

THEORY AND PRACTICE OF ECONOMIC FEDERALISM

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SUMMARY

The theory of economic federalism should especially research two aspects: the States optimum dimension and the general exchange relationships between the territorial corporations, certain costs and benefits amongst them.

A series of matters are analyzed which have to do with the state federalism formation: the economic and political approaches of State functions, the criteria of regional distribution of the State functions, and those state activity development "laws".

Also the balance between central and non central forces, and the loss of welfare, that can take place due to their misinterpretation. Decentralization not only of the resources, but also of the expenses and services; we will make special reference to the German State which we have expressly studied.

Then a brief analysis of the Argentinean public sector is done, and of tax incidence on people, with special reference to the social class, to which the individual belongs, whose burden goes from 20% for the indigent poor, going up to a 51.8 for the average manager and less than 40% for the upper class.

The 2006 state budget is studied, where the existence of centralized organisms and social security institutes is observed which do not consolidate in the national public sector, due to different juridical and institutional reasons, that makes the public expenditure difficult to control due to its quantitative significance that allows discrecionalidad in its use.

Finally, an "Argentine State Reformation Proposal", is formalized, if it is, that one really wants to live in a federal country, with its supposed advantages.

KEY WORDS: Economy Federalism; Regional Distribution; State Failures; Scarcity; Integrality

INTRODUCTION

Is Argentina a federal country? According to article 1 of the National Constitution "The Argentine Nation adopts for its government the federal representative form", but analyzing the structure of the Nation's consolidated resources and expenditures, 24 Provinces and 2,150 Municipalities show a noticeable centralized bias, centralist, and unitarian.

Also, article 75, incise 2, of the National Constitution establishes that an agreement law will institute a co-partnership régime and the regulation of the Federal Fiscal Organ before the end of 1996. Nearly ten years have gone by, and its fulfillment has been a mere declamation. A régime like the present one, in the National Constitution is practically impossible, if previously we do not try to apprehend what we understand as economic federalism, which is more embracing than the idea of fiscal federalism, and which will be the purpose of this paper.

1 The economics theory and federalism policy

The economics federalism theory should specially research two aspects:

a) The States' optimum dimension according to Aristotle's sense (332 BC) whose opinion was that if a State can make men happy, it must be big, but nobody defines the meaning of a big or small State.

b) The general exchange relationships between the territorial corporations from the costs and, benefits, including intangible magnitudes in the analysis. Among these are those expressions of financial federalism and fiscal equivalence that are unilaterally and closely, the finance economic concepts or public finances or of fiscal federalism.

In fact the principle of economic and political integrality should be studied, which not only explains and analyzes the financial flows. This principle, in the sense of the classic political economy, demands that the beneficiary, the taxpayer, the offerer (public bureaucrat) and the decider (legislator), in the more extensive possible sense, be bound amongst themselves so that the costs and the benefits are not arbitrarily valued the same as the regional and personal distribution. According to the integrality principle, the natural construction of the State consists of centralized and decentralized elements that depend fundamentally on a mixture between the radius of action, of the benefits and costs in the extension of public property.

The balance or financial coordination, so common in economic literature, is guided preferably in its horizontal and vertical version to the financial flows, where a description and positive systematizing is really treated, while the normative aspects are generally omitted.

On the other hand, the economic theory and federalism politics highlight the normative structure, where the functions, expenses and revenues should always be considered simultaneously and, the horizontal and vertical points of view should be included in its reciprocal action.

2. State federalism organizational formation

This form of federalism aspires to a political, economic and cultural balance between the conformation of the central and non central elements of the community.

A federal State consists of several member states whose competitions are settled down in most of the National Constitutions and whose extension and structures change during economic development.

Politically federalism is democracy's essential element. The external protection and the representation of interests towards the exterior demand a centralized organization.

Culturally federalism demands a creative multiplicity.

Economically and financially an optimum distribution of the competencies, is looked for, for the realization and financing of the public functions. The balanced financial federalism can contribute with determination, since the efficiency and distribution of income can be improved by means of decentralization. The subsidiary principle contributes to the regional distribution of the functions and the principle of economic integrality, relates the beneficiary, the taxpayer, the public offerer and the legislative decider, to each other, to optimize in this way the provision of public assets.

The degree of the federalism is perceived in the regional distribution of functions and expenses. The following comparative chart for the 1900-1975 periods, between diverse countries, highlights:

Years	SWITZERLAND			GERMANY			USA			G.B.		FRANCE		
	F	P	M	F	P	M	F	P	M	F	P	F	P	M
1900	20.4	41.2	38.4	39.7	33.2	27.1	34.1	8.2	57.7	6 1.8	35.2	7 0.5	5.9	2 3.7
1950	32.9	35.2	31.9	48.4	30.2	21.4	58.3	75.2	26.5	7 6.6	23.4	8 5.6	4.3	9.5
1971	25	40.5	34.5	37.9	33.2	28.9	48.4	18.6	33	5 8.1	41.9	7 6.9	5.6	1 7.5
1981	31.6	39.2	29.2	38.8	36.3	24.9								

F = central State; P = Provinces and M = Municipalities

3. Economic and political criteria of the State's functions.

In a globalized world with division of work, technified and densely populated, without there being a State, chaos would reign, if we take the human beings, just as they are historically (and not as they should be). Even in the economic development stage, formed by farmers and hunters, there already existed the necessarily minimum common protection, outwards and inwards, which on the other hand, supposed a certain collective cohesion.

The State should be an essential integrative element of the economic system, since it, within a world of resources shortage, the same as the individual, should drain and use them efficiently to help to overcome poverty and increase social welfare.

The developed community depends on the coercive power of an efficient and fair State, because it should fulfill the functions which the market cannot carry out or only carries them out in an imperfect way:

1. Efficient provision, including the financing, with public assets and services.
2. To act as corrector of the external effects.
3. To improve the assignment according to the market order.
4. To stabilize the economic process in the short term.
5. Redistribution of the income and patrimony
6. To foment the development of the markets of the future

While families aspire to maximize, with a given income, their utility, private enterprises, on the other hand, try to minimize their costs and they are permanently under pressure from dynamic competition, and with the help of technological progress they conveniently increase their benefits, while the State lacks such a behavior. On the contrary, while the State tries to minimize its costs, there arises the desire on behalf of the politicians and bureaucrats of increasing their expenses. There,, where utility or benefit, are hardly known, there is neither the possibility of it being measured. Also, an expensive apparatus is required to produce and provide public assets. In this offer there inevitably interact different political agents, that is to say, voters, political parties, legislators, officials and bureaucrats.

Also, the mass media, influence on the level and composition of the public assets. Consequently, the citizens demand and use with null tariff or price, public assets, thus the scarce resources administered by the public sector, are squandered by the inhabitants.

4. State's functions regional distribution criteria

The State's construction is the reflection of the central and federal distribution of its functions, where the central and non central tendencies are exchanged or they mix among themselves, facing the change in the social historical process.

