons in their political interactions. An unfortunate history of repeated military "interruptions" from 1930 to 1983 made short-termism the natural strategy for most political players.[32] This history left an imprint in the actions and expectations of many relevant actors, and in lower level institutions (such as the internal organization of Congress, the Bureaucracy, and federal fiscal arrangements), that still hinders cooperation almost two decades after the last military government. But short horizons of key players come not only from the interrupted democratic history, but also from some more structural features. For instance, electoral mechanisms (including intra-party mechanisms for selecting candidates), lead to national legislators that spend short spells in Congress, and that are not too involved in technical aspects of national policy making, or in building strong congressional institutions, or in supervising the administration.[33]

The sub-national electoral connection makes (the 24) provincial governors very important actors in national politics, since governors are the political bosses of national legislators. This interacts with a fairly perverse federal fiscal system, which makes provincial finances heavily dependent on decisions taken in the center. Since the national executive has a

[30] For brevity, we focus here on formal politico-institutional actors: President, Ministers, Legislators, Provincial Governors, party leaders, bureaucrats, etc. A more complete description should include other players such as unions, business associations, and other socioeconomic actors relevant for the policy game. Also for brevity and simplicity, we focus here on the transactional problems among political representatives, leaving aside the quality of representation (i.e., the democratic principal-agent problem).

[31] Elster (1995), as well as Haggard and McCubbins (2001), also include electoral rules among the deep-level determinants of political and economic behavior.

[32] For simplicity, I am implicitly treating the "military spells" as exogenous shocks, although they were endogenous to some underlying forces as well as to aspects of the workings of the political system during democratic times.

[33] The workings of Congress and their determinants (mostly electoral incentives plus some legislative prerogatives of the executive) are analyzed in Jones, Saiegh, Spiller and Tommasi (2001) and (2001b).

number of legislative and budget opportunities for "unilateral moves," this leads to a rather short-sighted and opportunistic exchange of money for votes, leading to a perverse criss-crossing between purely national legislative issues and intergovernmental financial arrangements.

Congress is not the arena where key political bargains are struck; it is more an outside value or bargaining threat, where initiatives could be vetoed if there is not a previous "arrangement." But then the key exchanges take place in arenas that are far less institutionalized than parliaments (often meetings of the president or national ministers with provincial governors). This does not facilitate the enforcement, and hence the agreement, of efficient and transparent policies.

Furthermore, other possible enforcement technologies, such as an effective judicial enforcement, or delegation to a qualified and independent bureaucracy are not available either. Iaryczower, Spiller and Tommasi (2001) explain the relatively weak enforcement of political bargains provided by the Supreme Court, as a consequence of the Court's history. Bambaci et al (2001) characterize the Argentine bureaucracy as composed of an irresponsive and poorly qualified low-level permanent bureaucracy, and a cadre of very short-lived higher-level political appointees, and explain those features as deriving from the lack of any long-term principal, mostly due to the weakness of Congress.

To summarize, public policies (independently of their title) have several undesirable properties; this is the outcome of lack of intertemporal cooperation among political actors; which in turn derives from Argentine history and higher level political institutions (RH). Now we are ready to come back from the detour, in order to look briefly into Argentina's trajectory in the 1990's in the light of the main issues of this paper.

VII. Crisis, Reform, and Crisis again. The Argentine case

1. The Fairytale

Argentina in the early part of the 1990's was fortunate enough to undergo a process similar to (most of) the schematic 13-steps of section III. There was a deep economic crisis, including hyperinflation and looting (with poverty climbing to a totally unprecedented 47.3% of the population in October of 1989).[34] That crisis was interpreted as the terminal stage of the inward-looking, state-led, fiscally irresponsible model of previous decades; its timing coincided with demonstration effects from other developing countries, abundant international funding and advice, as well as a reasonable amount of consensus among domestic economists on that diagnostic and on the general direction that a way out was supposed to take. There was a political leader who found in his best interest to steer such a market-oriented reform process. He had the institutional resources to carry it through,

