MONTHLY REPORT

ECONVIEWS

ECONOMÍA Y FINANZAS

August 2023

Issue #230

The **PASO primaries** changed the **electoral outlook**

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Provinces are fiscally stable: they should begin to **cut taxes**

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THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- At the Federal Reserve's annual symposium, chairman Jerome Powell said the entity would keep rates high for as long as needed, against the market view that they could fall from their current 5.50% to 4.50% by late 2024.
- Libertarian Javier Milei's 30% win in the primaries surprised pollsters. JxC came in second with 27%. The government's candidate, Minister Massa, finished third. Argentine stocks fell 5% the days after the election and sovereign bonds fell 9%, but both have since rebounded.
- The BCRA complied with the IMF and devaluated the official exchange rate by 22% to ARS 350 on August 14th, a day after the elections. It has promised to keep it pegged at that rate until the end of October, although the futures market is pricing an ARS 375 dollar on September 30th.
- The informal dollar had already jumped from ARS 530 to 570 in the run up to the primaries and overshot to ARS 780 after Milei's victory. Last week it closed at ARS 725 an 107% spread with the official dollar, but the BCS heated up to ARS 787. The government's intervention has kept the MEP dollar at 673.
- Argentina's CPI print came in below expectations in July, at 6.3% monthly and 113% year-on-year. Seasonal prices (+5.1%) and food and beverages (+5.8%) increased less than the general index.

FIGURE OF THE MONTH

The Central Bank devaluated the official ARS/USD rate

22%

the day after the primaries.

TO BE ALERT

The BCS is trading at ARS

787

A 41% devaluation so far in August.

WHAT'S COMING NEXT?

- On Sunday 27th, Minister Massa announced two ARS 30,000 bonus for formal workers, three ARS 37,000 bonuses for minimum pension retirees, and tax breaks for self-employed workers. The measures aim at recomposing real incomes, but risk fueling inflation in a very unstable environment.
- After the devaluation, we expect to see 12% monthly inflation in August and September; it should return to one digit in October if the BCRA is successful in pegging the official rate at ARS 350 but will accelerate again in November and December as wholesale and retail businesses seek to get ahead of a likely devaluation by the new government.
- The general elections will take place on October 22nd. With a virtual three-way tie, all eyes will be on the two candidates which end up in the likely run-off on November 19th. Polls favor Javier Milei, and accelerating inflation plays in favor of his proposal to dollarize the economy, although he has toned down his remarks on the subject after the primaries.
- The IMF disbursed USD 7.5 billion on August 23rd, most of which will be used to repay Qatar, the CAF, China and the Fund itself. In the staff report, the IMF urged the government to accelerate the fiscal adjustment, but this is a tough sell, less than two months away from the general election.

SUMMARY OF MAIN INDICATORS

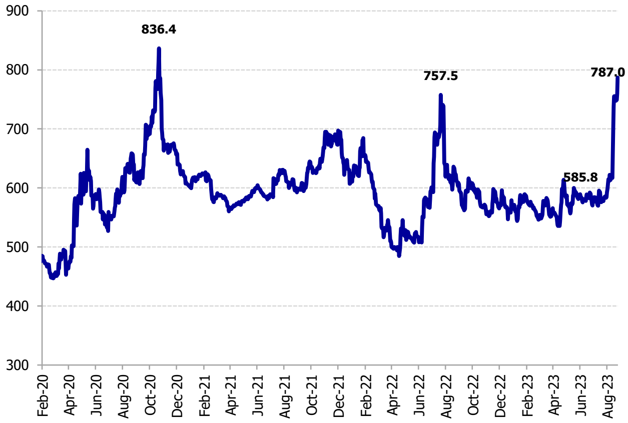
	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	-0.2%	-0.6%	Inflation (monthly)	6.3%	6.0%
Consumer confidence (MoM)	4.3%	9.1%	FX spread (21day avg.)	108.4%	99.7%
Industrial activity (MoM s.a.)	-1.3%	-1.6%	Country risk (bps 21day avg.)	2,026	2,055
International accounts			**External data**		
Current Account (USD BN)	-5.64	1.75	Soybean price (per ton, 21day avg.)	513.5	557.0
CB Reserves (USD BN 21day avg.)	24.26	27.60	Brazilian activity (MoM s.a.)	0.6%	-2.1%
Primary balance (ARS BN)	-334.34	-611.74	Financial Conditions Index	23.4	17.3

Source: Econviews based on multiple sources - working days only

GRAPH OF THE MONTH:

The BCS is nearly as expensive as in October 2020

Real blue chip swap at August 25th prices



Source: Econviews based on Reuters and BCRA

RECENT ECONOMIC DEVELOPMENTS

JUL 28th	AUG 4th	AUG 13th	AUG 14th	AUG 22nd	AUG 23rd	AUG 28th
Econviews Monthly #229: The new IMF agreement + special report on chronic inflation and stabilization.	**Government obtains USD 775 million bridge loan from Qatar** to cancel IMF maturities, also using funds from CAF.	Presidential primaries: **Far-right Javier Milei wins 30% of vote,** ahead of JxC opposition (28%) and Massa (27%) in shock result.	After elections, **BCRA moves official FX rate from ARS 287 to 350 (+22%)** and promises to peg it until the end of October.	After **informal dollar jumps to ARS 780 and food inflation accelerates,** riots and looting in Argentine cities.	**IMF finally disburses USD 7.5 billion,** most of which will be used up to repay Qatar, CAF and the Fund itself.	**Econviews Monthly #230**

POLITICS

In a *déjà vú* of 2019, the PASO election upended markets and polls. Libertarian Javier Milei won 30% of the vote and was first in 16 out of 24 provinces. JxC came in second with a disappointing 28%. Patricia Bullrich won the primary over moderate Rodriguez Larreta, and now the question is if she will be able to retain his votes and force her way into a very likely run-off. The government's candidate, Minister Massa, reached 21%, plus 6% from his left-wing primary contender Juan Grabois, leaving the Peronist front at 27%, its worst result in history. The general election is on October 22nd, but it is unlikely the next president will be known until the eventual run-off on November 19th.

IMF

Last week, the IMF finally disbursed USD 7.5 billion, which will allow the government to cover maturities in the next months. The staff report disclosed that the 22% step devaluation on August 14th was part of the "prior actions" required by the Fund. The IMF was very critical of the SIRA/SIRASE import license system to retain reserves, urging the BCRA to unwind FX controls. It also made explicit that the government had agreed to increase utility rates for low-and-middle-income residential users starting in September. With these modifications, the current bridge program will stay operative until December, when the new administration will have to negotiate a new long-term program.

