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Argentina – Strategy
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Heading towards a war of attrition

- **IN THIS PIECE.** We take a deep dive into the provincial fiscal balances, their income and expenditure composition, to better grasp the implications the strategies the national government is currently implementing could have on provincial balance sheets.

- **OUR KEY TAKEAWAYS.** Since Mr. Milei inaugurated his tenure, the relationship between the national government and the provincial space has been strained to the limit, pushing the current institutional framework, which is heavily flawed, to a breaking point. The strategy of the current national government consists of choking out the provincial space, weaponizing the fiduciary fund and discretionary transfer system, before proposing a new, rules-based relationship to the provinces, in exchange for bolstering its weak legislative muscle. This move compounds with a complex economic scenario, which will push provincial balances to their limits. In this context, we run a sensitivity analysis to gauge the effect of the recession in activity levels.
We estimate that all provincial revenue lines are bound to suffer significantly in 2024. Both provincially levied taxes and automatic transfers originating from the Copa scheme are highly sensitive to activity levels. We calibrate our model with three alternative scenarios to stress test provincial income sources. While under our baseline scenario, estimates envisage an average -13.8% real drop in income sources for 2024 in the space, we find the assumptions under the bull scenario mildly mitigate these risks, as the average drop in income, in that case, amounts to -9.5%. Instead, risks are skewed to the downside, as in our bear scenario the average drop in income sources would come closer to the -23.5% mark. Beyond over-the-line transfers and income sources, we take a look at the fiduciary funds system, which has been the bloodline fueling the provincial space since the 1994 constitutional reform. Being not as ironclad as the Copa law, with nearly 50% of the total monies coming from funds institutionalized by presidential decree, these are proving relatively easy to dismantle. Furthermore, given that the 2024 budget was not approved, and therefore the 2023 budget was extended, nominality can do massive damage to the funds on its own, with no need for further government intervention to achieve that objective.
So, with income sources bound to suffer significantly in 2024, most governors face an uncomfortable issue, which has to do with the inflexibility of their public spending. Even if there are some caveats that suggest the provinces are accommodating their fiscal balances to weather the storm, we find that major fiscal consolidation is inconsistent with the political mandate of the newly elected governors, and with the heavily inflexible provincial expenditure, of which on average, nearly 2/3rds consists of Soc.Sec outlays and salaries. This brings us to the uncomfortable issue of external debt services. Even if the balance sheet effect suffered in Dec-23 diluted, the better-than-expected performance of inflation makes the devaluation hit more permanent. While we believe that a debt restructuring process would not be a palatable choice for any province, especially with the current international rate scenario (which is wildly more adverse than in the 2020-21 period), it will be up to each of the governors to pick which outlay line to cut. In our view, there is one province whose situation is more delicate than the rest, and that is PBA, both from a political and financial standpoint. In this context, its strategic incentives do not line up with the deal proposed by the administration, as such a deal requires complex political contortions and loss of face for Mr. Kiciloff, and given a new coparticipation regime would still not solve PBA's dependence on the national government. This threatens to leave PBA ostracised and defunded, which is also functional for the national government, that is bound to prefer a declawed Buenos Aires province.

- **STRATEGY IMPLICATIONS.** All in all, we believe that the federal government is aware that time is in its favor and is preparing for an attrition war with the provincial space, one it has all the tools to win. This means that, sooner rather than later, the governors will start to pledge to the administration's banner, especially as provincial cash positions start to dry out. We find this scenario to be credit-negative for the provincial space, as it will erode sub-sovereign fundamentals significantly.

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The twin objectives of exploiting a broken institutional framework: Public sector consistency, and building legislative muscle

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Since Mr. Milei inaugurated his tenure, the relationship between the national government and the provincial space has been strained to the limit, pushing the current institutional bridges to a breaking point. The problems surrounding the relationship between the provinces and the national government date back to at least 35 years ago. When the current coparticipation law was approved, back in 1988, the issues surrounding it were circumscribed just to the secondary distribution of the scheme. The law defines a primary distribution of the collected taxes, between the federal government and the provinces, and a secondary reshuffle, in which each province receives its share. So, by 1988 the distribution between the national government and the provinces was adequate. The former was responsible for the brunt of government services, such as education, healthcare, and security, and received 42.3% of the total collection, while the provinces took home 56.7%. The issue then was that the distribution between provinces showcased some signs of scantiness. This was mainly due to the political nature of the new distribution. While the previous law based each of the provinces' shares on its population (weighting 65% in the distribution scheme), the gap in development between provinces (25%) and their population density (10%), political factors had a significant influence in the passing of the 1988 law (for more details, please click here). This resulted in a significant imbalance relative to the prior calculation, leaving Buenos Aires as the main loser of the space, going from receiving 28% of the provincial share to a meager 21.3%. This deterioration mainly benefitted the northern provinces, and severely skewed the distribution of provincial income, relative to the size and contribution of each province to the national economy. So, while the 1988 law had significant imbalances relative to the distribution of the provincial income inside the space, the 1994 Constitutional reform deepened the woes for the provinces, as it transferred most of the public sector payrolls into their balance sheet, as from then onwards, provinces became directly responsible for paying the salaries of healthcare workers, security forces and teachers. While the constitutional reform did have a provision to pass a new Coparticipation Law before 1996, the difficulty surrounding said feat forced said determination to be ignored for nearly 30 years. So, the original state of the relationship between provinces and the federal government, after 1994, dictated the former were left structurally under-financed relative to a more opulent national government, which was able to dispatch the liabilities originating from expenditure-heavy services while continuing to bag the resources to pay for them. In addition, the inclusion of Tierra del Fuego as an independent province rather than a national territory, and the creation of CABA, marked the obsolescence of the existing Copa law. To emphasize this point further, currently, while the national government payroll totals 2.5% of GDP, the provinces have to face salary payments for 7.5% of GDP. This clearly conveys that the current Copa law skews resources in favor of the federal administration, albeit not by design, but due to the ironclad institutional structure, and incentive misalignments, which make it near-impossible to modify.

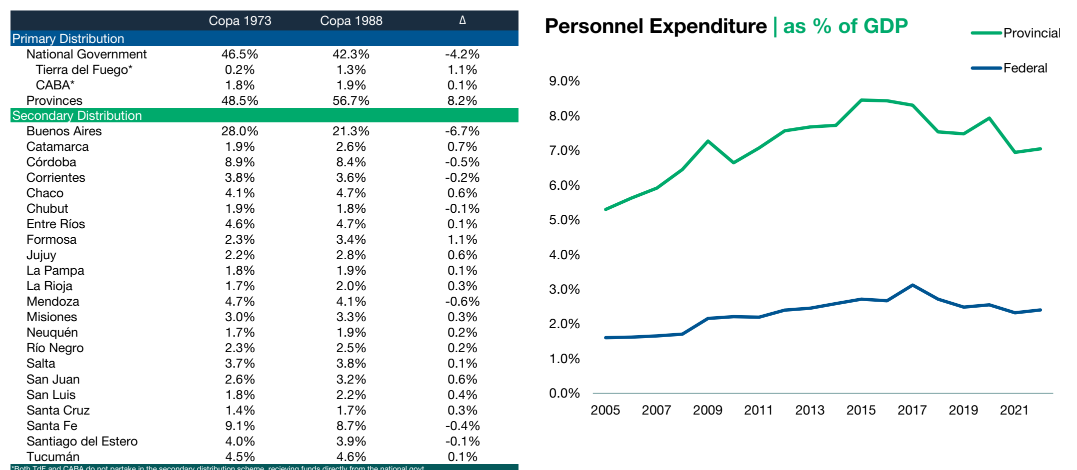
With this institutional framework threatening the sustainability of the relationship between the federal govt. and the provinces, the political scenario after 2001 favored a blend between semi and fully discretional transfers

With this institutional framework threatening the sustainability of the relationship between the federal govt. and the provinces, the political scenario after 2001 favored a blend between semi and fully discretional transfers to finance the provincial space. The institutional design post-1994 left a significant mismatch between the automatic transfers given to each province and their contribution to the national economy. Comparing the jurisdictional gross product to Copa transfers, one can easily arrive at the conclusion that some provinces are being discriminated against. This looks especially true for both CABA and PBA, with both contributing 17.8% and

to finance the provincial space.

11.2% more than their Copa share suggests. However, it is important to keep in mind that these discrepancies arise due to the historical and political backgrounds surrounding the implementation of the law and constitutional reform, which makes complaints regarding these issues sound more like a political squabble and a clash of interests rather than legitimate claims. So, with the provinces being in financial turmoil after the 2001 crisis when Mr. Krichner came to power in 2003, he saw this structural flaw in the institutional framework as a way to build political power. While discretionary transfers date back to the Menem administration, Mr. Kirchner´s initial position and political capital were weak, and one of his strategies was to purchase endorsements via creating the fiduciary fund structure, which, even if not as ironclad as the Copa scheme, were less tied to the whims of the national government relative to discretionary transfers. This responds to the fact that these funds financed programs in the provinces automatically. So, with the instauration of this scheme, Mr. Kirchner ensured the loyalty of the governors, while at the same time avoiding the structural under-financing of the provinces to cripple the space. So, the provinces lost their independence from the national government, as they required it to continuously plug the financing gap left by the flawed institutional design. This worked for around 30 years, before imploding with the irruption of Mr. Milei into the scene.

