



# Argentina: From “funny money” to fiscal responsibility

BY ALEJANDRO ARLIA

**In** Argentina, the past decade was marked by recurring deficits and a resulting increase in indebtedness at all levels of government. Progressively the country became submerged in a deep economic recession that lasted almost four years, from 1998 to 2001.

The continued contraction of economic activity meant a huge reduction in the levels of taxes collected. The result was that the national and some provincial governments resorted to alternative tools of financing. A whole series of quasi-currencies were issued. These took the form of credit notes for local circulation, whose redeemable value varied significantly among the different jurisdictions. As a result, 11 quasi-currencies were circulating through the nation’s territory, many of which suffered a high rate of depreciation (see box).

This was a drastic strategy. But the governments thought it necessary in order to give a measure of liquidity to a highly depressed economy and to allow them to continue at least a minimum level of public spending.

The worst point came at the end of 2001, triggering the greatest crisis in Argentine history. The massive deterioration of the economic, political and social fabric meant the break-up of the institutional order, and thus the breaching of most social contracts. In this framework, the national government and the provincial governments alike entered into suspension of payments.

## Orderly financing

The year 2002 became the year to establish order and new starting points. The Argentine public sector began a massive process of reordering its finances, and by means of different programs developed in 2002 and 2003, the country achieved monetary reunification, refinancing of the municipal, provincial and national debt, and convergence towards financial equilibrium.



*The city of Buenos Aires issued its own currency, as did many provinces.*

The 24 subnational jurisdictions began by implementing “orderly financing programs.” Through these programs, the national government grants financial assistance to the 23 provinces and the autonomous city of Buenos Aires to address their financial deficits and their repayments of capital. The latter entities commit themselves to a series of fiscal objectives that are designed to lead them to equilibrium.

As for the accounts of the national government, their progress towards equilibrium was not regulated by particular programs or laws. It was not even framed by a new agreement with the International Monetary Fund.

In both cases - the national government and the 24 subnational jurisdictions - the quest for balance was the result of a strong political conviction about the importance of a return to fiscal health and of the national government’s re-establishing its role as the single monetary authority and the main body responsible for fiscal policy.

As a result, after more than ten years of deficits, the national government and the 24 jurisdictions achieved financial balance in the 2003 fiscal year, and went on to

obtain a surplus in the year 2004. This underscored the need for establishing harmonized criteria and coordinated actions among all levels of government in order to consolidate the fiscal recovery.

## Sound management and transparency

The progress of these transformations made possible the Fiscal Responsibility Act of August 2004. This legislation institutionalizes the fiscal rules agreed to in the framework of the “orderly financing programs.”

The Act establishes the adoption of harmonized fiscal rules that ensure orderly management in the use of resources, and favour transparency in public administration. This facilitates

citizen control over public operations and predictability of fiscal policy performance.

The most relevant provisions of the Act are as follows:

- **Application of uniform budgetary categories.** These permit the consolidation of public accounts and comparisons of fiscal information between the nation and the provinces and among the latter.

## Quasi-currencies

(October 2002 - in millions of pesos. The amounts represent the value of each unit of quasi-currency for each Argentine peso, at the October 2002 rate.)

Jurisdiction	Amount Issued	Market Value *
Buenos Aires	2,793	0.95
Cordoba	876	0.84 - 0.88
Corrientes	250	0.40
Catamarca	40	1.00
Chaco	100	0.68 - 0.74
Entre Rios	260	0.70
Formosa	100	0.66 - 0.76
La Rioja	27	1.00
Mendoza	120	0.90
Tucuman	173	0.85 - 0.90
Subtotal	4,739	
National Government	3,300	
Total	8,039	

Alejandro Arlia is the President of Centre for Federal Studies (CEFED) in Buenos Aires.

