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The "model" in the provinces

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This document intends to analyze the functioning of the "economic model" in the provinces, reflecting on the political impact which the current economic crisis could have there. The leading argument is that, since the country overtook the 2002 crisis, the provincial governments adopted a pro-cyclic model that is based upon a constant increase of public spending and public sector employment, which will enforce a cutback on expenditures, starting on June 28th. There are several reasons to expect that, at first, this cutback will be less drastic than the one needed on the national level; however, if the crisis gets worse and forces the government to apply broad saving measures, its impact on provincial politics can be very tough.

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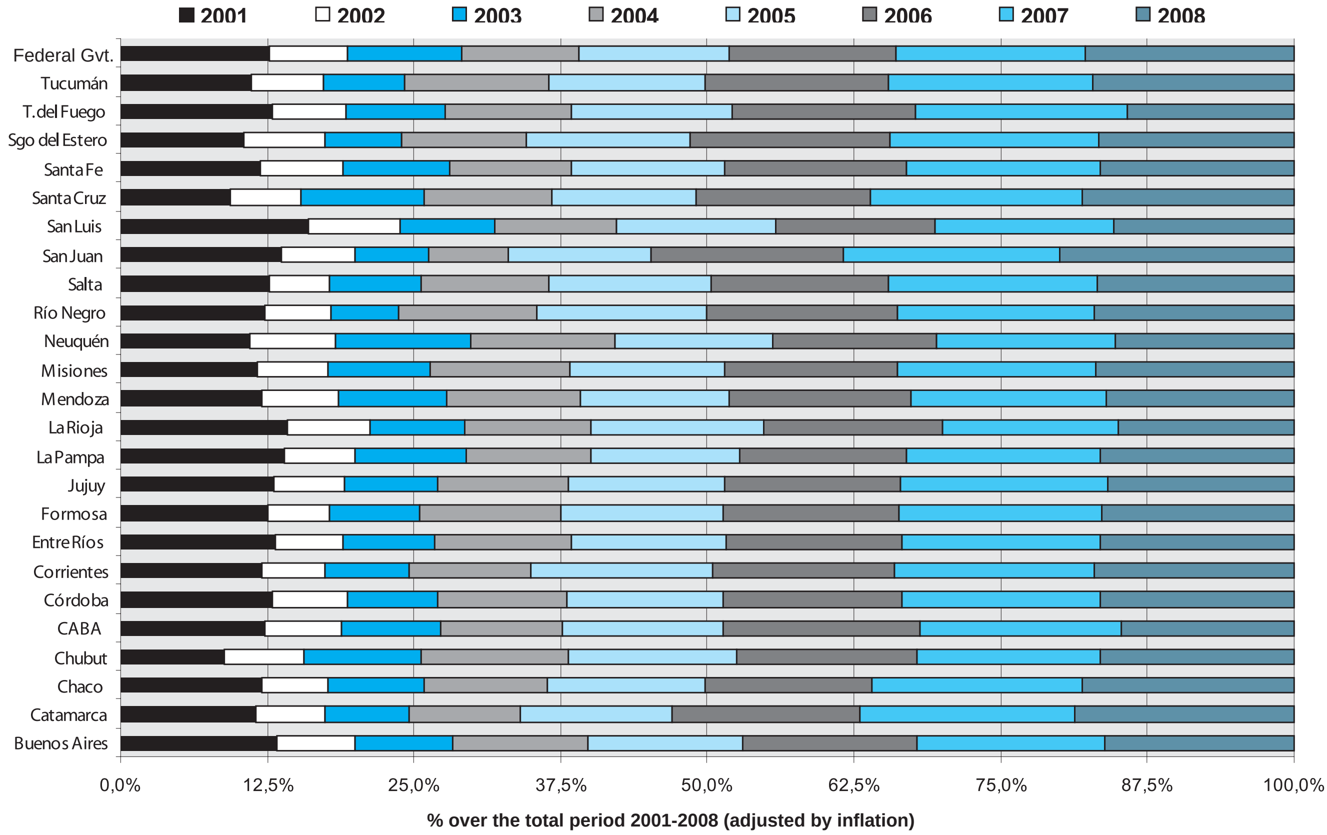
1. The federal model and the provincial models. The economic model that has been adopted by the “Kirchnerism” in 2003 is based on the idea that public spending promotes internal consumption, which in turn stimulates industrialization, making the economy grow, generating employment and reducing social inequality. At least, that is what theory says; many could put forward that the economic recovery experienced since 2003, with growth-rates over 8% annually during five consecutive years, are more likely to be due to the magnitude of the collapse in 2002 and to the high international prices of the “agricultural commodities”, than to the model that has been adopted by the government. However, beyond the dispute considering if the model generates the results which are cited by its defenders, there is the fact that it does have an Achilles’ heel: it is a pro-cyclic model, which can only work to the extent that the revenues increase systematically, to back the continuous increase in public spending. If, as a consequence of external factors – like the current international financial crisis which made the prices of “agricultural commodities” drop – the cycle reverts, the revenues drop; the public spending must be reduced, since the country has banned any access to external funding.
The situation in the provinces is not very different from the national situation. Graph 1 shows that public spending (inflation adjusted) dropped sharply in 2002 and 2003, but started growing again rapidly in 2004. If the spending had remained constant throughout the eight years between 2001 and 2008, every single one of the eight segments the bars are divided into would have the same length; however, it is worth noting that practically half of the public spending of the period is concentrated within the last three years. San Luis is the only province that (partially) escapes this pattern.

