

ISSUE BRIEF

No. 4491 | DECEMBER 4, 2015

Nine Steps President Macri Can Take to Restore Economic Freedom in Argentina

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In a decisive 51–49 victory on November 22 the voters of Argentina elected conservative “*Cambios*” (“Let’s Change”) coalition party candidate and current mayor of Buenos Aires Mauricio Macri as the country’s new president. He will take office on December 10. Under his left-wing populist predecessors, Peronists Néstor Kirchner (2003–2007) and Cristina Fernández de Kirchner (2007–2015), Argentina’s economic freedom score in The Heritage Foundation/*Wall Street Journal*’s annual *Index of Economic Freedom* plummeted. It is currently ranked 169 out of 178 countries measured¹ and has fallen deep into the *Index*’s “repressed” category.

Argentina is mired in a climate of corruption and economic repression. Steep declines have been registered in all 10 of the country’s economic freedom indicators, including control of government spending, labor freedom, and business freedom. Severely hampered by state interference, the formal economy has stagnated while informal economic activity expanded.

Monetary stability is particularly weak, the peso is overvalued, foreign currency reserves in the central bank are low, and, despite extensive price controls, inflation has surged. Government interference in the financial sector has further distorted price levels.

Argentina’s investment profile was badly damaged by monetary and fiscal mismanagement, rising

protectionism, and expropriations during the Kirchner years. The 2001 sovereign debt default remains unresolved (denying the country access to international credit markets), economic growth has weakened, and the poverty rate has increased. Capital controls have spurred capital flight.

The Wages of Perónism

The Kirchners’ statist policies only accelerated an erosion of economic freedom that began decades before under Juan Perón, who weakened the foundations and institutions necessary for sustainable economic development in Argentina. Perón and his political progeny, in power more or less continuously from the 1940s onward, followed a simple but economically destructive formula: wasteful welfare state handouts, a swollen bureaucracy to redistribute wealth, and powerful closed-shop trade unions protected from foreign competition, all of it generously lubricated with corruption. The commodities export boom and concomitant rising state revenues during most of the years they were in power enabled the Kirchners to finance the continuation of these populist policies.

Especially under President Cristina Fernández de Kirchner, Argentina strengthened ties to governments in the region that are hostile to Western values. Under her watch, the government’s seizure of nearly \$30 billion in private pension funds in 2008, its failure to settle with a small group of “hold-out” creditors from the 2001 default, and its 2012 expropriation of YPF, a subsidiary of Spanish oil company Repsol, severely damaged Argentina’s investment profile. In addition, Kirchner’s leftist, centrally planned economic policies removed the independence of the central bank.²

This paper, in its entirety, can be found at <http://report.heritage.org/ib4491>

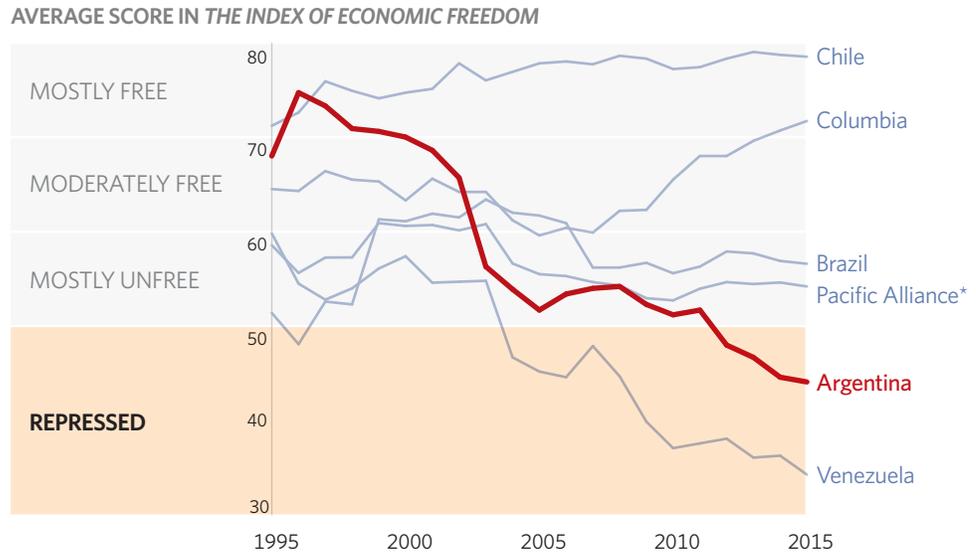
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CHART 1

Argentina Falls Into “Repressed” Category in Economic Freedom

Under its last two presidents, Argentina has steeply declined in economic freedom. It is now ranked 169th out of the 178 countries measured.



* Chile, Colombia, Mexico, and Peru.

Source: Terry Miller and Anthony B. Kim, *2015 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones and Company, Inc., 2015), <http://www.heritage.org/index/download/> (accessed November 24, 2015).

