

Framework Paperⁱ

Oil and Gas in Argentina

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1. Overview

Argentina has been constitutionally organized as a federal country since 1853, when the provinces founded the Argentine Republic with a Federal Government.

Since the constitutional reforms of 1994, it is clear that oil, gas and other natural resources of the subsoil are of provincial domain and subject to private exploitation or to state companies only by a provincial concession.

Although traditionally oil and the gas have been considered strategic resources for Argentina's economic development, its reserves are rather modest (approximately 0.21% of world proved oil reserves, and 0.25% of proved gas reserves according to BP Statistical Review 2007). Oil and gas contribution to GDP was 6.5% in 2007, of which 5.3% came from upstream activities).

All three levels of government have some taxing authority on oil and gas. The federal government levies export and import taxes, which it does not share with the provinces, though it must share the proceeds of other general taxes, including value added tax, corporation and personal income tax, as well as specific taxes on the sale of oil products, and has the right to impose royalties on offshore production located between twelve and 200 miles from the coast line. The provinces levy a gross sales tax on commercial activities (a turnover tax in multiple stages), property taxes, vehicles taxes, seal tax on the contracts and other juridical acts, and impose royalties on oil and gas production in their territories. The municipalities impose various fees for services, such as garbage, solid waste and sewerage disposal, safety and health inspections.

There are some concerns and complains among petroleum producing provinces regarding the effects of federal fuel and energy policies and export taxes. In particular, the federal export tax has de-linked internal and international oil prices, protecting local consumers while reducing royalties' proceeds and undermining incentives for upstream investment.

2. Federal system and constitutional provisions

Argentina declared its independence in 1816. It was formed out of three of the River Plates Intendencias, with fourteen provinces that were transformed "Cabildos" with a very high degree of autonomy. From then, until 1853, there were repeated military confrontations between Unitarians, who had a liberal ideology and favored a centralized country, against Federalists, who were conservatives with wide popular support favoring provincial autonomy. During this period, there was no national constituted authority and the governments of the provinces delegated their foreign affairs and in some cases even national defense to the

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governor of the Province of Buenos Aires. The provincial governments signed several agreements expressing their intentions to become one nation. Finally, in 1853 the Unitarian troops of the Governor of Buenos Aires were defeated by a federalist alliance of several provinces in the battle of Caseros. This led to an agreement of the fourteen founding provinces to establish a federal constitution for Argentina.

The new constitution was federal and republican, with a presidential system and a Congress. The legislative power is vested in a Congress composed of two Houses, one of Deputies of the Nation and the other of Senators for the provinces and for the City of Buenos Aires (though the regime was highly “presidentialist”, with the president having important powers of decree). The Provinces determine their own local institutions and are governed by themselves. They elect their governors, legislators, and other provincial officers, without intervention of the federal government. Each province enacts its own Constitution, ensuring municipal autonomy and ruling its scope and content regarding the institutional, political, administrative, economic and financial aspects.

The Constitution reserved to the provinces all the powers not delegated to the Federal Government, as well as certain other powers expressly reserved to provinces by special pacts at the time of their incorporation. The ownership and management of the oil and other natural resources were not constitutionally assigned to the Federal Government and therefore, were provincial.

Among the powers assigned to the Federal Government are those to enact penal, civil, commercial, and mining laws (codes). The Federal Government was given the unique power to levy customs taxes, and the power to levy indirect taxes concurrently with the provinces. It was also empowered to impose direct taxes for a limited time only and only for national emergency reasons.

Federal involvement in the development of oil and gas arises from the location of the early petroleum developments, starting with the discovery of oil in Patagonia in 1907, within the national territories. Oil and gas were considered strategic for the economic development of the country and so oil and gas policy was based on federal ownership of energy resources. This position was reinforced during military regimes and even by elected governments of the forties and fifties. In 1949 the government of Juan Domingo Perón enacted a new constitution which provided for federal ownership of all natural resources of the subsoil including oil and gas. But this was reversed when Peron was ousted and the Constitution repealed. The original 1853 Constitution was re-enacted with some changes. But these did not affect the original principle that the provincial rights over natural resources of the subsoil were not delegated to the Federal Government.

These important issues of public policy continued to be discussed for many years, during which the situation on the ground was unclear. Finally, provincial ownership was recognized by a federal law of 1992 (National Law 24145) and fully included in the constitutional reform of 1994, which recognized the provincial ownership over the natural resources of the subsoil.