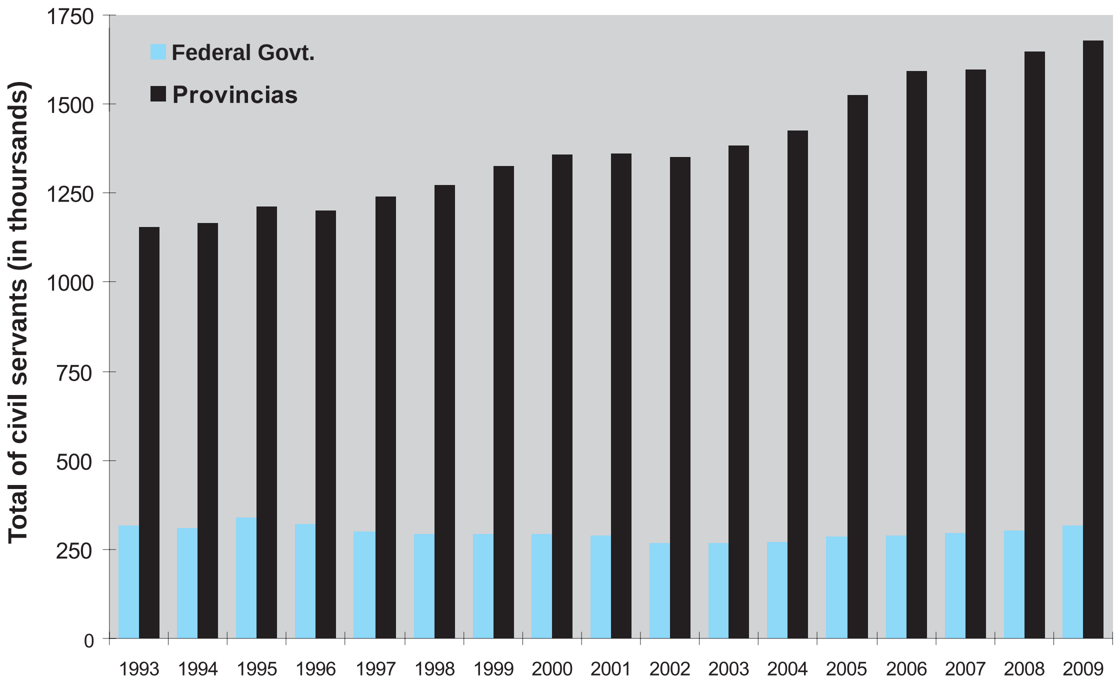
Graph 1. Public expense by inhabitant, 2001-2008



Source: Made by the author, based upon data by the National Budget Office, ProvInfo and INDEC (National Institute of Statistics and Censuses).