Figure 1: After 1994, the primary distribution scheme started to favor the federal govt, as it offloaded services provision to the provinces.



	Copa 1973	Copa 1988	Δ
Primary Distribution			
National Government	46.5%	42.3%	-4.2%
Tierra del Fuego*	0.2%	1.3%	1.1%
CABA*	1.8%	1.9%	0.1%
Provinces	48.5%	56.7%	8.2%
Secondary Distribution			
Buenos Aires	28.0%	21.3%	-6.7%
Catamarca	1.9%	2.6%	0.7%
Córdoba	8.9%	8.4%	-0.5%
Corrientes	3.8%	3.6%	-0.2%
Chaco	4.1%	4.7%	0.6%
Chubut	1.9%	1.8%	-0.1%
Entre Ríos	4.6%	4.7%	0.1%
Formosa	2.3%	3.4%	1.1%
Jujuy	2.2%	2.8%	0.6%
La Pampa	1.8%	1.9%	0.1%
La Rioja	1.7%	2.0%	0.3%
Mendoza	4.7%	4.1%	-0.6%
Misiones	3.0%	3.3%	0.3%
Neuquén	1.7%	1.9%	0.2%
Río Negro	2.3%	2.5%	0.2%
Salta	3.7%	3.8%	0.1%
San Juan	2.6%	3.2%	0.6%
San Luis	1.8%	2.2%	0.4%
Santa Cruz	1.4%	1.7%	0.3%
Santa Fe	9.1%	8.7%	-0.4%
Santiago del Estero	4.0%	3.9%	-0.1%
Tucumán	4.5%	4.6%	0.1%

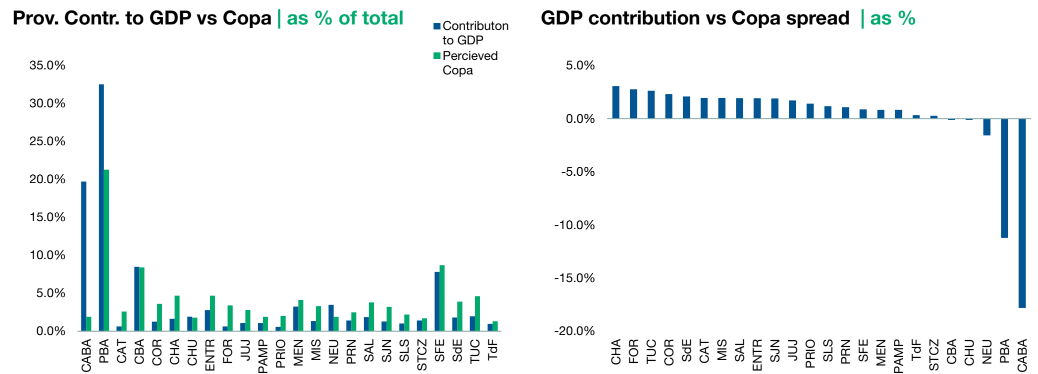
*Both TdF and CABA do not partake in the secondary distribution scheme, recieving funds directly from the national govt.

Source: TPCG Research based on the Economy Ministry, Law 20,221, Law 23,548 and amendments.

The strategy of the current national government was to choke out the provincial space, weaponizing the fiduciary fund and discretionary transfer system, before proposing a new, rules-based relationship to the provinces, in exchange for bolstering its weak legislative muscle.

The strategy of the current national government was to choke out the provincial space, weaponizing the fiduciary fund and discretionary transfer system, before proposing a new, rules-based relationship to the provinces, in exchange for bolstering its weak legislative muscle. With no governors to its name, and a flawed institutional system that relied strongly on the national's government willingness to finance the provinces, Mr. Milei's irruption in the scene dynamited a framework that was perceived as untouchable by the political class. In this context, the lack of a 2024 budget, and the fact that the national government could start to weaponize some of the loans given to the provinces within the fiduciary fund framework, gave Mr. Milei the chance to rip apart this system, which was established as the spare tire of a flawed coparticipation mechanism. In a pincer maneuver, the administration also closed off discretionary transfers to the provinces and waited for the distressed provincial administrations to soften their political stances, as their need for cash became increasingly apparent. The application of this strategy was accelerated by the administration after the botched Omnibus Law. On a cash basis, the national administration reported a -76.6%yoy drop in discretionary transfers since the start of the year. Once the turmoil in the provincial space started, then the administration offered an olive branch to governors in the May Pact proposal. To support the administration's reform in Congress, in exchange for, initially, a fiscal support package, and in the best-case scenario, a new coparticipation law. With this, the administration would reinforce its weak legislative muscle significantly, while governors would receive a bailout, given they do comply with what the administration requires of them, that is, supporting the program in Congress, and dialing their fiscal bias back to hawkish.

Figure 2: Politics also muddled secondary distribution, skewing it.



Source: TPCG Research based on Indec and the Economy Ministry

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So, while the main concern regarding the health of provincial fiscal numbers is its relationship with the national government, we also calibrate a sensitivity model to evaluate the impact the recession could have on provincial income, which also has the potential to derail provincial finances. Throughout the space, we identify mainly three types of provinces, in regard to their income sources. Firstly, we find the provinces which are mostly reliant on their local revenue sources. Inside this group, some are dependent on royalties coming from the mining and oil industries, those that rely on local levies with stable taxable mass (such as the Real Estate Tax, or Automotive Tax), and those who depend on local income which is sensitive to activity levels. In the second group, we find those provinces that have weaker local tax bases and depend largely on automatic transfers, such as the Copa scheme. Finally, some provinces fail to levy enough local taxes to compensate for relatively weak Copa transfers and depend largely on the non-automatic transfers and fiduciary funds provided by the federal government. While non-automatic transfers and fiduciary fund disbursements depend strongly on political willingness from the national government, we calibrate our model to estimate the response of the other two income sources, local taxes and automatic transfers to the recession, to establish the stress these revenue lines will suffer going forward. In our baseline scenario, we expect the economy to drop by roughly -7%yoy in real terms, therefore determining the slump in provincial and Copa taxes. In addition, we expect the administration to maintain its bias regarding discretionary transfers, and we project the current cuts forward. Finally, we expect the administration's negotiations with the provinces to be partially successful, which should result in reinstating the Income Tax Law, which would avoid further losses in the income department. Our bull scenario expects the recession to hover around the -5 % mark in 2024, which should put a cap on the drop in tax collection. In addition, given the negotiations with the governors develop smoothly, in this scenario the Income tax law would also be reinstated, while the bias regarding discretionary transfers would soften, resulting in a -50% drop in real terms throughout the space, improving relative to the current -69%. Finally, our bear scenario envisages a deep economic recession, nearing the -10% mark, and botched negotiations between the federal government and the provincial space. This would result in discretionary transfers being cut off entirely, and in the Income Tax law not making a comeback. So, compounding our modeled estimates calibrated for our baseline macro scenario for local taxes and Copa transfers with our view on non-automatic disbursements, our baseline calibration envisages an average -13.8% real drop in income sources for 2024 in the space. Instead, calibrating the model to the bull scenario mildly mitigates these risks, as the average drop in income, in that case, amounts to -9.5%. However, risks are tilted to the downside, as with our bear scenario assumptions, the average drop in income sources would come closer to the -23.5% mark. All in all, we believe this adequately portrays the stress provincial fiscal figures are poised to endure going forward. In the following section, we proceed to dissect these results, addressing each revenue line individually.

Figure 3: The provinces' reliance to different revenue streams split them into three categories

LTM 3Q23	Provincial Income Sources		Federal Automatic Transfers		Non-Automatic Transfers	
	as % of Income	as % of Outlays	as % of Income	as % of Outlays	as % of Income	as % of Outlays
CABA	87.6%	99.6%	10.0%	11.3%	2.4%	2.8%
BUENOS AIRES	38.3%	35.1%	37.4%	34.3%	8.3%	7.6%
CATAMARCA	24.3%	22.1%	73.4%	66.7%	2.4%	2.1%
CORDOBA	39.2%	41.4%	44.8%	47.3%	3.0%	3.2%
CORRIENTES	13.3%	12.9%	71.7%	69.7%	2.9%	2.8%
CHACO	13.9%	12.3%	69.0%	60.9%	5.1%	4.5%
CHUBUT	47.8%	49.2%	34.9%	36.0%	1.5%	1.6%
ENTRE RIOS	24.7%	23.5%	58.1%	55.2%	3.1%	2.9%
FORMOSA	10.0%	9.3%	76.0%	71.0%	2.9%	2.8%
JUJUY	16.5%	15.9%	77.5%	74.6%	6.0%	5.7%
LA PAMPA	35.0%	33.4%	53.2%	50.8%	2.5%	2.4%
LA RIOJA	12.2%	10.8%	83.7%	74.0%	4.1%	3.6%
MENDOZA	46.7%	43.6%	51.0%	47.6%	2.4%	2.2%
MISIONES	31.3%	29.6%	52.0%	49.2%	4.7%	4.5%
NEUQUEN	64.7%	63.9%	18.8%	18.6%	1.2%	1.2%
RIO NEGRO	32.1%	30.5%	64.7%	61.6%	3.1%	3.0%
SALTA	29.7%	28.6%	66.4%	64.0%	3.9%	3.8%
SAN JUAN	22.7%	21.9%	74.5%	71.7%	2.9%	2.7%
SAN LUIS	23.3%	18.3%	74.7%	58.8%	2.0%	1.6%
SANTA CRUZ	42.1%	42.8%	40.5%	41.1%	4.3%	4.3%
SANTA FE	30.3%	29.0%	52.9%	50.6%	3.3%	3.1%
SANTIAGO DEL ESTERO	14.7%	14.3%	82.6%	80.6%	2.7%	2.7%
TUCUMAN	25.9%	24.1%	69.2%	64.5%	4.9%	4.6%
TIERRA DEL FUEGO	39.2%	36.5%	45.7%	42.6%	2.0%	1.9%

Source: TPCG Research based on the the Economy Ministry

The recession is bound to hit provincial income strongly, especially as the bulk of the locally levied tax revenues are deeply sensitive to activity levels.

