

A light blue map of Argentina is positioned on the left side of the cover, showing the country's outline and internal provincial boundaries. The background is a solid blue with a subtle diagonal line pattern.

ECONOMIC FREEDOM COUNTRY AUDIT ARGENTINA 2017

Government Consumption
Transfer & Subsidies
Judicial Process & Efficiency
Property Rights
Contract Enforcement
International & Domestic Trade
Credit Market Regulations
Business Regulations
Labour Regulations

LIBERTAD / y Progreso

ECONOMIC FREEDOM COUNTRY AUDIT ARGENTINA 2017

IMPROVING THE ECONOMIC FREEDOM OF ARGENTINA



Fundación Libertad y Progreso
May 2017

In collaboration with



Introduction

Libertad y Progreso, partnering with the Atlas Network and Fraser Institute has undertaken a project to analyze economic policies in Argentina with the goal of increasing economic freedom and thus the prosperity of Argentines.

Argentine economic policy has had many twists and turns over the last years but perhaps now the opportunity has come to put Argentina on a permanent path to growth, affluence, and job creation.

Fortunately, a reliable blueprint for a better future is available. Economic freedom, extended to all, has been shown to generate positive social and economic outcomes, including opportunity, higher economic growth, enhanced job creation, increased political stability, and the peaceful development of other freedoms.

The Economic Freedom Index provides a comprehensive description of economic policy, examining five economic policy dimensions with a total of 42 variables. The index shows, in detail, the current status of economic policy and how the policy can be improved. It also provides models of world class policy that, if implemented, would begin renewed hope to Argentina.

Economic freedom reflects the ability of individuals and families to make their own economic decisions with limited interference from government or crony capitalists. Put simply, the ingenuity and drive of individuals is more effective in creating prosperity and other positive outcomes than government planning or crony greed.

The evidence is obvious to anyone with just a glance around the world based on common knowledge. The only nations that offer high levels of prosperity and opportunity to their citizens are free market economies. Those nations that chose other paths, whether socialism or cronyism, deliver a bleak future for their citizens.

Improving the economic freedom of the people of Argentina

Economic Freedom: Brief Overview

Economic freedom is simply the ability of individuals and families to make their own economic decisions free of government control or that of crony capitalists. The economic freedom index measures this through 42 variables rated on a scale of 0 (worst policy) to 10 (best policy).

In the world's top peer-reviewed research journals, economic freedom has been shown to generate positive social and economic outcomes, including higher economic growth, increased political stability, and the peaceful development of other freedoms. (See the Appendix for more details.)

It is easy to see how economic freedom promotes well-being. Any transaction freely agreed to must benefit all parties; any transaction that does not benefit all parties would be rejected by the party that would come up short. This has consequences throughout the economy.

Consumers who are free to choose will only be attracted by superior quality and price. Producers and sellers, including new ones, are welcome to market place and must constantly improve the price and quality of their products to meet customers' demands or customers will not freely enter into transactions with them. Billions of mutually beneficial transactions occur every day to power this dynamic and spur increased productivity and wealth, new job creation, and reduced poverty.

Restrictions on freedom prevent people from making mutually beneficial transactions. Free transactions are replaced by government action or by restricted, unfree markets often controlled by elites connected to the government. These transactions are marked by coercion in collecting taxes and lack of choice in accepting goods and services: instead of gains for both parties arising from each transaction, citizens must pay whatever bill is demanded in taxes or by crony capitalists and make do with whatever good or service is offered in return.

For the benefit of the elite, often including powerful unions, workers and entrepreneurs without connections are kept out of the market through high taxes, onerous regulation, and raw corruption. They are shunted to the informal economy where growth and job creation are stunted.

While the incentives of producers in a competitive market revolve around providing superior goods and services in order to attract consumers, the public sector and crony capitalists face no such incentives. Instead, incentives often focus keeping others out of the market place and on rewarding interest groups, seeking political advantage, or even penalizing unpopular groups. In other words, people benefit from making others worse off. This is far different from mutually beneficial exchange, and can set group against group as each seeks advantages for itself at the cost of others.

Economic freedom transforms the dynamics of society. When people make their own economic choices, they gain only when they produce products or services desired in free exchange—in other words, by increasing prosperity through improved and novel products and higher productivity. Those in other groups become customers, suppliers, clients. Overtime, this builds tolerance and a common sense of citizenship.