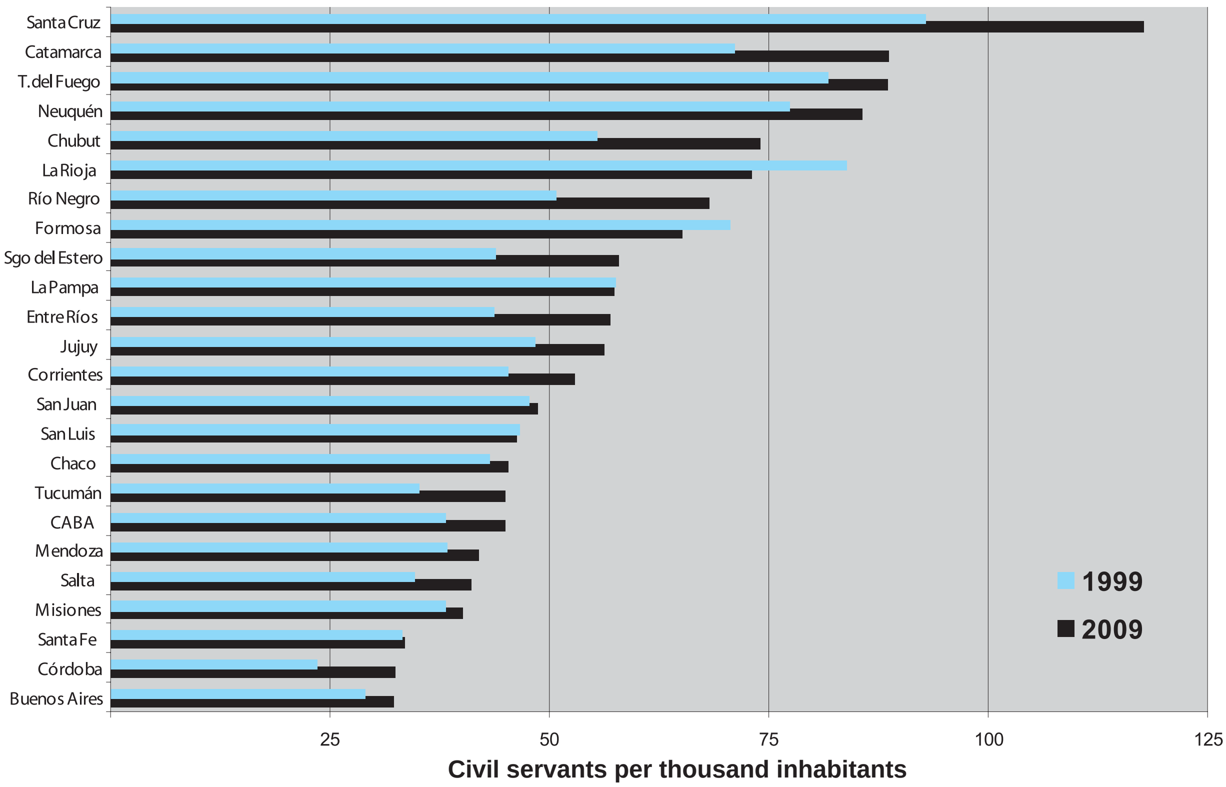
Furthermore, as can be observed in Graph 2, the provinces as a whole employ a lot more people than the federal government. This is partially due to the fact that the provinces offer services (like security, health and education) that are more work-intensive than the national services (like pension payments, economic policy, etc.); however, there are also important political reasons that intervene. In fact, Graph 3 shows that during the last decade, the quantity of civil servants per inhabitant has grown in most of the districts, sometimes even significantly. Given that in these years the provinces did not incorporate new spending functions, it seems to be clear that this increase in the quantity of civil servants results rather from political reasons than from the necessity to offer more and/or better services.

Graph 2. Public employment in Argentina, 1993-2009 (*)



*Comprises public administration, decentralized entities and social security institutions. Does not include government companies or partnerships, universities or other public entities.
Source: Made by the author, based upon dates of ProvInfo, ASAP and national and provincial budgets of the respective years 2006-2009.