The causes are multiple; mainly the technological and economic changes demand a flexible distribution of the State's functions on the regions, if the population's provision has to be maximized and if it should take place in a relatively balanced way. This happens through a) the financial reforms and b) the vertical and horizontal financial compensation in the short term.

In economic literature and in practice, the division of State's functions is based and takes place by means of different criteria. Historically the political-state characteristic, dominated, such as the subsidiary principle, (with own regional responsibility and, thus its own administration), equality in the provision of public assets, (with equilibrium in the regions) and national objectives.

These approaches should be supplemented with economic-financial and institutional measures, as the technical and administrative aptitude, the financial standing and flexibility and decentralized organization. It is just then, that the economic approaches achieved greater importance, as much in theory as in practice, as to state activity.

With it, profitability and the fair distribution of the benefits and positions among the regions play a decisive role, in which the external effects and the magnitude (scale performance) of the different activities and organizations are in the central point of discussion.

The regional distribution criteria for the State's functions are represented in the following chart:

	Objective at desc. level	Objective at centr. level
ASIGNATIVE APPROACHES - Voting of the public offer based on individual preferences - Consideration of the regional radius cost-benefit (fiscal equivalence) - Fomentation of innovation capacity in the public sector - Technical evaluation of production (scale economics, divisibility degree)	X X X	 X
DISTRIBUTIVE CRITERIA		X
STABILIZATION CRITERIA		X
GROWTH ORIENTED CRITERIA - Macroeconomic growth - Regional growth	 X	 X

5. State activity secular development "laws"

The state activity secular development is a political economic eternal problem, and cause for the recent theoretical and empiric analyses. In spite of the considerable efforts and new knowledge, it lacks up to now, an acceptable positive and normative theory, of state activity, with regard to considering:

- a) The extension and
- b) Expenses structure

The theories do not explain neither the causes nor do they satisfactorily describe the historical development, due to which one can scarcely foresee, or, with their help, be prepared to act in a practical way.

Most theories occupy themselves, in the extension of state activity. The analyses on the structure refer: a) to the regional or federal division of the State's functions (Popitz' Law, Federalism); b) to the system of the government revenues, i.e. taxes, (tax system); c) the State's expenses classified according to war or peace conditions, to consumption, to investment and to savings as well as to specific functions "menu" such as infrastructure or personnel expenses.

The foundations are easily understood, because the theoretical and empiric analyses have produced not very satisfactory results. 1. It is difficult to develop a comprehensible concept that, however, remains predictable; 2. To find variables dependent and independent and to use them for empiric ends; 3. To obtain statistical material to build homogeneous series and to elaborate them significantly; 4. To find the qualitative and quantitative causation, in an economic and political, extremely interdependent system. Also, such an analysis should consider: 5. the retard and advance effects, according to Timm's Hypothesis; and 6. Offer and demand are overlapped cyclically (Recktenwald). Due to indivisibility of public property, the overcapacity or congestion phenomenon in the offer takes place, which a deeper analysis of the monetary expenses cannot understand and, also, 7. The benefits of public expenditures are rarely considered.

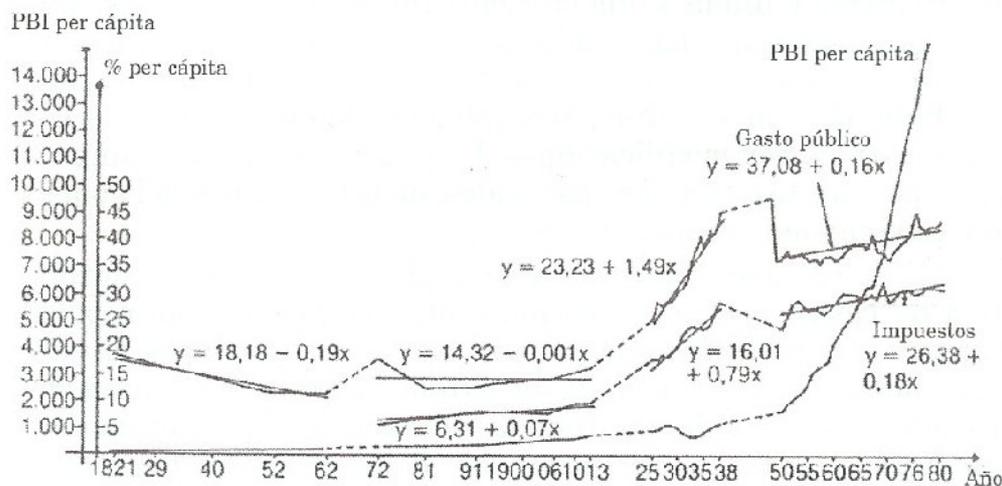
On the extension of public activity, the theories express the following: 1. most of the speculative trials exaggerate on the explanation of a law of secular development of the expenses; 2. the qualitative theories (descriptive) not rarely generalize temporary and subjective experiences, where at least the plausibility of the hypotheses, through time, lose validity; 3. The controversy on the question on which factors or facts, growth really determine the state activity and to what degree and extension; 4. The discussion continues if they influence economic-technical magnitudes (not only political) in this secular process, or if: 5. It owes itself to a determinant or mechanic process as it is always formulated in Marx, Wagner or Schumpeter's sense; and 6. The empiric analyses are increased (in developed and in developing countries) on the importance and exam of old hypothesis (Wagner) and new hypothesis with uncertain times, even when their results are really true nonsense and contradictory.

The development process forces instigators of the public economy can be classified in 4 main points; a) economic-technical; b) demographic (growth and structures of the population, urban density, urbanization); c) political-institutional (forces that act more or less constantly); and d) accidental causes (wars, catastrophes, political transformations, economic crisis, weapons competition) that abruptly influence State activity.

A. Wagner said in 1861:

that the participation of the State in resources and their use grows "according to a law", the state activity expands itself with cargo to private activity and at the expense of the market. However this "law" has been questioned, as shown on the chart for Germany during the last two centuries.

Percentage of state expenses and taxes within the German GDP during the period 1821 – 1976 compared to the GDP growth per capita



F.: H. C. Recktenwald, Markt und Staat, Göttingen 1980.