The recession is bound to hit provincial income strongly, especially as the bulk of the locally levied tax revenues are deeply sensitive to activity levels. Provincial income sources mainly rely on 4 key taxes, which are: the Local Sales Tax, the Real Estate Tax, the Stamp Tax, and the Automotive Tax. However, of all these, Local Sales tax represents the largest chunk of provincial income, historically accounting for 67.6% of provincially levied taxes, albeit current figures put that number closer to 80%. To evaluate the performance of these taxes relative to activity levels, we stress their sensibility to unfavorable economic scenarios. Our findings suggest that the Stamp Tax (8.5% of provincial income) shows a high sensitivity to movements in economic activity, followed by the Local Sales Tax and Automotive Tax, which, even if highly responsive, do not show the elasticity of the former, while real estate tax revenues (6.3% of total) are mostly insensitive to shocks in consumption and GDP (unsurprisingly). So, with the recession bound to amount to a drop of between 6% and 7% in 2024, our model was able to estimate the drop in real income for each of the mentioned taxes. Under this scenario, Local Sales Tax collection is bound to drop by -8.6% in real terms, while collection of the Stamp tax could fall up to -16.5%. Automotive Taxes could resent by up to -10.2%, while the only tax revenues which could fall by less than activity levels would be the Real Estate collection, which would fall by -6.5%. While the taxable mass in the last two is relatively insensitive to activity levels, higher delinquency fostered by the drop in disposable income explains the drop. Finally, our model estimates that the residual provincial income (ie. the remainder of the provincial taxes) should fall by -12.1%. Such a scenario would stress provincial finances significantly, especially as, for most provinces, it is true that the brunt of their locally sourced revenues responds poorly to changes in economic activity.

Figure 4: The sensitivity of provincial taxes to activity is quite high

Provincial Tax Composition	Gross Income Tax		Real Estate Tax		Stamp Tax		Automobile Tax		Other Taxes	
	Average	Last	Average	Last	Average	Last	Average	Last	Average	Last
Buenos Aires	58.4%	75.0%	14.9%	8.5%	9.4%	8.2%	9.1%	6.4%	8.3%	1.9%
Catamarca	73.6%	86.2%	6.7%	1.6%	11.4%	7.0%	7.2%	5.2%	1.1%	0.0%
Córdoba	65.9%	78.4%	18.9%	7.5%	9.5%	10.8%	3.8%	3.3%	2.0%	0.0%
Corrientes	71.6%	86.6%	11.2%	1.5%	13.0%	11.7%	0.4%	0.0%	3.9%	0.2%
Chaco	75.6%	76.5%	2.2%	0.3%	9.0%	9.7%	0.6%	0.0%	12.6%	13.5%
Chubut	77.6%	85.3%	0.8%	0.1%	15.0%	11.9%	1.0%	0.0%	5.6%	2.7%
Entre Ríos	50.2%	70.4%	23.0%	12.3%	10.1%	7.4%	9.8%	8.7%	6.9%	1.2%
Formosa	77.9%	87.4%	3.8%	0.7%	12.3%	10.2%	1.0%	0.0%	5.0%	1.7%
Jujuy	73.2%	87.8%	10.2%	3.3%	12.4%	8.8%	0.3%	0.0%	3.9%	0.0%
La Pampa	54.5%	73.9%	16.4%	9.0%	16.3%	10.6%	11.0%	5.9%	1.8%	0.6%
La Rioja	74.0%	82.9%	5.3%	1.2%	10.2%	8.5%	9.6%	7.4%	0.8%	0.0%
Mendoza	62.2%	80.0%	9.7%	3.4%	13.9%	9.5%	10.8%	6.8%	3.3%	0.3%
Misiones	75.2%	94.0%	7.7%	1.2%	9.4%	3.9%	1.8%	0.6%	5.9%	0.2%
Neuquén	76.6%	91.1%	6.6%	2.7%	16.1%	6.2%	0.6%	0.0%	0.0%	0.0%
Río Negro	64.2%	74.2%	10.3%	5.1%	12.6%	6.4%	10.8%	10.0%	2.1%	4.3%
Salta	75.4%	90.4%	4.1%	0.5%	13.8%	8.6%	1.1%	0.0%	5.6%	0.5%
San Juan	57.9%	67.3%	8.2%	3.6%	11.0%	6.4%	9.5%	10.9%	13.4%	11.8%
San Luis	66.4%	74.6%	13.0%	2.5%	10.1%	7.2%	5.4%	5.8%	5.1%	9.9%
Santa Cruz	85.0%	91.9%	0.3%	0.0%	13.4%	8.0%	0.9%	0.0%	0.4%	0.0%
Santa Fe	64.5%	85.6%	16.3%	5.8%	14.0%	8.2%	2.6%	0.2%	2.5%	0.2%
Santiago del Estero	61.7%	75.5%	9.8%	6.6%	11.2%	12.1%	5.6%	5.1%	11.6%	0.8%
Tucumán	64.3%	82.1%	8.6%	2.7%	12.8%	6.4%	6.9%	5.2%	7.5%	3.6%
Tierra del Fuego	77.0%	62.4%	0.7%	0.0%	6.5%	5.2%	0.7%	0.0%	15.0%	32.4%
CABA	70.8%	79.4%	15.1%	6.3%	3.5%	8.7%	8.1%	4.6%	2.5%	1.0%
Sens. to activity levels	Medium		Low		High		Medium		Medium	

Source: TPCG Research based on the Economy Ministry and Indec

In terms of the impact on each of the provinces, this depends both on the reliance of local finances on provincial revenues, and the composition of these and their elasticity to activity levels.

In terms of the impact on each of the provinces, this depends both on the reliance of local finances on provincial revenues, and the composition of these and their elasticity to activity levels. On average, provincial revenues represent 26% of total income for the space. However, the dispersion of said metric is significant. While there are provinces such as Formosa (7.2%), La Rioja (7.9%), and Santiago del Estero (9.4%) where provincial taxes represent less than 10% of their total revenue, relying largely on automatic and discretionary national government transfers, there are others, such as CABA (85%), Neuquén (51%) or Buenos Aires (42.6%), where provincial tax revenues acquire critical mass. So, to determine the impact of the recession for each particular province, we compound their local tax sensitivity to activity levels, based on provincial idiosyncratic characteristics and tax composition, weighted by the relative importance of provincial sources in their total income. So, on absolute terms, the provinces that are bound to lose more of their tax revenues to the recession are Formosa (-17.2%), Santa Cruz (-17.3%), San Juan (-15.2%), La Rioja (-13.8%), Catamarca (-13.3%), and Mendoza (-12.3%). Still, average provincial tax sensitivity suggests a coefficient of around 1.42, which means tax revenues are bound to drop significantly more than activity levels. There are a few exceptions, including Córdoba (-5.5%), Salta (-5.8%), Neuquén (-5.9%) and Chubut (-6.3%). However, weighting the importance of provincial taxes on total revenues, our model showcases a different set of winners and losers. In that sense, even if some of the aforementioned names remain, such as Santa Cruz, and Mendoza, which are bound to lose -4.7% and -4.3% of their total revenues in real terms due to the fall in provincial tax collection, CABA is also bound to lose -7.6% of their total revenues in real terms, while Buenos Aires appears as another province which could see its total income fall by -4% relative to their 2024. On average, under our base scenario, the recession is bound to cost each province -2.3% of its total income sources.