Graph 3. Civil servants per inhabitant, 1999 and 2009



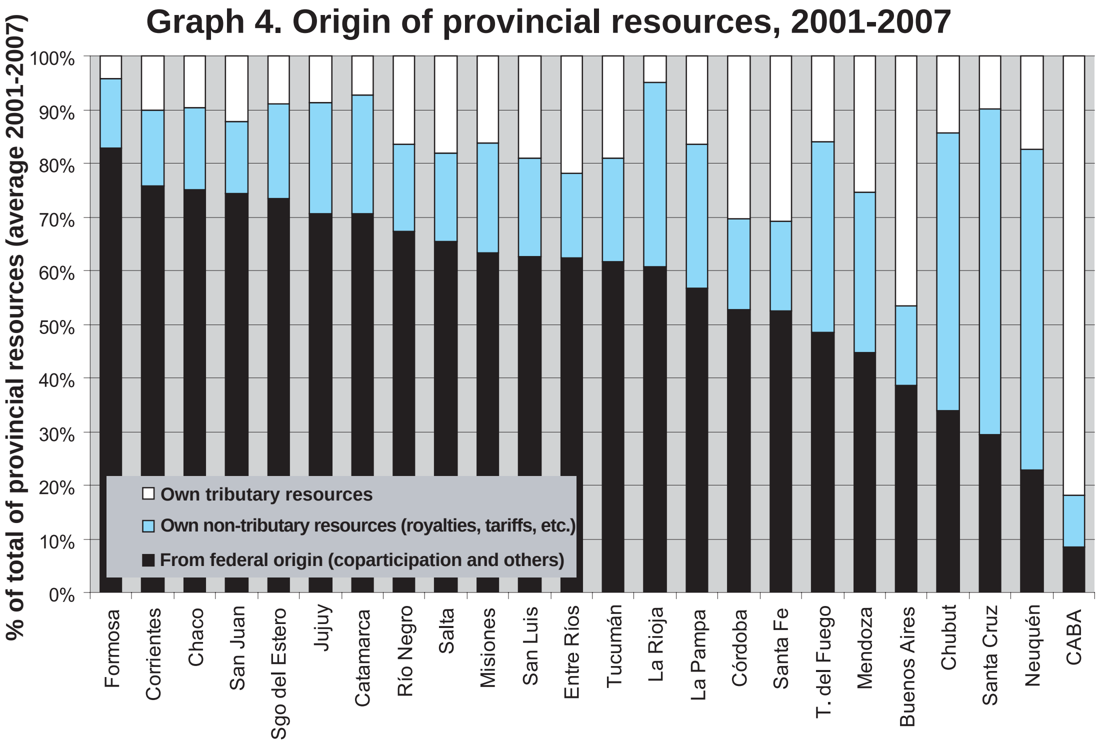
Source: Made by the author, based upon data by ProvInfo, INDEC and the provincial budgets of 2009

In short, the provinces stick to a model that rests on public spending and public sector employment as the main promoters of economic activity. This model shows the same weaknesses as the national one, since most of the provincial revenues come from federal transfers, from oil and mining privileges and from the gross income tax; all of them pro-cyclic, too. However, the situation in the provinces – and especially in the small ones – presents two features that help distinguish the provincial situation from the national one:

a) The structure of financing reduces any incentives to adjust the provincial fiscal situation within times of crisis, which in turn aggravates the federal fiscal situation.
b) The relative importance of public spending and public sector employment is higher; and for that reason, once the adjustments are made, they can have political consequences which are far more serious.