ECONOMIC ACTIVITY

Activity fell 0.2% in June and May's figure was revised downwards from -0.1 to -0.6%, leaving the quarter-on-quarter variation for Q2 at -2.5%. The economy has already contracted 1.9% in the first half of 2023 and with more volatility after the primaries result, we expect it to fall 2.4% in Q3. We have adjusted our full year GDP forecast from -3 to -3.5%. Manufacturing slumped 1.3% monthly in June and Construction fell 1.5%. Initial data for July is mixed, with a 6.9% monthly decrease in cement output, electricity use down 3.4%, but 3.9% growth in the auto industry. However, activity will surely slump further in August, with the full effect of the increase in the official and parallel exchange rates.

INFLATION

July's monthly inflation came in at 6.3%, below private estimates which were closer to 7%. Communication (+12%) and recreation (+11%) increased the most, while food rose 5.8% and regulated prices grew 6.7%. Year-on-year inflation decreased slightly to 113%. But this is all yesterday's news: the compound effect of the 7.5% tax on goods' imports, the 22% official exchange rate's devaluation in mid-August and the 32% jump in the informal dollar, which has a growing pass-through to prices. The higher dollar must also pass on to utilities, with second round effects. Taking all this into account, we expect 12% inflation in August and September and have adjusted our forecast for 2023's inflation from 148 to 180%.

MONETARY SECTOR

After the elections, the Central Bank devaluated the official exchange rate by 22% to ARS 350, one of the "prior actions" the IMF requested to concede the 7.5 billion disbursement, and promised to peg it there until the end of October. It also hiked the Leliq rate by 21 points, from 97 to 118%, leaving the effective monthly rate at nearly 10%. This is still negative *ex ante* given our inflation forecasts, but with a fixed dollar for two months, it may entice some investors into a carry trade. The futures market is doubtful whether this is a good bet: futures for September 30th trade at ARS 375, 25 pesos above the announced rate. With a clamp on imports and the devaluation, the BCRA bought USD 1.02 billion reserves in August.

FISCAL ACCOUNTS

July's primary deficit stood at ARS 334 billion, accumulating 1.2% of GDP in the first seven months of 2023. Real revenues fell 3.4% against 2022, affected by the collapse in export duties (-73%) due to the drought and also in import taxes (-11%). Taxes linked to the level of activity such as VAT (+10%) and social security contributions (+5.8%) are still doing well, though credit and debit revenues fell 3.4%. Real spending grew 2.6% year-on-year, but many expenditures were frozen in July 2022 due to the political crisis after Minister Guzmán resigned. In the coming months, accelerating inflation will reduce real spending on pensions and other social programs. We are still forecasting a primary deficit of 2.4% of GDP this year.

I. The PASO changed the electoral outlook

The primary elections came with many surprises. The big winner was Javier Milei, who was in the radar and was thought to be competitive, though nobody expected that he would end in first place and obtain 30% of the votes. Rodriguez Larreta was the big loser, as he lost badly the primary to Patricia Bullrich, who is now the candidate of Juntos por el Cambio (JxC). The Peronists had a poor election and finished in third place, but they still have a good chance of winning the province of Buenos Aires, where Axel Kicillof won, and they are likely to have a close race with JxC for the governorship. In Buenos Aires there is no second round.

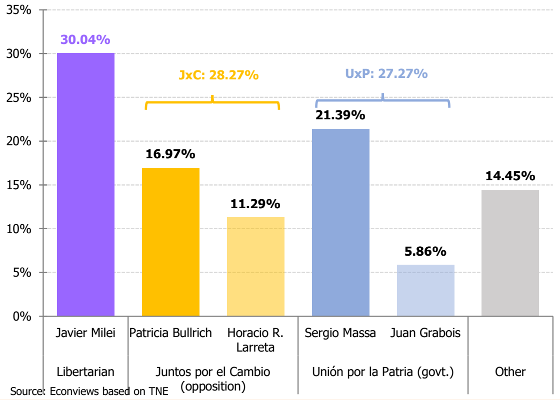
The economic outlook has become more uncertain. JxC clearly has the strongest economic team and a clear roadmap to deal with the large macroeconomic imbalances. There is a plan to remove gradually the FX restrictions. They plan to achieve a balanced budget with clear and realistic ways to cut government expenditures, and to bring down inflation drastically within the first year of the administration. JxC also has the intention of avoiding a restructuring of the domestic and the foreign debt and to reach an agreement with the IMF to boost reserves. But to do all these things it needs to win, which today appears to be an open question.

Javier Milei, who is the front runner now, presents the greatest uncertainty. He has no experience in executive positions, he is weak politically in the sense that his party, in the best scenario, would have very few congressmen, and no governors or mayors. This means that that he will face significant difficulties to pass laws in congress and to ensure governability. In addition, he has not a solid economic program, he only has few economists around him none of whom appears to be the candidate for economic minister; and his proposal to dollarize the economy is non-viable as there no dollars.

He has some good ideas about where he wants to go, such as unifying the exchange rate, removing the "cepo", balancing the fiscal accounts, and opening up the economy to foreign trade among others. However, without a solid and homogenous economic team, with urgent problems such as lack of reserves, debt payments in January, the removal of the "cepo" and the need to devalue while receiving spiraling inflation chances are that something will go wrong. He will be running against time and there will be no margin of error. We shouldn't be surprised if there is a turbulent beginning and there is little progress on inflation, on the debt and on the turnaround on reserves.

Massa represents the third scenario. It won't be more of the same, as the current policies are unsustainable, though we shouldn't expect a shock approach as in the previous cases. The main drawback is that Massa will not be able to break from one day to the other from the with the Campora and the most progressive sectors of the Peronist coalition. As a result, in this scenario we expect a gradual approach to the problems and with an outcome that would be similar in many ways to those observed in the Milei case.

Primaries: president of Argentina
National results, 70% voter turnout



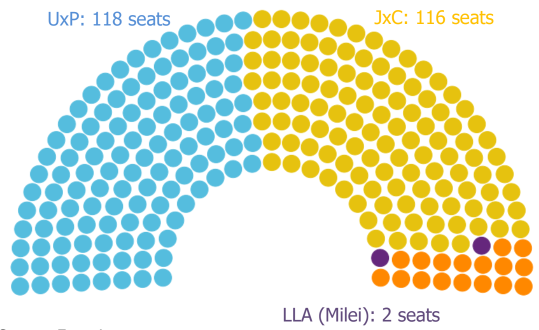
Source: Econviews based on TNE

Voter turnout
Presidential elections since introduction of PASO primaries

	2011	2015	2019	2023
Primaries	81.4%	72.4%	76.4%	**69.6%**
General election	79.4%	81.1%	81.3%	??

