Nation-Provinces Fiscal Relationship in Argentina

In general, around the world the distribution of power and function among the levels of government is established by the Constitution. In Argentina, article 75 section 2 of the Constitution defines the tax powers of the federal Government and the provinces and establishes that indirect taxes are concurrent among both levels, except for import and export duties which are collected by the federal government (Article 4). Direct taxes are collected by the provinces; however, the federal government is entitled to use the revenues from these taxes for a limited period of time provided that the State's defense, Security and well being so require.

From mid-nineteenth century to 1890, tax revenue sources were clearly defined; the federal government was basically entitled to the revenues from foreign trade, while the provinces collected taxes on the production and consumption of specific goods. Subsequently, between 1890 and 1935, as several federal consumption taxes were created, which overlapped with the provincial ones, a competition for tax revenues ensued. As a result, since each province's main source of revenue is their own self-generated revenues from tax collections, the provinces cut their spending according to their budget constraints. This meant, given the large economic differences, a significant inequality in the availability of provincial public goods.

Article 67, section 8 of the Constitution of 1853 set forth the only transfer mechanism, whereby the Congress agrees on the subsidies to provinces which cannot meet their regular expenses. Currently, these transfers are referred to as Federal Treasury Funds (ATN). This instrument was established to consolidate the provinces' federal autonomy system and certain fiscal equality, however, the quantitative impact was not very significant.

The tax-sharing system dates back to 1935. It was created in response to the crisis in 1930, since the federal government's revenues were highly correlated to customs duties. Against this context, the tax system was reorganized to achieve: fairness on tax burdens across the country, the best performance of the overall tax system, improvement in tax collection, reduction in the burden excess taxes, inter-provincial trade barrier avoidance and the correction of fiscal disparities among provinces.

The first tax-sharing system was created pursuant to laws 12139, 12143 and 12147 which organized the existing internal taxes and enabled the provinces to collect on two recently created taxes (sales and income-tax). Simultaneously, two different distribution mechanisms were provided. On the one hand, in answer to the concurrent power for the new taxes (sales and income-tax), laws 12.143 and 12.147 were created to provide a compensation mechanism which established a primary distribution of 82.5% for the federal

government and 17.5% for the provinces. The secondary distribution was created on the basis of four parameters: population, provincial expenditures budgeted for 1934, own revenues collected by the provinces and the tax revenue to be distributed to each province. On the other hand, the distribution of the internal taxes was established to repeal a complex mechanism of tax collection based on consumption and production of the taxed products.

In the forties and the fifties, the tax co-participation laws 12.956 in 1946 and 14.788 in 1959 and other fiscal laws regulated the federal tax co-participation regime until 1973. It defined the incorporation of new taxes to the co-participation revenues, the provinces' increase in the primary distribution of resources and the three different allocation mechanisms in tax distribution. The main goal of these mechanisms was devolution; however, the most important mechanism in terms of tax revenue, established by law 12.956, introduced a 2% distribution in inverse proportion to the population of each province. For the first time, it included an explicit redistribution mechanism, apart from what the population method implied. Afterwards, law 14.788 established only three parameters: population, provincial expenditure and own revenues. It also incorporated a new parameter: equal shares. Therefore, as time went by, the weight of the redistribution increased.

Since 1973, the federal tax co-participation regime was regulated by one single law 20.221, which had four main features. Firstly, it included all of the federal taxes to be distributed, except for the taxes on foreign trade and those allocated for specific purposes (mainly on oil and energy). Secondly, regarding the primary distribution mechanism, the same rate was established for the federal government and the provinces, 48.5%, the highest provincial destination since the tax-sharing system was created. Thirdly, a Regional Development Found was created, financed by the remaining 3% in order to invest in public infrastructure. Fourth, the coefficients of the secondary distribution resulted from the combination of three parameters: 65% of revenues were distributed according to population, according to the relationship between public services and the number of inhabitants; 25% to the development gap between the regions, with a different treatment to low-income provinces to provide public goods towards equal treatment to all their inhabitants. Finally, the remaining 10% was distributed according to the special situation of the provinces with low density population regarding the provision of their public services. Consequently, the scheme is significant for two reasons: it constituted a unique tax sharing system and it set objective coefficients for the secondary distribution.