X : Years

Y : GDP

6. Central and non central tendencies in federalism

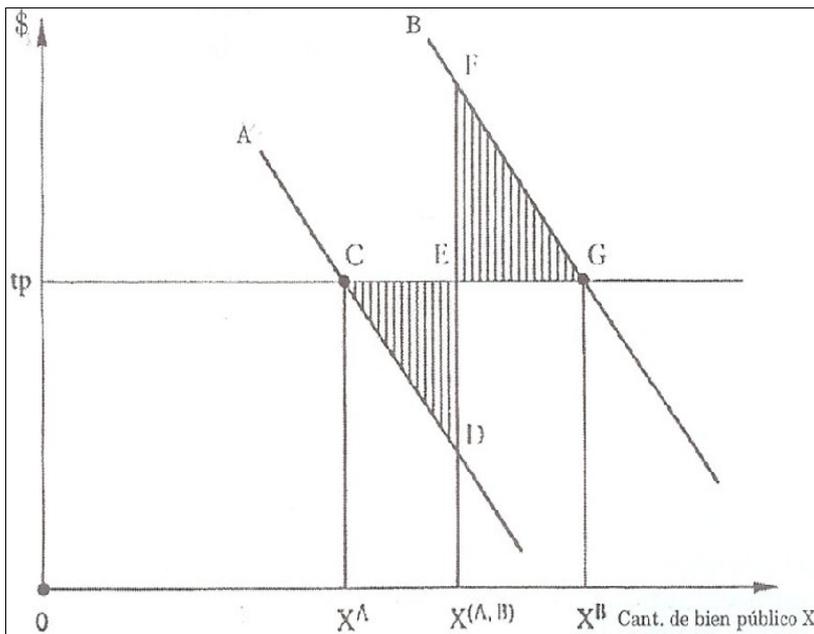
The spatial organization of a State has interested science, politics and men throughout history. The dispute between centralists and federalists, not rarely, has led to violent controversies on how you can achieve, in the best possible way, an equilibrium in a community, which is political, economic and cultural between central and non central elements.

Centralization in economy and in the State, is called, in an only center of decision and direction, in opposition to decentralization or federalism in which economy competence and policies are distributed objectively and spatially. Centralization is joined to the loss of efficiency,

when one does not take into account, the preference differences which exist between the population's groups and, instead of that; they offer public assets in a uniform way.

Analytically you can represent this loss of welfare graphically - according to B. S. Frey – in this way:

Adaption of Public Assets Offer through the territorial units



X :Quantity of public assets

Source: Blankart, C. B. (1991)

A: Is the predisposition to pay for public services, by population group A.

B: Is the predisposition to pay by population group B.

The losses of welfare measured by both triangles, as consequence of centralization, are higher when the preferences amongst the regional groups are more different. Centralization damages a fundamental principle of democracy in which the "referred" should decide on its own will. Also, centralization leads to an undesired political concentration, because the spatial dimension of the political competence is not given.

Decentralization designates in general, in opposition to centralization, the principle of transferring competences or decision faculties or functions to inferior units be they companies, the market or the State. Fundamentally, the provision by means of private assets which are successful in the free competition market, is the extreme form of decentralization. The individual decides here,

by means of exchange or purchase, the asset, the one which is more valued, than that other one he has to give up, as he has to pay a market price.

If the assets are offered or financed publicly or collectively one should get group consensus, because the assets are indivisible and that is the reason they should be used in common and an exclusion of such a "consumption" or use, is not possible.

Decentralization principle here looks for the true group, so that competition and influence radius which includes benefits and costs should cover them as much as possible.

Decentralization degree depends with it, on service spatial influence. The defense competence or the relationships with the exterior are functions of the central territorial corporation, since here the benefits correspond to all the Nation's members. But if the benefits are limited regionally, decentralization demands a collective decision, and with it competence at land, district or municipal level.

In public practice, the decentralization principle is tried to be carried out within federalism.

7. Economic and political integrity principle.

This principle attempts, normatively, to give an answer to humanity's cardinal question: how big or small should a community be? Aristotle formulated it as follows: "there exists a limit for the size of the State, as well as for any other thing, for plants, animals and for tools. Because these things lose their natural effects, when they are too big or too small". Integrity principle belongs as, the "beginning of interest itself" and the "exchange principle" between the explanations and central matters of modern political economy.

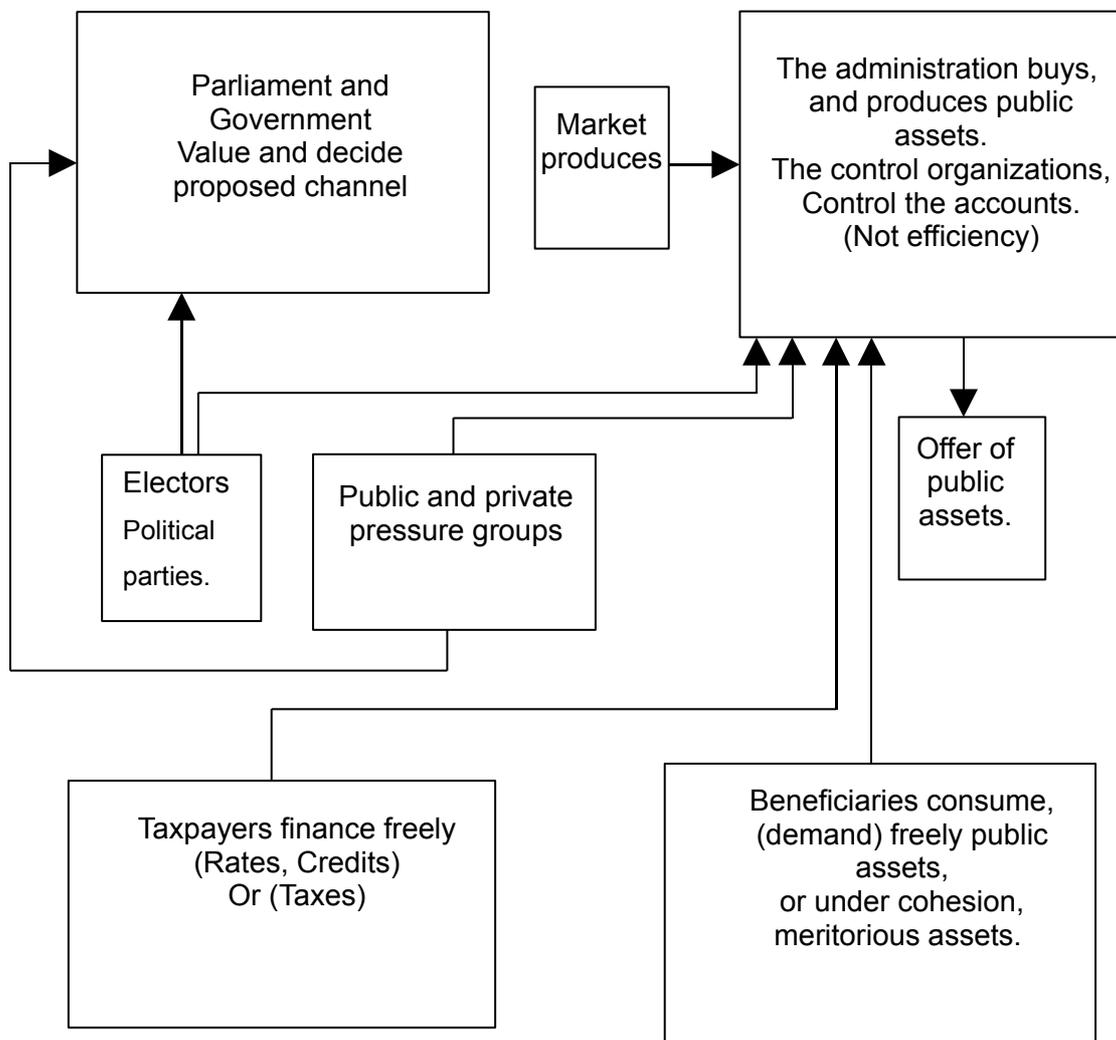
They are evident in themselves, and independent of space and time. For that reason, they also have an axiomatic character. In their combined effect they explain the mechanisms of market and State economy.

