

WebMemo



Published by The Heritage Foundation

No. 2874
April 22, 2010

Cronyism and Corruption Are Killing Economic Freedom in Argentina

James M. Roberts

Argentina's ranking in *The Wall Street Journal*/Heritage Foundation's *Index of Economic Freedom*—now 135th out of the 179 countries ranked in the *Index*—has declined steadily in the seven years since President Cristina Fernández de Kirchner and her husband, former President Nestor Kirchner, took power. It is by far the lowest ranked G-20 nation. Recently Charles Krauthammer neatly summarized why: Argentina is “a chronically unstable, endemically corrupt polity with a rich history of dictatorship, economic mismanagement and the occasional political lunacy.”¹

The relentless drop in Argentina's *Index* rank is due to, among other things, the Kirchners' statist policies as well as their failure to protect private property and to fight against corruption. Meanwhile, the performance of market-friendly, democratic Peru, Colombia (the most improved country regionally in the 2010 *Index*), and long-time economic freedom leader in Latin America Chile proves that South American governments can—through the correct mix of policies favoring private property, rule of law, and market-based, democratic institutions—deliver true economic and political freedom to their citizens.

Argentina's Economic Freedom: Corroded by Pervasive Cronyism. A closer look at Argentina's scores on the 10 indicators in the *Index* reveals exactly how and why, under the rule of the Kirchners, Argentina has suffered a decline in prosperity and economic freedom.

- **Business freedom.** Argentina's burdensome regulatory environment is inconsistent and lacks trans-

parency. Recent moves to nationalize unprofitable businesses represented by powerful unions in the Kirchners' coalition (e.g., Aerolíneas Argentinas and Telecom Italia Argentina) have sent strong signals to private-sector companies that their inefficient but unionized competitors will be unfairly (and unwillingly) subsidized by Argentina's taxpayers.

- **Trade freedom.** Import/export bans, controls and taxes, restrictions on trade in services, higher tariffs, reference pricing, licensing provisions, subsidies, restrictions on ports of entry, domestic preference in government procurement, and issues involving enforcement of intellectual property rights—all for special interests and cronies—have added to the cost of trade.
- **Fiscal freedom.** Argentina has relatively high tax rates, and they will have to go higher unless the wildly irresponsible spending by the Kirchners can be brought under control.
- **Government spending.** The Kirchners' economic stewardship has been dismal. Although highly indebted and facing declining commodity prices, the Kirchners have imposed unsustainable levels of government spending. To help finance this spending spree, in the fall of 2008 the Kirchner

This paper, in its entirety, can be found at:
<http://report.heritage.org/wm2874>

Produced by the Center for International
Trade and Economics (CITE)

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting
the views of The Heritage Foundation or as an attempt to
aid or hinder the passage of any bill before Congress.

government seized \$30 billion in 401(k)-type private pension accounts belonging to individual argentine citizens.²

- **Monetary freedom.** Although the Kirchners manipulate official government statistics to hide the true rate, private estimates show inflation in Argentina to be spiraling out of control. In 2010 it soared to more than 20 percent, raising fears of a return to the bad old days of 1980s-style hyperinflation.³ In trying to contain the rate of inflation, the Kirchner government has subsidized or price-controlled electricity, water, retail-level gas distribution, urban transport, and local telephone services. It also pressures companies to artificially hold down prices and wages.
 - **Investment freedom.** The Kirchners manipulate foreign exchange rates and restrict capital flows to artificially pump up the economy. Corruption, weak institutions, and uncertain creditor, contract, and property rights are also serious deterrents to investment.
 - **Financial freedom.** Argentina's largest bank (Banco de la Nación) is state-owned and is the only financial institution operating in some parts of the country. International banks that have returned since the 2001 default have not recovered their former prominence, and capital controls remain in place. Overall, financial freedom in Argentina remains constrained by government influence, political interference with an inefficient judiciary that hinders foreign investment, and other official and informal obstructions to due process.
 - **Property rights.** The executive branch influences Argentina's judiciary; the courts are notoriously slow, inefficient, secretive, and corrupt. Many foreign investors must resort to international arbitration. Government manipulation of inflation statistics has caused foreign and domestic bondholders to lose billions in interest payments on their rightful property.
 - **Freedom from corruption.** The entire political economy of Argentina is blighted by the Kirchners' brand of "crony capitalism"—one of the most corrosive and hardest-to-eradicate forms of corruption. Foreign investors complain about widespread government and private-sector corruption as well as pervasive demands by government officials for bribes. Money laundering, trafficking in narcotics and contraband, and tax evasion plague the financial system. Furthermore, the U.S. State Department's 2009 Investment Climate Statement for Argentina notes that the corruption is so endemic and deep-rooted that U.S. businesses (which are subject to the U.S. Foreign Corrupt Practices Act) frequently complain that "their adherence to the letter of the tax and regulatory codes at times places them at a competitive disadvantage."⁴
 - **Labor freedom.** Inflexible labor regulations hinder job creation and productivity growth. According to the World Bank's 2010 "Doing Business" survey, terminating an employee in Argentina costs, on average, 95 weeks of wages, a rate significantly above the Latin American average of 54 weeks and more than three times the OECD average of 26 weeks.⁵ Additionally, labor unions, a major component of the Kirchners' Peronist Party governing coalition, enjoy access to an extensive patronage system supported by massive government subsidies.
- Argentina Must Reform.** The *Index* rankings of neighboring Peru, Colombia, and Chile prove that Argentina can also enjoy prosperity and economic freedom—if reforms are instituted.