Thus, without economic freedom, the biggest gains are made by making others worse off; with economic freedom, the biggest gains are achieved by people who increase the size of the pie for everyone. This is a key reason that economic freedom has been shown to promote trust, democracy and other freedoms. It is a dramatic change in dynamics that over time transforms society.

The impact of economic freedom on corruption needs emphasizing. Increasing economic freedom in and of itself will lessen corruption. Lack of economic freedom is the raw material of corruption. If you need to ask someone's permission to do something, then there is someone to demand bribes. If you are economically free and able to make your own economic decisions, if you don't need someone's permission to do something, then there is no one pay-off.

Economic freedom has produced prosperity across Europe and North America. It is propelling growth in the most economically free nations in Asia, Latin America, and Africa.

Opening up economic freedom in Argentina could lead to a new era of increased prosperity, reduced poverty, job creation, and growth for Argentina.

Argentina: Background

Argentina has had considerable ups and downs in economic freedom, but since 2000, it has steadily declined. Of the South American nations for which the EFW Index has scores, only Venezuela has a lower score—and it is dead last. Argentina is fourth worst.

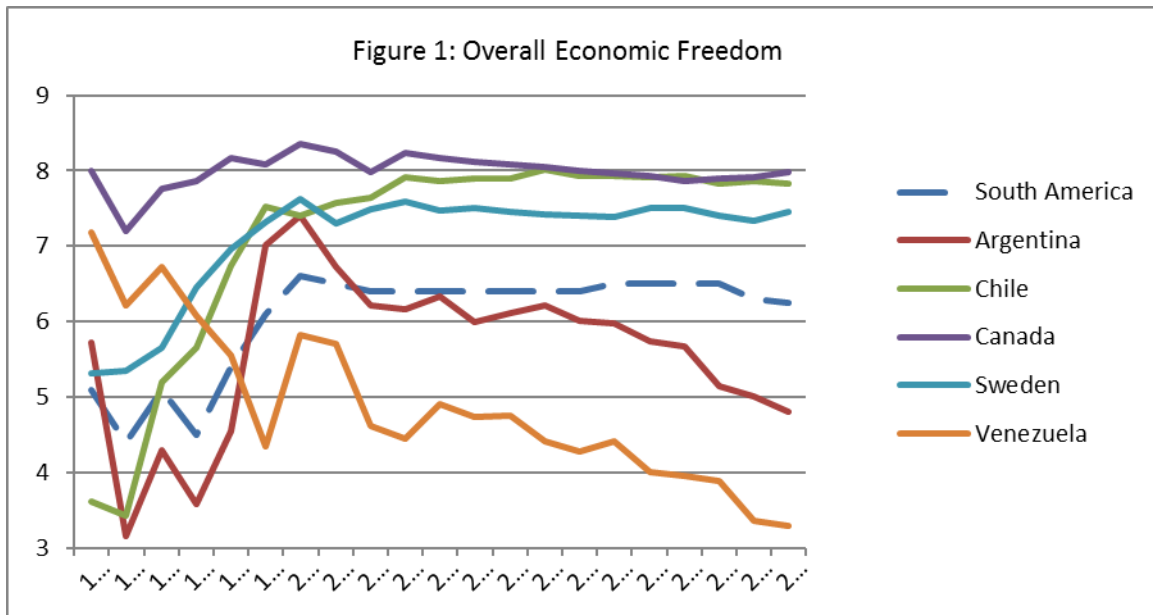


Figure 1 compares Argentina's score to the Latin American average and a select group of nations. Chile, with the highest level of economic freedom, is now the richest nation in Latin America on a per person basis. Sweden is included because many people assume Sweden is a socialist nation. Nothing can be further from the truth. The Nordic nations have among the highest levels of economic freedom on the planet. Although they do have large government, in every other aspect of policy they are highly business friendly and support free market development.

Argentina's fall is an object lesson. Venezuela, with the lowest score in the world, has suffered an economic collapse after many years of economic retreat as its score declined. Similarly, as Argentina's score weakened, its economic problems deepened and crises loomed. It is crucial for Argentina to reverse its plunge in economic freedom or it too will ultimately face an economic calamity.

