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## Reforming Intergovernmental Fiscal Relations in Argentina

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Fiscal Affairs Department

**Reforming Intergovernmental Fiscal Relations in Argentina**

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**Abstract**

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Argentina has committed itself to a reform of its revenue-sharing system. This paper examines this system and the issues involved in its redesign, and discusses the pros and cons of various options with a view to specifying a preferred approach.

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## I. INTRODUCTION

Argentina has committed itself to reforming its revenue-sharing system. This paper looks at the issues involved in a redesign of the revenue-sharing arrangements, and discusses the pros and cons of various options with a view to specifying a preferred approach.

Formally, the impulse for the revision of the system of fiscal relations between government levels is simply the result of a pending constitutional obligation. The current system of fiscal relations was meant to be temporary, and the initial deadline for its definitive reform went unheeded six years ago. The continuing delay in the reform is due not only to neglect of this legal obligation but also the continued operation of the political factors that prevented the establishment of a permanent regime in the first place. Many parties want reform, but not for the same reasons and not in the same direction. For the nation and provinces, the reform of the federal fiscal system is often viewed as a zero-sum game, with provinces seeking to obtain broader guarantees and larger flows of resources from the center, and the nation trying—as in the last few months of the Fernando De la Rúa presidency—to preserve or even increase its share in the resources it collects.

This dispute has been, for the most part, played out within the limits imposed by the terms of reference established by the constitution: the features of the revenue-sharing, or “coparticipation,” system. Any serious proposal for reform, however, should go beyond this issue to include at least two other aspects of intergovernmental relations: tax assignment and borrowing limits—in fact, some proposals have tried to do that. The goal of the reform should be to strengthen responsible fiscal behavior at the subnational level (or, at least, to prevent profligacy there), and this requires fundamental change in at least one of those two dimensions. A more narrow reform, focused only on improving the revenue-sharing system, would still be useful; but it would not tackle the main weakness of the federal structure of public finances in Argentina. A reform that ignores these issues will be unlikely to establish fiscal responsibility at the provincial level.

During recent years, the fiscal federalism rules in Argentina often changed when the federal government<sup>2</sup> wanted something in return from the provinces. Not surprisingly, most of the changes thus agreed resulted in more, or more heavily guaranteed, resources flowing to the provinces, but seldom in more responsibility being effectively imposed on provincial governments. The crisis that started in 2001, by contrast, affects all levels of government, and may thus present an opportunity for the discussion of a reform that may harden the budget constraint facing the provinces.

The next two sections of the paper describe the system of intergovernmental fiscal relations in Argentina and discuss its main shortcomings. In that light, Section IV summarizes, and comments on, various reform proposals put forward by important political figures and

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<sup>2</sup> In the paper, the expressions “federal government” and “national government” are used interchangeably.

entities in recent years. Section V presents what is hopefully a constructive and viable reform proposal. Section VI discusses the main guidelines for reform agreed upon by the national and provincial governments, and the last section offers some concluding thoughts.

## II. THE PRESENT SYSTEM OF INTERGOVERNMENTAL FISCAL RELATIONS

### A. Main Tax and Expenditure Assignment Decisions and the Vertical Imbalance

Argentine federalism is characterized by a high degree of decentralization of public expenditure, with education and health services largely assigned to provincial governments while the main responsibility entrusted to the federal government is the payment of social security benefits. In fact, total spending by provincial governments (including the government of the city of Buenos Aires) has been around 10 percent of GDP during the last several years.<sup>3</sup> The tax system, however, is dominated by federal taxes, including the value added tax (VAT), various social security contributions, the income tax, a series of excises, and trade taxes. These resources have totaled between 17 and 18 percent of GDP in recent years. By contrast, provincial governments collect a little over 3 percent of GDP in tax revenue, largely from their own sales tax (the gross receipts tax, GRT) and property and stamp taxes. This imbalance has been bridged with a complex system of transfers that annually channels to provinces approximately 6 percent of GDP in resources of federal origin. Provinces were—until 2001—able to borrow virtually without check, in part because of their ability to put up federal transfers as collateral.

The main element of the revenue-sharing system is the “coparticipations” scheme, which distributes a large proportion of federal revenues between the national (federal) government, the national social security administration, and the provincial governments. Several taxes are fully or partially outside the system of coparticipations, but most are subject to some sharing rule. The only federal taxes whose proceeds have remained with the federal government in full are the foreign trade taxes, the charge on insurance premia, and the federal stamp and social security taxes. The financial transaction tax started out as a wholly federal tax, but it lost this status as a result of the pact between the nation and provinces of February 2002, which left 30 percent of this tax unassigned and therefore subject to the sharing regime.

The December 1998 tax reform had major implications for revenue sharing, as it increased coparticipated revenues to pay for a reduction in (noncoparticipated) payroll taxes. This reform was accompanied by a modification in the coparticipations system to compensate the federal government for this net redistribution toward provinces *during a limited period*. Later, the December 2000 federal fiscal pact temporarily replaced the coparticipations transfers with a single, fixed transfer from the nation to the provinces. During the tenure of Minister Domingo Cavallo, the government introduced a series of tax reforms that greatly complicated the task of administering the revenue-sharing system. After

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<sup>3</sup> GDP ratios computed with pre-2002 data.

Mr. Eduardo Duhalde became president of the country, a new fiscal pact was signed whose main elements were the commitment of the nation to help the provinces deal with their debts and the inclusion of certain resources in the pool of shared taxes in exchange for the elimination of the guarantees on the amount of the transfers from the center negotiated during Mr. De la Rúa's presidency.

The rest of this section describes the revenue-sharing system as it stood after the 1998 tax reform, the main changes introduced by the 2000 and 2002 fiscal pacts, and some of the issues raised by certain tax changes introduced in 2001.<sup>4</sup> This section mentions some rules that were eliminated in the last round of negotiations between the provinces and the nation, which took place in February 2002.

### **B. The Coparticipations System After the Tax Reform of 1998**

The following funds are distributed by the coparticipations scheme: (i) 64 percent of the income and profit taxes, after a deduction of Arg\$580 million; (ii) 89 percent of the VAT; (iii) 90 percent of the personal assets tax; and (iv) 100 percent of excise and other taxes not explicitly earmarked for other purposes. The "primary" distribution of these resources refers to the splitting of revenues among different levels of government, and is determined in three steps.

First, the revenues of the coparticipations scheme are subject to a deduction of Arg\$45.8 million a month, earmarked for accumulation in the Provincial Disequilibrium Fund (PDF). Until recently, there was a second deduction of up to Arg\$2,154 million a year. It is interesting to describe it, since it reflects very well the complexity of fiscal relations between government levels in Argentina. This deduction—originally meant to expire at the end of 2000, subsequently extended through 2005, and finally discontinued in May 2002—followed two rules: (i) the federal government could not take these funds for as long as the cumulative average of the monthly transfers of coparticipated revenues to the provinces were below Arg\$920 million; and (ii) the cumulative average of the monthly amounts kept by the federal government for this concept could not exceed Arg\$179.5 million. This precoparticipation had been established as a complement to the 1998 tax reform. That reform was meant to be neutral with respect to the revenues collected by the federal government; but it was not neutral with respect to the distribution of revenue between national and provincial governments. The reform cut employer social security contributions, which are not coparticipated, and raised income tax and other coparticipated taxes, reducing the overall share of the federal government in total federal revenue. The deduction of Arg\$2,154 a year aimed to offset this effect for a while; but the reform ultimately involved a cession of resources to the provinces.