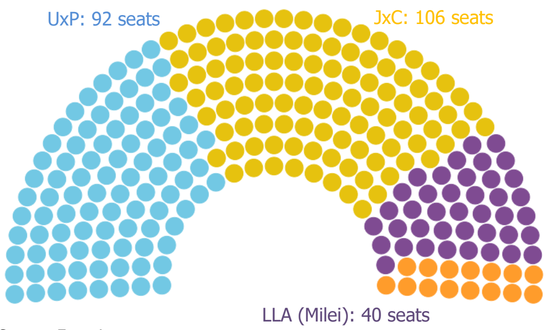
Source: Econviews based on TNE

Current composition of Lower House
Majority = 129 seats



Source: Econviews

Post-election composition of Lower House
If August 13th primary results are repeated in general election

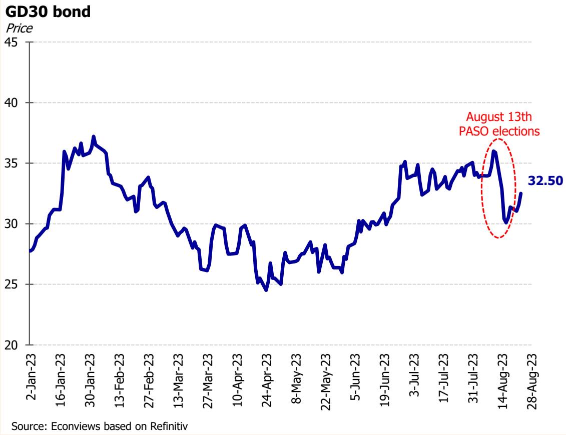


Source: Econviews

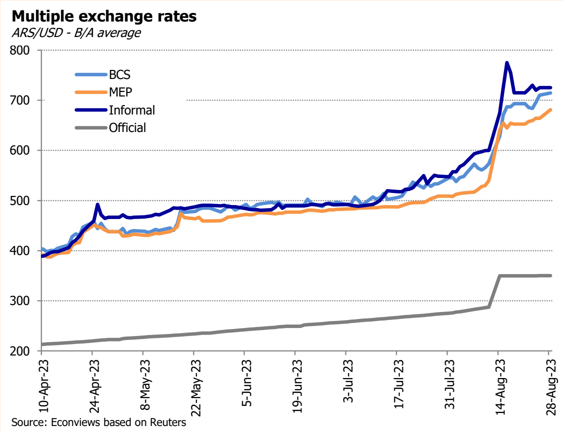
ECONVIEWS
ECONOMÍA Y FINANZAS

The economic road to the general elections

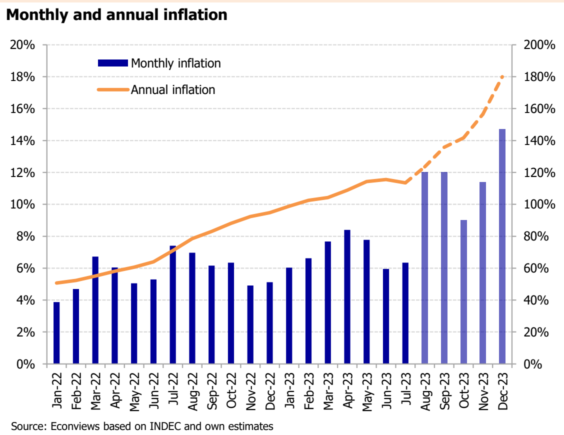
As we leave the PASO behind us, there are lessons and questions regarding what might happen on October 22nd in the general elections. **The market response to Milei's victory was by and large slightly negative**. Prices of bonds and stocks drop roughly 10% and that the parallel exchange rate depreciated significantly on impact, though then receded and there are signs that it has stabilized. The bottom line is that Milei, who was largely distrusted by markets, is still getting the benefit of the doubt, at least till October. The reasons could be that in the end he might not win (though today he is the frontrunner) or that instead he might move to the center and discard or postpone his most daring and unviable proposals (such as dollarizing an economy with a Central Bank that does not have dollars, or mor accurately it owes USD 10 billion according to the latest IMF report).



Markets were also surprised by the government's decision to depreciate the currency by 18% a day after the primaries. Probably this had already been negotiated with the IMF, as the Fund wanted to release the USD 7.5 billion dollars once Massa had complied with a number of prior actions, including a step devaluation moving the exchange rate to ARS 350.



The devaluation represented a change in policy relative to the crawling peg that the Central Bank has been using throughout the tenure of Miguel Pesce at the Central Bank. However, the 20% jump was calculated to be equivalent to the total depreciation that would have been implemented until the general elections if the Central Bank had maintained the previous policy. In other words, instead of getting to ARS 350 on October 22nd gradually as had been the case, it did it in one step with the intention of maintaining a fixed exchange rate for almost two months.



This policy decision, however, opened a Pandora box, and at least initially. It led to a large depreciation in the parallel exchange rates and big uncertainty about inflation. The parallel exchange rates jumped from ARS 605 to 780 in a matter of days. Many businesses stopped selling goods as they were unsure how to set the new prices. This also happened in previous episodes of step devaluations as in January 2014 and in February and April 2018.

But the most concerning issue is that inflation jumped almost instantly. It is well known that the passthrough in Argentina from the exchange rate to prices is roughly between 25 and 35%, compared with low inflation countries where is typically less than 10%. The most surprising thing is that while in other countries it takes around one or two years in Argentina the effect is felt within one or two weeks.

The result was that the step devaluation generated concerns about a possible episode of runaway inflation or of a vicious cycle of inflation and depreciation that could be difficult to stop. While the uncertainty continues it seems that the Central Bank has a good chance of maintaining the 350 pesos exchange rate until the general election and that the depreciations in the parallel market were related to the uncertainty in the change of regime and the impact of Milei's victory in the primaries.

Expected inflation rate

Monthly variations

August	12.0%
September	12.0%
October	9.0%
November	11.4%
December	14.7%

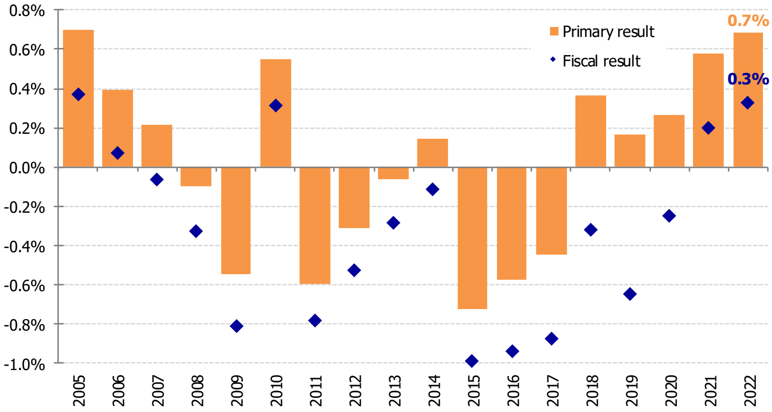
Source: Econviews based on own estimations

However, it seems that the underlying rate of inflation has jumped to the 12% monthly rate, an increase that is likely to stay and will be difficult to reverse. Even if the government succeeds now in avoiding runaway inflation, this episode shows the difficulties that the next administration will face once it tries to correct the overvaluation of the currency through another step devaluation. It seems clear that rates of inflation will show another worrisome jump, and that the challenge at that will be to design a comprehensive program with consistent monetary and fiscal policies and some critical structural reforms that can be effective in anchoring expectations.