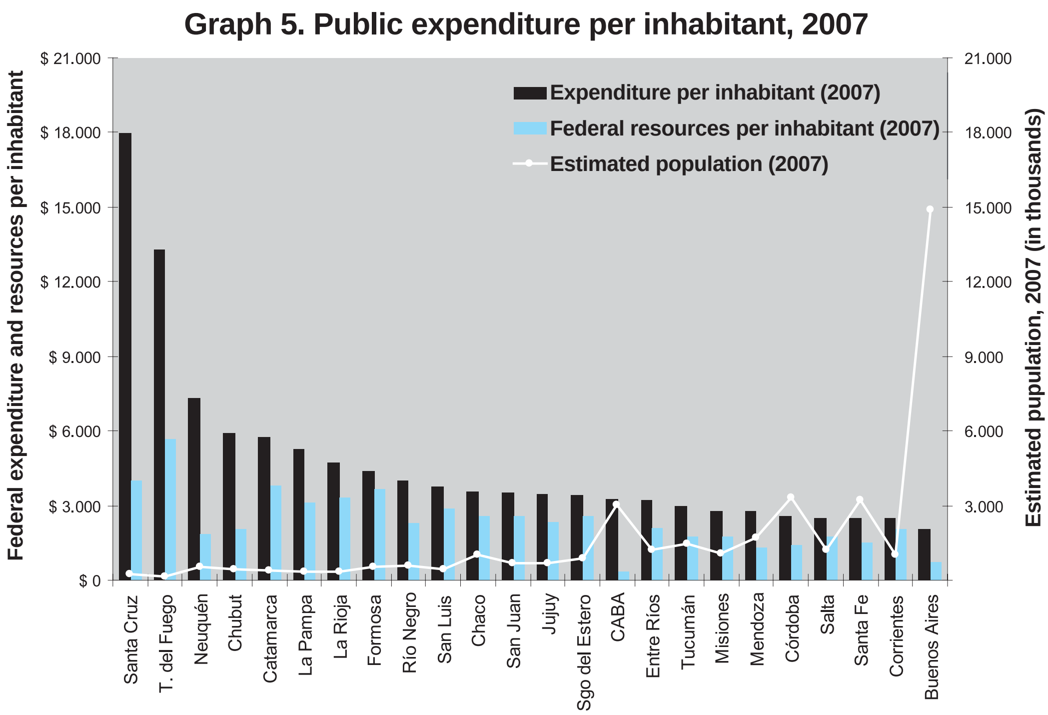
2. Public sector employment is more important within the provinces than within the federal government. Within many provinces, and especially within the smallest ones, a significant part of the population lives of the state: Graph 3 shows that, in 2009, 13 out of 24 provinces of the country had more than 50 civil servants per thousand inhabitants, a figure that comes up to almost 120 per thousand in the extreme case of Santa Cruz.
This is relevant in both, economic as well as political terms. In relation to the first, the system of federal tax-coparticipation redistributes the resources in favor of the smallest provinces which thereby can allow themselves higher levels of public spending per inhabitant (Graph 5). This means that they can pay relatively high salaries for relatively little demanding and very steady posts; that's why the main aspiration of the inhabitants in these provinces is to achieve a public office. This again leads to the fact that for private companies it is more difficult to hire a person increasing the labor costs in the provinces, where labor productivity is relatively low. Hence, the situation ends up falling into a vicious circle: in many provinces the labor productivity is very low – which explains that they are very poor – however, the most attractive offices are found within the state, which is already oversaturated with employees; and for that reason in the end the resources address mainly the unproductive activities that do not help these provinces to get out of their situation of underdevelopment.
On the other hand, the political impact of provincial public sector employment becomes evident in two ways. First of all, there is the clientelism: the appointment of civil servants often serves award "punteros" (party members who mobilize the poor and working-class neighborhoods for elections and other political activities) or loyal voters. However, to practice clientelism by contracting civil servants is expensive: social plans and "food bags" are cheaper and easier to withdraw in the event of default on the part of the client. Hence, the benefit the governors gain from public sector employment doesn't consist in the quantity of votes they can win on election day, but rather in the fact that within these provinces, where there is no such a thing as an extensive and independent private sector, and where a large part of the population depends directly or indirectly on public sector employment, it is very difficult to sustain an independent newspaper or to finance parties of the opposition.
In other words, the abundance of civil servants allows to exercise a control that goes beyond an electoral triumph, which explains that in many of these provinces there is little alternation in power – in seven out of eight districts where a single party has won every election since 1983, the quantity of civil servants per thousand inhabitants is superior to 55[1]. This also explains situations like the one recently took place in Formosa, where the Agricultural Negotiation Group decided to organize an act in an open public space because two restaurants, two hotels and a club refused to rent them an assembly-room[2].

3. The redistributive effects of the system of federal tax-coparticipation favors the sparsely populated provinces. However, how can it be possible that even poor provinces like Catamarca, Formosa, Jujuy or La Rioja, can finance such levels of public sector employment? The answer lies in the fact that the system of federal tax-coparticipation that exists in Argentina, separates the decisions concerning revenues on the one hand, and expenditures on the other; at the same time it redistributes the recourses favoring the sparsely populated provinces of the country – the poorest ones included.
Referring to the first point, the most important taxes in Argentina, like the VAT and the income tax, are collected by the federal government and then redistributed to the provinces according to a pre-established formula[3]. This means that the political cost of determining taxes as well as collecting them goes to the expense of the national authorities; however, the governors receive the benefits of increasing the expenditures and contracting civil servants. As can be seen in Graph 4, in some districts these benefits are quite important: between 2001 and 2007, some 17 out of 24 provinces received more than 50% of their resources through national government transfers, and in 7 of them the federal funds represented more than 70% of their total revenues. Moreover, the districts which financed themselves to a higher extent through funds of provincial origin generally did that with "non-tributary" resources, like oil and mine privileges, which only affect a tiny sector of the electorate. Only within the province of Buenos Aires, the capital of Buenos Aires, Córdoba, Entre Ríos, Mendoza and Santa Fe, their own tributary resources represented more than 20% of the total.



Source: Made by the author, based upon data by ProvInfo

Regarding the second issue, the Argentine fiscal federalism is strongly redistributive: the funds which every province receives are not related to the economic activity level within that province, but rather to its population. This permits that the sparsely populated provinces of the country receive more funds per capita than the large ones, and that the public spending per inhabitant is significantly higher, as can be noticed in Graph 5.



Source: Made by the author, based upon data by ProvInfo and INDEC

4. Political consequences of the "provincial model". The pro-cyclic character of provincial expenditures indicates that, given the actual international economic crisis, the governors see themselves forced to adjust their budgets. However, a cutback of this type is more complicated (and less probable) on provincial level than on federal level. First of all, many governors can do lobby-work before the national government to receive extra resources to cover their deficits. And secondly, since the impact of public spending inherent to a provincial economy (and especially to a small province) happens to be higher than on national level, every governor who introduces cutbacks on his budget, risks to lose political support and/or suffer demonstrations by dissatisfied civil servants.