By 1990 all the national territories were granted the status of provinces. The federal government continued to administer oil and gas rights and to collect royalties up to 1992, when a new law transferred the management of oil fields to the Provinces. At the same time, the Federal Government transformed Yacimientos Petroliferos Fiscales, the state-owned oil company created in 1952, into a purely commercial corporation, with mixed governmental (federal and provincial) and private ownership of its shares. Together, these steps meant that oil and gas onshore fields (and the offshore up to twelve miles) were fully brought under provincial jurisdiction. As a result, the federal direct role is now limited to its ownership of submarine deposits located between the 12th mile and the 200th mile line of the Atlantic Ocean.

3. Ownership and jurisdiction

The 1994 Constitution explicitly recognized in Section 124.- “... *The provinces have the original dominion over the natural resources existing in their territory*”. This constitutional mandate was implemented through Law 26.197/94.

As part of the new arrangement, the provinces agreed to recognize oil field concessions granted by the federal government prior to the new law of 1992. Provincial rights will be fully recovered at the expiration of the current federal concessions. The renewal of existing as well as new concessions will be totally under the respective provincial authority. In addition the provinces provide royalty and tax stability in respect of the concessions already granted.

The federal government has other relevant Constitutional powers, which have given it broad influence over the sector. The National Congress has the power to enact mining and industry laws, and the federal government has the authority to regulate these activities. The federal government has powers in relation to the trade and transportation of oil and gas, including decisions on the construction and control of gas and oil pipelines. Other federal powers include the control of port facilities (shared with the provinces), the regulations on the preservation and restoration of the environment (shared with the provinces), the control and regulation of the market and internal prices; and taxes on imports and exports (an exclusive right stated in the Constitution and therefore the collection is not shared with the provinces).

4. Petroleum revenue arrangements in context of the federal fiscal regime

The fiscal regime comprises federal revenues that must be shared with the provinces, federal revenues that are not shared, and provincial and municipal revenues that remain with the provinces and municipalities. The whole system has been dubbed “labyrinth”. Revenues from the petroleum sector have been a secondary part of the total system, though highly important for some of the main producing provinces. However, the peculiarities of the regime have motivated some clearly dysfunctional federal policies, which are having a depressive effect on the development of the upstream sector. This has been a source of significant tension between federal government and producing provinces.

The federal government collects taxes on petroleum exports and imports, and a tax on the sales and transferences of fuels, the value-added tax and the income tax. Likewise, the federal government charges royalties for the production of oil and gas in the territorial Argentine sea between 12 miles and 200 miles of the coast and rights of exploration in the same area.

The provinces collect royalties and also have the legal power to collect taxes on economic activities and assets, like the gross sales tax, property tax, vehicles, seals tax on contracts and other transferences. In addition they participate in the federal taxes proceeds with the exception of those from export or import taxes.

Of the \$5 billion in total proceeds from the sector, about half is the fuel tax downstream. The two major revenues of significance to the upstream are the provincial royalties (29%) and the federal export tax (22%). The federally collected fuel tax is shared among the federal government and all 24 provinces. The export tax need not be shared by the federal government. And only the producing provinces benefit from their royalties. In fact, four provinces collect about 85% of total royalties paid on oil and gas.

The relative importance of oil and gas royalties as a percentage of provincial current public revenues varies from 34% in Chubut, 26% in Neuquen, 24% in Santa Cruz, 12% in Mendoza, 10% in Rio Negro to 8% in Tierra del Fuego. Gas royalties are very important in Neuquen, representing 17% of their Provincial current public revenue, while they are 6% in Salta and 5% in Tierra del Fuego. As for the rest of the gas producing provinces, gas royalties represent less than 3% of their current public revenues.

While the federal government is by far the largest collector of taxes and other revenues, some of these must be shared with the provinces or be directed to special purposes or both. This system creates incentives for

the federal government in particular to favor certain revenue sources where it need not share the proceeds with the provinces and municipalities. Moreover, the system has proven very resistant to reform because of its complexity and the fact that any new regime would entail winners and losers.

By far the most import taxes on the upstream are royalties and export taxes. The provinces receive royalties on oil and gas production (as does the federal government for the offshore beyond 12 miles). The federal government receives the export tax (as well as an import duty, which is currently minor in the case of petroleum).