II. Provinces are fiscally stable: they should begin to cut taxes

In contrast with the national state's fiscal woes, **Argentine provinces had a primary surplus equal to 0.7% of GDP in 2022**, the 5th such surplus in a row. They also achieved a fiscal surplus of 0.3% of GDP, the second in the last decade after 2021's 0.2% positive balance.

Provincial fiscal accounts
Consolidated, as a % of GDP



Source: Econviews based on Min. of Economy

21 out of 24 provinces reached a primary surplus last year. The City of BA (0.23%) and Córdoba (0.14%) made the greatest contribution in terms of GDP. Together with Santiago del Estero, they also had the largest surplus measured against their own receipts, spending 10-15% less than what they collected (or received from the national treasury).

Of the three provinces with deficits, San Luis and La Pampa had achieved primary surplus in 2021 and failed to reach a balance by a small margin. **Buenos Aires is the only province with a structural deficit**, with negative primary results in 11 of the last 15 years. Even so, last year it spent 1.3% more than it collected, much less than 2015-16's primary deficits which on average were 4.5% of receipts.

While the shorter sovereign bonds yield close to 40%, some dollar bonds issued by provinces (City of BA, Neuquén, Santa Fe, etc.) yield 10 to 15%. In terms of risk, this puts them closer to neighboring countries like Brazil than to the federal government.

But are provinces really a world apart? Their current fiscal strength is not a result of austerity, but rather a combination of excessive taxation, reliance on the national government and inflation eroding their wage bill in the last five years. The oil industry's boom has also helped Patagonian provinces. **In this special report, we will analyze taxes, spending and debt at the sub-sovereign level.**

i. Where do provinces' resources come from?

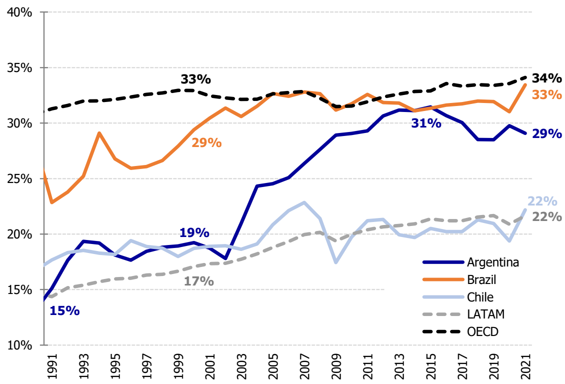
Argentina's tax pressure nearly doubled in the last 30 years: it went from 15% of GDP in 1991, to almost 20% at the turn of the century, and today reaches 29% of GDP, a figure closer to OECD countries than Latin American peers, but with a more regressive tax scheme.

Primary result by province
As a % of current receipts and of GDP

		As % of receipts	As % of GDP	In bn '22 pesos
1	City of BA	14.6%	0.23%	191
2	Santiago del Estero	11.3%	0.04%	35
3	Córdoba	10.0%	0.14%	116
4	Mendoza	9.2%	0.05%	44
5	Jujuy	8.9%	0.02%	20
6	Tucumán	5.9%	0.03%	25
7	Chubut	5.4%	0.02%	15
8	Corrientes	5.3%	0.02%	17
9	Entre Ríos	4.9%	0.03%	25
10	Salta	4.3%	0.02%	15
11	Santa Fe	4.3%	0.06%	46
	Total	**4.1%**	**0.68%**	**563**
12	San Juan	3.6%	0.01%	10
13	Santa Cruz	3.4%	0.01%	8
14	Río Negro	3.3%	0.01%	8
15	Tierra del Fuego	2.8%	0.01%	5
16	Misiones	2.4%	0.01%	10
17	Catamarca	2.3%	0.01%	5
18	Chaco	2.1%	0.01%	9
19	Formosa	2.1%	0.01%	6
20	La Rioja	2.0%	0.00%	3
21	Neuquén	0.8%	0.01%	4
22	La Pampa	-0.7%	0.00%	-2
23	Buenos Aires	-1.3%	-0.06%	-52
24	San Luis	-1.9%	0.00%	-4

Source: Econviews based on Min. of Economy

Total tax revenues
As a % of GDP, including subnational governments



Source: Econviews based on OECD

Of this fiscal burden equal to 29% of GDP, **17 points go to the provinces.** It breaks down into 5.1 points of provincial tax revenues, 1.6 points from social security contributions, and 1.8 points from royalties, interest income and other sources: **8.3 points of GDP are directly levied by the provinces**. The other **8.7 points come from the national government**, 7.9 from shared taxes and the rest in direct transfers.

Seen in another way, provinces raise 48% of their financing on their own, through taxes (30%), social security contributions (9%), royalties (2%) and other sources (7%). They obtain the other 52% from the national government, through shared taxes (48%) and as direct tranfers (4%). How does this break down province by province?

- **Taxes**

Provincial taxes are directly responsible for 1.3 points of the rise in tax pressure between 2005 and 2022. The turnover tax in first place and the stamps tax secondly, both on goods and services, explain the increase, as property taxes on real estate and vehicles fell or stagnated. Provinces also benefitted from the rise in national taxes of which they receive a share. Under the 1988 *Coparticipación* bill, 50% of VAT revenues and 56% of income taxes end up in provincial coffers, among others. Total provincial receipts rose by 3.6 points of GDP in the last two decades.

The turnover tax grew beyond common sense. *Ingresos brutos* is a sales tax collected at every phase of the production chain; hence it cascades on the next one. Unlike VAT where every phase pays on the value added, the turnover tax means that consumers end up paying several times the same tax, making the effective rate gigantic.

This tax's weight in GDP swelled from 2.5% in 2005 to 4% in 2013. One of the 2017 fiscal pact's main objectives was lowering the turnover tax, and it managed to bring it down to 3.6% of GDP in 2019. But after the change of government the pact was suspended and the tax is back to 4% of GDP. It has also gained in relative weight, from 60% of provincial tax collection in the early 2000s to nearly 80% in 2022.

In some provinces such as Misiones, **it increased eightfold over the last twenty years**. Misiones channels trade with Paraguay and its extensive use of the turnover tax has been characterized as a "parallel customs". In fact, Misiones accounts for 3.4% of all turnover tax revenues, three times its share in national GDP. The turnover tax also had an explosive growth in Formosa (+452%), Jujuy (+381%) and Neuquén (302%). Focusing on the last three years, Formosa (+46%), Catamarca (+36%) and La Rioja (+36%) show the largest increase in turnover tax collection.