As is well known, in the early part of the 20th century, Argentina was one of the most promising nations on the planet, with one of the world's highest levels of prosperity and potential equal to the other fast developing or nations of the time: Canada, Australia, New Zealand, and the United States.

However, those nations maintained free market policies and their people became the most prosperous on the planet while Argentina turned toward populism and its prospects faded. Today, in economic freedom, Canada is 5th; Australia is 10th, New Zealand is 3rd, and the United States¹ is 16th. Argentina, once as rich as these nations, is 156th, between the Central African Republic and the Republic of the Congo.

A turn toward economic freedom could help Argentina rise to an equal level of prosperity with the top nations, given Argentina's potential. Nevertheless, it will require not just change today but an enduring change to assure people and investors that they do not face an uncertain future.

If Argentine policy regains the trust of its people, investors, and entrepreneurs, growth will be tremendous. However, with so many difficulties in the past, regaining trust will be difficult and take time.

Nobel Laureate Douglass North calls this index the “closest thing we have to” a description “of efficient markets”, which in turn leads to economic growth. Sixty of the world's top scholars from many disciplines, including three Nobel Laureates, were involved in the design of the index.

Higher levels of economic freedom have shown to promote economic growth and prosperity along with a number of other positive outcomes. More than 600 fact-based, peer-reviewed and policy articles have examined the impact of increased levels of economic freedom and found that it not only promotes prosperity, but also a number of other positive outcomes such as deepening democracy, prompting other freedoms, and lessening civil tensions. (See the Appendix for more details on the research)²

Fundación Libertad y Progreso (FLyP) has pointed out this since its origins. In a recent book a group FLyP experts evaluates the situation in the country and presents proposals to change its course. According to it, the most important consequences of such a restriction of economic freedoms are:

“High inflation; overwhelmed public expenditures and a very high fiscal deficit; monetary expansion; lack of investments; postponements of tariff rate adjustments in public services; decay of infrastructure; capital flight; trade deficit; depletion of foreign exchange reserves; economic recession; distortion of relative prices; deterioration of international

¹ The United States has been steadily falling in economic freedom since 2000 and now has a populist anti-free trade administration. It will be interesting to see if the United States at the beginning of the 21st century follows the same disastrous route as Argentina at the beginning of the 20th century.

² For a free download of the World Economic Freedom reports and other related research go to:
<http://www.freetheworld.com>

relations with many countries, including neighbors; corruption; degradation of republican institutions, particularly Justice”.³

There are many concurrent causes to explain these results, but behind them all there is a deeper one, also outlined in this work:

“More than 90% of the population believes inflation comes from the selfish and anti-patriotic decisions of businessmen and traders, who arbitrarily increase their prices. Public opinion does not understand or does not give enough relevance to macroeconomic factors such as fiscal and monetary issues. The idea that the world is ran by big business’ interests following spurious ends is extended as well. This unrealistic view adds to a general understanding that ‘neoliberal’ policies were the source of all evils, particularly the 2001/02 crisis.” (p. 1).

The EFW Index

The Economic Freedom of the World Index is annually produced and published by the Fraser Institute from Canada. It takes into account the following elements:

1. Size of government: Expenditures, Taxes, and Enterprise

As government spending, taxation, and the size of government-controlled enterprises increase, government decision-making is substituted for individual choice and economic freedom is reduced.

2. Legal Structure and Security of Property Rights

Protection of persons and their rightfully acquired property is a central element of both economic freedom and civil society. Indeed, it is the most important function of government.

3. Access to Sound Money

Inflation erodes the value of rightfully earned wages and savings. Sound money is thus essential to protect property rights. When inflation is not only high but also volatile, it becomes difficult for individuals to plan for the future and thus effectively utilize economic freedom.

4. Freedom to Trade Internationally

Freedom to exchange – in its broadest sense, buying, selling, making contracts, and so on – is essential to economic freedom, which is reduced when freedom to exchange does not

³ Fundación Libertad y Progreso (2016); M. Solanet (ed.); *Progresar en Libertad: Propuestas para salir de la decadencia*; (Buenos Aires: Fundación Libertad y Progreso, Fundación Friedrich Naumann), p. 1.

include businesses and individuals in other nations.