The integrability principle relations the public assets theory with the most modern explanations on the causes of, profitability lack and inefficiency in the offer, in consumption and in financing of the state services (public squander). As the available resources in the State are also

scarce, it is under obligation just as the individual, to apply under the shortage law, in an efficient way, the resources and to equally distribute liabilities and benefits.

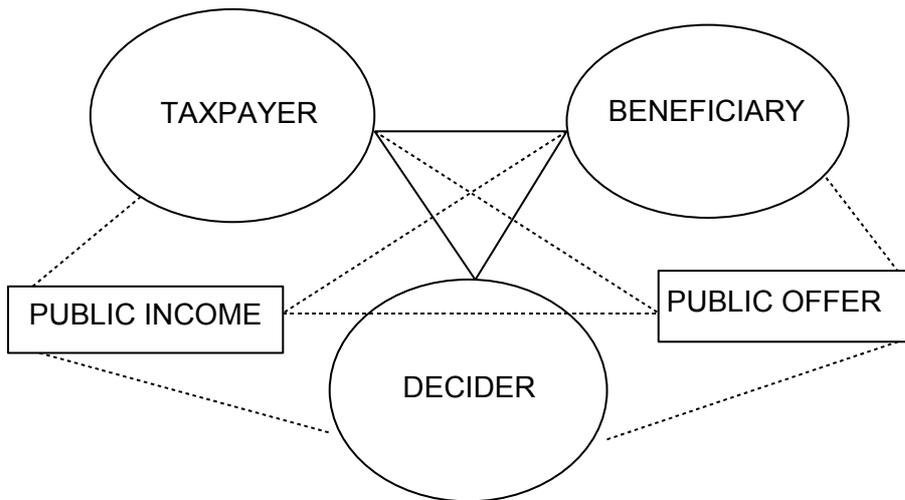
A "collective" can proceed in this way, only when it considers the integrality principle, in which the beneficiary, the taxpayer, the legislative decider and the bureaucratic offerer, interrelate among themselves the offer and demand of the public assets, and it results in the biunivoc relationship as long as this makes economic and political sense. B (Beneficiary), C (Taxpayer), D (legislator) and O (Public Offerer).

Institutional separation due to state inefficiency



Source: Recktenwald, H. C. (1983)

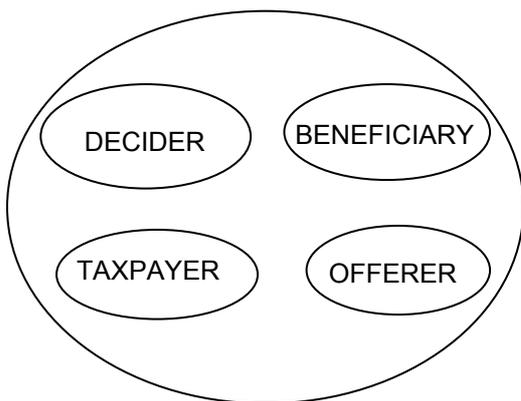
Integrity principle element



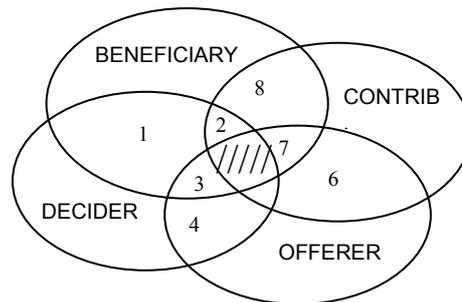
Source: Grulske, K. D. (1985)

State Integrity Principle

Absolute Separation at Three Levels



Scaled Integrity at each Level



- 1, 4, 6, 8 = Integration between two groups
- 2, 3, 5, 7 = Integration between three groups
- Shaded area = Perfect integrity

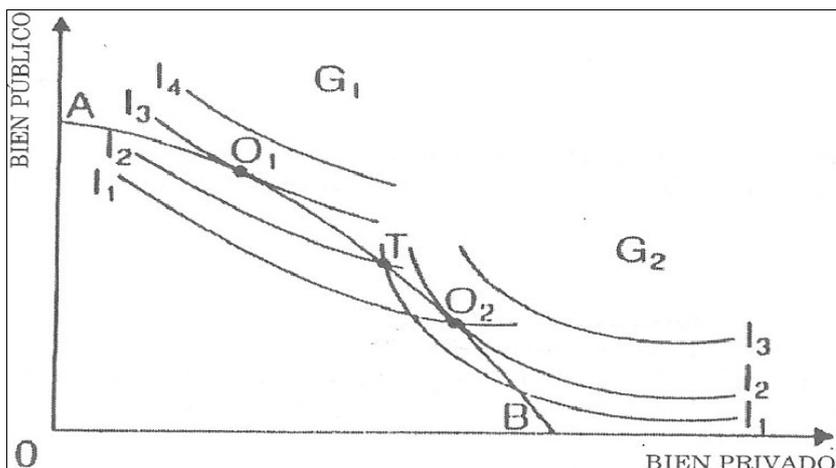
Source: Grulske, K. D. (1985)

The principle demands a joining or union (also regional and temporal), in which the advantages and disadvantages of this classification together with the cost/benefit analysis, be treated and evened. The principle includes not only the financial or fiscal input products, but also the welfare in the political and economic sense.

In this way, one should achieve that the eventual political and administrator citizen, with complete knowledge, can decide on the public assets, their fiscal loads and discharges. Starting off from the integration of the benefits with the fiscal loads then only is it possible : 1) a legitimate (not arbitrary) valuation of public services; 2) which enforces greater profitability; 3) strengthens one's own responsibility and administration; 4) assures a greater citizen approach to politics and bureaucracy; 5) brakes the administration in the overflow of the expenditure use; and 6) it reduces the free-rider behavior.

The welfare losses that can arise due to the non observation of this principle, can thus be understood graphically:

Incidence due to spatial participation on the integrality principle



Source.: Recktenwald, H. C. (1983), S.668

X: Private Assets

Y: Public Assets

G1: Group 1, G2: Grupo2

O1: Optimum point G1, O2: Optimum point G2

T: Suboptimum point

8. Federalism's economic theory

8.1 fundamental matters

- Organization and construction of a community structure.
- Functions of each one of the levels

- Expenses and revenues of each one of the levels
- Necessity of a financial balance (vertical and horizontal), i.e. Horizontal and vertical relationships amongst themselves

8.2 Bases for the creation, conformation and construction of a federal State

- Shortage Principle
- Territorial limitation of public assets
- Cost-benefit Analysis
- Political and economic integrality principle in regional environment
- Decisive in the Radius Cost-benefit in public offer services
- Changes in the objectives of economic and fiscal politics system.