Figure 5: On average, we estimate provinces could lose -13.8% of their income sources in 2024

Baseline scenario calibration Provincial over the line income sources (2023)	Provincial Taxes / Revenues	Prov. Tax intake loss due to activity	Copa resources / Revenues	Copa intake loss due to activity	Disc. Transf / Revenues	Loss due to potential Nat. Govt. bias	Total
BUENOS AIRES	42.6%	-4.0%	45.4%	-4.3%	12.0%	-8.2%	-16.5%
CATAMARCA	11.1%	-1.5%	81.7%	-7.8%	7.2%	-3.7%	-13.0%
CÓRDOBA	34.7%	-1.9%	61.5%	-5.9%	3.8%	-3.0%	-10.7%
CORRIENTES	12.6%	-1.1%	81.0%	-7.7%	6.3%	-3.9%	-12.7%
CHACO	12.6%	-1.0%	78.9%	-7.5%	8.5%	-7.6%	-16.1%
CHUBUT	35.1%	-2.2%	60.3%	-5.7%	4.6%	-1.2%	-9.2%
ENTRE RÍOS	22.3%	-2.1%	71.1%	-6.8%	6.5%	-5.6%	-14.4%
FORMOSA	7.2%	-1.2%	84.8%	-8.1%	8.0%	-7.1%	-16.4%
JUJUY	13.9%	-1.6%	81.0%	-7.7%	5.1%	-2.1%	-11.4%
LA PAMPA	25.9%	-2.0%	67.0%	-6.4%	7.1%	-6.1%	-14.5%
LA RIOJA	7.9%	-1.1%	72.8%	-6.9%	19.3%	-17.8%	-25.9%
MENDOZA	35.0%	-4.3%	60.8%	-5.8%	4.2%	-3.2%	-13.3%
MISIONES	33.5%	0.4%	59.9%	-5.7%	6.6%	-3.8%	-9.2%
NEUQUÉN	51.6%	-3.0%	41.0%	-3.9%	7.5%	-5.6%	-12.5%
RÍO NEGRO	25.7%	-2.7%	68.2%	-6.5%	6.1%	-4.3%	-13.5%
SALTA	22.8%	-1.3%	71.0%	-6.8%	6.2%	-5.1%	-13.2%
SAN JUAN	14.1%	-2.1%	81.6%	-7.8%	4.3%	-3.6%	-13.5%
SAN LUIS	19.4%	-1.6%	74.9%	-7.1%	5.7%	-4.8%	-13.5%
SANTA CRUZ	27.1%	-4.7%	64.1%	-6.1%	8.8%	-4.3%	-15.1%
SANTA FE	31.0%	-2.9%	64.3%	-6.1%	4.6%	-3.7%	-12.7%
SANTIAGO DEL ESTERO	9.4%	-1.1%	82.6%	-7.9%	7.9%	-6.0%	-15.0%
TUCUMÁN	23.5%	-2.1%	70.6%	-6.7%	5.9%	-4.0%	-12.8%
TIERRA DEL FUEGO	26.6%	-3.6%	66.6%	-6.3%	6.7%	-5.5%	-15.4%
CABA	85.3%	-7.6%	10.9%	-1.0%	3.8%	-1.1%	-9.7%

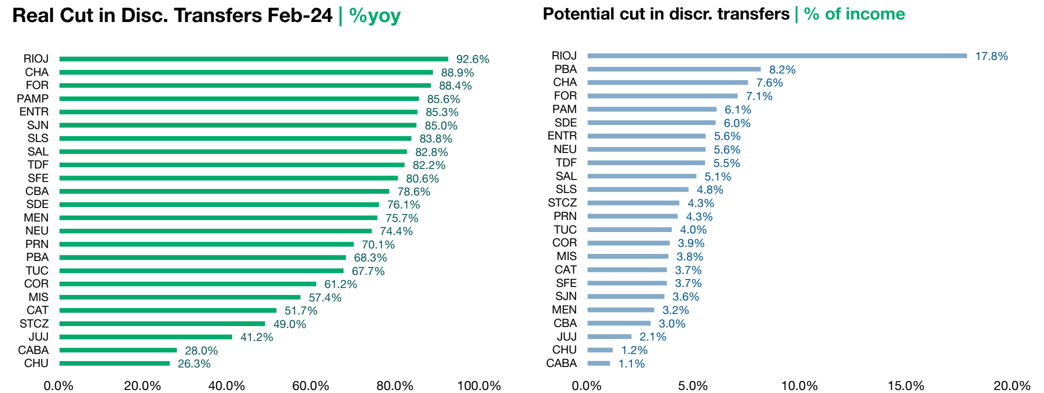
Source: TPCG Research based on OPC and Economy Ministry

In addition, while the administration counts with indexed tax lines to brave the storm, the mass of coparticipable taxes is not and is also prone to suffer due to depressed activity levels.

In addition, while the administration counts with indexed tax lines to brave the storm, the mass of coparticipable taxes is not and is also prone to suffer due to depressed activity levels. Now performing a sensitivity analysis over the recession's impact on coparticipable taxes, we find these present similar levels of elasticity to activity levels than provincial taxes, with the coefficient standing near the 1.41 mark. Therefore, calibrating our sensitivity model with our base scenario assumptions, Copa revenues are bound to drop by roughly -9.5% in real terms in 2024. While these originate from the national government, there are near to no instruments the administration can use to avoid transferring these resources to provinces. As with provincial taxes, the weight of Copa resources on provincial total income varies wildly between provinces. On average, automatic government transfers related to the Copa scheme represent 66.8% of total provincial revenues. So, the drop in tax collection at the national level is bound to affect the provincial fiscal position by more than the drop in provincial revenues. On the edges of the distribution, Formosa (84.8%), SdE (82.6%), Catamarca (81.7%), San Juan (81.6%), Jujuy (81%)

Corrientes (81%), and Chaco (78.9%) are the provinces that rely the most on automatic transfers as sources of income, while CABA (10.9%), Neuquén (41%) and Buenos Aires (45.4%) lie on the other side of the spectrum. Compounding both indicators, the provinces that will suffer the drop in national tax collection would be Formosa (-8.1%), SdE (-7.9%), Catamarca (-7.8%), San Juan (-7.8%), Jujuy (-7.7%) Corrientes (-7.7%) and Chaco (-7.5%).

Figure 6: A dissection of non-automatic transfer programs



Official USDmn	National Teacher Incentive Fund	Fiscal Strenghtening Fund	Financial Assistance to Provinces and munis	Provincial relations and Regional Development	Provincial Pension Funds	Educational Management and Socio-educational Policies	CABA security transfers	School Cafeterias and Nutrition Policies	Territorial Approach	Hydrocarbon Policy development and execution.	Capex	Rest	Total
CABA	89.5	0.0	0.3	0.0	0.0	1.7	221.2	0.0	0.0	0.0	22.7	35.4	370.7
Buenos Aires	363.4	820.4	514.8	67.8	396.3	119.6	0.0	90.5	42.4	0.0	404.4	66.1	2885.7
Catamarca	19.0	0.0	10.1	27.0	0.0	1.6	0.0	2.4	2.2	0.0	44.5	3.6	110.3
Córdoba	75.9	0.0	0.0	59.1	43.5	10.6	0.0	3.9	3.3	0.0	44.6	12.0	253.0
Corrientes	28.8	0.0	0.0	14.9	2.0	9.5	0.0	0.1	3.2	0.0	69.5	8.6	136.4
Chaco	40.0	0.0	3.4	32.3	25.2	20.3	0.0	13.2	4.0	0.0	97.0	14.1	249.5
Chubut	17.8	0.0	0.0	11.4	1.8	3.2	0.0	0.0	2.8	0.1	14.5	4.5	56.1
Entre Ríos	43.5	0.0	0.0	34.6	25.0	19.9	0.0	2.7	2.3	0.0	68.4	10.8	207.1
Formosa	17.4	0.0	8.1	29.8	8.7	5.5	0.0	6.2	3.1	0.0	71.8	7.3	157.9
Jujuy	20.9	0.0	12.2	12.9	0.0	9.1	0.0	2.5	1.1	0.0	16.2	6.5	81.4
La Pampa	11.5	0.0	0.2	16.6	14.4	1.6	0.0	1.8	2.4	0.0	38.4	5.6	92.4
La Rioja	17.8	0.0	16.9	23.5	0.0	1.5	0.0	3.5	3.2	0.0	178.1	4.9	249.4
Mendoza	47.6	0.0	4.1	27.7	0.0	5.7	0.0	2.6	2.5	0.4	31.6	8.9	131.0
Misiones	42.9	0.0	6.8	16.6	4.8	1.5	0.0	2.9	6.4	0.0	68.5	21.8	172.2
Neuquén	29.0	0.0	2.1	14.8	4.1	1.1	0.0	3.4	0.7	46.8	41.2	4.5	147.7
Río Negro	25.5	0.0	10.2	19.1	0.0	7.4	0.0	1.2	1.1	1.8	25.3	10.9	102.6
Salta	32.9	0.0	10.1	18.2	0.0	21.5	0.0	9.8	4.7	0.0	49.5	9.8	156.6
San Juan	19.6	0.0	0.0	25.1	0.0	3.3	0.0	2.9	1.3	0.0	21.2	7.0	80.3
San Luis	12.7	0.0	0.2	20.7	0.0	0.4	0.0	0.0	1.3	0.0	39.9	3.0	78.2
Santa Cruz	16.3	0.0	13.7	13.6	13.7	7.7	0.0	2.0	0.9	0.8	28.5	3.6	100.9
Santa Fe	81.3	0.0	0.6	60.3	38.5	23.9	0.0	5.6	3.8	0.0	73.8	16.4	304.2
Santiago del Estero	25.2	0.0	8.7	29.4	0.0	14.9	0.0	2.2	4.4	0.0	87.9	9.7	182.4
Tucumán	31.8	0.0	27.1	29.0	0.0	15.3	0.0	6.5	2.2	0.0	60.9	9.3	182.1
Tierra del Fuego	10.2	0.0	3.4	9.1	0.0	3.4	0.0	1.0	1.4	3.8	21.6	3.1	56.9
Non-Classified	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.4
Total	1120.5	820.4	652.9	613.5	578.0	310.2	221.2	166.8	100.6	53.8	699.7	287.3	5624.9

Source: TPCG Research based on the Economy Ministry

Beyond automatic transfers and provincial tax revenues, the more dependable sources of income for the provinces, discretionary transfers suffered a significant slash, increasing the distress of provincial finances.