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<sup>4</sup> An excellent description of the revenue-sharing system prior to the 1998 tax reform can be found in Schwartz and Liuksila (1997). A brief but informative explanation of the history of intergovernmental relations in Argentina can be found in Cetrangolo and Jiménez (1998).

Second, of the resources left after the deduction (preparticipation) described above, 15 percent goes to the Social Security Administration (ANSES).

Third and finally, the remaining resources are distributed thus:

- 1 percent for the Federal Fund for Assistance to Provinces (known as National Treasury Contributions, or ATN, this is a vehicle for discretionary transfers).
- 57.05 percent to provincial governments.
- 41.95 percent to the federal government.

These shares may be modified to ensure that the monthly transfer of coparticipated revenues to provinces is not less than Arg\$740 million, a guarantee last exercised in late 1996.

The “secondary” distribution of coparticipated revenues refers to the horizontal allocation of resources to individual governmental units of the same type. In Argentina, the coparticipations law of 1988 fixed the percentage of the provincial coparticipated revenues that each province is entitled to receive. Those percentages were based on the actual transfers each province received during 1984–87, when there was a legal void in this area.

### **C. Changes in Coparticipations Introduced by the Federal Fiscal Pact of December 2000**

The federal fiscal pact signed by the national and provincial governments in November 2000—and passed into law by congress in December 2000—extended until 2005 the validity of the deduction of up to Arg\$2,154 million a year described above, and introduced two major changes for the period 2001–2005:

- During 2001–2002, instead of sending them revenue-based coparticipation transfers, the government was supposed to pay the provinces a fixed amount of Arg\$1,364 million a month. In practice, the federal government continued to make revenue-based transfers, making up for any shortfall relative to Arg\$1,364 (the so-called “guarantee”) on the first days of the following month. During the second half of 2001, however, even this system started to break down, as the federal government began to accumulate arrears in the payment of the *guarantee* in order to meet its target of a zero deficit on a cash basis.
- During 2003–2005, the provinces were to receive transfers calculated as the moving averages of their legal shares in the effective collection of coparticipated taxes during the previous three years. These transfers were not supposed to fall short of an increasing series of guaranteed minimum levels.

#### **D. Complications Arising from Tax Changes Adopted in 2001**

Traditionally, the universe of shared revenues could be identified with the flow of collections from each tax subject to sharing. However, this equivalence was lost after two reforms introduced in 2001:

- The financial transactions tax (FTT) introduced in March 2001, initially placed outside the revenue-sharing scheme, can be partially credited toward the settlement of VAT and income taxes, which have always been subject to revenue sharing. Note that not all payers of FTT are also payers of shared taxes, so there is no easy way to calculate the part of FTT collections that will ultimately be credited toward other (shared) taxes.
- The *increase* in employer social security contributions (not shared), decreed in mid-2001, can be credited toward VAT and income taxes (shared). Even before this change, this contribution rate was a function of several incentive schemes, and so it varied by region and even according to the changes in the number of employees during the previous year. Thus, there is no easy way to calculate the part of these contributions that will eventually be credited against shared taxes.

In other words, some obligations arising from the application of shared taxes could be settled through “advances” in the form of payments of certain nonshared taxes. But these advances were a variable and unknown proportion of those nonshared taxes. Information on credit claimed on such advances by each taxpayer was needed to identify the mass of resources subject to sharing.<sup>5</sup> Thus, the correct allocation of resources to different levels of governments became impossible to verify by outside observers with access only to aggregate tax collection data.

#### **E. Changes Introduced by the Pact of February 2002**

The generalized crisis unleashed by the freezing of bank deposits quickly led to the negotiation of a new pact between the national government and the governments of the provinces. This pact, made into law in April 2002, was necessitated by the inability of the national government to send the provinces the guaranteed levels of transfers mentioned above. The 2002 pact introduced three important changes in the revenue-sharing regime. It abolished the deduction of Arg\$2,154 million a year that used to compensate the government

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<sup>5</sup> Additional rules may be needed to determine shared revenue. Consider a firm with a large stock of VAT credit to unload. Now, this firm also has credits for FTT paid. If the firm has low gross tax to report, it may be able to choose which credit to claim to make a zero net payment of VAT this period. If credit from VAT on purchases is claimed, there is nothing new to share with provinces, since the amount now credited was shared when the tax on the purchases was paid. But if the credit is for the payment of FTT, the tax subject to sharing would be equal to the amount of the credit. Apparently, however, there are no rules on the order in which credits may be used; but carry forward and other rules may influence the taxpayer’s decision to use certain credits earlier than others.

for having reduced social security contribution rates in 1999; it made 30 percent of the amounts collected by the financial transactions tax subject to the revenue-sharing regime; and it eliminated the guarantees on transfers established in the 2000 pact for 2002 and beyond. Thus, transfers are, again, driven by collections, though they remain subject to the floor of Arg\$740 million mentioned earlier in Subsection B.

In exchange for the loss of the guarantees, provinces obtained the promise that the national government would establish a scheme to help them restructure their debts. The scheme would have the federal government or the Provincial Development Fund issue new debt to be exchanged for old provincial debt. This way, the national government would become responsible for servicing the new securities. However, this operation would not be an assumption of liabilities: the provinces would become indebted to the national government, pledging part of their entitlements under the revenue-sharing scheme in partial guarantee of this new indebtedness. In addition, provinces participating in this debt conversion scheme would have to commit to reducing their deficits and accept close monitoring by the federal ministry of the economy.<sup>6</sup>

#### **F. Other Revenue-Sharing Arrangements Between the Federal and Provincial Governments**

Besides the coparticipations scheme, revenues from many federal taxes are shared with the provinces through various “funds.” The tax on energy, taxes on cigarettes, and 71 percent of the revenues from taxes on liquid fuels are used to finance the operations of six funds which, in their turn, make earmarked transfers to the provincial governments: the Regional Tariff Compensation Fund, the Rural Electrification Fund, the Infrastructure Fund, the Road Fund, the National Housing Fund, and the Tobacco Fund.

As noted above, not all of the revenue from coparticipated taxes is channeled through the coparticipations scheme. First, an annual amount of Arg\$580 million from the income tax is set aside to be distributed between ANSES (Arg\$120 million), the provinces (Arg\$440 million), and the ATN (Arg\$20 million). The rest of the proceeds from that tax are divided between the coparticipations scheme (64 percent), the social security administration (20 percent), the provinces (14 percent, of which up to 10 percent may go to Buenos Aires), and the ATN (2 percent). Similarly, while 89 percent of the VAT goes to the coparticipations scheme, the rest is transferred directly to the social security: 9.9 percent to ANSES and 1.1 percent to the remaining provincial and local social security schemes. The latter also receive 10 percent of the revenues from the personal assets tax. The single presumptive tax (*monotributo*) is shared between the ANSES (70 percent) and the provinces (30 percent).