The theory and practice of economic federalism can be represented schematically in the following way, where the exposed ideas are explained by means of a simple example and which should be kept in mind, if it is that the public problem is attacked seriously, taking into account that the State's new roles re a globalized world, indicating the new functions that it should fulfill, by means of the offer of public assets which originate expenses and require resources for its financing.

STATE'S FUNCTIONS PUBLIC ASSETS EXPENSES RESOURCES

(fulfills) (by means of) (produces) (require)

Examples:

Globalization	Services	Territorial Environment	Fiscal Resp.	F. of Financing
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Political federalism: - Nation -Provincias -Municipios	Defense Foreign Relations . Security Welfare Health Públic Ed. P.M.Envir Infrastructure Est.Monet. Competencie TerritorialOrd	National National National/Prov National Nat./Prov./Mu n. Nat./Prov./Mu n. National Nat./Prov./M un. National National National	National National National/Pr ov. National Nat./Prov./ Mun. Nat./Prov./ Mun. National Nat./Prov./ Mun. National National National	Taxes Rates Taxpayers National National Taxes Rates Contrib. Prices Púb. You produce Prop. Public credit
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The integrality principle is also worth mutatis mutandis for the balance between the benefits and the loads between the generations. In the representative democracy, the decisor (political) and the voter (as beneficiary and financier of public assets) are reasonably temporarily separated, there being the danger that the state cohesion be not well used not only for meritorious reasons, non meritorious or of political groups.

In such cases, the principle of gradual integrality can help. E.g.: by means of political minorities or the basic principle that says: No expense without the beneficiary's own participation and the cost decisors.

9. The decentralization of functions, resources and expenditures in the federal states

The public activity is not only carried out mainly in a single government unit with jurisdiction over the whole country, for the taking of public decisions, the existence of regional and Domestic governments implies that the public sectors are structured in territorial decision levels (central/regional/Domestic) that distribute amongst themselves, according to matter, the decisive power.

This way, a good part of the public functions are decentralized especially from the central government (with jurisdiction mainly over the whole country), to the regional and/or Domestic governments (with jurisdiction only on concrete domestic areas). The economic base of

decentralization is that the Domestic governments spend better than the central government. Tax decentralization is the logical consequence of the expense decentralization. It would be absurd to suppose that the territorial governments know better how much and what to spend on, and at the same time, to deny them the necessary instruments so that they can freely determine the level of their revenues.

If a government cannot decide how much to enter, neither can it decide how much to spend. Contrary to what happens with the expense, the decentralization of the taxes does not take place, per se, clear efficiency earnings, equity and management.

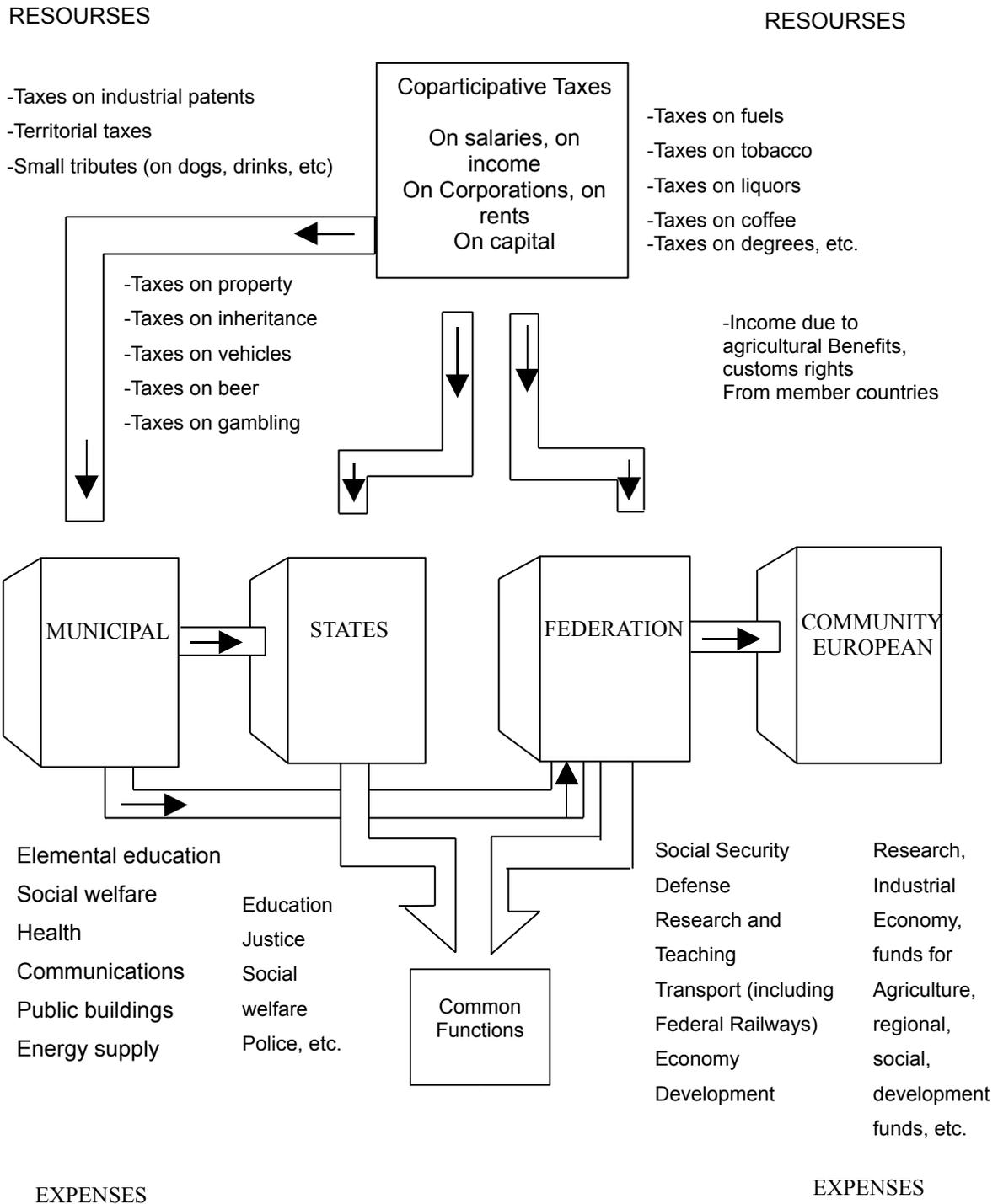
In and of itself, the objective of taxes decentralization is to endow the territorial governments the necessary instrument to finance their expenses, not to endow it an additional expense instrument to alter the assignment and redistribution of resources.

In elementary economy when one studies and analyzes the behavior of the individuals, of the families and of the enterprises, one sets off as from what is known as straight-line balance, or budget restriction, what are above this are no other things that mere desires or expectations. In a same way it should be the behavior within the State, but this does not happen in this way because there is not a system of prices, the public assets are offered and demand a null tariff.

In the following chart the coordination of functions are represented, expenses and resources between the territorial corporations in a federal country such as Germany.

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Functions coordination, expenses and resources between the Territorial Corporations in functions and taxes



Also, in the following charts one can observe in what percentage of the GDP the different government levels usually participate in most of the expense and resources functions. Six

countries with federal organization have been taken as reference: Germany, Australia, Austria, Canada, United States and Switzerland.