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Weak Rule of Law

Transparency International ranked Argentina 107 out of 175 countries in its 2014 *Corruption Perception Index* (see Figure 7),³ which reported that the judicial system is increasingly vulnerable to political interference and that corruption is prevalent.⁴

It is not hard to understand why the public has become so jaded. Instances of corruption abound. Some of the most notorious recent examples: In January 2015, Argentine federal prosecutor

Alberto Nisman was found dead the day before he was to testify about official corruption.⁵ According to press reports, businessman Lázaro Báez and others were allegedly involved in a scheme with President Néstor Kirchner to funnel money out of Argentina illegally.⁶ Fashion designer Ralph Lauren admitted to paying bribes to Argentine officials between 2005 and 2009 to expedite the importation and customs clearance of his products.⁷ Aerolíneas Argentinas, the national airline, paid \$4.3

1. Terry Miller and Anthony B. Kim, *2015 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2015), p. 103, <http://www.heritage.org/index/download/>.
2. Kim Iskyan, "Argentine Governor May Further Dilute Central Bank Independence," *Global Finance Magazine*, November 13, 2014, <https://www.gfmag.com/magazine/november-2014/new-governor-may-further-dilute-central-bank-independence> (accessed September 21, 2015).
3. Transparency International, *Corruption Perception Index 2014*, <http://www.transparency.org/cpi2014/results> (accessed September 21, 2015).
4. Transparency International, "Argentina," *Corruption by Country*, http://www.transparency.org/country#ARG_Overview (accessed September 21, 2015).
5. "Who killed Alberto Nisman?" BBC News, <http://www.bbc.com/news/magazine-32887939> (accessed November 17, 2015).
6. J. Webber, "Argentine Corruption: Business as Usual?" *Financial Times*, April 22, 2013, <http://blogs.ft.com/beyond-brics/2013/04/22/argentina-and-corruption-business-as-usual/> (accessed September 22, 2015).
7. K. Scannell, "Ralph Lauren Settles Bribery Charges," *Financial Times*, <http://www.ft.com/intl/cms/s/0/166a49d4-ab68-11e2-ac71-00144feabdc0.html#axzz30YY5H43T> (accessed September 22, 2015).

million over list price *for each of* the 20 Embraer E-190 aircraft it purchased. The airline claimed that the price included spare parts and pilot training,⁸ but suspicions of bribery abound because airlines typically pay below list price for aircraft.⁹

External influences, such as narco-trafficking, also negatively affected economic freedom. Argentina's porous borders make it an attractive waystation for criminals transporting drugs to Europe. The fact that Argentines enjoy the right to visa-free travel to the European Union (EU) and that many hold European passports facilitates these crimes, which are on the rise. Narco-traffickers have even "infiltrated law enforcement agencies, politics and the judiciary,"¹⁰ and the Kirchner government's response was feeble.¹¹

In fact, instead of taking steps to strengthen the rule of law, in 2013 the Kirchner government pushed legislation through the Argentine Congress that actually weakened the judiciary, which was already vulnerable to corruption. While Supreme Court justices are appointed by the President with the consent of the Senate,¹² under the 2013 law the executive branch gained more influence through a new provision to mandate election of provincial judges. That gave the ruling Perónist party an advantage in campaigning for its nominees.¹³

Currency Controls, Black Markets, and Capital Flight

After decades of inflation, hyperinflation, and more inflation, Argentines have understandably become reluctant to hold pesos. In January 2002, when the government stopped pegging the peso to the dollar, the peso's purchasing power fell dramatically,¹⁴ going from parity (1:1) to more than 3:1 within a year. In the years following, the peso has kept falling and now is at more than 9:1.¹⁵

In an attempt to prop up the peso and prevent additional foreign currency from leaving the country, Kirchner imposed a series of controls on foreign currency transactions, enacting more than 30 regulations since 2011. These included: curtailing most foreign currency purchases; taxing Argentines on the estimated value of their foreign vacations and on Internet purchases; preventing foreign companies operating in Argentina from paying out dividends; and restricting imports¹⁶ (which has meant higher input costs for import-dependent local companies). By 2013, facing a deteriorating balance of payments, the government imposed truly draconian bans on foreign-currency transactions to protect dwindling dollar reserves.