- **Presentation of the projected fiscal framework annually by the national government for the next fiscal year**, so that the provincial administrations have the necessary information to develop their budgetary projections.
- **Regular and harmonized publication of fiscal information.** The two levels of government must publish their budgets, fiscal operations, information on the public debt and the level of activity of the public sector.
- **Rules for the treatment of public income and expenditures in the stages of formulation and implementation of the budget.** In particular, this limits the expansion of primary spending to the nominal growth of the Gross Domestic Product. It demands a primary surplus from jurisdictions whose debt servicing exceeds 15 per cent of their current revenues (net after transfers to municipalities.)
- **Establishment of anti-cyclical funds.** All levels of government must create these funds so as to guarantee the continuity of their operations in critical moments, without falling into fiscal imbalance.
- **Credit sustainability.** The Act promotes coordination measures to assure that basic services are maintained. It regulates the access by provinces to new credit, and promotes strategies of recovery for those that are highly indebted, setting as a limit the assignment of 15 per cent of current revenues (net after transfers to municipalities) for debt servicing.
- **Creation of the "Federal Council for Fiscal Responsibility."** This operates as the means for applying the provisions of the Fiscal Responsibility Act. It is composed of the ministers of economy and/or finance of the national and provincial governments and of the autonomous city of Buenos Aires.

The national government invited the provinces and the autonomous city of Buenos Aires to voluntarily adhere to the Act. At the same time, the provinces broadened the scope of application of this regulatory framework through the participation - also voluntary - of their respective municipalities.

Currently, 17 provinces out of 24 adhered the Act: Buenos Aires, Catamarca, Corrientes, Chaco, Chubut, Entre Ríos, Formosa, Jujuy, La Rioja, Mendoza, Misiones, Río Negro, San Juan, Santa Cruz, Santa Fe, Santiago del Estero y Tucumán.

### Questions remain

While the need to consolidate the recovery of public finances at the different levels of government is indisputable, there are some controversial aspects of the Act.

One of them is the direct correlation between the increase in GDP and the performance of current primary spending. The linking of the potential increase of current primary spending to the growth of the Gross Domestic Product has as its implicit logic the need to avoid diversions of funds that could lead to a new fiscal crisis, in the face of increases in irreducible costs at some unfavourable moment of the economic cycle. However, the priority given to fiscal discipline cannot be divorced from the socioeconomic circumstances of the country nor from the commonly accepted basic rules of economic performance.

When the Act was approved in August 2004, some sectors were worried by the low proportion of GDP represented by

public spending during the 2002 and 2003 fiscal years. It was valid to argue that freezing spending at these levels would not allow a response to society's growing demand for public benefits, basically those linked to social services and assistance to the most disadvantaged sectors. But the economic growth of 2004, and therefore the increase in fiscal resources, allowed the public sector to increase its expenditures to reach 38 per cent of GDP. Even if this ratio is low in comparison to international levels (50 per cent), it means a higher starting point than that of previous years.

The question of anti-cyclical funds was also controversial. Even though everyone agreed with the need for these funds, some objected to the omission of uniform criteria in the Act, and to the lack of quantitative objectives for meeting uniform criteria. This "omission" by those who drafted the Act was based on the belief that it would be not possible to oblige any provincial administration to keep a percentage of its resources to address future adverse situations, given the current enormous pressures on their levels of spending.

The crisis of 2001 had a profound effect on the "fiscal culture" of the authorities at the different levels of government. The current reality of fiscal surplus is proof of this culture change. In that light we can be sure that each administration will know how much it will need in its anti-cyclical reserve.

### The art of the possible

The results of the arrangements made for the provincial debt were satisfactory. Achieving the 15 per cent relationship between services and current net revenues is not always possible. In the year 2005 at least eight jurisdictions will not be able to meet the objective. In any case, the regulatory framework foresees scenarios in which the national government and the provinces will seek alternative mechanisms in order to reach such an objective.

In this sense, the year 2005 can be seen as a very good opportunity for achieving credit sustainability for some jurisdictions that, due to different circumstances, did not achieve the same financial recovery as the rest of the provinces. That is to say, given favourable economic conditions, and with the resolution of the structural problems of provincial and national indebtedness, fiscal year 2005 offers the opportunity to attend to pressing needs of the people.

With regard to the Federal Council for Fiscal Responsibility, there were very important advances made in the first months of the year. In January 2005, all its members met for the first time, and set up monthly meetings in which they worked on the operational rules of the Council. As a result, in the coming days the National Executive will approve the Council's Regulatory Decree, which will permit its regular functioning beginning in the month of May.

To date it is fair to say that the Fiscal Responsibility Act has served to consolidate a number of fiscal rules (control of public spending, preservation of budgetary balance, limits on indebtedness, monetary unification) and to deal with the financial exposure of different levels of government. Based on the successful experience of fiscal reordering in the three-year period 2002-2004, Argentines will be able to look back on the past year as one of continued progress toward sound public administration and financial stability. (6)