1. Charles Krauthammer, "Disrespecting Foreign Allies," Real Clear Politics, April 2, 2010, at http://www.realclearpolitics.com/articles/2010/04/02/slapping_friends_105025.html (April 2, 2010).
2. Matt Moffett, "Argentina Makes Grab for Pensions Amid Crisis," *The Wall Street Journal*, October 22, 2008, at <http://online.wsj.com/article/SB122460155879054331.html> (April 14, 2010).
3. Gary S. Becker, "Deficit Spending Got Argentina into This Mess," *Business Week*, February 11, 2002, at http://home.uchicago.edu/~gbecker/Businessweek/BW/2002/02_11_2002.pdf (April 14, 2010).
4. U.S. Department of State, Bureau of Economic, Energy and Business Affairs, "2009 Investment Climate Statement—Argentina," at <http://www.state.gov/e/eeb/rls/othr/ics/2009/117861.htm> (April 9, 2010).
5. Doing Business 2010, Argentina, at <http://www.doingbusiness.org/ExploreEconomies/?economyid=9> (April 9, 2010).

Table 1 illustrates these diverging performances. Chile has scored highest throughout the period, while Colombia's score has improved steadily, reflecting the tough economic reform measures implemented by President Alvaro Uribe over the past half decade. In contrast, Argentina and all three "Bolivarian ALBA" countries in the Andes have registered a progressively downward trend in their scores.

Recommendations. Although economically freer countries in the Western Hemisphere (e.g., the U.S., Canada, Chile, Mexico, and others) cannot do much to influence Argentina's government to adopt market-friendly reforms, they should take advantage of every opportunity to do so, at the very least as an encouragement to reformers within the country. The U.S. in particular should take the lead in this effort. Specifically, the Obama Administration and the U.S. Congress should:

- Encourage the Kirchners to turn from their fiscally reckless statist approach before they completely destroy Argentina's economic freedom and return to the core principles of The Heritage Foundation's *Index of Economic Freedom*: limited government and private-sector-led prosperity built upon a foundation of private property rights that are impartially protected by transparent judicial institutions.
- Instruct the U.S. Trade Representative to open negotiations with the Kirchner government on a U.S.–Argentina "Trade and Investment Framework Agreement (TIFA) to provide a strategic framework and principles for dialogue on trade and investment issues."⁶ The TIFA could lead to an eventual free trade agreement and a strengthening of Argentina's institutions.
- Instruct the U.S. Ambassador to the Organization of American States to propose a resolution condemning Argentina's destructive economic and political policies toward international financial institutions (e.g., the International Monetary Fund).
- Encourage Argentina to respect international laws and institutions in light of its continuing failure to reschedule all of the sovereign debt from the 2001 default.

Economic Freedom in Argentina and Neighboring States, 1995–2010

Based on Scores in the 2010 *Index of Economic Freedom*



Source: Terry Miller and Kim R. Holmes, *2010 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2010), Appendix: Index of Economic Scores 1995–2010.

Chart 1 • WM 2874 heritage.org

6. U.S. Trade Representative, "Trade and Investment Framework Agreements," at <http://www.ustr.gov/trade-agreements/trade-investment-framework-agreements> (April 15, 2010)

- To further this step, President Obama should ask the U.S. Executive Director at the Inter-American Development Bank (IADB) to request that the IADB fund programs to modernize Argentina's government structures to improve democratic governance, make the judiciary more transparent and efficient, and institutionalize the fight against corruption.

These steps, while by no means an immediate panacea, will begin correcting some of the Kirchner government's most egregious economic missteps and move Argentina in the direction of renewed economic freedom.

—*James M. Roberts is Research Fellow for Economic Freedom and Growth in the Center for International Trade and Economics at The Heritage Foundation.*