The turnover tax replaced other sources of revenue, especially property taxes. Real estate taxes' share in provincial tax collection fell from 15% at the turn of the century to 6% nowadays. In real terms, they fell 0.5% in a twenty-year period due to undervaluation of properties, shrinking from 0.5 to 0.3% of GDP.

Taxes on automobiles grew 84% in real terms since 2003, but nearly all the growth took place in the first decade of the century. **Revenues from taxes on cars fell 7.8% since 2013**, and are stuck at 0.2% of GDP. This is partly a macro issue: new car sales shrunk from nearly a million per year

Provincial total receipts
Consolidated, as % of GDP

	2005	2016	2019	2022
Provincial tax revenues	3.8%	5.2%	4.8%	5.1%
Turnover tax	*2.5%*	*3.9%*	*3.6%*	*4.0%*
Stamps tax	*0.3%*	*0.5%*	*0.4%*	*0.4%*
Real estate tax	*0.5%*	*0.4%*	*0.4%*	*0.3%*
Automobile tax	*0.2%*	*0.3%*	*0.3%*	*0.2%*
Others	*0.3%*	*0.1%*	*0.1%*	*0.1%*
Social security	1.1%	1.8%	1.7%	1.6%
Royalties	0.7%	0.3%	0.4%	0.4%
Other	1.0%	1.4%	1.3%	1.2%
National shared taxes	5.9%	6.8%	7.6%	7.9%
Current transfers	0.9%	1.2%	0.6%	0.8%
Total	**16.4%**	**17.5%**	**16.5%**	**17.0%**

Source: Econviews based on Min. of Economy

Increase in turnover tax collection by province
As % of current receipts and variation in real terms

		2022 vs. 2005	As % of receipts	In bn '22 pesos
1	Misiones	721.8%	27.9%	113
2	Formosa	451.6%	5.7%	17
3	Jujuy	381.2%	10.9%	25
4	Neuquén	302.1%	21.2%	114
5	La Pampa	294.7%	15.2%	34
6	Tucumán	293.1%	20.0%	85
7	Catamarca	283.4%	8.9%	19
8	Corrientes	278.5%	9.4%	30
9	Entre Ríos	267.8%	13.4%	70
10	Salta	258.9%	19.2%	69
11	La Rioja	257.0%	7.6%	11
12	Mendoza	251.0%	23.5%	113
13	Chubut	235.4%	16.2%	46
14	Córdoba	232.5%	21.2%	246
	Total	**214.5%**	**24.1%**	**3,313**
15	Santiago del Estero	213.5%	7.3%	23
16	San Juan	211.9%	8.4%	23
17	City of BA	201.2%	62.1%	811
18	Santa Fe	193.6%	22.9%	244
19	Buenos Aires	187.2%	27.2%	1,058
20	Río Negro	178.1%	16.3%	39
21	Chaco	172.2%	8.5%	38
22	Santa Cruz	151.4%	14.9%	37
23	San Luis	131.2%	15.4%	29
24	Tierra del Fuego	130.1%	11.1%	18

Source: Econviews based on Min. of Economy

New car sales and automobile taxes
In billions of 2022 pesos

	2003	2013	2022
New car sales*	138	892	341
Car tax in bn '22 pesos	103	206	190
Real variation	**-**	**99.5%**	**-7.8%**
Share of provincial taxes	5.2%	5.0%	4.5%

*three-year average, thousands of units
Source: Econviews based on Min. of Economy and ADEFA

in 2011-13 to 340,000 on average in 2020-22 due to the crisis. As the national car fleet grows older, less vehicles pay the full tax.

- **Royalties**

Vaca Muerta explains half of all royalties. The 1994 Constitution grants provinces rights over their natural resources. Oil producers like Neuquén make the most of this: the Patagonian province collected ARS 157 billion last year, 48% of the national total, up from 24% ten years ago, when the shale revolution was just getting started. Together, Neuquén, Santa Cruz and Chubut represent 80% of royalties. The three Patagonian provinces get 20-30% of their revenues from royalties. However, only Neuquén collects more than 2005 in real terms, with the other two 25-30% below.

None of the mining provinces come close. Mendoza levied ARS 20 billion last year, only 4.5% of its revenues. In real terms, the Andean province's royalties are 56% less than in 2005.

- **Federal shared taxes and transfers**

Of course, not all provinces are equally dependent on the national State. Northern provinces like La Rioja (89%), Santiago del Estero (86%) or Jujuy (85%) get nearly all their resources through shared taxes (they receive a proportionate share of direct transfers). Of the 12 provinces which depend the most on federal taxes and transfers, 9 are located in the North of Argentina, an historically poorer region. Of the 7 provinces that sit below the national average, 3 are located in the productive Pampean region and 4 are from the Patagonia.

It is tricky to determine who are the net winners and losers of the federal tax-sharing system. 69% of VAT and 65% of income tax is collected in the City of BA, but a lot is from provincial companies whose offices are located in the capital. Provinces like Buenos Aires, Santa Fe or Entre Ríos rely on the national government for 45-60% of their receipts, but they provide the bulk of agro exports which account for 10% of total tax revenues. And export duties are not shared with provinces.

Another case is Tierra del Fuego, which is 19th in term of dependence on federal taxes, but whose manufacturing companies do not pay VAT or income tax under a much criticized special regime passed in the 70s to populate the island.

ii. What are the provinces spending on?

Mostly, wages. Total provincial spending expanded from 12.7% of GDP in 2005 to 16.3% in 2022. Of this, the provinces spent 7.1 points of GDP on wages, 1.5 points on other operational expenses such as goods and services, 2 points on social security and 1.4 points on CAPEX. The other 4 points are mostly current transfers to other levels of government and the private sector.

Seen in another way, provinces allocated 42% of their budget to wages, 9% to other operational expenses, 13% on social security and 8% on CAPEX. The other 28% is explained by current transfers.