Beyond automatic transfers and provincial tax revenues, the more dependable sources of income for the provinces, discretionary transfers suffered a significant slash, increasing the distress of provincial finances. The administration is trying to get the entire provincial space in line with its austerity program, as it needs the balance of the whole consolidated public sector to be hawkish, to cleanse the fiscal position of the national government, and to tame inflationary pressures going forward. In this context, discretionary transfers to provinces accumulated up to February collapsed in real terms, shrinking by -69%yoy. While the effect was not even throughout the space, extrapolating the current reduction in transfers vs the relative weight of these in each of the province's balances, we find the most affected regions to be La Rioja (-17.8% of income sources), PBA (-8.4%), Chaco (-7.6%) and Formosa (-7%). According to the Budget Office of Congress, the administration has funded around 10 programs via these non-automatic transfers, amounting to nearly USD5bn in 2023, designed to fund current expenditures. Of these, 5 account for nearly 80% of the total. These are the National Teacher Incentive Fund (USD1.1bn), PBA's fiscal strengthening fund (USD0.8bn), The financial assistance to Provinces and Munis program (USD0.65bn), the Provincial Relations and Development (USD0.6bn), Provincial Pension funds (0.6bn), and the Educational Policies program (USD0.3bn). In addition, non-automatic transfers in 2023 included USD1.6bn in Capex programs. In this context, the political space believed that while these transfers carry the name of non-automatic, their disbursement was mostly guaranteed, especially for those programs funding current expenditures and salary payments, such as the National Teacher Incentive Fund (FONID). In fact, on its 26th of February report, the Budget Office of Congress points out that 44% of total transfers are rigid, and they are likely to be disbursed. These include the National Teacher Incentive Fund and the Provincial Pension Funds. The BCO's definition of rigid seems to be based more on how urgent or strategic the funding needs of each program are, rather than on the administration's ability to stop funding them. So, while the FONID

finances crucial current expenditures in the provinces, the Milei administration had little issue to stop financing the program, meaning that, whatever the strategic importance of the funds, the administration has the ability (and up to now, the willingness) to cut off these types of transfers.

Figure 7: Alternative calibrations for our bull and bear scenarios

Bull scenario calibration Provincial over the line income sources (2023)	Prov. Tax intake loss due to activity	Copa intake loss due to activity	Loss due to potential Nat. Govt. bias	Total
BUENOS AIRES	-2.9%	-3.0%	-6.0%	-11.9%
CATAMARCA	-1.0%	-5.5%	-3.6%	-10.1%
CÓRDOBA	-1.3%	-4.1%	-1.9%	-7.3%
CORRIENTES	-0.8%	-5.4%	-3.2%	-9.4%
CHACO	-0.6%	-5.3%	-4.3%	-10.2%
CHUBUT	-1.3%	-4.0%	-2.3%	-7.6%
ENTRE RÍOS	-1.5%	-4.8%	-3.3%	-9.5%
FORMOSA	-0.9%	-5.7%	-4.0%	-10.6%
JUJUY	-1.1%	-5.4%	-2.5%	-9.1%
LA PAMPA	-1.4%	-4.5%	-3.6%	-9.4%
LA RIOJA	-0.8%	-4.9%	-9.6%	-15.3%
MENDOZA	-3.1%	-4.1%	-2.1%	-9.3%
MISIONES	0.8%	-4.0%	-3.3%	-6.5%
NEUQUÉN	-1.6%	-2.7%	-3.7%	-8.1%
RÍO NEGRO	-2.0%	-4.6%	-3.0%	-9.6%
SALTA	-0.8%	-4.8%	-3.1%	-8.6%
SAN JUAN	-1.6%	-5.5%	-2.1%	-9.2%
SAN LUIS	-1.1%	-5.0%	-2.8%	-8.9%
SANTA CRUZ	-3.2%	-4.3%	-4.4%	-11.9%
SANTA FE	-2.1%	-4.3%	-2.3%	-8.7%
SANTIAGO DEL ESTERO	-0.8%	-5.5%	-4.0%	-10.3%
TUCUMÁN	-1.4%	-4.7%	-2.9%	-9.0%
TIERRA DEL FUEGO	-2.5%	-4.5%	-3.4%	-10.4%
CABA	-5.4%	-0.7%	-1.9%	-8.0%

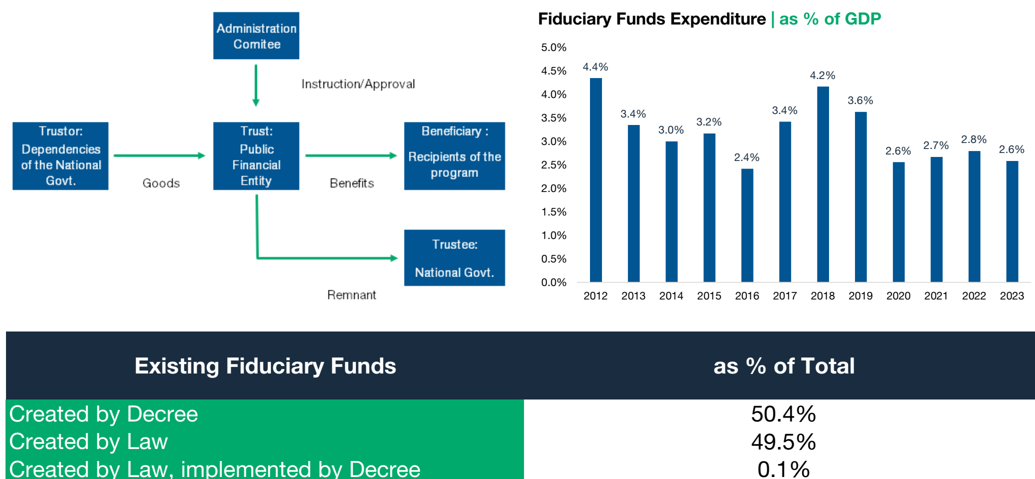
Bear scenario calibration Provincial over the line income sources (2023)	Prov. Tax intake loss due to activity	Copa intake loss due to activity	Loss due to potential Nat. Govt. bias	Loss due to Tax Income Law	Total
BUENOS AIRES	-5.7%	-6.2%	-12.0%	-2.3%	-26.2%
CATAMARCA	-2.2%	-11.2%	-7.2%	-5.3%	-26.0%
CÓRDOBA	-2.8%	-8.5%	-3.8%	-3.2%	-18.3%
CORRIENTES	-1.6%	-11.2%	-6.3%	-4.7%	-23.9%
CHACO	-1.5%	-10.9%	-8.5%	-4.6%	-25.5%
CHUBUT	-3.7%	-8.3%	-4.6%	-2.3%	-18.9%
ENTRE RÍOS	-2.9%	-9.8%	-6.5%	-3.9%	-23.1%
FORMOSA	-1.8%	-11.7%	-8.0%	-5.2%	-26.6%
JUJUY	-2.3%	-11.1%	-5.1%	-5.2%	-23.7%
LA PAMPA	-3.0%	-9.2%	-7.1%	-3.5%	-22.8%
LA RIOJA	-1.6%	-10.0%	-19.3%	-5.7%	-36.6%
MENDOZA	-6.1%	-8.4%	-4.2%	-3.6%	-22.2%
MISIONES	-0.4%	-8.2%	-6.6%	-3.4%	-18.6%
NEUQUÉN	-5.2%	-5.6%	-7.5%	-1.3%	-19.7%
RÍO NEGRO	-3.8%	-9.4%	-6.1%	-4.4%	-23.7%
SALTA	-2.1%	-9.8%	-6.2%	-4.4%	-22.5%
SAN JUAN	-3.0%	-11.2%	-4.3%	-5.2%	-23.8%
SAN LUIS	-2.3%	-10.3%	-5.7%	-5.1%	-23.4%
SANTA CRUZ	-7.0%	-8.8%	-8.8%	-2.7%	-27.4%
SANTA FE	-4.0%	-8.9%	-4.6%	-3.5%	-21.0%
SANTIAGO DEL ESTERO	-1.6%	-11.4%	-7.9%	-5.6%	-26.5%
TUCUMÁN	-3.2%	-9.7%	-5.9%	-3.1%	-21.8%
TIERRA DEL FUEGO	-5.1%	-9.2%	-6.7%	-4.7%	-25.7%
CABA	-10.8%	-1.5%	-3.8%	-0.8%	-16.9%

Source: TPCG Research based on the Economy Ministry and Indec

Finally, it's time to discuss fiduciary funds, which quadruple the size of the non-automatic transfers, and are a vital bloodline in provincial funding sources.