PERCENTAGE DISTRIBUTION OF EXPENSE FUNCTIONS BETWEEN GOVERNMENT LEVELS IN FEDERAL COUNTRIES

Functions / Government Levels	Average Values (six countries)		
	Central	Intermediate	Domestic
1. General public services of public order and security (4.5 GDP)	37	38	25
2. Defense (2.6 per 100)	97	1	1
3. Education (5.3 per 100)	5	56	39
4. Health (6 per 100)	43	45	12
5. Social Security and Welfare, housing and communitarian activities, (14.2 per 100)	75	14	11
6. Leisure, culture, religious matters (.9 per 100)	14	26	59
7. Economy matters and services (4.7 per 100)	40	42	18
7.1 Fuel and energy / mining and manufactures (.3 per 100)	73	18	9
7.2 Agriculture, forestry and fishing (1.0 per 100)	52	40	8
7.3 Transport and communications (2.5 per 100)	31	46	23
7.4 Other economy matters and services (.9 per 100)	46	39	15
8. Other expenses (4.6 per 100)	54	29	17
TOTAL (42.9 per 100)	42	30	18

The polar public assets, i.e., those services where the intervention of intermediate units or Domestic communities is not sufficiently justified, are awarded to the Central Government, for example, Defense expense is 2.6% of the GDP with an assignment of 97% to the Central Government, except Switzerland, where it is attributed to the cantons. Social security and welfare, housing and community activities, i.e. to say, the redistribution of expense per excellence, is of 14.2% of the GDP in which, 75% of this service has to do with the Central Government.

In the case of Education which represents 5.3% of the GDP and 5% of the total expense is attributed to the Central Government, the responsibility corresponds mainly to the Intermediate Governments with 56% and 39% to the Domestic Governments. In the general public Services which have to do with politics, safety and health, one notices a relative balance.

In the following chart information is collected on the distribution of revenues between government levels and the importance of the tax revenue, according to its source. 87% of all

Central Government revenues of the of the previously aforementioned countries is tax incomes, 54% in the case of the Intermediate States and 44% in the Domestic States. The relative weight changes when we refer to non tax revenues. Now it is the Domestic communities that obtain a superior percentage. As regards to transfers it can be observed, that the Domestic Governments and the Intermediate Governments have significant percentages in their total revenues in form of received transfers from other Government levels.

**DISTRIBUTION OF REVENUES AMONG DIVERSE GOVERNMENT LEVELS
(MEAN VALUES IN %)**

Kinds of Government incomes / levels	Central	Intermediate	Domestic
Tax Incomes	87	54	44
Non Taxed Incomes	12	17	29
Transferences	1	19	27

As for tax revenue according to source and Government, in the following chart, the personal income tax is distributed among the Domestic, Intermediate and Central levels in almost similar proportions, but in greater percentage in the Central Government. The tax on property has a marked Domestic bias, with 49.5% and the general taxes on consumption are distributed equally among the Intermediate and Central Governments.

TAX REVENUES PER SOURCES

(Mean values in % of each source)

Tax Sources	Central	Intermediate	Domestic
Tax on rent	46	38.5	30
Societies	10	7	5.5
Payroll	2	4.5	2
On property	2.5	11.5	49.5
Generals on Consumption	20.5	19.5	1
Specials on Consumption	17	9	1
Others	2	10	6.5

10. Empiric focus on Argentine public economy

In order to be able to reach interesting conclusions, we analyzed the Savings-Investment-Financing Account, for the non Financial National Public sector, the Consolidated Provincial Public sector for 24 jurisdictions and the Consolidated Municipal Public sector of 2,150 Municipalities and Communes, in what refers to income and expenses of the Argentine public sector for 2000, e.g.

ARGENTINE PUBLIC SECTOR

Account	Public Sector National non Financial	Public Sector Provincial Consolidated	Public Sector Municipal
Savings – Investment - Financing			
I Current Incomes	56,670.3	31,895.3	7,543.4
II Current Expenses	60,002.7	31,656.1	6,691.4
III Savings / Non savings	3,332.4	207.2	652.0
IV Capital Resources	648.8	648.8	134.9
V Capital Expenses	3,348.9	3,595.6	1,111.9
VI Total of	57,319.1	32,543.3	7,678.3
VII Total of Expenses / Expenses	63,351.6	35,283.7	8,000.3
VIII Fiscal Deficit	6,032.5	2,740.4	325.0
IX Financial Sources	28,977		
X Financial Applications	22,945.4		

Source: Message and General Dispositions. 2001 Budgets Law Project

We first observe that the phenomenon of maintaining a certain balance between centralization and decentralization, so important in the federalism economics theory, in Argentina it has a marked centralist bias towards the National State, be it on the side of the expenses as to the resources, with all the consequences that it produces, for not respecting the principle of economic integrity that we have studied.

With such a purpose, Professor Antonio I. Margariti has elaborated a chart on the Argentine Tax System, as the result of studies carried out on the tax burden which is suffered by groups of people which have rents of different categories in the provinces of Buenos Aires, Córdoba, Santa Fé, and the City of Buenos Aires. The following chart summarizes the tax incidence on people with different levels.

TAX INCIDENCE ON PEOPLE			
SOCIAL CLASS	INCOME PER MONTH	DIRECT AND HIDDEN TAXES	TIME THEY MUST WORK FOR THE STATE
1. Poor indigent	\$ 150	20%	2 months 12 days
2 Laborer	\$ 700	39.8%	4 months 23 days
3 Professional	\$ 2,500	41.3%	5 months
4 Medium Entrepreneur	\$ 5,000	51.8%	6 months 6 days
5 High Executive	\$15,000	53.9%	6 months 14 days
6 Upper Class	\$40,000	39.4%	4 months 22 days

Also, the same author indicates in a four column chart with its corresponding taxes listing, when distinguishing the stages when money is earned, when it is spent or one buys, when the asset is used and kept, following the technical analysis made by the United States Congress Committee, formed by congress members Dick Armey and Alan Shelby, which shows the tax chaos that contrasts with the chart on page 12.

On the other hand, we do not agree with the estimate of the tributary pressure of 22.42% of the GDP for the national public sector that estimates the State Budget for 2006, since, in the first place, its value is inconsistent with regard to the numerator and, in second place, it only refers to national taxes and, finally, it is an average without distinction between social layers.

Just like doctor Margariti in his book "Impuestos y Pobreza" (Taxes and Poverty), subtitled also, "Un cambio copernicano en el sistema impositivo" (A Copernican change in the tax system), we have added that simultaneously it is also necessary a Copernican change in the public expenditure system, for which we would wish to formulate some observations to Law 26,078 of General Expenses Budget and National Administration Resources Calculation.