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<sup>6</sup> This is similar to the partial debt restructuring programs administered by the Provincial Development Trust Fund between 2000 and 2001 in which initially nine provinces participated—but on a potentially much larger scale. The results of those restructuring programs through mid-2001 were mixed, but the balance was probably positive. One of the consequences of the fiscal crisis of late 2001 was that it became ever more difficult for the Trust Fund to continue to play its role in those agreements.

### **G. Intraprovincial Revenue-Sharing Schemes**

Provincial governments share with their municipalities revenues from provincial sources and from federal transfers. Through the 1990s, provincial governments transferred about one-tenth of their resources to their municipalities (about 1 percent of GDP on average on an annual basis). These transfers represented approximately 45 percent of municipal revenues.

There are great varieties of arrangements for the transfer of resources from provincial to municipal governments. Most provinces transfer to municipal governments between 8 and 25 percent of their income from federal transfers and between 10 and 50 percent of the proceeds from provincial turnover and property taxes. The share of the tax on automobiles transferred to municipal governments varies between 5 and 90 percent, and, in some cases, the tax has been ceded to the municipalities. A few provinces have different types of rules. One province, for example, determines the overall amount of the transfer on the basis of the wage bills of the municipal governments.

In most provinces, the largest part of the resources transferred to municipal governments is distributed in proportion to the population of the municipalities. In many provinces, however, significant amounts are transferred based on other criteria, such as the municipalities' own revenues. For redistribution purposes, most provincial governments distribute a fraction of the transfers equally among all municipalities. Finally, some transfers are made through funds established to address specific needs, often associated with public works.

### **III. MAIN PROBLEMS OF THE PRESENT STRUCTURE OF INTERGOVERNMENTAL RELATIONS**

The features of the current system give rise, more or less directly, to a wide variety of problems of variable severity; and some of these features and problems reinforce one another to produce a syndrome of provincial economic weakness and indiscipline.

#### **A. Soft Budget Constraints**

The disparity between expenditure responsibilities and own revenues, combined with unchecked borrowing ability based on the collateralization of future transfers, has allowed provincial governments to run unsustainably large fiscal deficits. This borrowing against, essentially, federal revenues and the paucity of provincial adjustment instruments make bailouts by the federal government almost inevitable. Two recent experiences of this type are the debt restructuring and financing program for 11 highly indebted provinces operated through the Provincial Development Trust Fund since mid-2000, and the program for the conversion of provincial debt into national or nationally guaranteed debt, agreed upon in the February 2002 pact and whose implementing legislation was issued in August 2002.

The disconnect between provincial spending decisions and own revenue efforts has been exacerbated by the political inclination of the central government to finance additional

provincial spending with new transfers, as in the case of the *Fondo de Incentivo Docente* (the teacher's fund). The general practice of fiscal federalism in Argentina is characterized by a form of rent seeking: it is easier for the provinces to press for new transfers than to generate their own revenues or to reallocate existing spending. In short, few provinces in Argentina have had to face the cost of financing the increases in their own spending. The most egregious example of the uncontrolled spending that follows from this permissive system was observed in 1999, an election year, when the provincial wage bill rose from 5.6 to 6.4 percent of GDP.

### **B. Revenue Sharing**

The Argentine system of intergovernmental fiscal relations is based on the principle of revenue sharing, with all major taxes assigned to the national government. This choice has had two key consequences: the frequent dissipation of adjustment efforts at the center, and the procyclical and volatile nature of transfers to the provincial governments. Almost every time the federal government has increased taxes for the purpose of adjusting its own finances, a new provincial entitlement has been created, which has been eventually translated into extra spending.

Regarding the volatility of transfers, this is problematic for the financing of such trend spending as health and education, and the provincial response has been to push for, and obtain, guaranteed minimum transfer levels. By their very nature, these tend to ratchet up, skewing the sharing of risks between provincial and federal governments. As a result of the 2000 pact, a more positive approach was introduced by making transfers depend on multi-year averages of shared resources. However, this feature may require an accumulation fund to operate safely.

### **C. Economic and Political Implication of the Differentiation of Treatment of the Various National Levies**

As seen in other countries, the application of different sharing rules to different taxes provides the federal administration with skewed incentives for their collection. A corollary is that the determination of the form a new tax enters the revenue-sharing regime becomes itself a subject of political dispute, as the example of the congressional battle over the coparticipation of the tax on bank debits and credits (the "financial transactions tax") in 2001 illustrates.

The fact that various taxes and levies enter the revenue-sharing scheme in different ways implies that the effects of many structural reforms are partially determined by the revenue-sharing system. The implementation of some reforms necessitating changes in particular taxes may require the modification of certain revenue-sharing rules. This can make structural reform at the national level hostage to the provincial governments, whose acquiescence must be somehow obtained, as these examples illustrate:

- In 1993, when the social security reform was implemented, a revealing bargain was struck. In exchange for “making room” for the social security administration in the revenue-sharing scheme (a necessity for the national government, which was losing contribution revenues to the newly privatized social security scheme), provinces obtained an increase in the minimum guaranteed level of transfers, the right to pass their imbalanced pension schemes to the nation,<sup>7</sup> and the nation’s commitment to organize a system of regional credits operated through the provincial banks.
- During the tax reform of 1998, the federal government obtained only partial compensation through a temporary modification of the revenue-sharing rules when it implemented a revenue-neutral tax reform aimed at reducing the relative tax burden on labor. That is, the national government had to accept a decline in its share in resources of national origin upon expiration of the temporary compensation.

There is a basic asymmetry between the nation and the provinces in this political tug-of-war. When the nation needs provincial support to implement a reform, it often needs *all 24* provinces to go along, and so it must make some general concession in return; but when provinces falter, they do so individually, and the national government cannot obtain general concessions in exchange for its support. Ever since the current system was introduced in 1988, this dynamic has led to the ratcheting up of benefits for the provinces. By contrast, during the present crisis most provincial governments are in need of assistance. This affords an opportunity to reach agreements on reforming the system of intergovernmental relations in ways that may promote or force more prudent behavior by all provincial governments.

#### **D. Complexity of the Transfers System**

A system of fiscal relations between different government levels cannot be simple for it must assign revenues and expenditures, address the resulting vertical imbalances, and take into account regional disparities. However, the Argentine system is more complex than any observer would imagine necessary, as it has accumulated new wrinkles every time a bargain has been struck between the nation and the provinces.

The complexity of the system detracts from transparency, making it difficult to assess, at any given moment, what is the precise fiscal situation of provincial and national governments. It also encourages a sort of rent seeking, providing a niche for those with deep knowledge of the loopholes in the system and the best ways to exploit them. More mundanely, this complexity hampers the operation of intergovernmental fiscal mechanisms. For example, when taxpayers with debts to the fisc enter payment facilitation schemes, it is a complicated administrative matter to determine the provincial and national shares in the back taxes being made up, delaying the flow of these resources to their ultimate recipients.