However, it was under this law when the first transgressions to the regime occurred; centralized decisions generated fiscal intra-provincial externalities with the federal government. In the late seventies, the federal government unilaterally conducted a decentralized fiscal process and transferred hospitals and elementary schools to the provinces without the

corresponding funds. Secondly, in 1980 a portion of the value added tax was allocated to the social security system, introducing the pre-coparticipation scheme, as it reduced the payroll burden. These federal policies brought about financial imbalances in the provinces which were financed with ATNs and completely disrupted the regime. The conflict between provinces was so important that when the law 20221 came out of effect in 1984, it was impossible to establish a new regime for three years.

By the end of 1987, law 23 548 set forth a temporary tax revenue sharing regime between the federal government and the provinces, which is currently in effect, although it had several modifications. This new law meant significant changes to the primary and secondary revenue distribution. Firstly, the share of the provinces in the fund transfers increased to 56.66% in the primary distribution, recognizing the financial impact of the transferred services in the late seventies. As for the secondary distribution, the main difference with the law 20.221 is the elimination of any explicit parameters to establish distribution coefficients. The coefficients of the law 23.548 are based on the distributions made in 1985-1987. At which time there was no governing law and the transfers were made according to each province's needs and the bargaining power. However, the percentage set forth by the old law 20221 was considered. Secondly, a 1% limit to the ATN was introduced to the tax sharing revenues, as a mechanism to deal with emergencies and a limit to avoid the excesses of past experiences. Finally, it established that the amount to be distributed to the provinces could not be less than 34% of the federal tax collections, whether or not they are co-participable.

Again, in the early nineties, secondary education and hospitals services were transferred to the provinces, without any financing compensation and 15% of the tax sharing revenues was allocated to finance the pension system[1].

In 1994 the federal tax co-participation regime was granted constitutional status, establishing general principles[2] and the obligation to adopt a new tax sharing law before December 31, 1996[3]. Despite the constitutional mandate, a regulatory law could not be approved, in part, because of the difficulties inherent to the system.

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[1] This results from a series of budget cuts which meant, under the new capitalization regime, that personal contributions were no longer perceived by the federal government and were, in turn, to be allocated to the Retirement and pension Fund Administrators (AFJP). As a result, pension obligations remained to be canceled. Also the provincial pension funds were transferred to the federal system, eleven out of the twenty-four provinces signed the agreement.

[2] In article 75 section 2 the third paragraph established: The distribution between the federal government, the provinces, the City of Buenos Aires and among them, will be made in direct correlation to their powers, services and functions under these Distribution Criteria; fairness, solidarity and priority over equal degree of development, quality of life and equal opportunities, throughout the federal territory.

[3] Point Six of Temporary Provisions.

In the last decade, federal non-coparticipable taxes have been re-implemented and certain provincial expenditures have been established, for instance through the federal Education law and wage policies.

In the late seventies, the Federal government collected and spent a similar proportion of the total. However the greatest revenue concentration and the expenditure decentralization brought about a strong pressure on the distribution systems. This is one of the reasons for the intra-province conflicts that ensued in the last decades.

A characteristic feature of the relationship between the federal government and the provinces during the law 23.548 was the various agreements or arrangements designed to deal with several difficulties: pension system financing and debt refinancing. It required agreements between the executive powers which modified the revenue sharing established by the revenue sharing law.

As a result of all this, there was a change from the current transfer system to tax-sharing scheme. What should be a single coefficient to calculate all co-participable revenues has become a complex matrix of tax co-participation to destinations through a number of fixed sums and percentages reflecting the distribution struggle in our public accounts.

As for the share of Buenos Aires in the transfer distribution, the 1973 reform significantly modified each province's share because of the redistributive effect of the mechanism. This resulted in the Province of Buenos Aires yielding five percentage points.

This a time for the system to mature, to gain transparency, for the goals to be more objective and for the regime coverage, calculation and for the sources of information to be accurately described. In 1983, due to the modifications made in the last decade, Buenos Aires received 2 point less than with the law 20.221. At the end of 1984, the legal basic regime expired and all the funds transferred to provinces became National Treasury Funds (ATN), which resulted in the Province of Buenos Aires losing ten percentage points in the Tax Sharing Regime. Law 23.548 helped recover percentage points. However, this recovery remains far below the amount to which the Province is entitled under law 20.221. Finally, the reforms conducted in the last two decades modified once again the tax sharing regime, Buenos Aires, in turn, received two percentage points as compared with the law 23.548 and eight percentage points less as compared with the law 20.221.

Combined effect of the Tax Sharing Regimes

In %

	1972	Law 20.221 1973	Law 20.221 and Amendments 1983	ATN 1985-1987	Law 23.548 1988	Law 23.548 and Amendments 2010
Buenos Aires' share in the transfers to the provinces	32.8	28.0	26.3	17.5	21.7	19.7