Despite these measures, capital flight has accelerated. A recent and telling example has been the purchase of U.S. real estate by Argentines to circumvent capital controls. A real estate developer in Florida,

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8. La Nación, "Embraer ratificó que investiga una operación con Aerolíneas," *La Nación*, p. 13, <http://www.lanacion.com.ar/1575060-embraer-ratifico-que-investiga-una-operacion-con-aerolineas> (accessed September 22, 2015).
 9. Daniel Michaels, "The Secret Price of a Jet Airliner," *The Wall Street Journal*, July 9, 2012, <http://www.wsj.com/articles/SB10001424052702303649504577494862829051078> (accessed September 22, 2015).
 10. EFE, "Argentine Pols Suggest Using Military against Drug Traffickers," Fox News Latino, January 17, 2014, <http://latino.foxnews.com/latino/news/2014/01/17/argentine-pols-suggest-using-military-against-drug-traffickers/> (accessed September 22, 2015).
 11. H.C., "Southward Marching Powder," *The Economist*, November 2013, <http://www.economist.com/blogs/americasview/2013/11/drugs-argentina> (accessed September 22, 2015).
 12. "Politics," *The Argentina Independent*, June 13, 2010, <http://www.argentinaindependent.com/insideargentina/politics-insideargentina/politics/> (accessed September 21, 2015).
 13. Transparency International, "Argentina and the Judiciary: Subverting the Rule of Law," Judiciary, April 18, 2013, http://www.transparency.org/news/feature/argentina_and_the_judiciary_subverting_the_rule_of_law (accessed September 21, 2015).
 14. Stephen H. Hanke, "Argentina's Current Political-Economic Crisis," Cato Institute, March 5, 2002, <http://www.cato.org/publications/congressional-testimony/argentinas-current-politiceconomic-crisis> (accessed September 21, 2015).
 15. Google Finance, "U.S. Dollar to Argentine Peso," <https://www.google.com/finance?q=usdars&ei=BmDjVQJgJnnn7onADQ> (accessed November 30, 2015).
 16. Katia Porzecanski, "Argentina Devaluation Sends Currency Tumbling Most in 12 Years," *Bloomberg Business*, <http://www.bloomberg.com/news/articles/2014-01-23/argentina-s-peso-plunges-17-as-central-bank-scales-back-support> (accessed August 6, 2015).

for example, recently reported that almost 50 percent of all new condominiums built in Miami are sold to Argentines.¹⁷

Nine Steps to Restore Economic Freedom

To reverse the heavy damage caused to Argentina's economy and governance that resulted from the many bad policies put in place under the Kirchner governments, President Macri should take these nine steps immediately:

- Improve Argentina's investment climate by re-establishing the rule of law with an aggressive campaign to root out corruption and re-establish an independent judiciary.
- Get inflation under control by implementing a coherent policy to end the printing of money and the sale of U.S. dollar futures market derivatives.
- Restore the independence of the BCRA central bank so that the new government can execute effective monetary policy.
- Resolve remaining issues connected to the 2001 default and implement a debt strategy modelled on the 1980s "Brady Plan." With such a poor credit history, it might be advantageous for the next government of Argentina to issue short-term maturity debt and denominate it in U.S. dollars, a strategy that could allay investor fears.
- Grant toll and user fee concessions to private companies to make badly needed infrastructure improvements to the country's roads, bridges, ports, airports, and other facilities.
- Streamline regulatory structure to encourage private business formation and overhaul antiquated bankruptcy laws.
- Institute a flat tax, by which every taxpayer pays the same percentage of their income, with no deductions. Additionally, the 35 percent flat tax on businesses should be lowered to attract new investment.

- Reduce export taxes on soybeans and other agricultural commodities to generate additional revenue to the state that will result from increased exports of more competitively priced products and can be used to fund new infrastructure.
- Work to improve and make more market friendly the MERCOSUR agreement, seek membership in additional free trade agreements, improve existing Bilateral Investment Agreements, and seek new ones.

Argentina, renowned for the diversity and quality of its agricultural products, exports high quality beef and wine and is one of the largest exporters of cereal grains and oilseeds (such as soybeans), fruits, and vegetables. The improved investment climate that will result from the actions above will attract foreign investors, especially in sectors where Argentina has a competitive advantage (e.g., auto parts, information technology, wine, shale oil, and gas reserves).

Conclusion

Argentina's new president will inherit a legacy of political instability and restrictive policies that hinder economic growth. The destruction of Argentina, once a great and wealthy country, really began under Juan Perón. Even worse, since democracy was restored in 1983, only two non-Perónists (Raul Alfonsín and Fernando de la Rúa) have been elected to Argentina's presidency—and neither of them was able to complete a full term of office. Deeply entrenched *Kirchnerista* Perónists in the Congress, government bureaucracy, unions, and public companies will be certain to oppose Macri, too.

President Macri needs to bury Perón and Perónism, once and for all, and announce the advent of a new day for Argentina, a day when everyone can get back on the road to market-based democratic principles, economic freedom, and prosperity.

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17. Alexei Barrionuevo, "Argentines Turn Cash into Condos in Miami," *The New York Times*, September 13, 2012, http://www.nytimes.com/2012/09/16/realestate/argentines-turn-cash-into-condos-in-miami.html?adxnln=1&adxnlnx=1399737782-fAREOk4soV/YXJkPppBXAA,&_r=0 (accessed September 22, 2015).