Dr. Antonio I. Margariti / Rosario
2nd May 2006

ARGENTINE TAX SYSTEM

Taxes charged to us by the national + provincial +municipal State

WHEN MONEY IS EARNED	HOW MUCH IS SPENT OR	WHEN THE ASSET IS USED	WHEN IT IS KEPT
1. Tax on persons'	13. Tax on	TAXES IN SERV	

earnings	international freight	PUBLICS	
2. Tax on societies' earnings	14. Tax on Real Estate transference	49. VAT 27% tariffs on light, water, gas and telephones	75. Tax on Urban real estate
3. Tax on the presumed minimum rent	15. Tax on debits and credits.	50. Education Fund And promotion.	76. Tax Real estate rural
4. Tax originated in the prohibition of carrying out of adjustments due to the effect of adjusting accounts for inflation effect	16. Tax on deposits and own checks	51. Tax on internal law 25239	77 Tax on personal assets.
5. Tax for adjustments in transfer prices	17. VAT on purchases to 21%	52. Tax operac concessionaire. bank	78. Rate of contribution of rural improvements
6. Monotribute	18. VAT on purchases to 10.5%	53. Tax Gross incomes gas transport.	79. Urban tax on paving and sewers
7. Export duties	19. Tax on gas and liquid fuels	54 Fiduciary Fund subs. Residenc	
8. Retentions ono commodities export	20. Kerosene, gas-oil and oil rate	55. Municipal canon for net servitude	81. Tax on land
9. Obligatory Contribution to Social Security	21. Employer contribution for ANSES	56. Special Fund for Big Projects	
10. Retentions on Salaries for ANSES	22. Employer contribution for PAMI	57. Retributive Tax Law 11,220	
11. Retentions on Salaries for PAMI	23. Contribution for family assignments	58. Tax For public Lighting	
12. Contributions towards	24. Retention on possible labor discharges	59. Taxes subtitu. other taxes Bs. Aires	
	25. Retention for possible double	60. Incentive resol. Power Secretary	

	indemnization		
	26. Retention prevention of accidents and labor risks	61. Tax on Patagonian gas Santa Cruz	
	27. Tax on hydraulic infrastructure	62. Fund compensator on social tariffs	
	28. Taxes challenge	63. Tax on high consumptions of gas	
	29. Emergency additional Tax on cigarettes	64. Development Tax Fund	
	30. Tax on purchase and sale of stocks	65. Tax on Radio and TV	
	31. Tax on the purchase of new railcars	66. Tax on Provincial Fiscal Stamps	
	32. Tax on Gambling	67. Judicial Tax	
	33. Tax on Gross Income	68. ITC Transference Tax	
	34. Tax on Multilateral Agreement	69. Tax on Highway Toll	
	35. Municipal Tax on registration and inspection	70. Tax on Banking Transactions	
	36. Tax for National Institute	71. ABL, illumination, sweeping and cleaning	
	37. Tax on Shows	72. Tax on Car Registration	
	38. Import Duties	73. Tax on launches and airplanes	
	39. Customs Duties	74. VAT – Gross Income and Others	
	40. Imports VAT		
	41. It appraises of statistic		
	42.		
	43. Municipal Tax on Advertising in		

	shop stands		
	44. Municipal		
	45. Tax on Public Advertising		
	46. Vehicle Tax		
	47. Municipal Transport Tax		
12 TAXES 22%	36 TAXES 28.5 %	16+ 10 TAXES 13,5%	7 TAXES 1%

Due to this, we set off from the information from the Message to the 2006 State Budget et Project, made by the National Treasury. It is not the purpose in this paper to do an itemized analysis of each one of the Jurisdictions and Entities that conform the National Administration, this merits another study. We only want to mention some global figures that reflect the degree of concentration of the expenses that give way to [discretionality](#) and inefficiencies in the resource.

In 2006 the National Administration will spend the sum of 92,702.4 billion pesos, consumer spending 16,009.7 billions, interest payment 10,413.9 billion, social security benefits 28,768.0 billions, transfers to the private and public sector 26,033.9 billions, and capital expenditures for 12,473.2 billions, amounts that are also expressed in purposes and functions and by means of programs and physical goals, some outstanding ones but others which are senseless.

In "The Other Entities of the National Public sector" the Fiduciary Funds of the National State are mentioned as "differentiated components of the State budget whose individual budgets are approved by means of an article of Law 26,078 (art. 14) ". These are fiduciary funds of the most varied species for the provincial development, regional infrastructure, reconstruction of enterprises, of capital stock, scientific and technological promotion, for the federal electric transport, transport infrastructure system, hydro infrastructure, national fund for the small and medium sized enterprises, guarantee fund for the small and medium sized enterprises, for the recovery of the ovine activity, for subsidies for residential gas consumptions, fiduciary program, for the mortgage refinancing and for the promotion of the software industry, giving an expenses consolidate for 4,178.3 billion pesos.

In the sub sector "Other National State Entities" they conform to budgets of organisms that are not included in the state budget such as the Federal Administration of Federal Revenues, National Institute of Cinema and Audiovisual Arts, Superintendence of Administration of Funds for Retired and Pensioned, "Yerba Mate" (Ilex paraguayensis) National Institute, Special Unit System of Transmission of Yacyreta, (Hydro Electric Dam), National Institute of Social Services for Retired and Pensioners (PAMI), being a consolidated expense of 7,150.4 billion pesos.

In the sub sector "State Companies and Societies", it is a sector that due to its commercial nature and its juridical figure of private law, operates outside of the state budget and is made up of 26 public corporations of the most varied kind, absorbing 2,455.0 billion pesos. However, it is worth highlighting that they are not true enterprises producers of social assets, but they render assets and services that could be carried out by the private activity.

The sub sector "Funds and Entities that do not consolidate in the SPN for different institutional and juridical reasons": a) affected funds (Special Fund for Tobacco, Special Fund for Salto Grande (Hydro Electric Dam), and Redistribution Solidity Fund, they consume 1,270.5 billion pesos). b) National Universities, spend 2,984.4 billion pesos c) national Institutes and Foundations (Institute for the Promotion of Bovine Meat, Argentine Wine Corporation, Argentine Newly Born Foundation, d) Interstate Entities (Buenos Aires Central Market Corporation, "Old Puerto Madero" Corporation, Tripartite Entity for Works and Sanitary Reparation, e) Bi-national Entities (Yacyreta Bi-national Entity). f) State Social Services, (Army Social Welfare, Navy Health and Social Service, Aeronautics Social Service, Federal Police Health and Social Welfare, National Penitentiary Service Welfare, National Judiciary Welfare and Congress Personnel Welfare. g) National Public financing sector A) Official Banks (Banco Central de la República Argentina, BNA, and BICE) and B) Financial Enterprises (National Life Insurance, National Retirement Insurance, National Market, Fiduciary Funds, National Leasing, National Factoring, Carlos Pellegrini Common Investment Fund Manager.)

The consolidated national public sector, gives as a result the following expenses level.