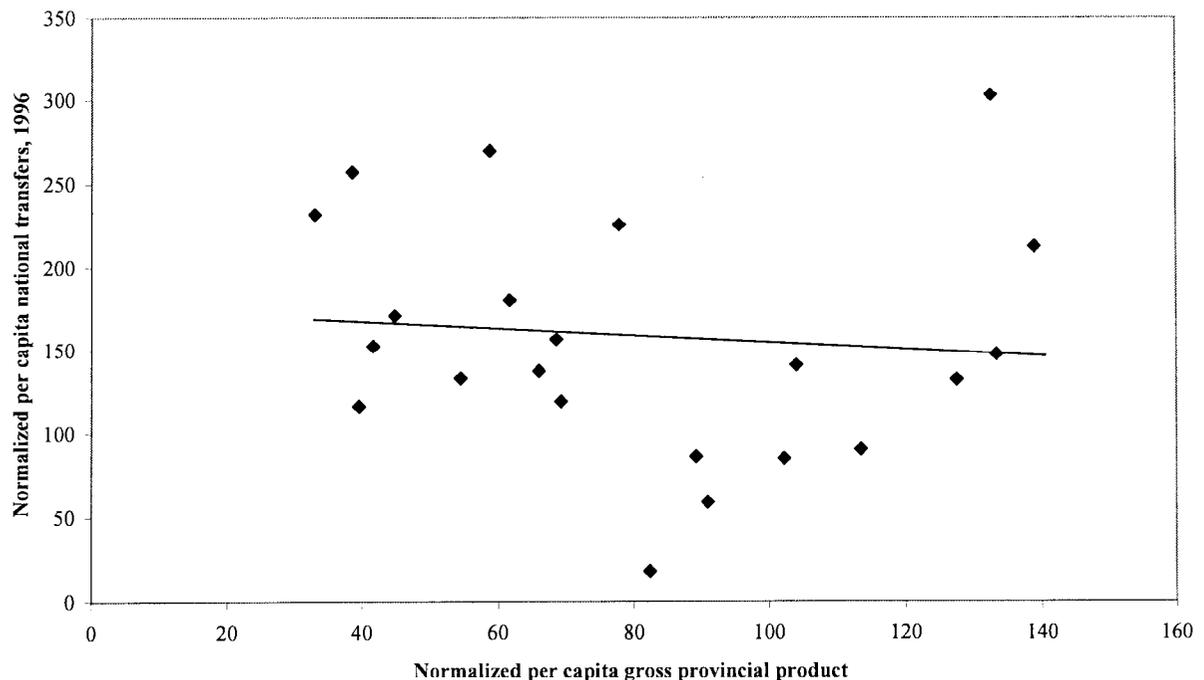
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<sup>7</sup> Not all provincial governments took advantage of this possibility. Those which did not, however, became entitled to receive a small portion of receipts of VAT and personal property tax to help finance their pension costs.

### E. Instability of the Federal-Provincial Regime

A corollary of the problems described above has been the instability of the federal fiscal arrangements. Six federal fiscal pacts have been signed since 1992 to deal with the clash between the coparticipation scheme and other policy goals, or to readjust the balance of risks between nation and provinces in the face of critical circumstances. And each time, these pacts have necessitated complex and wearying negotiations between the nation and 24 provincial governments. In most cases, the outcome has been an even more complex system of fiscal relations. But more to the point, these agreements were always known to be temporary—sometimes explicitly so—and the ability and willingness of the signatories to carry out their commitments has seldom been complete.

Figure 1. Argentina: Transfers to Provinces and Regional Disparity  
(As a percentage of the average)



Source: elaborated on the basis of data in Remes Lenicov (1997), Cuadro 3.

### F. Secondary Distribution

The distribution of resources of national origin among the various provinces (known as secondary distribution) is often criticized for its apparent arbitrariness. For the most part,

this distribution is carried out through a very simple procedure, since the law determines the percentage of the main mandatory transfers that ought to go to each province. These percentages reflect the actual distribution of transfers over a period in the mid-eighties during which there was no rule in effect to govern such distribution. Transfers during that period were thus the result of previous patterns of transfers and of the ability of each governor to secure more resources from the center.

The fixed-percentages distribution rule, however, does in practice incorporate some important criteria. If we exclude the Municipality of Buenos Aires (MBA), which receives a discriminatory treatment in the revenue-sharing scheme, the correlation between provincial governments' own revenues and transfers from the national government in 1999 and 2000 was a remarkable 97 percent; including the MBA, this correlation drops to a still high 78 percent. Essentially, this derivative character of the secondary distribution is driven by the disparity in size between the provinces, among which Buenos Aires stands out with about one-third of all provincial resources. A further, less dominant, character of the secondary distribution scheme is a geographical redistributive slant, especially away from the municipality and—to a lesser extent—the Province of Buenos Aires. These two entities together account for almost two-thirds of the national tax base and about 55 percent of total revenues of provincial origin, but receive only about one-fourth of all national transfers (and most of these go to the Province of Buenos Aires, not the MBA). But this redistributive element appears quite mild if one excludes the MBA and adjusts for provincial population, leaving some interprovincial variation in transfers per capita unexplained, as the deviations from the regression line in Figure 1 (which excludes the MBA) show.

The fact that the secondary distribution is not explicitly based on any economic criterion makes it a constant target of the critics. However, the secondary distribution probably represents the least of the problems afflicting the federal system in Argentina. For one thing, it seems to implicitly obey a derivation criterion, and to a lesser extent, a redistribution criterion stemming mainly from the atypical treatment of the MBA. For another, the system of fixed percentages, by itself, does not penalize any province for making above-average efforts to collect its own revenues.

### **G. Provincial Taxes**

Provincial tax revenue comes mostly from the gross receipts tax (GRT), which is a complex and distorting turnover tax, since it cascades, is levied on an origin basis, and is subject to numerous exemptions and multiple rates.<sup>8</sup> There have been several efforts to simplify these taxes, and the provincial governments have repeatedly expressed their desire to phase them out. However, the GRTs provide about one-half of all provincial tax revenue, and it has proved difficult for the provincial governments to replace them. At the same time, property taxes are underutilized. Taxes on real estate, in many other countries assigned to

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<sup>8</sup> It has been noted that in 1995, "laying out the rates and exemptions for the 24 provinces [took] 20 pages of small type." See Bird (1999).

municipalities, are in Argentina (deficiently) collected by provinces. A key weakness in the administration of these taxes is the wide discrepancy between cadastral and market values of property. This discrepancy, moreover, has adverse effects on the base of the federal personal property tax. A final problem often mentioned in the discussion of subnational taxation is the instability of provincial tax frameworks, which are subject to frequent changes.

#### **H. The Buenos Aires Factor**

The Province of Buenos Aires dominates the universe of subnational governments, and its policies and politicians have national prominence. Its large size gives this province access to financing sources not available to most subnational governments, including international markets (until recently). This way, Buenos Aires province, with about one-third of all fiscal revenue of provincial origin, accounted for more than 50 percent of the combined provincial deficit in the last few years. The key reason for this discrepancy is that while the province gets somewhat less in national transfers than it would on a pure derivation basis, it spends as if it were not on the “giving” end of the redistributive mechanism implicit in the transfer system, simply compensating its relative lack of transfer revenue with debt.