The principal downstream tax is that on liquid fuels and gas dating back to the thirties. This is shared with the provincial governments according to a specific formula, which is currently that 21 per cent of the revenue goes to the National Health Service and the remainder is split 60-40 between the federal and provincial governments. Much of what goes to the provinces and the federal government is allocated to specific funds, such as the National Housing Fund (FoNaVi), the Federal Road Fund (administered federally by the National Highways Agency and provincially by their own agencies), the Water Infrastructure Fund, the Electrical Infrastructure Fund, the Transport Fund (FCT), the Fund for the Electrical Development of the Interior (FEDEI). Several of these funds receive contributions from the tax on electric power.

Of course, oil and gas companies are subject to normal taxes of general application, such as personal and corporate income tax and the value added tax, the proceeds of which are also shared amongst the federal and provincial governments according to the revenue sharing system. However, on oil and gas exports there is a rebate of the value added tax. The provinces for their part also apply general taxes on hydrocarbon activities: the stamp tax (on the amount of the contracts and other juridical acts) and a gross sales tax (a turnover tax), as well as a tax on real property, such as land, buildings and vehicles.

This complex system of distribution rates for different revenue sources is not unique to the hydrocarbon sector, but applies generally. The current federal fiscal regime for revenue sharing largely dates from 1988, but there have been a number of subsequent modifications since then. These are done by agreements among the federal and provincial governments and must be ratified by laws at both levels of government. Because any change would produce winners and losers, it has proven impossible so far to find a new agreement that would establish a more stable and simpler system, based on the objectives for sharing set out in the 1994 constitutional text, namely equality of opportunity and an equivalent degree of development across the whole federation.

A recent source of contention between federal government and producing provinces relates to the tax on export and fuel price regulation for the domestic market (both introduced in 2002). With regard to tax on export, in 2007 federal regulation established a “reference price “of US\$60.90 per barrel and a “cut price” of \$42. When the international price is higher than the reference price, the rate of tax increases so that the exporter receives only US\$42 per barrel; when the price is between \$42 and US\$60.90, the tax is 45% of the “cut price” of US\$42, that is the tax becomes fixed at US\$18,90 per barrel. Should the price fall below US\$42, the government establishes a new tax rate.

While the tax on export allowed the federal government to achieve its goal of decoupling domestic prices from the international market, the provinces have been hit hard. Indeed, with rising oil prices, the domestic price used for royalty calculation has topped US\$42 per barrel. For each dollar of federal export tax the provincial royalties decrease by 12 cents. This tax scheme has also discouraged oil companies from exploring for more oil and gas, with negative effects on reserves growth.

The export taxes on oil poses a dilemma to the federal government: if it reduces the tax rate, this would provide an incentive to explore for new reserves and soothe the provinces, but inflation would rise with rising fuel prices.

5. Macroeconomic challenges

Petroleum policy in Argentina has been strongly influenced by the macroeconomic goal of avoiding inflationary pressures. Given the importance of energy prices for more general price indexes, the federal government has looked for ways to decouple domestic and international prices through administered energy prices and export taxes.

Fiscal deficits have been a chronic challenge. For many decades, Argentina's economic structure was marked by industrial protection and the strong presence of numerous state companies both in strategic sectors (railroads, telephones, post office, airlines, oil, gas, mining industry, steel, arms, sanitary services, etc.) and in other less economically relevant sectors (such as radio stations, hotels, manufacturing of regional productions, etc.). Most state owned companies ran deficits with a significant impact on the already very high federal budgetary deficit.

Since the 2008 international economic crisis, dramatic drops in some commodity prices has contributed to a notable decrease in the fiscal surplus of the federal government, with much lower collections from export taxes on hydrocarbons and their derivatives and on agricultural products. The federal fiscal surplus risks turning into a deficit, and the government has, therefore, moved to cut public expenditure.

The country has been unable to implement a counter-cyclical policy, because of the risk of stoking inflation or stimulating capital outflows. The story would have been different if there had been a significant reserve in a fiscal stabilization fund, as had been provided for in the so-called — Fiscal Convertibility Law of 1999 and the federal fiscal responsibility law of 2004. But these funds never materialized.

Argentina's Fiscal Convertibility Law of 1999 provides in article 9 for a fiscal stabilization fund. The Ministry of the Economy and Public Works and Services was to manage it. Six of the 24 provinces—all significant oil or gas producers— also created their own stabilization funds under their own fiscal responsibility legislation. Unfortunately, these institutions have not been used effectively to accumulate significant reserves. The automatic fiscal integration of the federal fund was suspended almost immediately on its creation, so that it was limited only to the revenues from federal oil and gas concessions, which are insignificant. Some provinces did continue with their own funds although currently no provincial fund is significant.