[34] A number that has not been reached yet in the midst of the terrible 2002 crisis, although it might be around the corner.

including the benefit of some explicit delegation mechanisms as a consequence of the crisis. So that Argentina underwent a very fast and profound process of economic liberalization, which included widespread privatization of public enterprises, substantial trade liberalization, deregulation of several markets, some tax reforms, and a very successful inflation stabilization plan which lowered inflation from 4923% in 1989 and 1343% in 1990 to 7.4% in 1992 and 3.9% in 1993, and which lead from negative growth in the 1980s to more than 60% cumulative growth in the 1990s (even including the severe downturn started in mid 1998, as well as the Tequila crisis of 1994-95.)

2. Some Catches

Even though the Argentine case has been considered a salient case of radical and *unconstrained* reform, a closer scrutiny of the process shows that the building and maintenance of support for the reforms involved several deviations from an "idealized" reform blueprint, and that those deviations (which left an important imprint on the economy) were conditioned by idiosyncrasies of political institutions and politics in Argentina.[35] Furthermore, even those reforms which were actually undertaken, were "done" in specific ways, also derived from idiosyncrasies of the Argentine political economy, and which also cast a long shadow on later events.

Argentina underwent an important transformation in intermediate-level institutions (whether utilities are private or public, for instance), a transformation of such magnitude that caught the world's attention. Yet, there was no transformation in the more fundamental institutions (RH) which are the deeper determinants of how policy in the utility sector works, be that as direct provision through public enterprises or as regulation of the newly private firms.

The fact that the deeper determinants of the policymaking game had not changed was reflected in the precise manner in which these transformations were instrumented. As an example, there were allegations of corruption in the privatization process, where utilities went to the hands of some of the same economic groups which have been the input providers of the State monopolies, as a way of buying the support of those business groups for the overall reform process. Furthermore, the quality of the ensuing regulatory framework for privatized utilities was uneven and questionable, also for reasons relating to the deeper workings of political, administrative, and judicial institutions in Argentina (Abdala and Spiller, 2000). This highlights again one of the points I have been stressing: the details of policies (how you regulate) are perhaps more important than the grand titles ("privatization").

The political instrumentation of the reforms could be described as a "vote-buying" strategy, in which pivotal players for the government coalition received substantial benefits and exemptions throughout the reform process (Bambaci et al, 2002). The key pivotal actors were several provinces, mostly from the backward periphery, some union leaders, and some

[35] The economic and political details of the reform process are narrated in Bambaci, Saront and Tommasi (2002).

business groups. These concessions in timing and design left an imprint that included: insufficient fiscal reform, specially at the provincial level, insufficient labor market reform, no reform of the health sector (which is very inefficient and source of important rents for the unions, some provincial actors, and some business sectors), and no (deep) reform of the very distortive federal fiscal arrangement.[36]

Furthermore, even the reforms that were instrumented took very peculiar forms, also dependent upon political and historical features of Argentina. I already referred to the example of privatization. Let me focus on monetary / exchange rate / stabilization policy. The cornerstone of reform in that realm (and the cornerstone of the whole package) was the Convertibility Law, establishing one-to-one convertibility between the peso and the dollar, in effect eliminating (almost) any monetary or exchange rate policy. Needless to say, that very peculiar policy choice had a lot to bear with the events 10 years later leading to the terrible crisis we are witnessing these days. Yet, for all the cheap criticism at the regime by "airplane economists," there was a profound logic to that regime choice and to its (ex post, very costly) maintenance throughout the 90's, a logic that again is grounded in the details of Argentine political institutions and history, mainly on the inability of the Argentine polity to instrument discretionary policies in non-opportunistic ways.[37]

3. *Fast Forward: The End of the Story*

The first Menem government (1989-1995) undertook the reforms in the manner described above. After changing the Constitution in 1994, Menem was reelected in 1995. In his second term no important reform measures were taken. In particular, no change in deep institutions occurred, and measures were not taken in the realm of macroeconomic policy that could have prevented the later disaster.[38]

The Argentine economy in the late part of the 1990's started to show some of the limitations and inconsistencies of the overall macroeconomic framework, and was subject

[36] For brevity I am narrating as if the Washington Consensus reform blueprint is the metric from which we measure deviations. Of course, this is an oversimplification, and my previous point that there are no effective universal blueprints should be kept in mind. (See also Acuña and Tommasi, 2000). Still, the WC blueprint was the "package" being played through this process; perhaps for the "signaling abroad" reasons argued in Mukand and Rodrik (2002) and Mukand (1999), in combination with the bundling/oversimplification reasons suggested here.