The tendency of Buenos Aires to run relatively large deficits is accentuated during times of crisis for political reasons. The governor of Buenos Aires is usually considered a natural candidate for the presidency of the country, and so this province finds it particularly difficult to undertake unpopular fiscal adjustment measures. In 1999, an election year when the provincial and federal deficits swelled, Buenos Aires province explained 46 percent of the combined deficits of all provincial governments. During the adjustment year of 2000, however, this proportion rose to 60 percent, as Buenos Aires lagged most other provinces in its efforts to reduce its deficit. Projections for 2001 made in mid-year put this proportion still at 55 percent, as Buenos Aires continued to avoid deep nominal expenditure cuts by making payments with quasi-currency bonds.

#### **IV. PAST PROPOSALS TO REFORM THE ARGENTINE REVENUE-SHARING SYSTEM**

As noted earlier, the current revenue-sharing system was meant to be temporary, and its reform is behind schedule although there has been no scarcity of proposals to reform it, official and otherwise. The most complete proposal was made by the federal government during the last months of the Menem administration. This section presents, in chronological order, brief summaries of several proposals selected mostly on the basis of the political influence—past or present—of their authors (see also Table 1).

##### **A. Provincial Minister Remes Lenicov’s Proposal (1997)**

The lack of “fiscal correspondence” between revenue and spending in the provinces is, as we have seen, a fundamental problem: provincial governments have no incentive to moderate spending, since they make no effort to finance it; and the national government has no incentive to improve revenue collection, since it must give away a large portion of the proceeds. Taking this viewpoint, Mr. Jorge Remes Lenicov, at the time, the Finance Minister

of the Province of Buenos Aires, proposed a further decentralization of certain tax bases to complement the already deeply decentralized expenditure structure.<sup>9</sup> He proposed transferring excises to the provinces, introducing a provincial surtax to piggyback on the federal income tax, and simultaneously reducing the rate of the federal VAT and increasing the rates of the main provincial taxes—while reforming the latter to reduce distortions.

This proposal, however, came short of ensuring that provinces would be self financed. Thus, the remaining vertical disequilibria would be addressed with a simple system of transfers, concentrating all national taxes in a single mass. This mass would be shared in fixed proportions between the national and provincial governments. This arrangement would guarantee that transfers to provinces would be automatic, stable, and unconditional. Over time, these proportions should periodically be revised in favor of the provinces, since the demand for federal services (largely pensions) should decline eventually as a consequence of the pension reform of 1993, while the demand for provincial services—basically, education and health—will grow with the population and the level of development of the country. In addition, social programs currently managed by the federal government should be transferred to the provinces.

The secondary distribution of resources (the distribution among provinces) should largely reflect the contribution of each province to the generation of revenue, although some redistributive elements could be included with the goal of ensuring that residents of different provinces enjoy similar opportunities for personal development. However, redistributive mechanisms should be limited to preserve the “fiscal correspondence” principle that motivates the proposal in the first place.

This proposal, finally, called for an increased degree of responsibility of the provinces for their own finances. Provinces should manage their debt independently of the federal government, but must do so cautiously, imposing on themselves stringent tests for the approval of indebtedness. Provinces should also be responsible for managing their finances over their cycles. In this regard, Mr. Remes Lenicov’s proposal disallows any nationwide anti-cyclical mechanisms, noting that the provincial economies differ considerably from one another.

### **B. Mr. López Murphy’s Contribution to the Debate on Fiscal Federalism (1998)**

Mr. Ricardo López Murphy—who would briefly hold the Economy portfolio in early 2001—contributed to the debate on the reform of the revenue-sharing system by exploring further the ideas of subsidiarity and fiscal correspondence in Argentina.<sup>10</sup> He argued in favor of furthering decentralization, but especially by strengthening municipal governments. Without

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<sup>9</sup> See Remes Lenicov (1999). Mr. Remes Lenicov was the country’s minister of the economy for a few months in 2002.

<sup>10</sup> López Murphy and Moskovits (1998).

offering specific proposals, he recommended the reduction of vertical imbalances through the reallocation of tax bases toward lower levels of government.

The main remaining imbalances should be addressed with transfers structured in such a way as to provide incentives for the strengthening of provincial and local revenues. Mr. López Murphy cautioned strongly against attempting to implement redistributive policies through the system of intergovernmental transfers. Too often, he noted, these attempts resulted in schemes where the poor living in rich regions subsidize the rich living in poor regions. The proper focus of redistributive policy is the family, not the region.

Mr. López Murphy also emphasized the need to look for mechanisms to limit the ability of provincial governments to issue debt. This is important since, once a province has become heavily indebted, it is very difficult to avoid a rescue by the federal government. Along with the vertical imbalances in the present system, such moral hazard is a strong incentive for overspending at the provincial level.

### **C. The Project of the Menem Administration (1999)**

This project<sup>11</sup> involved a reform of the provincial taxes as well as a change in the system of federal transfers to the provinces. Regarding the provincial tax reform, the main change would be the phasing out of the provincial stamp and gross receipts taxes, which would be replaced with a “shared value added tax” (SVAT). The SVAT would basically add a surcharge to the federal rate of the VAT; the surcharge would be administered and kept by each province and its rate and base in each province would be set by the corresponding provincial government. Interprovincial sales would be handled by the application of a “national” surcharge on sales to a different province. This surcharge would be payable to the national government, and the purchaser may use it as credit toward the national VAT. In the future, revenue decentralization would be simply implemented by lowering the federal VAT rate and simultaneously increasing the rates of the provincial SVAT surcharge.<sup>12</sup>

The new system of transfers would include simple primary distribution rules. All federal resources—with the sole exception of taxes on foreign trade—would be concentrated in a single mass subject to sharing. This mass would be split simply between the national government (61.2 percent) and all provincial governments (38.8 percent). This split would preserve the effective shares obtained by these governments in 1998, and the federal government would finance all its social security spending from general revenue.

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<sup>11</sup> See Argentina, Jefatura de Gabinete (1999).

<sup>12</sup> For a detailed explanation of this tax, see Fenochietto (1998). Renowned experts in fiscal federalism have endorsed the “compensating” VAT, or CVAT, a similar scheme requiring that all subnational tax bases be the same as the national base. See, for instance, McLure (1998) and Bird (1999). For a critique of the SVAT and other modalities of subnational VATs, see Piffano (2000).

The secondary distribution of resources, however, would become more complex, as the system of fixed percentages would be replaced by a set of transfers determined on the basis of certain economic criteria, aiming to reduce inequality while limiting moral hazard. To this effect, four types of transfers were to be implemented: (a) devolution transfers, based on where tax revenues originate; (b) equalization transfers, aimed to compensate provinces with low revenue raising capacity due to structurally low tax bases; (c) territorial equity transfers, aimed at ensuring that all provinces have enough resources to offer some minimum level of public services; and (d) compensatory transfers, designed to ensure the reform does not reduce any province's income from transfers in nominal terms. Over time, the last two types of transfers would fall in importance relative to the others.