Royalties by province

As % of current receipts and variation in real terms

		As % of receipts	2022 vs. 2005	In bn '22 pesos
	Total	**2.4%**	**-20.6%**	**323.8**
1	Neuquén	29.2%	3.7%	157.3
2	Chubut	20.3%	-25.2%	58.0
3	Santa Cruz	20.0%	-30.4%	49.0
4	Mendoza	4.2%	-56.3%	20.1
5	Río Negro	5.5%	-35.8%	13.2
6	Tierra del Fuego	5.3%	-50.3%	8.7
7	Salta	1.5%	54.6%	5.2

Source: Econviews based on Min. of Economy

Dependence on national government by province

Shared taxes and direct transfers as % of current receipts

		As % of receipts		As % of GDP
		Shared taxes	Direct transfers	
1	La Rioja	84.0%	5.05%	0.16%
2	Santiago del Estero	83.0%	2.65%	0.32%
3	Jujuy	77.7%	7.55%	0.23%
4	Formosa	77.1%	3.72%	0.29%
5	Catamarca	77.7%	2.63%	0.21%
6	San Juan	76.8%	2.64%	0.26%
7	Corrientes	72.3%	4.11%	0.30%
8	San Luis	74.3%	2.14%	0.17%
9	Chaco	69.6%	4.05%	0.40%
10	Tucumán	69.0%	4.60%	0.38%
11	Salta	67.6%	3.29%	0.31%
12	Río Negro	64.7%	2.89%	0.20%
13	Entre Ríos	57.7%	3.46%	0.39%
14	Santa Fe	52.9%	4.32%	0.74%
15	Misiones	51.4%	5.48%	0.28%
16	Mendoza	53.5%	2.61%	0.33%
17	La Pampa	52.2%	2.07%	0.15%
	Total	**47.5%**	**4.94%**	**8.74%**
18	Córdoba	47.4%	3.35%	0.71%
19	Tierra del Fuego	46.0%	1.66%	0.10%
20	Buenos Aires	37.8%	7.96%	2.16%
21	Santa Cruz	40.2%	4.16%	0.13%
22	Chubut	34.9%	1.56%	0.13%
23	Neuquén	20.3%	1.01%	0.14%
24	City of BA	10.8%	5.56%	0.26%

Source: Econviews based on Min. of Economy

Provincial primary expenditure

Consolidated, as % of GDP

	2005	2016	2019	2022
Public wages	5.3%	8.4%	7.5%	7.1%
Consumption goods	0.4%	0.4%	0.4%	0.5%
Services	1.0%	1.0%	1.0%	1.0%
Social security	1.3%	2.1%	2.2%	2.0%
Current transfers	2.7%	3.4%	3.4%	3.8%
Capex	1.5%	1.4%	1.3%	1.4%
Other	0.6%	0.6%	0.5%	0.6%
Total	**12.7%**	**17.4%**	**16.2%**	**16.3%**

Source: Econviews based on Min. of Economy

- **Wages**

Wages explain half of the growth in provincial spending since 2005, 1.8 points of GDP. Between 2004 and 2016 provinces hired 777,000 workers, swelling their ranks by 54%. For comparison, private formal employment grew 40% in the same period. The last official data from 2017 counted 2.3 million provincial public employees, 74% of total public sector jobs.

Real spending on wages doubled (+105%) from 2005 to 2015, peaking at 8.5% of GDP. It fell 16% over the following 5 years but has rebounded 5% since 2020 and is currently at 7.1% of GDP. Public sector employment did not vary significantly in 2016-20, meaning the 16% cut in spending was at the expense of real wages, and not reducing payrolls.

For the full 2005-2022 period, the provinces which most increased their spending on wages were Neuquén (+162%), Salta (+156%) and Misiones (+130%).

Another relevant metric is the ratio between provincial public sector and formal private sector employment. For example, Formosa has nearly 1.5 public jobs for each private one, and Catamarca comes close to that figure. 6 provinces, all located in Northern Argentina, have more public than formal private jobs. On the other extreme, in the City of BA private jobs outnumber city government jobs by almost 10 to 1. Counting total public sector jobs logically worsens the ratio, as Ministries and national organisms such as ANSES have their offices in the Capital. Córdoba and Santa Fe have a 4 to 1 ratio of private-to-provincial public jobs.

There is less discrepancy in how much of each province's budget goes to wages, with Río Negro (62%) spending the most in relative terms. Santiago del Estero (28%) allocates the smallest portion of its budget to wages, despite being one of the 6 provinces with more public than formal private jobs.

- **Capex**

The City of BA spends the most on infrastructure. With an investment of ARS 173 billion in 2022, it accounts for 15% of total provincial spending on public works. Of course, without municipalities, investment is much more concentrated. However, with 5 times the population, neighbouring Buenos Aires spent only 134 billion in 2022. Though the City still leads in absolute terms, its CAPEX last year was half of 2017's ARS 318 billion (adjusted for inflation).

Santiago del Estero and San Luis lead in relative terms. Santiago assigns 30% of its budget to infrastructure, and San Luis, 23%. This is not new, as both allocated more than 20% of their resources to CAPEX since 2008. Of the 12 provinces that invest more than the national average (8.1%), 8 are located in Northern Argentina. The same ranking for 10 or 15 years ago shows only minor changes, with one exception: in Santa Cruz, CAPEX fell from 20 to 2.5% of total spending, dropping 85% in real terms.

Patagonian provinces underinvest in infrastructure, occupying 5 of the 8 bottom spots in our CAPEX list. Like Santa Cruz, Chubut (-71%), Río Negro (-34%) and Neuquén (-24%) all spend less than in 2005 in constant pesos.

Public/private jobs and spending on wages by province

Spending as % of current receipts and variation in real terms

		Public/private formal jobs*	As % of receipts	2022 vs. 2005
1	Formosa	147%	35.0%	68.8%
2	Catamarca	138%	45.2%	102.8%
3	La Rioja	125%	48.9%	77.1%
4	Jujuy	113%	47.9%	64.2%
5	Chaco	112%	43.4%	91.7%
6	Santiago del Estero	110%	28.2%	26.1%
7	Corrientes	76%	38.7%	62.5%
8	La Pampa	63%	39.6%	107.3%
9	Salta	61%	56.6%	155.9%
10	Santa Cruz	59%	45.5%	122.2%
11	Misiones	58%	37.8%	129.9%
12	Entre Ríos	57%	45.1%	93.1%
13	Neuquén	55%	49.3%	162.7%
14	Río Negro	52%	62.0%	106.3%
15	Tucumán	49%	52.6%	100.7%
16	Tierra del Fuego	49%	47.6%	69.8%
17	Chubut	45%	51.9%	72.2%
18	San Juan	44%	45.2%	97.7%
19	San Luis	42%	43.8%	113.8%
20	Mendoza	39%	41.1%	50.8%
	Total	**36%**	**42.3%**	**81.4%**
21	Buenos Aires	35%	42.3%	64.8%
22	Santa Fe	26%	39.5%	78.9%
23	Córdoba	25%	32.0%	72.8%
24	City of BA	13%	40.4%	86.5%