4.1. The governors have incentives to be fiscally irresponsible. The main problem of the financing structure in the provinces is that it encourages an irresponsible behavior on the part of the governors of those districts which are most dependent on federal budget. Within the context of the crisis in which the external financing is banned, governments only have two alternatives: reduce their expenditures or increase the revenues. To cut back expenditures is always politically expensive, but to increase the revenues is only politically expensive when it implies an increase of taxes as well.

If, on the other hand, high revenues get financed by national transfers, it is not necessary to incur in the political cost of increasing taxes. And the governors of the smallest provinces are in a good position to negotiate with the national government to gain more funds, since their districts are very overrepresented in the Federal Congress: the 12 provinces with the smallest population represent 13% of the country's total population; however, among these provinces 24% of the national representatives and half of the senators are chosen[4]. In other words, this encourages the transfer of funds to the smaller provinces, since within those the political impact of every spent peso is bigger than in the large ones[5].

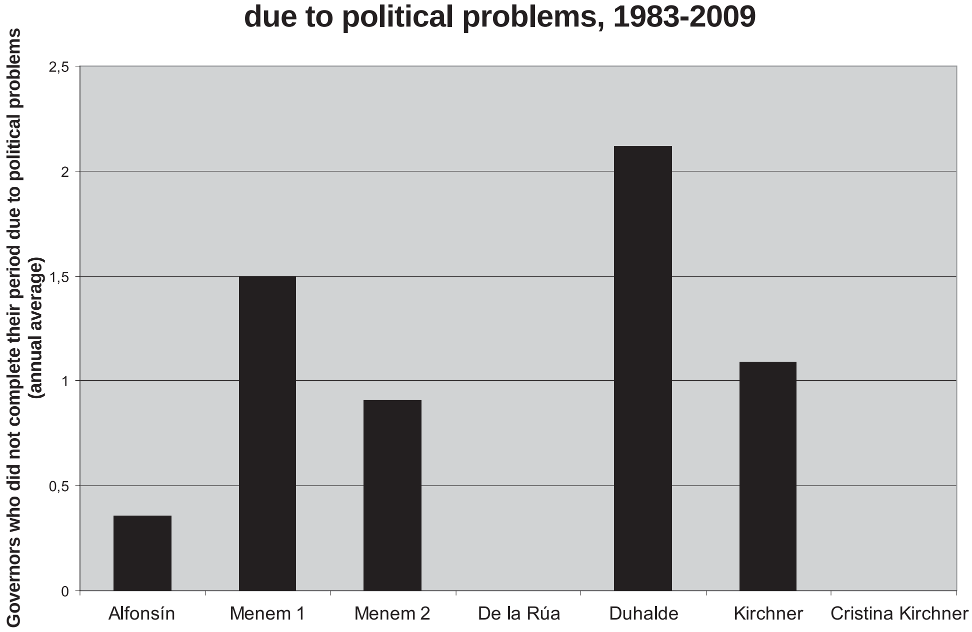
What happened during the economic crises of 1989-1991 and 2001-2003 is illustrative on this matter. With the return of democracy in 1983, many of the governors significantly increased their public spending and the payroll, since the absence of a co-participation law permitted them to directly negotiate the transfer of discretionary funds – which could cover their fiscal deficit - with the president. The result was most provincial administrations spent far in excess to their possibilities and in 1986 the accumulated fiscal deficit in the provinces reached 6,2% of the GDP. This deficit had been covered by the federal state, which in turn accumulated a deficit of 4,6% of the GDP, financed by printing money. In other words, the provinces continued spending despite their bad financial situation, because the costs of increasing expenditures could be transferred to the federal government.

The economic reforms which were introduced by Carlos Menem succeeded in partially slowing down this logic: the federal state improved its own fiscal situation, on the one hand by cutting back its expenditures and increasing taxes, and on the other hand by transferring responsibility for the provision of health and educational services – a transfer that included more responsibilities for expenditure, but no more funds – enforcing the provincial administrations to employ their resources in a more efficient way. Moreover, the sanction of the Convertibility law (1991) provided credibility for the national government's threat that it would not be able to finance the provincial deficits by printing more money. However, given the economic growth that accompanied the first years of convertibility, this threat was not felt immediately and it allowed the national government to transfer more resources to the provinces, without compromising its fiscal situation.