Finally, it's time to discuss fiduciary funds, which quadruple the size of the non-automatic transfers, and are a vital bloodline in provincial funding sources. In our estimation, fiduciary funds totaled 2.6% of GDP in 2023, quadrupling the size of non-automatic transfers, which amounted to 0.7% of GDP. Of these, most are off-balance of both the national and provincial governments and operate as funding sources for the provinces, rather than being outright cash transfers to local administrations. In that sense, the Fiduciary Fund system was the lifeline designed to bail out a provincial space that under normal circumstances would post a structural deficit. However, the introduction of these funds was relatively heterogeneous, both in time and institutional tools used to implement them. And while they do provide automatic funding to provinces, their structure is not as ironclad as the political system expected. In fact, more than 50% of the total expenditure of fiduciary funds comes from funds that were put into place with presidential decrees. This means that they can be as easily overturned. The funds which total the remaining 50% were instituted by Congress, meaning that they are not as easily defunded. Still, given that the 2024 budget was not approved, and therefore the 2023 budget was extended, nominality can do massive damage to the funds on its own, with no need for further government intervention to achieve that objective. In this context, it seems that the provinces can not only lose significant over-the-line resources but also financing sources coming from the fiduciary fund system.

Figure 8: Fiduciary funds' size and structure



Existing Fiduciary Funds	as % of Total
Created by Decree	50.4%
Created by Law	49.5%
Created by Law, implemented by Decree	0.1%

Source: TPCG Research based on the Treasury and Economy Ministry

The provinces’ response. How they plan on weathering the storm?

While the picture portrayed by historic correlations between activity levels and taxes paints a bleak picture going forward, especially compounded with the strained relationship with the national government, there are some caveats that suggest the provinces are accommodating their fiscal balances to weather the storm.

While the picture portrayed by historic correlations between activity levels and taxes paints a bleak picture going forward, especially compounded with the strained relationship with the national government, there are some caveats that suggest the provinces are accommodating their fiscal balances to weather the storm. The first consists of the fact that most governors took note of the winds of change that have been blowing in the country since Mr. Milei’s win at the national level and have announced, in varying degrees, compensating measures to tighten up provincial fiscal balances. These range from significant increases in Real Estate Taxes, indexing taxes to inflation, to cuts in political appointees and frozen vehicle and durable goods purchases. On the income side, most measures revolve around the Real Estate Tax, as it has less sensitivity to activity levels, and the Local Sales Tax, which generally composes the largest chunk of provincially levied revenues. On the expenditure side, measures vary significantly, with some governors announcing the reversal of some last-minute hires of the previous administrations, freezes in goods purchases, or the revoking of privileged pensions. Still, it is very difficult to gauge the significance of these measures on aggregate provincial expenditures, especially as most of them generally affect minor lines in both the expenditure and income segments and are generally designed to avoid loss of real tax revenues to inflation rather than compensating for the incoming blow generated by the recession. However, there is a project that could present some spillovers to the rest of the provinces, even the ones that are not willing to negotiate with the federal government. That is the reinstating of the Income Tax law, which would see all provinces recover some revenue sources, as the tax is coparticipable. While it is bound to aid provincial finances, its impact should be quite limited, as this tax should also suffer from the drop in activity levels and represent a less sizable chunk of provincial revenue sources. So, while corrective measures are being put into place, the jury is still out on both the magnitude and significance of the former.

Figure 9: A top-down view of some of the proposed provincial consolidation efforts

Province	Proposed Measures	Change in Political Color?	Current ruling Party
BUENOS AIRES	New Tax Law. Gross Income Tax to be paid in Advance	No	UxP
CATAMARCA	500% Increase in Real Estate Tax.	No	UxP
CÓRDOBA	Montlhy Indexation of Real Estate Tax, to either the salary index (for urban properties) or to the agricultural price index (for rural properties) Budget envisages a 5.4% cut in real expenditure	No	Fed. Peronism
CORRIENTES	No concrete measures announced	No	JxC
CHACO	Austerity measures to include freezes in public hiring and durable goods purchases, auditing social assistance plans, cut of 5000 telephone lines, cutback in overtime and strict shift controls and increase subsidy transparency. Selloff of old provincial equipment.	Yes	JxC
CHUBUT	Selling Provincial Unused Goods, Getting back unexploited Areas from YPF, redo fishing permits to allow for up to USD7mn in revenues.	Yes	JxC
ENTRE RÍOS	Automotive Tax Increase (in line with inflation) Gross income increases to specific categories (Retail Stores (4.5%), Financial Institutions (9%) Tobbaco commercialization (8%). Reduction in public employment	Yes	JxC
FORMOSA	Increase in Automotive Tax	No	UxP
JUJUY	Gross Income Tax to be paid by all goods entering the province to be commercialized.	No	JxC
LA PAMPA	No concrete measures announced	No	UxP
LA RIOJA	No concrete measures announced	No	UxP
MENDOZA	20% reduction in expenditures for all ministries.	No	JxC
MISIONES	Gross Income Tax to be paid in Advance Frozen Public Automotive Purchases (excl. Security and Health) for one year. Frozen transfers to effective positions for a year. (excl. Health, Security and Education)	No	Local Peronism
NEUQUÉN	Austerity Measures, including the annulment of privileged pensions. 50% reduction in political positions.	Yes	Local Party (allied with JxC)
RÍO NEGRO	Austerity Measures announced, no concrete policies.	No	Local Peronism
SALTA	Austerity measures to include freezes in public hiring, voluntary retiring programs, cuts in excess financial asitance to munis, 6-month freeze in durable goods purchases, 6-month pause in capex project auctions, 180 day freeze in provincial executive power employee salary increases, 6-month pause in advertising expenditure and increased expenditure	No	UxP
SAN JUAN	Austerity measures to include freezes in public hiring, 30% cut in politically appointed employees, annulment of hirings done 6 months prior to the elections, cutback in public contracts	Yes	JxC
SAN LUIS	40% cut in politically appointed employees, cut in reserved outlays and trips, revision of public contracts, suspension of capex works.	Yes	JxC
SANTA CRUZ	Austerity Measures including selloff of provincial assets, including 80% of the provincial vehicles, 50% cut in advertising expenditure, cut in 1480 telephone lines, auditing contracts and expenditure	Yes	Local Party
SANTA FE	Increase in Real Estate Tax. Cutback in ministries, from 18 to 11.	Yes	JxC
SANTIAGO DEL ESTERO	Austerity Measures including 6 month freeze in public hiring, 6 month freeze in advertising expenditure, 6 month freeze in public works auctions, cutback in reserved outlays and official trips	No	UxP
TUCUMÁN	Austerity Measures totalling a 13% reduction in expenditure.	No	UxP
TIERRA DEL FUEGO	No measures	No	UxP
CABA	Budget envisages a 6.1% cut in real expenditure	No	JxC

Source: TPCG Research based on provincial statements

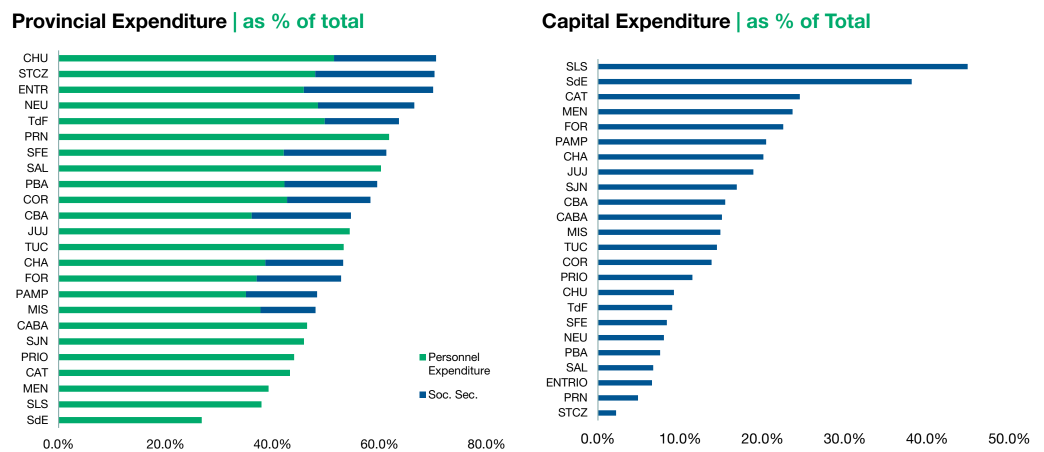
So, with income sources bound to suffer significantly in 2024, most governors face an uncomfortable issue, which has to do with

So, with income sources bound to suffer significantly in 2024, most governors face an uncomfortable issue, which has to do with the inflexibility of their public spending. So, while there is some intention of dialing back public expenditure in the provincial space, the issue is that most local outlays come down to current expenditures, in particular, salaries, which make trims deeply uncomfortable for the provincial administrations, especially those who have just gained

the inflexibility of their public spending.

access to power. On average, personnel expenditure, in addition to Soc. Sec outlays represent 53.8% of total expenditures in the provincial space. However, that number goes up as high as 70% for Entre Ríos, Chubut, and Santa Cruz and breaks the 60% mark for provinces such as Neuquén, Santa Fe, Río Negro and Tierra del Fuego. If we add capex to the equation, average expenditures included in those three lines add up to 69.5% of provincial outlays, with the distribution being extremely compact, with most provinces standing in the 63% to 75% range. The issue then is that each provincial administration faces a significant slump in income sources while having to make crucial salary and Soc.Sec. payments each month, which weigh heavily on public opinion and regional politics. This is especially true for the new administrations, of which there are seven. The new governors, especially those who were able to scrape wins in historically Peronist provinces, know that their victories are an accident, a product of the context at the national level. These newly instated governors were put by the electorate at the top of provincial power structures which remain strongly Peronist and will actively work to oust them and replace them with friendly figureheads. Therefore, they need to coopt these power structures to work for them, and that requires a high level of politically driven expenditure. So, while faced with mostly inflexible outlays, and pressed to spend to win over their electorate to consolidate their "accidental" victories, they still depend on a national government that is pushing for fiscal consolidation. Something must give.