*data from 2016-17, SIPA formal private employment

Source: Econviews based on Min. of Economy

CAPEX by province

As % of total spending and variation in real terms

		As % of spending	2022 vs. 2005	In bn '22 pesos
1	Santiago del Estero	29.0%	116.5%	89
2	San Luis	22.8%	56.3%	47
3	Formosa	19.4%	90.7%	58
4	City of BA	14.6%	161.3%	173
5	Catamarca	13.2%	26.8%	29
6	Jujuy	12.1%	37.6%	26
7	Chaco	11.9%	20.2%	55
8	San Juan	11.2%	6.4%	30
9	Córdoba	11.0%	90.1%	118
10	Corrientes	10.7%	-13.5%	34
11	La Rioja	10.6%	18.1%	19
12	Misiones	9.3%	-25.6%	38
	Total	**8.1%**	**25.8%**	**1,116**
13	La Pampa	8.1%	-37.0%	19
14	Salta	7.6%	-26.5%	27
15	Mendoza	7.2%	56.1%	35
16	Santa Fe	6.6%	7.5%	71
17	Tierra del Fuego	6.4%	67.3%	11
18	Río Negro	5.5%	-34.4%	13
19	Neuquén	5.3%	-24.1%	29
20	Entre Ríos	5.2%	-9.4%	27
21	Tucumán	4.2%	-45.9%	18
22	Chubut	3.7%	-71.2%	11
23	Buenos Aires	3.3%	77.6%	134
24	Santa Cruz	2.5%	-85.3%	6

Source: Econviews based on Min. of Economy

iii. Are the provinces indebted?

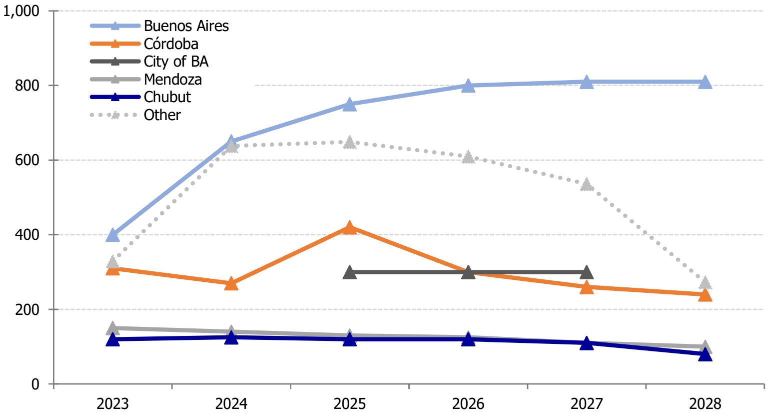
Not much. As of December 2022, provinces' debt stock was equal to 32% of their yearly receipts and 5.2% of national GDP, down from 8% in 2020. Last year, debt services amounted to only 4.5% of total expenditures, 2.4 points of maturities and the rest in interests.

Jujuy has the highest debt stock measured against its receipts (64%), but nearly half is owed to the national government and only 29% is in bonds. Arguably, Buenos Aires or Chubut's situations are more complicated, as their debt in bonds equals 45% of receipts. Last year, 4% of Buenos Aires' budget went towards debt service, but its annual bond maturities double between 2023 and 2025, from USD 400 million to nearly 800 million.

The 2020-21 restructurings cleared maturities these last years. However, provincial dollar bond maturities will rise from 1.3 billion this year to 1.8 billion in 2024 and a peak of 2.4 billion in 2025, decreasing gradually from then onwards. After Buenos Aires, Córdoba and the City of BA face the largest maturities, averaging 300 million per year in 2025-27.

Dollar debt maturities

International provincial bonds in million USD



Source: Econviews based on Min. of Economy

These are manageable figures, **but provincial bond yields are tainted by sovereign risk.** Even so, we can separate between Buenos Aires, La Rioja, Río Negro and Chaco's bonds, which trade at par with Argentine Globals, and the rest of the provinces, which yield 15-30 p.p. less. The City of BA, Tierra del Fuego and Neuquén's NDT11 bonds trade above 90 cents to a dollar, closer to Brazilian risk than to the sovereign. The last two, as well as Chubut's PUL26 bonds, are guaranteed by oil royalties, giving them further hedge against national volatility.

iv. Conclusion

Going back to our initial point, at 29% of GDP Argentina has the second highest fiscal burden in the region after Brazil (33%), closer to the OECD average of 34% than to LATAM's 22%. Some economists have justified this alluding to developed countries like France (45%) or Italy (43%) that have high tax pressure to GDP ratios. But not only do they offer superior public goods, their tax structure is much more progressive. Argentina also has a relatively larger submerged economy, meaning that the effective burden on the formal private sector ends up being much higher than 29%.

Debt stock by province

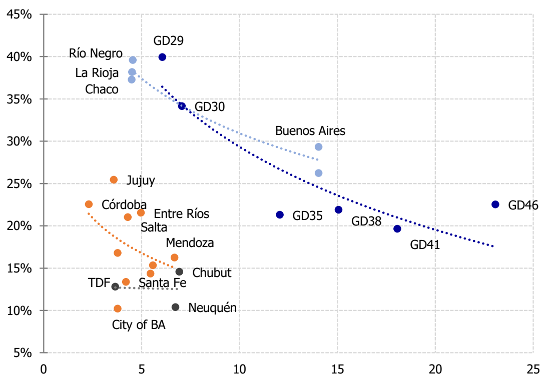
As a % of current receipts and bonds/total debt

	As % of receipts	% in bonds	In bn' 22 pesos
1 Jujuy	63.8%	28.7%	144
2 Chubut	59.7%	75.6%	171
3 Buenos Aires	49.9%	89.5%	1,942
4 Córdoba	39.0%	74.2%	452
5 Río Negro	37.9%	75.7%	91
6 Mendoza	37.6%	64.0%	180
7 Neuquén	34.4%	68.2%	185
8 La Rioja	34.1%	80.5%	51
Total	**31.7%**	**73.9%**	**4,268**
9 City of BA	30.0%	61.2%	392
10 Entre Ríos	29.0%	63.0%	152
11 Chaco	22.7%	50.4%	101
12 Tucumán	22.1%	13.9%	36
13 Salta	21.2%	64.7%	76
14 San Juan	18.3%	5.1%	49
15 Santa Fe	11.5%	54.6%	123
16 Tierra del Fuego	7.8%	83.9%	33
17 Catamarca	6.8%	14.0%	15
18 Formosa	5.9%	0.3%	17
19 Corrientes	5.5%	15.5%	18
20 Santa Cruz	5.0%	9.5%	12
21 Misiones	4.7%	47.4%	19
22 Santiago del Estero	2.1%	69.2%	7
23 La Pampa	1.1%	0.0%	3
24 San Luis	0.1%	0.0%	0

