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More Loans Without Reform Will Only Prolong Argentina's Economic Woes

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Néstor Kirchner, Argentina's new president, wants new longer-term financing to pay off old debts. This South American nation of 36 million is only now beginning to recover from a five-year economic meltdown during which its gross domestic product (GDP) shrank by 20 percent. Even so, Argentina has failed to reduce the size of its bloated public sector, restructure a complicated and repressive tax system, curb state intervention in the economy, lower trade barriers, or strengthen the rule of law. The Bush Administration should not support additional international financing until the new government proposes a credible reform plan to keep the money from being wasted.

Background. Argentina's economic troubles are the result of its chronic inability to remedy misguided trade and monetary policies, corruption, and state intervention in the economy. The administration of Carlos Menem implemented some changes—the sale of utilities to private monopolies and foreign investment deregulation—that largely benefited an entrepreneurial and political elite at the expense of small and medium-size businesses. His successor, Fernando de la Rúa, who inherited a $114 billion public debt and was unable to move forward with other urgent reforms, resigned in December 2001, only two years into his term. The following month, the National Congress named former Vice President Eduardo Duhalde as "transitional" leader to serve out de la Rua's term. Duhalde devalued the peso (formerly pegged to the U.S. dollar) and even welcomed Argentina's default on an $800 million payment to the World Bank.

On May 18, 2003, Néstor Kirchner, governor of an isolated southern province, won the presidency in a climate of fragmented political parties and low expectations after his chief rival, former President Menem, dropped out of the race. Kirchner, using populist rhetoric familiar to most Argentines since the time of dictator Juan Peron, promised to end the crisis.

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Down the Wrong Path. During his first week in office, Kirchner announced a set of market-spooking policies intended to end Argentina's economic troubles. He proposed a $2.8 billion public works program "to create jobs" and a stronger trade reliance on MERCOSUR (the South American Common Market), which has average common external tariffs of 13 percent—some of the highest in the world. In a blow to the rule of law, the central bank—heavily influenced by the executive branch—announced on June 6, 2003, that it would meet with the Administración Federal de Ingresos Públicos (the Argentine tax collection agency) to discuss blocking access—without a court order—to safe deposit boxes of those suspected of owing taxes. Not only will such measures reverse earlier market reforms, but they could also stymie growth and increase poverty by discouraging private investment.

Further spooking the private sector, at his inauguration, Kirchner warmly welcomed Fidel Castro only weeks after Castro had jailed 80 dissidents and summarily executed three defectors trying to flee Cuba by hijacking a ferryboat. Besides committing human rights abuses, the Cuban state runs one of the world's few remaining command economies, which is bankrupt and chronically in arrears in paying off its international debt—a system to be condemned, not praised.

Because Kirchner's proposals are more likely to destroy than generate wealth, the government is seeking new longer-term financing from the International Monetary Fund (IMF), as well as from the World Bank, to pay off existing debt and implement Kirchner's plan. But more loans will not resolve Argentina's underlying problems. As documented in the Heritage *Backgrounder* "Argentina's Economic Crisis: An 'Absence of Capitalism,'" $30 billion in IMF loans to Argentina since 1983 has failed to foster economic growth or stability. To the contrary, the loan packages have had the perverse effects of encouraging faulty policymaking and enriching the political elite and foreign investors while bankrupting ordinary Argentines saddled with paying off the notes.

How the United States Can Encourage Reform in Argentina. Only open-market reforms and the rule of law will attract investment and foster private-sector job creation, which in turn will encourage more private spending and growth. Although Argentina's destiny is ultimately in its own hands, the United States can create incentives to encourage the new government to adopt those vital reforms. To that end, the Bush Administration should support additional loans to Argentina only when its government implements a credible reform plan. Such a plan must include:

- **Reducing the size of the public sector.** Public-sector employees account for one-third of the labor force. Reportedly, many show up to work only once a month to collect their paychecks.
- **Decentralizing governing and tax authority** so that each province collects its own revenues to support its own public expenditures. Most provinces depend mainly on fund transfers from the national government.
- **Reducing state intervention in the economy** by lifting price controls and financial restrictions on individual and commercial bank accounts.
- **Strengthening the judiciary to enforce the law and punish corruption**—not by packing courts, but by institutionalizing and enforcing standards of conduct.
- **Lowering trade barriers.** Pursuing free trade agreements with many countries around the world, as has Chile, would benefit the economy much more than strengthening MERCOSUR.

Conclusion. More loans without reforms may help Argentine politicians, but they will not help the Argentine people. Financial crises have increased globally over the past decade as the IMF and the World Bank have poured greater resources into indebted countries. Only domestically driven reforms will improve the Argentine economy. The Bush Administration should support further loans to Argentina only when its leaders create and begin to implement a credible plan for long-term reform.

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