All this contributed to the fact that, except for the short crisis of Tequila, the period of 1993-1999 was relatively calm. In fact, between 1996 and 2000, the provincial public sector employment increased a 13%, a figure that is only excelled by the 18% of the period between 2002 and 2006 (Graph 2). However, as the recession which was initiated in 1998 got deeper and the fiscal revenues fell, the provincial authorities found themselves in situation that got more and more complicated, mainly because the Convertibility law prevented the state to cover these deficits by printing money. From the beginning of 2001 the situation got even worse, as the external debt became practically impossible and many provinces resorted to the device of issuing quasi-currencies to pay the salaries[6]. Finally, in 2002, the governors didn't have any alternative but to reduce both, the public spending and (to a lesser extent) the payroll (Graph 1 and 2).

4.2 In the provinces, the "adjustments" could be extremely expensive. In political terms, the before mentioned implies that during the first presidency of Carlos Menem, as well as during the more recent crisis of 2001-2002, many governors could not finish the term of office they had been elected for, due to political problems[7]. As can be seen in Graph 6, the highest concentration of governors who abandoned their office for these reasons is to be found during Menem's first administration as well as in that of Duhalde, just in the years of severe fiscal problems. Of course, the particular reasons for which a governor had to abandon his office before time depended on the circumstances of every concrete case, but unquestionably the fact of seeing oneself obligated to dismiss employees, reduce salaries and/or make other cutbacks on expenditure hindered the bargaining position of many governors who had to confront tough internal primaries and/or an impeachment requests.

Graph 6. Governors who did not complete their period due to political problems, 1983-2009



Source: Made by the author based on information by *Rulers*

However, not all provincial administrations operated with the same degree of fiscal irresponsibility and consequently not all of them had to resort to drastic adjustments which threaten the continuity of a governor in office. In particular, Remmer and Wibbels suggest that the provincial authorities that depend to a lesser extent on national transfers have higher incentives to be fiscally responsible, as their deficits must be covered by tax increase, and a "rescue" on part of the national government is less probable[8]. Given the fact that the provinces which are less dependent on national transfers happen to be the largest ones, and that this size causes a lower impact of public spending, we should expect that within the large provinces the uncompleted terms of office due to political problems were less frequent. And the data seems to confirm that, indeed, what is happening is this: within the 12 least populated provinces[9], there have been 8 interrupted mandates due to political problems during the first presidency of Menem, an 1 during Duhalde, whereas in the 12 largest provinces[10] there have been only three governors who did not finish their term of office within these years (one in 1993 and two in 2002)[11]. Furthermore, two of these three cases correspond to Santiago del Estero, the province with the eleventh highest population.

5. Conclusion. This analysis suggests two things: In the first place, the crisis will force the provincial authorities to reduce their expenditures after June 28th. Nevertheless, this reduction will be more striking within the large districts than within the small ones, where the governors are going to postpone the adjustments as far as possible for two reasons: because the political cost is higher – there are more people that depend on direct or indirect national spending – as well as because they can hope for help on the part of the federal government.

In the second place, if the crisis gets worse, the governors of the small provinces won't be able to carry on postponing the necessary reductions of expenditures and employment. However, the necessity of reducing the expenditures probably will cause the appearance of certain political conflicts on the surface which until then had remained latent and which might interrupt the terms of office of some governors, especially those who confront a more fragile fiscal situation, or who rely on a minor level of political support in their districts.

Since 1983, the longest period in which there weren't any governors who had to leave their office for political problems, has been of 41 months: between the resignation of Eduardo Angeloz (Córdoba, July 1995) and the one of Carlos Ferraro (Jujuy, December 1998)[12]. In July 2009, 26 months will be completed since the resignation of Carlos Sancho (Santa Cruz, May 2007), the last occasion on which a governor had to leave his office for these reasons. There are 29 months left until December 2011, when the terms of office of the 22 governors end that were elected in 2007. Will we reach this date without new cases of governors who have left their office due to political problems?