Finally, and in direct response to a constitutional mandate, a new federal fiscal agency would be created to control the operation of the revenue-sharing regime. Its function would be to solve any controversies that may arise in the implementation of the revenue-sharing system, and to propose changes to the system as they become necessary.

#### **D. Senator Ortega's Proposal (1999–2000)**

Senator Ramón Ortega elaborated a proposal that resembled in some important aspects the proposal of the federal administration described above.<sup>13</sup> It called for the replacement of distorting provincial taxes with provincial taxes on final consumption levied on a destination basis and for increased cooperation among provincial tax authorities. Like the federal government, it favored a single mass of coparticipated taxes that would exclude only foreign trade taxes and taxes temporarily earmarked, and proposed that the primary distribution reflect the actual revenue shares observed in 1998.

Senator Ortega's proposal, nevertheless, departed from that of the Menem government in several important dimensions. First, to reduce the volatility of transfers, it proposed using a two-year moving average of revenues as the base for the computation of actual transfers. Second, it shied away from specifying a set of rules for the secondary distribution of resources, noting only that it should aim to promote the equality of opportunities for the residents of the different provinces. And third, it called for the coordination of borrowing plans among the different levels of government and for the passage of provincial fiscal responsibility laws.

#### **E. Mr. Llach's Radical Proposal (2000)**

As indicated above, many commentators coincide in deploring the dependence of provincial governments on federal transfers. But the most radical remedy is proposed by Mr. Juan Llach, a former minister who favors a deepening of decentralization through the elimination of the system of transfers and a fundamental reallocation of tax bases between the different

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<sup>13</sup> See Argentina, Senado de la Nación, Ortega (2000).

levels of government.<sup>14</sup> The main element in this proposal is the replacement of the federal VAT and the provincial tax on gross receipts with a provincial tax on final consumption at a sufficiently high rate to ensure that the reform is broadly revenue neutral. The only national taxes that may still be shared would be those subject to special distribution regimes. In fact, if as a result of this reform the national government ended as net revenue loser, the provinces may set aside a small fraction of their taxes to help it. As provinces differ from each other, it would still be necessary to establish a limited system of redistributive, interprovincial transfers.

#### **F. Ministry of the Economy (Summer 2000)**

During the first several months of 2000, staff at the federal ministry of economy worked to develop the principles included in that year's federal fiscal pact (see below), producing a draft document on the "basis for a reform" in July 2000.<sup>15</sup> This document stressed the need for a provincial tax reform, emphasizing the distorting nature of the provincial gross receipts and stamp taxes, but came short of recommending the decentralization of any national tax base to the provinces.

Regarding revenue sharing, the document emphasized the need to make the pool of coparticipated taxes as inclusive as possible, extending it to cover social security contributions and disallowing precoparticipations. (However, under this proposal the coparticipated taxes would continue to exclude earmarked taxes, and not just taxes on foreign trade.) The primary distribution of resources would be based on a simple split between the nation and the provinces reflecting the effective shares these two received in 1999. Over time, as savings in the social security bill at the federal level materialize, they may be shared with the provinces, thus raising the latter's overall share in federal collections. To moderate their cyclical behavior, transfers to the provinces would be calculated on the basis of the average during the previous three years of collections of coparticipated taxes starting in 2002.

The ministry's draft document made two important points that went beyond the statements in the 1999 pact. First, it acknowledged the weakness of regional information systems for the application of objective criteria to the distribution of resources among the provinces (e.g., gross provincial products have not been calculated for many years). In this light, it explicitly noted the convenience of retaining the existing proportions allocated to each province until such statistical basis may be developed. In any event, it reiterated the idea that any new criterion for the interprovincial allocation of resources should be applied only to the increment in such resources. Secondly, this document proposed that provincial and national governments should coordinate their financing plans, and that the provinces should adopt legislation to cap their total indebtedness at 100 percent of their current revenues.

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<sup>14</sup> Llach and Llach (2000).

<sup>15</sup> Argentina, Ministerio de Economía (2000).

## V. A STRATEGY TO ADDRESS FISCAL FEDERALISM PROBLEMS IN ARGENTINA

### A. Some Basic Principles of Fiscal Federalism

Traditionally, the normative theory of intergovernmental relations offers a linear sequence of steps to think about fiscal federalism. First, expenditure responsibilities are assigned, trying to observe the principle of *subsidiarity*, often translated into the prescription that national governments should concern themselves with stabilization and distribution issues while all “allocation branch” functions should be entrusted to subnational governments.<sup>16</sup> Second, and independently, taxes should be assigned with a view to minimizing distortions and taking advantage of economies of scale and scope in administration. This usually means reserving for the national government the mobile tax bases and the more complex taxes. Third and last, the vertical gap that inevitably emerges from the two previous steps should be bridged with transfers from the nation to the regions.

In this sequential scheme there is *some* room to discuss the design of transfers, but their residual nature necessarily limits the scope for variation in this area. Also, this view provides some guidance on the matter of borrowing in the form of two corollaries: (i) it should be expected that some national borrowing will be related to the absorption of the effects of the cycle, whereas little or no cyclical borrowing by the regions may be necessary; and (ii) subnational borrowing could be justified if it were to improve the performance of its “allocation branch” functions.

This simplified version of decentralization, however useful, ignores an important feedback effect. The more dependent a subnational government is on transfers from a higher government, the less clearly it perceives the cost of its spending, and the stronger the incentives it has to seek to augment those transfers for the financing of existing or additional spending. Subnational governments cannot behave responsibly if they do not face the cost of their actions. For decentralization to be effective, those governments need to be able to affect their own revenues at the margin through their own choices—including by changing tax rates.<sup>17</sup> Also, if a subnational government is highly dependent on transfers from a higher level, it is ultimately the revenues collected at that level that will finance the regional debt service, reducing the incentive of the local government to moderate its borrowing.

A subnational government should be capable of raising its own resources to finance new spending and of rewarding local taxpayers if it reduces spending. Borrowing should be allowed only to finance worthwhile capital projects and subjected to tight overall limits, for the experience of many countries shows that markets are most of the time unable to discipline government borrowing.<sup>18</sup> With both these principles in effect, a provincial government’s autonomy and responsibility are strengthened. If one or both of these elements

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<sup>16</sup> See, for example, Oates (1994).

<sup>17</sup> Bird (1999) and McLure (1998).

<sup>18</sup> See Ter-Minassian (1997).

fail (that is, if there are no hard budget constraints), the consequences of regional government decisions are not internalized by local decision makers and taxpayers. It is worth noting that these two prescriptions can, to some extent, be traded off: additional borrowing may be allowed by regional governments capable of repaying loans from their own resources. Loans received by transfer-addicted provinces are ultimately dependent on the sufficiency of transfers and thus on national resources, so borrowing should be especially limited in those cases where regional governments have only minimal capacity to affect their revenues.