5. Regulation of Credit, Labor, and Business

Governments not only utilize a number of tools to limit the right to exchange internationally, they may also develop onerous regulations to limit the right to exchange domestically, gain credit, hire or work for whom you wish, or freely operate your business. This area measures the limits on economic freedom caused by excessive regulation.

Economic freedom ranges from 0-10 where a higher value indicates a greater level of economic freedom, as reflected in the following tables. The 0-10 scores are transformed from the raw data. Where the raw data are in an easy to report format, the data are reported in a column next to the score.

Economic freedom comes as a package. For the people of any nation to truly benefit from economic freedom, that nation must score well in all areas. For instance, a country that scores well in size of government through low taxes but has a failed legal system does not provide true economic freedom to its citizens.

The data in the *Economic Freedom of the World Annual Report and Index* is all from third party, objective sources. This maintains the objectivity of the report since the authors do not create their own data. It also allows for a key element of any good research, replicability. Any researcher anywhere with access to the data banks quoted in this report should be able to replicate all the results.

The data in the tables reflects the *Economic Freedom of the World: 2016 Annual Report*, which is based on 2014 data, the most recently available data at the time of publication.

The Audit

Libertad y Progreso organized a series of meetings in a two-day long event engaging economists, consultants, lawyers, public policy experts and economic policy analysts on a number of topics from the components and sub-components of the Economic Freedom of the World Index.

There was one session for each of the components of the EFW Index and, additionally, Size of Government was split into two (one to consider public expenditures and another for taxation) and Regulation was given two (Business and Labor) and Credit Regulations were considered in the Sound Money section.

Participants included former government officials who had responsibilities in different governments and positions such as Minister of the Economy, Vice President of the

Central Bank, Secretary of Political Economy, General Manager of the Central Bank, Secretary of Trade and others.

Hector Mario Rodriguez, Emilio Ocampo, Jorge Avila, Martin Lagos, Esteban Benegas Lynch, Julio Piekarz, Ricardo Lopez Murphy, Paula Premrou, José María Dagnino Pastore, Enrique Duhau, Jorge Tersoglio, Javier Canosa, Daniel Marx, Paul Leclercq, Emilio Apud, Javier Garcia Labougle, Osvaldo Schenone, Juan Dumas, Alejandro Estrada, Julio Elias, Guillermo Strauss, Marcos Hilding Ohlsson, Gustavo Lazzari, Enrique Szewach, JC Villa Larroudet, Julian De Diego, Eduardo Filgueira Lima, Javier Canosa, Juan Sola, Horacio Liendo, Jorge Perez Alati, Daniel Sabsay, Adolfo Casabal Elia, Horacio Lynch, Nicolas Gallo, José Luis Patiño, Diana Mondino, Santiago Bergada, Daniel Artana, Fausto Spotorno, Iván Carrino, Agustín Monteverde, Aldo Abram, Agustín Etchebarne, Manuel Solanet, Martin Krause.

These experts acted as research guides, providing direction and feedback on the final reports compiled in this publication. Based on the input gathered from the two-day event, and Libertad y Progreso's past and present own research work by its experts, LyP has developed this report, which brings analysis and recommendations on each of the topics mentioned above. Based on the challenges outlined in the areas of discussion in the audit process, our attempt has been to develop reform prescriptions that are practical and acceptable.

In discussing the six topics, the report analyzed some of the most important economic issues for Argentina such as government consumption, taxes, transfers and subsidies, law enforcement, judicial process and efficiency, property rights, contract enforcement, international and domestic trade and barriers to them, credit markets and banking, labor relations, price controls and regulations regarding entry and exit in the market. Therefore, the report's recommendations will be directly relevant to policy actors, opinion leaders and those affected by the policies in discussion.

Individual areas of economic freedom in Argentina

The overall evolution (or rather devolution) of economic freedom in Argentina was discussed earlier. We now look at the individual areas of economic freedom.