Sources:
ASAP (Asociación Argentina de Presupuesto y Administración Financiera Pública): http://www.asap.org.ar/
INDEC (Instituto Nacional de Estadística y Censos): http://www.indec.mecon.ar/
Provincial Budgets 2006-2009, different districts
ProvInfo, Department of the Interior: http://www.mininterior.gov.ar/provinfo/
Oficina Nacional de Presupuesto, Department of Trade and Finance: http://www.mecon.gov.ar/onp/html/
Rulers: Argentine provinces from 1983: http://www.rulers.org/argprov2.html

Notes:
[1] The mentioned districts are Formosa, Jujuy, La Pampa, La Rioja, Santa Cruz (always governed by the Partido Justicialista), Río Negro (Unión Cívica Radical) and Neuquén (Movimiento Popular Neuquino). The only exception is San Luis (PJ).
[2] When this incident became public, the governor himself offered an assembly-room within his seat of government to organize the act; however, the producers preferred to do it open-air. Maybe the governor has not been directly involved in the affairs, but it is still significant that the owners of a restaurant or a hotel thought they could have a falling out with the provincial authorities for renting a room to the opposition. See: "Inusual pelea por un acto del campo" (*La Nación*, 11/06/09); "Le niegan un hotel de Gendarmería a la Mesa de Enlace" (*Perfil.com*, 11/06/09); "Pese a haber pagado por su alquiler por adelantado, a la Mesa de Enlace le negaron un salón de un hotel" (*El Comercial (Formosa)*, 11/06/09) y "La Mesa de Enlace llegó a Formosa para 'acompañar a los candidatos del campo'" (*El Comercial (Formosa)*, 12/06/09).
[3] Within the last years, another significant burden have been the retentions on exports which do not coparticipate because they are taxes on the external trade. Nonetheless, in March president Cristina Kirchner decided to create the "Federal Solidarity Fund", composed of 30% of the retentions on soya, which will be shared out to the provinces that stick to soya, according to the same formula employed to distribute the resources that do coparticipate ("Se repartirán las retenciones a la soja", *La Nación*, 20/03/09).
[4] David Samuels and Richard Snyder highlight that Argentina is among the countries with more overrepresentation in both legislative chambers. See "El valor de un voto: Una perspectiva comparada sobre la desproporcionalidad electoral", in Ernesto Calvo and Juan Manuel Abal Medina (h) (eds): *El federalismo electoral argentino. Sobrerrepresentación, reforma política y gobierno dividido en la Argentina*, Buenos Aires, INAP/Eudeba, 2001, cap. 2, pp. 25-52.
[5] See: Edward Gibson, Ernesto Calvo y Tulia Falleti, "Federalismo redistributivo: sobrerrepresentación territorial y transferencia de ingresos en el hemisferio occidental", *Política y Gobierno*, VI (1), 1er semestre de 1999, pp. 15-44.
[6] The before mentioned provinces were Buenos Aires, Chaco, Córdoba, Entre Ríos, Formosa, La Rioja and Tucumán ("Con la emisión de bonos provinciales y las Lecop, ya circula en el país una tercera moneda", *La Nación*, 18/11/01)
[7] Between December of 1983 and June of 2009, 38 governors did not complete their term of office. Out of these, three passed away, six resigned to assume National Presidency or other posts, six were dismissed for federal interventions and the remaining 23 abandoned their post due to political problems (loss of political support, threat of trial, dismissal through impeachment) (Source: Made by the author based on information by *Rulers*)
[8] Remmer y Wibbels, *op. cit.*, pp. 434-40.
[9] Catamarca, Chubut, Formosa, Jujuy, La Pampa, La Rioja, Neuquén, Río Negro, San Juan, San Luis, Santa Cruz and Tierra del Fuego (Source: *INDEC*, Census 2001)
[10] Buenos Aires, Chaco, Ciudad de Buenos Aires, Córdoba, Corrientes, Entre Ríos, Mendoza, Misiones, Salta, Santa Fe, Santiago del Estero and Tucumán
[11] The mentioned governors are Carlos Ruckauf (Buenos Aires, he left his post in 2002); Néstor Perl (Chubut, 19990) Ricardo de Aparici, Roberto Domínguez, Carlos Ficoseco (Jujuy, 1990, 1993 and 2004), Augustín de la Vega (La Rioja, 1991), Jorge Escobar, Alfredo Avelín (San Juan, 1992 and 2002), Ricardo de Val, José Granero (Santa Cruz, 1990 and 1991), Carlos Mujica and Carlos Díaz (Santiago del Estero, 1993 and 2002)
[12] Furthermore, there were three more periods of 30 or more months without interruption of mandates: it have been 37 months between the resignation of Carlos Díaz (Santiago del Estero, November of 2002) and the dismissal of Jorge Colazo (Tierra del Fuego, December of 2005); 35 months between the resignation of Leopoldo Bravo (San Juan, November of 1985) and the one of Oscar Garbe (Catamarca, October of 1988) and 30 months between the dismissal of Victor Maidana (Corrientes, July of 1999) and the resignation of Carlos Ruckauf (Buenos Aires, January of 2002).

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