



Turning point for federalism in Argentina?

Many hope that new fiscal rules will encourage greater provincial self-reliance and responsibility.

THEME III: THE ASSIGNMENT OF RESPONSIBILITIES AND FISCAL FEDERALISM

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Argentina's last constitutional amendment mandated, for the first time, that a covenant-law (*ley-convenio*) should set up – not later than 31 December 1996 – a revenue sharing arrangement for the distribution of a number of direct and indirect taxes levied by the central government.

The Congress, on the basis of agreements between the national government and the provinces, would enact this covenant-law. The constitutional deadline has not been met. But the system the amendment would create is new for the country and would entail a significant change in the way power is shared between levels of government.

The current Argentine revenue sharing system can be traced back to 1935, when it was first used for existing excise taxes and later for the newly created Sales Tax and Income Tax.

In the beginning the arrangement purposely tried to devolve revenues to the provinces and keep some relation with the tax they were likely to collect in their territories. But over time, the system evolved to one in which only 'equity' considerations mattered for revenue distribution among the provinces.

This revenue sharing system and its evolution had an important impact upon both fiscal and political federalism in Argentina. Now, after more than 70 years of use, many Argentines are very critical of it

Ceded powers and too much "equity"

By delegating to the central government the collection of constitutionally assigned taxes (i.e. taxes on income) or taxes upon which there were concurrent responsibilities (indirect taxes such as Sales Tax and later the VAT) what provinces in fact did was to yield an

important part of their taxing power. They did this by moving tax bases to the national government's sphere. Proof of this is the jurisdictional structure of the overall tax revenue yield, where more than 80% is collected by the central government, while the provincial and municipal contributions amount to 15% and 4% respectively.

And so, in spite of constitutionally being a three-tier federation, with, in theory, all orders of government having ample tax powers and spending functions, Argentina behaves as a 'formal' rather than a 'true' federation.

The evolution of the revenue sharing arrangement and the fact of "tax collection concentration" not only weaken the federal fiscal structure, they put at stake the very notion of an institutionally and politically federal set-up.

By relying exclusively on 'equity' considerations, the existing revenue sharing system, which is to be replaced according to the 1994 Constitution, stands in part as the main obstacle to convincing the provinces to further their own fiscal efforts. The more fiscally efficient provinces resent their proportionately low share of the revenue mass and argue for a larger take.

The less fiscally efficient provinces have no incentive to enlarge their own tax sources if obtaining revenue transfers from the central government is both easier and politically less costly than levying their own taxes.

The reason the 'equity' principle, which aims to reduce financial inequality among the provinces (the so called "horizontal fiscal imbalances") did not serve its purpose – and produced, in fact, a "reverse devolution" of power to the national government – can be found in the expenditure performance of the provincial governments.

A sustained decentralization of expenditures – by delegation rather than by devolution – has occurred in Argentina. This is true for education (except for universities) and welfare and, to a minor extent, health services. For instance, provincial share of spending in education and welfare reaches almost 70% and 65% respectively, while provincial health spending makes up more than 40% of the total.

Fiscal and spending policies are organized in completely opposite ways. On the tax side, they are highly centralized; on the spending, very decentralized. Only five of the provinces' own fiscal yields range between 40% and 50% of total revenues. The others are much lower. The result is that most provinces cannot properly be considered fiscally autonomous. (Essential to the notion of fiscal autonomy is that orders of government should aim at enlarging the amount of spending actually covered by their own resources.)

Fails to foster equality

'Equity' considerations alone have not succeeded in reducing financial inequality. Fiscally weaker provinces remain backward despite the statistical evidence that - for decades - their share per capita of revenues received from the national government doubled, tripled and, in some cases, amounted to four times that of more developed provinces.

The hard fact of the matter is that a revenue sharing arrangement that does not reward 'fiscal effort' on the part of provinces will necessarily run counter to the goals of higher provincial accountability and sounder provincial spending policies. This is despite the fact that the arrangement also makes it possible for several provinces to rely exclusively on national grants to meet their budgetary needs.