Source: Econviews based on Min. of Economy

Sovereign and provincial dollar bonds

Yield (y axis) and years to maturity (x axis), 18th August 2023



Source: Econviews based on Min. of Economy and IAMC

Total tax revenues

As a % of GDP, including subnational governments

	1991	2001	2011	2015	2021
France	42%	43%	43%	45%	45%
Italy	37%	40%	42%	43%	43%
Germany	35%	35%	36%	37%	40%
OECD average	**31%**	**32%**	**32%**	**32%**	**34%**
United Kindom	32%	32%	33%	32%	33%
Brazil	23%	30%	33%	31%	33%
Argentina	15%	19%	29%	31%	29%
United States	26%	27%	24%	24%	27%
Uruguay	19%	22%	25%	25%	27%
Chile	18%	19%	21%	21%	22%
LATAM	**14%**	**17%**	**20%**	**21%**	**22%**
Colombia	13%	17%	19%	20%	20%
Mexico	12%	12%	13%	16%	17%

Source: Econviews based on OECD

Income tax accounts for 30% of developed countries' revenues, but only 16% of Argentina's. For worse, it collects more from businesses (9%) than individuals (7%), against policy guidance. **More than half of Argentina's revenues come from taxes on goods and services**. VAT's weight is similar to other countries. But trade and custom taxes, mainly export duties, make up 10% of the total. Most OECD countries have scrapped these restrictions on trade and even closed economies like Brazil use them sparingly. "Other taxes on goods and services" represent an unusually high 13% of the total.

Main revenue sources

As a % of total revenues including subnational governments, 2021-22

	Income tax			Social security	Property taxes	Taxes on goods and services					Residual	Total tax revenues as a % of GDP
	Total	*Individuals*	*Corporate*			Total	*VAT*	*Excises*	*Trade and customs*	*Other**		
United States	48%	42%	6%	24%	11%	17%	8%	3%	1%	4%	0%	27%
United Kindom	38%	30%	8%	20%	11%	31%	20%	6%	1%	4%	0%	33%
France	27%	21%	6%	33%	8%	27%	16%	6%	0%	5%	5%	45%
Italy	30%	26%	4%	31%	3%	28%	16%	9%	0%	3%	7%	43%
Chile	28%	11%	17%	5%	5%	53%	43%	5%	1%	4%	9%	22%
Colombia	31%	7%	24%	10%	9%	43%	30%	6%	2%	5%	8%	20%
Mexico	42%	21%	21%	14%	2%	37%	26%	9%	2%	1%	5%	17%
Argentina	**16%**	**7%**	**9%**	**18%**	**11%**	**52%**	**24%**	**5%**	**10%**	**13%**	**3%**	**29%**
Brazil	20%	9%	11%	24%	5%	45%	23%	3%	2%	17%	7%	33%

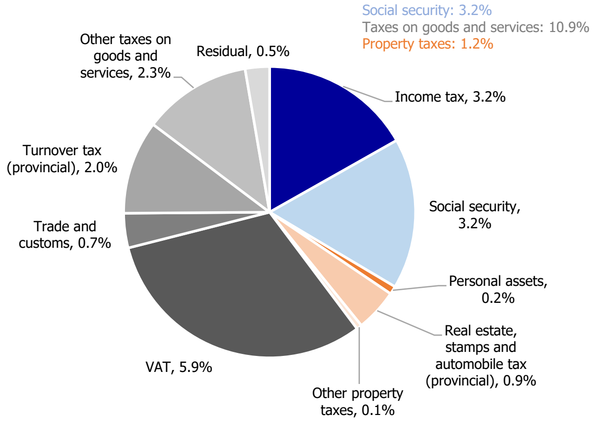
*includes "turnover tax" for Argentina

Source: Econviews based on OECD

While lowering taxes is a commendable goal, in the short term it comes at odds with the need for fiscal consolidation. There is no doubt export duties hinder one of the economy's most dynamic sectors, but they are unlikely to fully disappear in the following years. On the other hand, **the experience of 2017-19 shows it is possible to gradually reduce the fiscal burden at a provincial level**, for example, the distorsive "turnover tax".

Total tax revenues: 1999

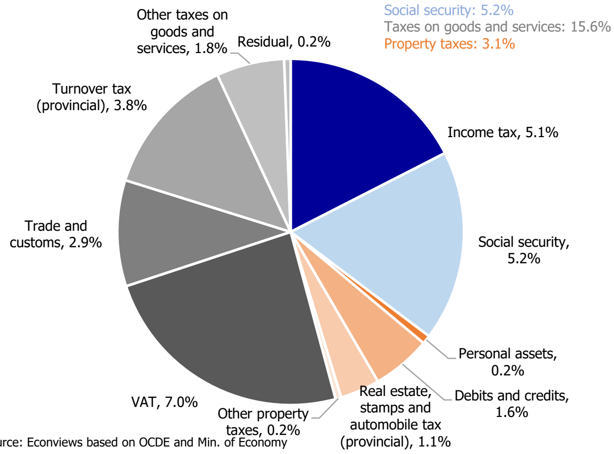
As a % of GDP; OECD classification



Source: Econviews based on OCDE and Min. of Economy

Total tax revenues: 2021

As a % of GDP; OECD classification



Source: Econviews based on OCDE and Min. of Economy

Base Scenario

	2019	2020	2021	2022 E	2023 E	2024 E
Inflation (eop)	53.8%	36.1%	50.9%	94.8%	180.0%	150.0%
Exchange rate ARS/USD (eop)	59.9	84.1	102.8	177.1	754.1	1,470.6
Exchange rate ARS/USD (eop, YoY)	58.4%	40.5%	22.1%	72.4%	325.7%	95.0%
Real exchange rate ARS/USD (eop, Dec-01=100)	151.5	158.3	137.1	129.4	200.5	161.2
Paralell exchange rate ARS/USD (eop)	74.6	140.3	203.1	340.8	942.6	1,470.6
Spread with official exchange rate (eop)	24.6%	66.8%	97.7%	92.4%	25.0%	0.0%
Gross reserves (USD billion, eop)	44.8	39.4	39.7	44.9	29.0	41.5
Net international reserves (USD billion, eop)	12.6	3.8	2.3	7.7	-4.0	6.0
Policy rate (eop)	55.0%	38.0%	38.0%	75.0%	130.0%	40.0%
GDP (YoY)	-2.0%	-9.9%	10.7%	5.0%	-3.5%	-0.5%
Formal wages in real terms (aop, YoY)	-6.0%	-1.9%	0.4%	0.3%	-3.0%	-2.5%
Primary result (% GDP)*	-0.2%	-6.4%	-3.3%	-2.7%	-2.4%	0.0%
Fiscal result (% GDP)*	-3.6%	-8.4%	-4.8%	-4.1%	-4.4%	-2.0%
EMBI Argentina (spread in bps, eop)	1,770	1,372	1,703	2,196	1,400	800
Public net debt (% GDP)	43.6%	52.7%	42.1%	35.2%	38.8%	44.4%
Current account (% GDP)	-0.8%	0.8%	1.4%	-0.6%	-3.1%	3.0%

Source: EconViews

*Excludes rents from primary debt issuance in 2022; PIPs below the line in 2019

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