[37] An institutional change complementary to Convertibility was the reform of Central Bank charters to make it an independent institution. Unfortunately, the first time that Central Bank independence really collided with the Executive will, in 2001, the Central Bank president was dismissed on the basis of some doubtful accusations of wrongdoing. This proves my point of the dependence of lower level institutions such as "central bank independence" (RM) on higher level political institutions, such as the capacity to enforce such independence (RH). For an application of the same logic to fiscal rules, see Braun and Tommasi (2002). For related thoughts with regards to monetary institutions, see Lohmann (2000) and references there. This is consistent with the concerns of Posen (1998) , who argued that "central bank independence" just replaces the credibility of a promise not to inflate by the credibility of a promise to delegate.

[38] For an excellent account of the dynamics of the Argentine economy see Perry and Servén (2002).

to a number of large shocks.[39] (Also, the social situation, including unemployment, deteriorated substantially since 1992). The hard peg imposed a protracted deflationary adjustment in response to the depreciation of the euro and the real (currencies of most of Argentine foreign trade), the terms of trade shocks and the capital market shock of 1998, leading to an important overvaluation of the currency and a rapidly deteriorating net foreign asset position. Such imbalances were aggravated by weak fiscal management, especially after 1995 (Perry and Servén, 2002). The need to address the rising concern with solvency – given a large debt, a weak primary fiscal balance and low growth – lead to tax hikes and budget cuts in 2000 and 2001 that deepened the economic contraction. The capital flow reversal and increased risk premium in 2001 amplified these problems by requiring a large external current account adjustment.

Given the closeness in time of the events described in this subsection, the treatment here is very brief and sketchy.[40] The explanation for the lack of adequate policy response is in large part political, along the lines suggested here, but it also contains important elements of difficult policymaking games, even under the assumption of a benevolent government. The policy moves that might have helped to alleviate the future costs of a crisis were very likely to bring the crisis forward in time. In the second half of the 1990's it was a razor's edge call to decide what to do. Political institutions and (myopic) political incentives did the rest of the job.

The Argentine polity showed, once again, a deep incapacity to cooperate to generate the adjustments that might have prevented or at least morigerated the effects of the crisis. Some of the details of the de la Rúa administration (December 1999- December 2001) and its fall are very illustrative of this point. One salient aspect of that was the role plaid by provincial governors, and by a perverse game of chicken between the province of Buenos Aires and the national government, the two largest fiscal players in the country (Tommasi 2002 describes in some more detail the dynamics of the federal fiscal and political game leading to the crisis).

On December 20 President de la Rúa resigned in the midst of popular protest of the middle classes whose bank deposits had been blocked, and of (partly spontaneous, partly organized by the political machinery of the province of Buenos Aires) looting of supermarkets and other stores. He was succeeded by a couple of temporary figures until January 1st 2002, when Eduardo Duhalde (the peronist *caudillo* of Buenos Aires who had lost the election to de la Rúa) was named president by Congress. Default on the government debt was declared the last week of December, and the peso was devalued (without any solid alternative plan in mind) by the Duhalde administration upon taking office.

By then, the crisis had escalated to a full-blown political and social crisis in the broader sense of a disintegration of some basic aspects of the social contract. At this point, dimensions that we have chosen to ignore in the simplified account of the first part of the

[39] It also had the unlucky timing of falling into a confidence crisis at the time in which the U.S. (and hence the multilateral organizations) decided to toughen its stance with countries undergoing financial crisis that were (in good part) the outcome of domestic "misbehavior."