Public Administration F.y E no SPN		Fiduciary Funds Total Expense	Other National State	Entities	Public Enterprises
93,702.4	4,178.3	7,150.	42,455.0	4,254.6 (*)	11,740.7

(*) Only funds affected in section a) were included and National Universities in section b). No information is given in detail, of the rest of the elements in sub sector, c) a g)

From this first reading of Message to the State Budget Project, and whose figures appear Programs, Subprograms, Activities, Projects and Works we can extract some conclusions that impact directly in the study that we have been carrying out on the economic federalism of our country.

1. The National State budget for 2006 just as it is structured in Law 26,078 does not respect the budgetary principles of universality and of unity, because it does not include the expense of the whole national public sector and it is not presented in a single document, since 18,038.3 billion pesos (19.3% of the expense) referred to public enterprises, fiduciary funds, other national State entities and funds and entities that do not consolidate in the national public sector and they are not part of the budget, with the consequences that that generates, from the point of view of transparency, the efficiency in its use and the effectiveness in the objectives.

2. The National Administration Budget is made according to the technique of the budget by programs; consequently its evaluation should be made in function of physical goals, but some lack economic relevance to measure results.

3. The National Administration includes programs and projects that should figure due to their federal significance, according to the principle of economic and political integrity, in provincial or municipal budgets.

4. The fiduciary funds, except those that are of regional or provincial character, should be included in the budget.

5. With regard to "Other National State Entities" some should be included in the State budget, others in provincial budgets and the rest should be suppressed.

6. As for the "State Enterprises and societies" sub sector, some should be liquidated as, for example, General Administration of Ports, others form part of provincial or municipal budgets and

the majority should be transferred to the private sector. As we have commented they are not true public corporations producers of public assets, but they exercise activities that correspond rather to the private sector.

7. The "Funds and Entities that do not consolidate themselves in the national public sector" sub sector in what concerns to the affected funds as the Tobacco Special Fund, should be made by the tobacco provinces, the Yacyretá Special Fund should be in the provinces' budgets of Entre Ríos, Corrientes and Misiones and the Redistribution Solidarity Fund should be eliminated. The National Universities should be incorporated, in the first place, and should return to the National Budget in the University Matters Department of the Ministry of Education, Science and technology and, later on, they should be transferred to the provincial jurisdictions as happens in all the federal system countries. The Institute for the Promotion of Argentine Bovine Meat should be transferred to the meat exporter provinces, the Argentine Wine Corporation to the wine producing provinces. The State Social Services should not be part of the national public sector and they should be financed by their members as the rest of the domestic social work.

11. Argentine State Reform Proposal

With the purpose that the political federalism of our CN evolves towards an economic federalism, we consider it convenient to begin with the reformation at municipal level before any modification at national level and by means of a gradual process, so much on behalf of taxes as on expense, redefining a new tributary structure and a new expense structure according to the functions that are defined for the different competences, national, regional, provincial or municipal.

One will have to think of a new State functions structure, according to the nature of the services that they render. That is to say, for example that the defense be, as it is, a national asset, university education be a provincial asset, and that artistic expressions and primary and secondary teaching be local.

The hacendistica literature has been paying close attention to taxes on property, maybe, because, due to their characteristics, they are especially suitable for the use of the local hacienda properties. Concretely its special attention is the localization principle, that, as being taxes on real estate, they are not therefore, susceptible to emigration in answer to high fiscal pressures, and the

internalization of costs that supposes, in general, the *non export* of taxes beyond the limits of the beneficiary jurisdiction, this has led to propose the property tax as the central nucleus of the local tribute. For that, it will be necessary to elaborate a national Cadastre to know, which is the true use of the physical space which it has. That is to say, the existence of usurped land, fiscal land, arable land, urbanization land and all other territorial surface not identifiable or not well assigned from a merely efficient point.

Territorial classification was the first reformation carried out by the European countries after the Second World War (Germany, Italy, France, Spain and the rest of the countries of the European Union). The classification and respective territorial cadastre represents, for economic federalism the same thing as the population or industrial census for the development of residence or industrial policies.

We understand by territorial classification the group of tasks in charge of the National State that, should contribute to the establishment of the best distribution in the physical space as for housings, working places, rest areas, cultural and social facilities as likewise to assure an adequate transport and communications system.

From the point of view of economic science, the tax on land is the only tax accepted and recognized by Milton Friedman, 1976 Economics Nobel Prize.

The Graduate Alejandro J. Spadacino of the Torcuato Di Tella University, carried out a work to estimate the value of land in the City of Buenos Aires, and reached the conclusion that with an aliquot of 1% or 2% annually, on said value, the Government of the City of Buenos Aires, could have resources to cover great part of its financial needs, thus eliminating the distortions and the bureaucratic corruption which the current tax system bears.

In the mentioned federal countries, the greater finances of the Local Governments is by means of the real estate tax, due to its special characteristics: it is a direct tribute, of real nature, with no escape possibility by means of concealment and lies (and the consequent corruption) because the taxable object is in everybody's sight, and its value is openly well-known. The physical space cannot be increased and, therefore, its offer is inelastic, and in consequence if the market demand curve is transferred for some reason, as could be the urban population's growth, or,

increase in the agricultural exploitations, an increase will take place in the price of the factor. The tribute on land tries fundamentally to make more rational, the use of this productive factor: soil, be it urban or rural and to avoid distortions in its speculative use, as there are earnings that are not product of the individual effort, and is at present, a way of maintaining savings when suffering domestic currency devaluations.

In the provincial order taxes should be eliminated on Gross Incomes and Fiscal Stamps, the provinces having fundamentally a rural real estate tax, value based on up-to-date cadastres and with reasonable proportional aliquot, following the methodology used by Graduate Alejandro J. Spadacino for the City of Buenos Aires.

The provinces should also have equivalent participation at the source, be it on VAT, Income Tax on Physical Persons, and the existent export duties, acting actively in the collection and the control, being the definitive distribution in charge of the Federal Fiscal Organization, (art. 75, Inc. 2 CN) in function of the internal gross product, generated by each jurisdiction.

At national level, one should generalize the Income Tax on Physical Persons, taxing all kinds of income, whichever be their nature, be they in dependence relationship or not, entrepreneurs, fees, etc. eliminating, also, all kinds of personal exemptions, but with a reasonable aliquot. As for the VAT, it should be universalized for all consumption with low uniform aliquot. Taxes such as Personal Assets, Presumed Minimum Gain, Tax Monotributo, Interests Paid and all kind of subsidy, should also be eliminated, by means of sectorial, regional or public services promotions.

Finely, for this, it will be necessary that the Argentine State integrated by the Nation, the Provinces, the City of Buenos Aires and the Municipalities assume fiscal co-responsibility, decentralizing the tributary administration, unifying the Provincial Rent Departments, the local AFIP Agencies, conforming a single political unit for Collection, Distribution and tributary Control, without affecting the domestic federal political structure, but only so that the National Treasury Department, be not just a mere Department, as it is at present, have up-to-date information on the management of the resources and expenditures of the different jurisdictions just as in Germany, which is a federal country par excellence.

The process of adaptation of the functions for jurisdictional level, the new tributary structure and the new expense structure, will require in the first place, for its carrying out, to have professionals, very well prepared in matters of public economy and patriotism besides time and political decision.

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