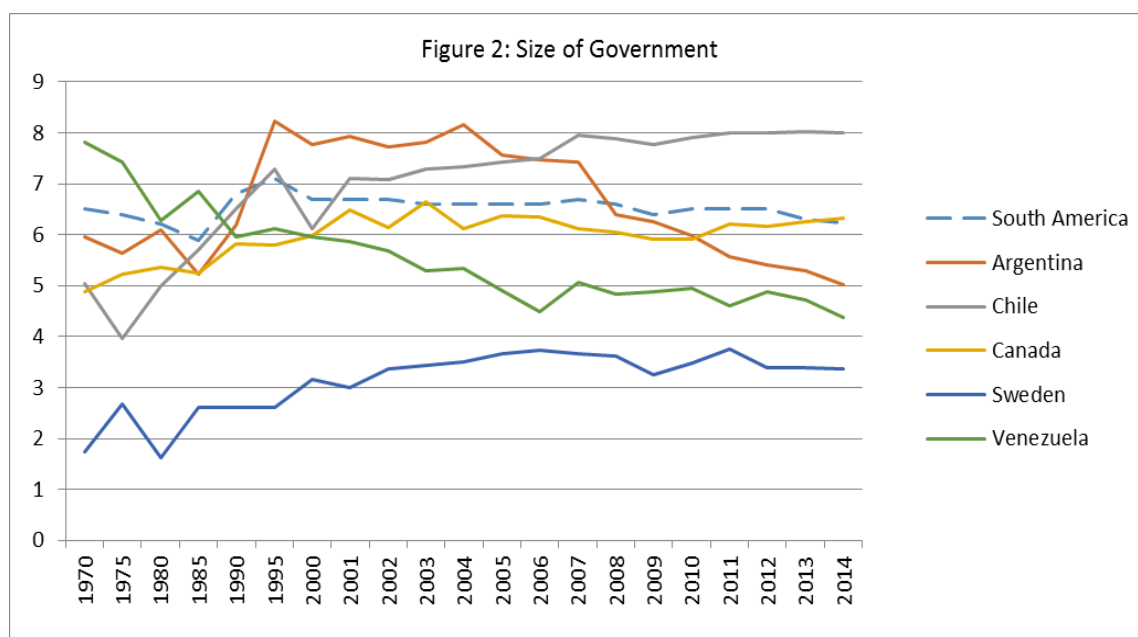
1. Size of Government

Overly large government spending and taxation can crowd out other economic activity. Argentina has done well in this area in the past. However, it now does very poorly compared to the selected nations and groups with the exception of Sweden and Venezuela, an economic disaster. However, Sweden has high levels of economic freedom in all other areas and thus has generated the wealth to support this spending, though it remains a limitation on economic freedom.

Argentina does particularly badly—scoring a zero—in government enterprises. Such enterprises have performed poorly everywhere and create a huge drag on the rest of the economy

Government consumption is another disaster area. This is the amount of money government itself consumes, leaving aside subsidies, transfers and investment.

Countries	1A Government Consumption		1B Transfers and subsidies		1C Government enterprises and investment		1Di Top marginal income tax rate		1Dii Top marginal income and payroll tax rate		1D Top marginal tax rate	1 Size of Government Overall Score
	Score	Data 1	Score	Data 2	Score	Data 3	Score	Data	Score	Data	Score	Overall Score
Hong Kong	8,1	12,5	9,2	3,6	10	12,6	10	17	10	17	10,0	9,3
Jordan	5,7	20,5	7,4	9,9	10	14,2	10	14	8	29	9,0	8,0
Chile	6,9	16,7	8,1	7,4	10	8,7	7	40	7	40	7,0	8,0
Georgia	6,1	19,3	7,2	10,6	8	19,4	10	20	10	20	10,0	7,8
Singapore	5,5	21,4	8,9	4,7	7		10	20	10	20	10,0	7,8
Armenia	7,9	13,0	8,0	7,9	10	9	5	36	5	36	5,0	7,7
Switzerland	6,8	16,9	6,0	15,1	10	12,7	9	26-42	7	35-49	8,0	7,7
Costa Rica	5,4	21,5	8,5	6,0	10	9,5	9	25	4	44	6,5	7,6
Mauritius	6,9	16,4	8,4	6,4	6	25,6	10	15	8	26	9,0	7,6
UAE	7,8	13,6	8,5	5,9	4	36,6	10	0	10	16	10,0	7,6
Top 10 Ave	6,7	17,2	8,0	7,7	8,5	16,5	9	20,8	7,9	27,6	8,5	7,9
World Ave	5,5	21,6	7,6	9,0	6	28,2	8	30	6	39	6,5	6
S. America Ave	5,9	19,9	7,8	8,5	5,1	33,5	7,8	29,7	5,1	41,5	6,5	6,2
Argentina	4,72	23,95	5,77	16,01	0,00	60,59	8	34,00	6,00	41,00	7,00	4,37
1	Government consumption spending as percentage of total consumption.											
2	General government transfers and subsidies as a share of GDP.											
3	Government investment as a share of total investment.											