### **B. An Incrementalist Approach to the Argentine Problem**

A minimal reform, conceived with the goal of maximizing the likelihood of its approval, could aim at eliminating some of the distortions created by the complexity of the rules currently in place, limiting itself to refining the system of revenue sharing. This moderation in its objectives would make such a reform incapable of helping reduce the main problems of provincial autonomy and responsibility, but it would still contribute to reducing some of the practical problems associated with the present system. This minimal reform would be guided by four principles that should enjoy some consensus among provincial and federal authorities:

- The coparticipation system should include all national taxes and levies. Sometimes, reform advocates seem inclined to keep taxes on external trade outside the revenue-sharing scheme, possibly for legal reasons. The economic rationale for this exception, however, is not clear, while it is evident that this exemption would distort incentives for the setting of these taxes, with an increase in protectionism a likely side effect.
- Transfers to provincial governments should be made more stable and predictable through the operation of a moving average mechanism. To work safely, however, this mechanism may require the federal government to build up a fund to save the excess of shared revenues over actual transfers during upswings. Although the federal government could borrow at the same time it builds up this fund, such provisioning would reduce the risk that it may find itself unable to make the required transfers during a downturn.
- Changes in the secondary distribution of resources of federal origin should be marginal, and should tend to equalize the treatment of similarly endowed provinces.
- A federal agency should be set up to monitor the operation of the system and propose further improvements.

A more difficult, but more productive reform would also try to tackle the two key issues of tax assignment and borrowing ability, and would try to help distribute the burden of the fiscal adjustment between the two main levels of government:

- A SVAT could be gradually introduced, starting with very modest provincial rates, a fully federal administration, and always on the understanding that the base of the

provincial tax should be the same as the base of the federal VAT. Possibly, provinces could introduce a surcharge on federal income tax. These new sources of revenue should not be (fully) offset by possible reductions in the provincial GRTs, and should help increase overall tax collection by the provinces. The design of transfers should be such that provinces are not penalized for exploiting their own tax bases.

- Borrowing limits should be introduced, possibly through the enactment of provincial fiscal responsibility laws following some minimal national standards of prudence, but preferably through the passage of national legislation with applicability to all provincial governments. This legislation should give clear authorization and enforcement powers to the national government. A change of this magnitude, however, may require a constitutional reform.
- The reform should be calibrated so that all governments share to some extent in the adjustment necessitated by the recent decline in revenues. This runs against most proposals discussed so far in Argentina, which usually try to ensure an increase in transfers to the provinces. But this promise seems ever harder to honor.

Although the SVAT would pose an administrative challenge, it is not impossible to implement, especially since all that must be decentralized is the authority to set subnational rates, not the administration of the tax itself. The SVAT, however, seems to have gone out of fashion, in part perhaps for political reasons.

Finally, a riskier, more radical agenda might deepen the revision of tax assignments and modify the nature of the transfer system:

- Some excises could be given to the provincial governments, and amounts equivalent to their current yield should be deducted from the total transfers received by provinces.
- Transfers should be calculated as the difference between the average cost of providing key provincial services and the tax capacity of each province. The federal government should carry out any redistribution policy through mechanisms unrelated to the federal system of intergovernmental transfers.

The last two proposals are hardly viable at present. Local tax administrations may be unable to cope with the excises, some of which are difficult to administer. The radical shift of the transfer system away from a revenue-sharing logic would be very difficult to administer at present due to the paucity of provincial data. These two reforms, therefore, may have to wait for several more years to become viable.

## **VI. A BLUEPRINT FOR REFORM? THE FISCAL PACTS OF 1999, 2000, AND 2002**

Although the main objective of the federal pacts of 1999, 2000 and 2002 was to set temporary rules for the distribution of resources and for certain forms of federal support to

the provinces outside the revenue-sharing system, these pacts also committed the provincial and national governments to negotiate a new coparticipations scheme.<sup>19</sup> In fact, the pacts established broad principles to guide the design of a new coparticipations law. The main principles included in the 1999 and 2000 pacts are the following:

- (1) All federal taxes, with the sole exception of those on foreign trade, should be included in a single mass of shared resources, avoiding precoparticipations and exclusions.
- (2) Provincial governments should have more influence over the primary distribution of resources.
- (3) The new coparticipations scheme should have smoothing mechanisms, including the calculation of transfers on the basis of multiannual averages of shared resources.
- (4) The federal government should cover the deficits of the extant provincial social security systems, which must in their turn be harmonized with the national system. (This federal commitment is already in effect; talks with two provincial governments started early in 2001, but were interrupted due to the present difficulties).
- (5) Any savings in federal spending arising from a reduction in social security spending should be shared with the provincial governments.
- (6) The reform should not reduce transfers to any province.
- (7) Any new criteria for distributing resources among the provinces should apply only to the increment in the total pool of resources sent to the provinces.
- (8) Provinces should adopt fiscal responsibility laws to control their spending, deficit, and debt. But these should remain areas of provincial autonomy.
- (9) Provinces should strive to harmonize their tax systems and to cooperate on matters of tax administration with each other and with the federal government.
- (10) The federal fiscal agency called for in the constitution should be set up.

After the large changes in the main political and economic policy parameters that took place during end-2001 and early 2002, it was unclear whether these principles remained a focus of consensus. In fact, the 2002 pact contained mostly the same ideas, albeit expressed in more tentative or broader terms. However, being the product of negotiation between the provinces and the federal government, they merit consideration. The implementation of many of these guidelines would result in some degree of improvement over the current system. The main exceptions to this assessment are points 2 and 6, which threaten to reinforce a climate of

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<sup>19</sup> Law 25.235 of December 30, 1999, Law 25.400 of December 7, 2000, and Law 25,570 of April 10, 2002.

fiscal imprudence in the provinces. Point 4, yet another instance of the central government buying the provincial governments' support for a national structural reform, could also end up involving significant extra spending at the general government level. Points 1 and 8 are insufficiently ambitious, the former by failing to include *all* taxes in any new revenue-sharing scheme and the latter by failing to call for a national standard of fiscal prudence for the provincial governments. But the main weakness of an action plan based on the points enumerated above is that it would abstain from imposing new general limits on subnational government borrowing and take the current tax assignment as a given. A reform along the lines suggested in the *pactos*, therefore, might be positive, but it would most likely fail to promote fiscal responsibility at the provincial level.

## VII. CONCLUSIONS

The system of intergovernmental fiscal relations in Argentina is afflicted by a long list of problems. This system has facilitated irresponsible fiscal behavior among the provinces, and has acted as an obstacle to structural reforms. Despite a proliferation of reform proposals, the reform of the system of intergovernmental relations has been impeded for years by a stalemate between the national government and the provinces, especially Buenos Aires. The present economic and political crisis *may* present an opportunity to finally reform this system if these political forces can acknowledge the importance of federal arrangements for the restoration of public credit and credibility.

At a minimum, a modest reform based on agreements reached in December 2000 may aim simply to rid the system of some of its distortions. Such a minimal reform would attempt the simplification of the vertical dimension of the revenue-sharing system and should attempt to consolidate a lower floor for coparticipation transfers consistent with the reduction in tax collections that has taken place since late 2000. Any problems associated with the secondary distribution are likely not worth addressing, and in any case it would be politically difficult to do so. While useful and viable, this type of reform would not begin to attack the origins of fiscal irresponsibility at the provincial level: the relationship between a province's spending and revenue decisions.