6. Environmental and social issues

The 1994 Constitution incorporated in Art. 41 the right and duties of the environmental protection: " All the inhabitants enjoy the right to a healthy, balanced, suitable environment for the human development and in order that the productive activities satisfy the present needs without compromising those of the future generations; and they have the duty to preserve it. Since the privatization of YPF, the environmental national authority and the provinces have concurrent regulatory and enforcing powers.

7. Conclusions

Given the perceived strategic relevance of oil and gas to Argentina's economy, the central aim of national energy policies has always been to achieve self-sufficiency in their production.

The 1990s were characterized by important institutional reforms in the oil and gas sector, focused on privatization and deregulation, which attracted considerable private investments. A federal law in 1992 and then a constitutional reform in 1994 explicitly recognized provincial ownership of natural resources in the subsoil, including oil and gas.

Access by each level of government to oil and gas revenues and rents depends on a complex tributary system derived from the different legal authorities. Arrangements reflect basic constitutional principles as

well as the many agreements signed between provinces and the federal government. As a result: (a) provinces collect royalties on oil and gas and have the legal power to collect other taxes on economic activities and assets, like the gross sales tax, property tax, vehicles, seals tax on contracts and other transferences. In addition they participate in the federal taxes proceeds with the exception of those export or import tax proceeds; (b) the federal government collects fuel taxes and shares the proceeds with the provinces. With respect to upstream activities, the federal government also collects taxes on export and imports, which are not sharable and have the effect to reduce the value of the provinces' royalties.

The drop in reserves is a cause of concern, especially when a large proportion of electricity generation depends on the availability of gas. The current system of controlled prices and export taxes has discouraged upstream investment, especially in exploration, with a consequent reduction in reserves growth. One possible solution could be to move towards international oil prices, and couple this policy with the introduction of effective stabilization mechanisms.

The major challenge now is to design a long-term federal oil and gas policy that addresses falling reserves and the shifting mix of energy supplies from domestic and offshore sources, in a context where both electricity and transportation have been heavily dependent on gas. The promotion of petroleum exploration and development should be a priority for the competitiveness of Argentina's economy. This should aim at promoting a more coordinated and transparent approach to upstream management, while preserving the provincial domain over oil and gas fields. Future political debates will likely focus more on the need for a coherent federal oil and gas policy rather than simply on who gets what tax or revenue from oil and gas production.

ⁱ This Framework Paper was prepared for the Conference on Oil and Gas in Federal Systems, and summarizes the findings of a more detailed paper on "Oil and Gas in Argentina". The Framework Paper is not for citation without author's permission. The full version of the paper is available on the Conference's webpage at <http://go.worldbank.org/J42LOWNS80>.

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Argentina



Courtesy of the Forum of Federations

Political and Economic Indicators

INDICATOR	DATA
GDP	US\$572.3 billion PPP (2008)
GDP per capita	US\$14,400 PPP (2008)
Number, type and % of population of constituent units	23 Provinces: Buenos Aires 38.1%, Córdoba 8.5%, Santa Fe 8.3%, Autonomous City of Buenos Aires 7.7%, Mendoza 4.3%, Tucumán 3.7%, Entre Ríos 3.2%, Salta 3.0%, Chaco 2.7%, Misiones 2.7%, Corrientes 2.6%, Santiago del Estero 2.2%, Jujuy 1.7%, San Juan 1.7%, Río Negro 1.5%, Neuquén 1.3%, Formosa 1.3%, Chubut 1.1%, San Luis 1.0%, Catamarca 0.9%, La Pampa 0.8%, La Rioja 0.8%, Santa Cruz 0.5%, Tierra del Fuego 0.3%
Total population	~40 million
Area	2 780 092 km ²
Currency and Exchange rate	Argentine Peso (ARS) 0.25c - \$1 US, floating rate
Political system – federal	Federal Republic
Political Party Regime	Competitive, largely two–three party regime
Distribution of powers/ Ownership of petroleum resources	Since the constitutional reforms of 1994, oil, gas and other natural resources of the subsoil are of provincial domain and subject to private exploitation or to state companies only by a provincial concession.

Source: CIA 2009 Fact Book; Juan Antonio Zapata, *Oil and Gas in Argentina*, from the *Conference on Oil and Gas in Federal Systems*, March 3-4, 2010, Washington, DC.