Figure 10: Provincial expenditure is highly inelastic



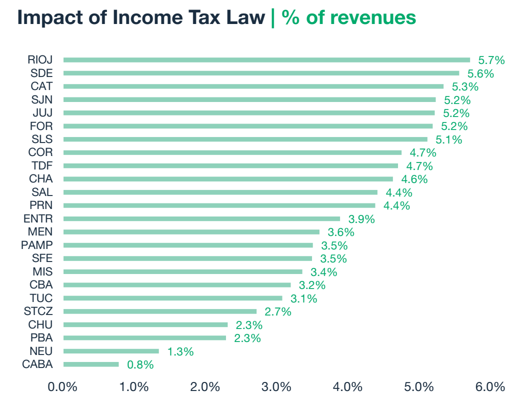
Source: TPCG Research based on the Economy Ministry

Then, there's the issue of external debt services. Even if the balance sheet effect suffered in Dec-23 diluted, the better-than-expected performance of inflation makes the devaluation hit more permanent.

Then, there's the issue of external debt services. Even if the balance sheet effect suffered in Dec-23 diluted, the better-than-expected performance of inflation makes the devaluation hit more permanent. During the 2020-2023 period, the provincial space was able to deleverage significantly, as it was able to source cheap USD at the official FX from the national government, while revenues growing at an inflation pace diluted debt services relative to revenues. However, with the initial devaluation in Dec-23, said effect reversed, as debt services in ARS ballooned relative to the figures of recent years. Previously we had argued that the balance sheet effect would dilute as inflationary pressures gradually caught up to the 2% crawling peg instated by the administration. However, the relatively weaker inflation prints mean that, even excluding activity level effects, the balance sheet effect is proving more persistent than expected. This means that debt services are still significantly more difficult to pay than in 2023. On average, for provinces with hard currency debt, their obligations amount to 7.6% of revenues, even after adjusting for the REER appreciation in recent months. This news is credit negative for the entirety of the space, as debt services are relatively harder to pay, in the context of a deep drop in revenues. Still, the key question is where debt services rank in the governor's priorities. While we believe that a debt restructuring process would not be a palatable choice for any province, especially with the current international rate scenario (which is wildly more adverse than the 2020-21 period), it will be up to each of the governors to pick which outlay line to cut, in a context, where the federal government is increasingly decoupling its reputation and payment ability from the provincial space. Up to now, governors have generally preferred to use their cash positions rather than to push for restructuring (except for La Rioja, at least initially), which is a good signal. However, if the national government blockade does not yield, that situation can deteriorate quickly.

Figure 11: Even with inflation catching up to the devaluation, the balance sheet effect for EXD debt persists.

External Debt Services 2024	USDmn	as % of 2023 Revenues	Adjusted to the current REER
Buenos Aires	702	8.4%	4.9%
CABA	100	3.0%	1.7%
Chaco	77	7.5%	4.4%
Chubut	135	31.9%	18.7%
Córdoba	541	23.4%	13.7%
Entre Ríos	130	11.8%	6.9%
Jujuy	47	8.4%	4.9%
La Rioja	77	17.2%	10.1%
Mendoza	100	9.2%	5.4%
Neuquén	142	20.7%	12.2%
Río Negro	92	15.7%	9.2%
Salta	107	12.2%	7.1%
Santa Fe	17	0.8%	0.4%
TdF	32	10.9%	6.4%



Source: TPCG Research based on the Economy Ministry, BCRA and OPC

The PBA question

In our view, there is one province whose situation is more delicate than the rest, and that is PBA, both from a political and financial standpoint.

In our view, there is one province whose situation is more delicate than the rest, and that is PBA, both from a political and financial standpoint. The change in political color at the national level has not been kind to Buenos Aires, as it exposed its reliance on the national government in the fiscal department. While generally, the political party ruling at the national level also controls PBA, and has heavy incentives to subsidize the province, as it harbors most of the country's population, this time around not only this did not happen, but both political colors stand at opposite ends of the ideological distribution. Dissecting the financial assistance from the administration to the provincial government, in 2023's official FX, the province received USD2.9bn (USD1bn at today's FX, 1.7bn REER- adjusted) in non-automatic transfers, of which USD820mn came from PBA's fiscal strengthening fund, which the administration has already discontinued. Another USD363mn came from the National Teacher Incentive Fund. Those two non-automatic transfers are generally used to fund provincial salaries. The first is to finance provincial security forces, and the second is to pay for the education workers' salaries. This means the province has to make ends meet with USD1.2bn less to pay salaries. That, added to the USD400mn received to bolster the provincial pension funds, put the province -USD1.6bn down in financing sources used to fund current expenditures. The rest of the programs add up to USD1.3bn, and even if they are used to finance a variety of expenditures, including the more flexible capex, the financing gap left by these would be significant. The real change in non-automatic transfers received by Feb-24 is a -68.3%yoy drop, standing in the best-performing half of the provincial space. In addition, the province is bound to suffer major automatic cuts in real terms due to the impact of the recession. The contraction in provincial taxes is bound to reduce revenue sources by -4%, while we estimate the fall in Copa transfers will result in a -4.3% compression of revenues. Compounded with the drop in non-automatic transfers, the province's total income could come down by a whopping -16.5% in 2024. While the province could recover points of revenue if the Income tax law is reinstated as previously, the net results still suggest a major contraction in revenues, given the recession has the expected severity, and that the current bias of the national government regarding non-automatic transfers continues going forward. The provincial administration is aware of the stress its fiscal numbers are under, and commanded significant tax increases across the board, which we believe could compensate for the effect of activity levels on revenues. However, the fact remains that, without discretionary transfers, in REER-adjusted terms, the province could be down up to USD1.7bn in non-automatic disbursements, which creates a massive funding gap for the province, especially as its international bonds start to sink, which also elevated the provinces GFN's this year. On a positive note, the administration used its cash position to pay for March's significant sinking and purchased 6 months of relative peace to reconstruct its finances. It also showcases the province has some willingness to pay. However, if the current situation persists, the problem could turn into an ability issue, rather than a question of willingness, especially as PBA's starting fiscal position is already concerning.

Figure 12: The freeze in non-automatic transfers opens a wide funding gap for PBA

2023 Non-automatic transfers to PBA	ARSmn	USDmn (2023 Avg.)	USDmn (Current FX)	USDmn (REER Adj.)	As % of revenues
National Teacher Incentive Fund	107,427	363	126	215	1.5%
Fiscal Strenghtening Fund	242,526	820	284	485	3.4%
Financial Assistance to Provinces and munis	152,187	515	179	305	2.1%
Provincial relations and Regional Development	20,031	68	23	40	0.3%
Provincial Pension Funds	117,167	396	137	235	1.6%
Educational Management and Socio-educational Policies	35,348	120	41	71	0.5%
School Cafeterias and Nutrition Policies	26,743	90	31	54	0.4%
Territorial Approach	12,543	42	15	25	0.2%
Capex	119,537	404	140	239	1.7%
Rest	19,552	66	23	39	0.3%
Total	853,061	2,886	1,001	1,708	12.0%

Source: TPCG Research based on the Economy Ministry

In this context, we find PBA's political and strategic incentives do not line up with the deal proposed by the administration.

In this context, we find PBA's political and strategic incentives do not line up with the deal proposed by the administration. We believe that the weak link in the administration's Copa proposal is the difficulty of actually passing said legislation. Not only does it need approval in both national congress chambers, but it needs ratification from all provincial legislatures. Which means any province can form a blocking position to the law. Therefore, to pass a Copa law, all incentives, both at the national and provincial levels have to be aligned. And even if the administration can get all the provinces to agree on a Copa law, it will be extremely difficult to get PBA on board. The arguments behind this reasoning are twofold. First, political alignments. As discussed above, it is very difficult to envisage Mr. Kiciloff climbing on board of the administration's plan, as it lies directly opposite to his view and political ideology. This is not only true for PBA, but several provinces, mostly of Peronist backgrounds, share the same issue. It would require a great sacrifice and loss of face to get on board with the May pact. In addition, the administration's political incentives are not completely aligned with funding PBA. After the defeat at the national level, the province became the main bastion of kirchnerism, the fortress where to regroup and rebuild. This conveys that the administration won't be very willing to fund the province, knowing it is financing its main political rival. That caps the best-case scenario for PBA to a muddle through, scraping by, with minimal funding by the national government, unless the provincial government decides to consolidate, albeit the political cost of doing so might prove too high for the Kiciloff administration.