[40] It draws on an ongoing research agenda with Sebastián Galiani and Daniel Heymann, preliminary reflected in Galiani, Heymann and Tommasi (2002).

paper, become operational. We are not witnessing just an economic crisis, but a new rupture of the Argentine social contract, which is so fragile that in the last decade it was tied to a particular exchange-rate regime.[41] It is too early, and the situation is too volatile (it is not even obvious that the current president will last until the scheduled time in 2003), to make any predictions at this time. The game is open again at the level of economic policies and intermediate institutions (will the economy be closed again? will privatized companies be nationalized?).[42] According to some people, the crisis is so deep that the higher-level institutional game might also be open. By the reasoning that I emphasized in the first part of the paper, it is far from obvious that the actual choices, at any given level, will be the best ones.[43]

Table 2 summarizes in a sketchy way, the dynamics followed by Argentina throughout the 90's with regards to the crisis and reform "paradigm."

<Table 2>

CONCLUSION

The purpose of the paper was not to argue that crisis is irrelevant for reform. There are circumstances under which you might be "stuck" until some form of crisis might change the equilibrium play of the game, or even change the game, in a positive way. But the paper presents several caveats. The 13 steps from crisis to happiness described in Section III represent a very special set of circumstances, and make several implicit assumptions that are often not true. Furthermore, the reforms to which the fairytale refers are not the deepest level institutional reforms.

Also, the details of policies are perhaps more important than their titles. And those details are conditioned by the workings of the deeper political institutions of the countries. As illustrated in the Argentine case, the reforms derive features from the underlying policy game. This in turn, conditions the (stochastic path of) future success of the policies, and reflects the fact that underlying political games might still remain the same than those that generated inefficient policies in the first place. Both channels point to potential vulnerabilities of the system. In the Argentine case, those vulnerabilities manifested themselves a few years later, and in the face of severe shocks the Argentine polity was unable to adjust, leading to this "second crisis." It is not obvious that the 13 magical steps might be operational this next round; on the contrary, several conditions seem to point in the wrong direction.

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[41] That is, of coruse, quite a weak anchor for a social contract. For related thoughts, see Macedo, Cohen and Reisen (2001).

[42] The latter may come about not too much because of a vigorous public choice, but because private operators, especially foreign ones, are running away scared by the current scenario. It has pretty much already happened in the banking sector.

[43] Once again, it is not an easy business to define what are exactly the best choices. Yet, I venture to say that some of the choices that seem to be on the table these days are clearly not good.

That is to say, the “wisdom” developed during the “modern economic reform movement” might not be that useful for this new round of crises. Furthermore, some of the political and marketing strategies adopted in the previous round might backfire now.

I concur with several authors who have been emphasizing the importance of “good institutions” to produce good policy outcomes, including policy reform when necessary. I suggest a particular way of operationalizing what “good institutions” mean, those that facilitate intertemporal political cooperation. Such institutions can help avoid the cycles of crisis and (short-lived) reform. As the Argentine case illustrates, crises are partly endogenous to bad institutions, to some extent independently of the title of the specific policies in place.

It is not the policy, it is the polity, stupid.[44]

[44] This statement was the original subtitle of the paper. That subtitle was written in a pessimistic mood, that made it sound too deterministic. As Jorge Braga de Macedo correctly pointed out, the type of intertemporal cooperation games that I describe do have multiplicity of equilibria, and we should not stop our quest for ways out of inefficient equilibria like the one Argentina is suffering. On multiplicy and possible institutional ways of getting to better equilibria, see Braun and Tommasi (2002).

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Table 1: The Good, the Bad, and the Ugly as a Response to a Crisis

	Right Reform	No Reform	Wrong Reform
Crisis	good	bad	ugly
No-Crisis			

Table 2: The Good, the Bad, and the Ugly in Argentina

	Right Reform	No Reform	Wrong Reform
Crisis	Menem I (early 90's)	de la Rúa (2000-2001)	Today? (2002)
No-Crisis		Menem II (late 90's)	