It is not by chance that poorer jurisdictions, benefiting from more national fiscal revenue per capita, exhibit both the worst performance in terms of quality of public goods and the highest indices of public employment per thousand of inhabitants.

The unwanted consequences of its application of the 70-year-old revenue sharing system undermine the possibility of a sound fiscal federalism in Argentina. They also work against *political* federalism by creating a vicious circle whereby provinces invest great energy in pushing for more of the nation's resources (either from revenue sharing or from transfers), which they can only get after protracted negotiations. This in turn reinforces provinces' fiscal and political dependence on the central government.

Could the reform change the pattern?

If Argentina were to put the revenue-sharing constitutional amendment into practice, would it modify not only the distribution of power between government levels but also induce provinces to meet higher accountability and governance standards?

The answer demands a thorough consideration of the 1994 constitutional amendment.

Although it only refers to revenue sharing systems instead of perhaps a more appropriate reference to all-inclusive interjurisdictional fiscal arrangements, for the first time it gives constitutional status to the fiscal relations between government levels.

Article 75, which deals with this matter, specifically indicates that Congress should enact "a covenant-law...setting up revenue sharing arrangements and guaranteeing that fiscal remittances be made automatically to the provinces". This "automatic" feature would bring about one of the most important advances to the existing system. One of the most serious problems provincial treasuries deal with is the financial strain derived from the poor timing between revenue and spending schedules.

Article 75 states as well that "...the distribution of revenues between the

national government and the provinces (the so called primary distribution) and among provinces (secondary distribution) will be carried out in direct relation to their competences, services and functions, observing objective criteria for delivering revenue." This would apply a sound fiscal principle establishing the need for a correspondence between revenues and spending at each government level.

It also suggests that the arrangement to come will have to introduce criteria other than the single 'equity' objective for revenue distribution and that these criteria would include provinces' own fiscal effort and budgetary performance.

Equity would remain an important consideration. It would be placed in a more far-reaching context of the need of the country's socio-economic sustainability. The amendment states that resource distribution "...will also show solidarity and will aim at an equal development level, quality of life and opportunities throughout the national territory".

In relation to the strengthening of fiscal federalism, one of the most important changes may take place in the field of the transfer of services and functions to provinces.

Many transferred services (i.e. education) occurred under the form of delegation for which specific funds, fed from the national budget by the central government, were set up to cater for the financial requirements of the service passed on to provinces. This in turn created a great deal of conflict with provinces in which teachers' wages were superior to the transferred funds for teachers' wages, as the central government - in assigning the funds - only recognized a certain amount for teachers' pay.

In the future this would not happen. The amendment requires that "no transfer of competence, service or function will take place without the respective resource reallocation, approved by a law of Congress and a law enacted by the Legislature of the concerned province". In addition, it states that "...the existing distribution of competences, services and

functions cannot be modified without the consent of the concerned province".

An opportunity for new ideas

The constitutional amendment also opens the debate on a thorough revision of fiscal relations beyond the single framework of a new revenue sharing arrangement. In this regard, many Argentines are saying that this is an opportunity to introduce new and efficiency-oriented mechanisms.

Many academic papers already suggest the convenience of devising mixed arrangements combining revenue sharing systems and a scheme similar to the Canadian Equalization System (in which provinces are subsidized for the amount their per capita tax yield falls short of an average provincial tax yield estimated on a national basis), or the Australian one, in which the subsidy is aimed at permitting states to supply a standard basket of public goods.

The main point remains the possibility of devising an arrangement whose instruments point to more rules-based fiscal and political relationships between the central government and the provinces. As well, it leads to the devolution of fiscal responsibility to constituent unit governments – which, in turn, will enhance their accountability.

Should this prove to be successful, not only would the distribution of fiscal power between levels of government be more transparent but it would also permit provinces to regain part of what they have given up.

In addition, the provinces would gain in the future distribution of political power, as negotiations with the central government would not be distorted by the need to grasp additional fiscal resources.

The Congress is now in the middle of the legislative process, and all options are at hand. It is clear that the "turning point", mentioned in the title, means that Argentina faces now, as never before, the challenge of placing itself in the select group of 'real' federal countries. ☺