The long-term hardening of provincial budget constraints requires a revision of some aspects of tax assignment and the imposition of stricter borrowing limits—all the more strict if provinces remain significantly dependent on transfers from the nation. The enactment of provincial fiscal responsibility laws meeting national standards would be a significant first step in this direction, which could usefully be accompanied by a strengthening of federal authority to restrict subnational borrowing. As a way to improve provincial governments' incentive structure, certain transfers could be made contingent on the observance of the principles established by the provincial fiscal responsibility laws. An ambitious reform plan would also involve the devolution of some tax powers to the provinces through the replacement of the gross receipts taxes with a shared (compensating) VAT with a uniform base and administered by the federal government. Provincial governments should also revise cadastral values to strengthen property taxes that are currently underutilized and consider

introducing provincial surcharges on federal income taxes. For the future, work could begin to prepare for the adoption of an incentive-compatible transfer system.

A hazard facing a reformer, however, is losing sight of the need to preserve the ability of the federal government to conduct macroeconomic policy. This policy includes not only the simple accommodation of the automatic stabilizers but also the introduction of tax policy measures to preserve public creditworthiness without thereby inducing an increase, immediately or with a lag, in additional spending resources for the provinces. How exactly this might be achieved while preserving some measure of stability in transfers to the provinces and some degree of solidarity between government levels during periods of consolidation is not clear. Any automatic, simple mechanism (such as a pluriannual moving average) would require the sacrifice of at least one of these goals; but extensive reliance on discretion or on exceedingly complex rules may prove just as disadvantageous, encouraging rent seeking and reducing stability. The proposals presented in this paper do not fully address these concerns, and it will be essential to continue searching for alternative formulas.

Table 1. Argentina: Various Proposals for a New System of Intergovernmental Fiscal Relations

|                                      | Federal Pact<br>December 2000  | Min. of Economy<br>Summer-Fall 2000  | Federal Covenant<br>December 1999   | C. Menem<br>Government 1999   | Senator R. Ortega<br>1999  | Juan Llach<br>2000   | R. López Murphy<br>1998  | J. Remes Lenicov (BsAs)<br>1997  |
|--------------------------------------|--|--|---|---|--|--|--|--|
| <b>Expenditure assignment</b>        |  |  |   | Preserves status quo, contemplates increased provincial social programs   |  | Deepen decentralization  | Room to continue decentralization, especially to municipalities                                      | Continue decentralization. Federal social programs can go to provinces.  |
| <b>Tax assignment and tax reform</b> |  | Vague pronouncements against provincial turnover tax   |   | Replace provincial turnover tax with surtax on VAT; implement "SVAT," gradually cutting basic (federal) rate      | Replace provincial turnover tax with new provincial consumption tax. Tax harmonization across government levels                      | Eliminate VAT and introduce major new tax on final sales, given to provinces                       | In favor of "fiscal correspondence," no specific proposal, but favors decentralization of tax powers | "Fiscal correspondence." More taxes to provinces: excises, surtax on PIT, strengthen provincial turnover tax (and reduce VAT). |
| <b>Shared taxes</b>                  | All federal taxes except those on foreign trade and those earmarked, but including social security contributions, all in a single mass | All federal taxes except those on foreign trade but including social security contributions in a single mass                                   |   | All federal taxes except those on foreign trade and those temporarily earmarked; all in a single mass             | Eliminate current system of national transfers. No national taxes would be shared, except maybe for taxes subject to special regimes |  |  | A single, all-inclusive mass of resources  |
| <b>Primary distribution</b>          | Take as starting point existing shares in 1999   | Provinces should have more control over primary distribution   |   | Reflecting status quo as of 1998: Federal government 61.2 percent; provinces 38.8 percent                         | If loss of VAT too large, provinces would send to nation part of the new tax on final sales  |  | Transfers should be structured to promote development of own taxes                                   | Unconditional transfers. Automatic transfers. Fixed percentages. Stable shares.  |
| <b>Other transfers</b>               | Allows certain budget transfers to continue (e.g., tobacco fund)   |  | Federally Funded Human Development Fund; conditioned transfers to provinces   | ATN (national treasury contributions) not decided by Min. Interior, but Federal Fiscal Agency                     |  |  |  |  |
| <b>Stabilization mechanism</b>       | Transfers equal moving average of share in mass of resources collected in previous years   | Three-year moving average mechanism starting in 2002; anti-cyclical fund; difference current tax and moving average                            | Stabilization Fund with shared resources; introduces three-year moving average in 2001  | Stabilization Fund with shared resources; calls for actual distributions to follow a two-year moving average      |  |  | Transfers need to be stable, but no specific proposal  | None; points to problems: Who manages assets? Disregards regional cycles.  |
| <b>Social security issues</b>        | Savings from reduction in social security deficit shared with provinces  | Social security financed from general federal revenue. Nationalize remaining provincial pensions   | Federal government will cover deficits of remaining provincial pension schemes, which will be harmonized                        | Social security financed from general federal revenue. Nationalize remaining provincial pensions                  | Consolidate all remaining provincial social security schemes into the national system.   |  |  | As social security unwinds, federal needs fall, freeing resources for provinces  |
| <b>Foreseeable trends</b>            | Coordination of borrowing policies; overall limit on provincial debt (100 percent of current revenues)                                 | Gradually rising provincial share as pension reform savings materialize  | Provinces to adopt Fiscal Responsibility Laws like the federal one to limit deficit spending. More provincial control over debt | Gradually rising provincial share as pension reform savings materialize   | Coordination of borrowing policies; provinces to pass Fiscal Responsibility Laws like the federal one                                |  |  | Funds to provinces should rise, since their services grow, while federal decline   |
| <b>Debt and deficit limits</b>       | Any new criteria should be applicable only to increases in shared revenues   | New criteria only on additional resources. Criteria should be agreed among provinces; statistical base for "objective" criteria does not exist | Tax harmonization and administration cooperation among provinces. Create Federal Fiscal Agency                                  | Devolutive (contributing) Equalizing ("Canadian") Geographic (redistributive) Compensatory (no provincial losses) | No details, just listing of desirable properties (promote equality of opportunities, etc.)   | System of inter-province transfers administered by national government with a redistributive slant | Strict criteria limiting provincial debt, to prevent bailouts  | Debt only for investment, only external borrowing. Provinces should commit to contain spending.                                |
| <b>Secondary distribution</b>        | Provinces should be agreeable in shared revenues   | Tax harmonization and administration cooperation among provinces. Create Federal Fiscal Agency   | Tax harmonization and administration cooperation among provinces. Create Federal Fiscal Agency                                  | Federal Fiscal Agency with a technical committee  | Strengthen existing Federal Fiscal Commission; increased transparency; integrate administration                                      |  |  | Should tend to equalize access to basic education, safety, and health.   |
| <b>Administrative issues, other</b>  | Create Federal Fiscal Agency   | Tax harmonization and administration cooperation among provinces. Create Federal Fiscal Agency   | Tax harmonization and administration cooperation among provinces. Create Federal Fiscal Agency                                  | Federal Fiscal Agency with a technical committee  | Strengthen existing Federal Fiscal Commission; increased transparency; integrate administration                                      |  |  | Improve management skills at provincial level.   |

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