Figure 13: Monthly provincial debt services

	ene-24	feb-24	mar-24	abr-24	may-24	jun-24	jul-24	ago-24	sep-24	oct-24	nov-24	dic-24	2024
Buenos Aires	0	0	353	0	0	0	0	0	349	0	0	0	702
Interest	0	0	235	0	0	0	0	0	231	0	0	0	465
Principal	0	0	118	0	0	0	0	0	118	0	0	0	236
CABA	0	0	0	0	0	33	0	0	0	0	0	33	100
Interest	0	0	0	0	0	33	0	0	0	0	0	33	100
Principal	0	0	0	0	0	0	0	0	0	0	0	0	0
Santa Fe	0	0	0	0	9	0	0	0	0	0	9	0	17
Interest	0	0	0	0	9	0	0	0	0	0	9	0	17
Principal	0	0	0	0	0	0	0	0	0	0	0	0	0
Mendoza	0	0	51	0	0	0	0	0	49	0	0	0	100
Interest	0	0	12	0	0	0	0	0	11	0	0	0	23
Principal	0	0	38	0	0	0	0	0	38	0	0	0	77
Córdoba	11	16	0	11	0	155	11	16	0	11	0	151	541
Interest	2	16	0	2	0	35	2	16	0	2	0	30	142
Principal	9	0	0	9	0	120	9	0	0	9	0	120	399
Neuquén	0	15	0	42	15	0	0	15	0	41	15	0	142
Interest	0	5	0	13	5	0	0	5	0	12	5	0	45
Principal	0	10	0	29	10	0	0	10	0	29	10	0	97
TdF	8	0	0	8	0	0	8	0	0	8	0	0	32
Interest	2	0	0	2	0	0	2	0	0	2	0	0	8
Principal	6	0	0	6	0	0	6	0	0	6	0	0	24
Chubut	35	0	0	34	0	0	34	0	0	33	0	0	135
Interest	10	0	0	9	0	0	9	0	0	8	0	0	35
Principal	25	0	0	25	0	0	25	0	0	25	0	0	100
Entre Ríos	0	66	0	0	0	0	0	64	0	0	0	0	130
Interest	0	19	0	0	0	0	0	17	0	0	0	0	37
Principal	0	47	0	0	0	0	0	47	0	0	0	0	93
Jujuy	0	0	24	0	0	0	0	0	23	0	0	0	47
Interest	0	0	5	0	0	0	0	0	5	0	0	0	10
Principal	0	0	18	0	0	0	0	0	18	0	0	0	37
Salta	0	0	0	0	0	38	0	0	0	0	0	37	107
Interest	0	0	0	0	0	13	0	0	0	0	0	12	39
Principal	0	0	0	0	0	25	0	0	0	0	0	25	68
Río Negro	0	0	47	0	0	0	0	0	45	0	0	0	92
Interest	0	0	11	0	0	0	0	0	10	0	0	0	21
Principal	0	0	36	0	0	0	0	0	36	0	0	0	71
La Rioja	0	26	0	0	0	0	0	51	0	0	0	0	77
Interest	0	10	0	0	0	0	0	13	0	0	0	0	23
Principal	0	16	0	0	0	0	0	38	0	0	0	0	54
Chaco	0	38	0	0	0	0	0	39	0	0	0	0	77
Interest	0	9	0	0	0	0	0	10	0	0	0	0	18
Principal	0	29	0	0	0	0	0	29	0	0	0	0	58

Source: TPCG Research based on TPCG Trading Desk

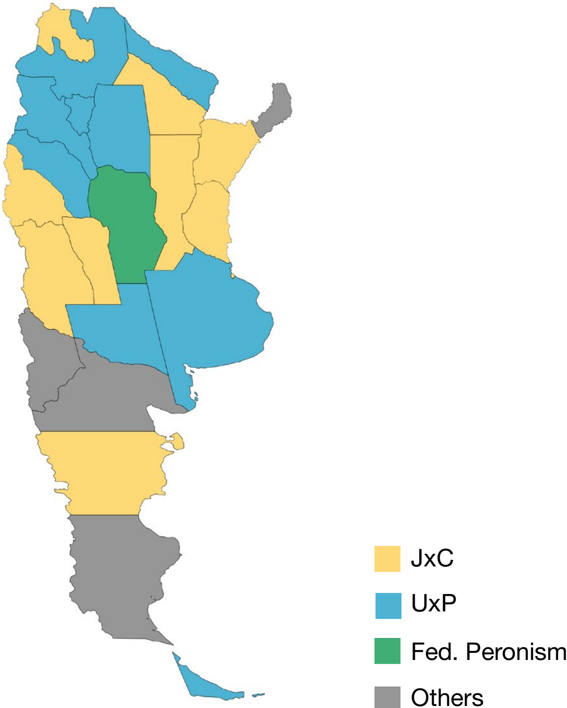
And on a second, and more important note, exclusive to PBA, a new coparticipation regime would not solve PBA's Copa problem.

And on a second, and more important note, exclusive to PBA, a new coparticipation regime would not solve PBA's Copa problem. While it is clear that, in order to achieve some consensus, the national government will give away some of its Copa share to sweeten the deal for the provinces, PBA needs to get 10pp more of its current cut to match its contribution to the national economy and tax collection. That means that it needs to receive most of what the federal government is planning to hand over to the entire provincial space, which seems extremely unlikely. So, a feasible Copa regime would see Buenos Aires recovering some of the points it lost back in 88', but not enough to bridge its current gap, an issue that the new regime will solve for the remaining provinces. That means that, said scheme would provide autonomy to the entire provincial space, but PBA. The main objective of the deal, to free the provincial governments from the national administration's discretion would be undone in the case of Buenos Aires. So, the issue for Buenos Aires is that it is bound to maintain a blocking position on a possible Copa law just because the new system does not solve the structural issues that plague it. So, how the Mr. Milei's administration is bound to respond to such an issue? Well, in our view it will probably put up a new scheme of fiduciary funds or automatic financing mechanisms for provinces, where the uncooperative provinces are discriminated against while granting funding and independence to the ones that do provide political support to the government plan. So, we find that PBA has the power and ability to derail the May Pact and a future Copa law, at least in the largest sense of the expression. The issue is that, by doing so, it risks becoming ostracized and defunded, putting it in an untenable financial position, as even without PBA's cooperation, Mr. Milei can muster enough legislative muscle in the rest of the space to pass at least some of his reforms. So, while PBA's non-cooperation does cloud the perspectives of a new Copa law, it does not prevent a pact between some governors and the federal administration, which gives viability to the government's plan. And the cost of such a stance is, at the very least, significant.

The federal government is aware that time is in its favor and is preparing for an attrition war with the provincial space, one it has all the tools to win, which means that, sooner rather than later, the governors will start to pledge to the administration's banner.

The federal government is aware that time is in its favor and is preparing for an attrition war with the provincial space, one it has all the tools to win, which means that, sooner rather than later, the governors will start to pledge to the administration's banner. The government's current proposal is simple. The requirements for the provinces to receive some financial aid are twofold. First, they must do a fiscal consolidation effort, to mimic the federal compression plan, at least up to a degree. Secondly, the governors must provide support for the new version of the Omnibus Law, the projects the administration sends to Congress, and the DNU in the lower chamber. Provinces that comply with this will receive funding. In addition, at the end of the road, the administration offers a new Copa law, to channel and automize the relationship between the provinces and the national government, replacing the battered institutions currently in place, which subordinates the former to the latter. We expect the financial choke to the provinces to break their political resistance, albeit we do not expect this to happen throughout the space. Our guess is that the provinces that will finally accept the deal will be the ones that need the financial assistance and are not as far in the political spectrum as the national government. According to our numbers, from a financial standpoint, most provinces could do with funds from the national government, which makes the first condition binding for the entire space. The problem is that there are provinces that are not willing to pay the political cost of supporting the administration's project in exchange for cash. For example, the political contortions required for Mr. Kiciloff's deputies to support the omnibus bill in Congress are too extreme. This can also be said of several other governors of Peronist ancestry. In the end, it is an attrition race. And while Mr. Milei does eventually need political support to institutionalize his reform package, he does not need it to stabilize the economy this year. Instead, the need for funding will probably be felt by the provincial governments in the coming months, putting them on the short end of the stick. This is especially true for provinces that are adjusting their fiscal bias by increasing taxes rather than by cutting expenditure, as maintaining their outlay levels will result in slowly but steadily exhausting their cash positions. So, while Mr. Milei can afford to have the omnibus bill delayed once more, the national government will continue to strangle the provinces financially and will continue to send their bills to Congress. While the national government can continue to play hand after hand, the provinces, with a limited cash supply, cannot do the same. This means that at some point, governors should start to fold.

Figure 14: A snapshot of the provincial space after the 2023 election cycle



Source: TPCG Research based on Tribunal Supremo Electoral

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