Columns marked “score” contain the economic freedom score, 0-10 where higher values indicate higher levels of economic freedom; columns marked “data” contain the raw data. For example, in government consumption Hong Kong has a score of 8.1, reflecting government consumption equal to 12.5% total consumption. For the same variable, government consumption in Argentina equals 24.0% of total consumption for a score of 4.7 out of 10 (adding transfers and subsidies it gets closer to 40%).⁴

Argentina scores below the South American average and some of the countries with the better performance in the region in terms of the quality of their institutions such as Chile and Costa Rica. It got closer to the worst performer in the region, Venezuela, and it does much worse than allegedly “big welfare state” governments such as Switzerland or Sweden.

The difference with the region is even larger in terms of subsidies and transfers (7.8 for South America and 5.77 for Argentina)

No wonder LyP had this to comment in one of its latest reports on the matter⁵:

“A fiscal correction and procurement of genuine financing are two of the most urgent needs. The present government’s inherited financial deficit (properly measured) reached over 8% of GDP in 2015. Such a deficit is totally incompatible the financial possibilities beyond a not so long transition. If kept in time such a deficit financed through debt, default risk will arise again. If, in the absence of financing, such a deficit is monetized, the risk will be even higher inflation.

⁴ We will later see that our figures for both Government Consumption and Transfers are even larger.

⁵ Fundación Libertad y Progreso, Manuel Solanet (ed), 2016; *Progresar en Libertad*; (Buenos Aires: Fundación Libertad y Progreso y Fundación Friedrich Naumann).

Consolidated public expenditures (national government + provincial + local governments) went from a historical 30% of GDP before 2002 to around 47% of GDP in 2015. Tax pressure also grew in that period from 27% to 39% of GDP. Both are unsustainable levels for Argentina's economy and must be reduced. The first measures of the present government reduced taxes. Such was the case of a cut on export taxes and an increase in the income tax floor. Though entirely justified, these measures evidenced the urgent and inevitable need to reduce expenditures. (p. 5)

Under any perspective, the increase of public expenditures is not rational....If measured in US dollars at the official rate it went from \$ 45.2 billion to \$ 235 billion. Only the absence of restraint and control under intense populism, between 2003 and 2015, can explain it.... The number of public employees grew from 2, 386,400 to 4,232,030, a 77% increase, (p.13) It is now around 10% of the total population.

Government accounting has its own failures. Expenses are recorded as paid and not as accrued, which omits important costs such as amortization, or the depreciation of government assets. Other expenses, unaccounted for, are:

1. High administration costs for tax and regulation compliance
The tax structure is so complex, with three different tax jurisdictions, requiring accounting procedures, statements and payments which themselves demand high cost managerial software and advice. Further, banking regulations, money laundering requirements, import procedures, exchange controls, environmental rules, statistical information requests, health and hygienic controls, work safety, etc., (considered in the Business Regulation section)
2. Consumption of government assets
Insufficient maintenance of infrastructure, government buildings, machinery transportation equipment and other assets shows lower accounted expenses.

The magnitud of public spending

Level of consolidated public spending (Nat+Prov+Munic)

Argentina 1980-2002	30% of GDP
Argentina 2015	47% of GDP
Latin America average	35% of GDP
First World countries average	42% of GDP

The extraordinary increase in expenditures during 2002-2015 has four main components, as shown in the following charts:

Where it increased (2002-2015) and why in % of GDP

	National State	Provinces	Municipalities	Total
Wages	0,5	3,8	1,2	5,5
Retirement Payments	3,1	0,3		3,4
Family subsidies	2,6	1,3		3,9
Economic subsidies	4,1	0,2		4,3
Total	10,3	5,6	1,2	17,1

Public Employment

	2003	2015	Increase 2015/2003
National	241.400	389.830	+61%
Provinces	1.766.600	3.045.900	+72%
Municipalities	379.000	796.300	+110%
Total	2.387.000	4.232.030	+77%

During 2016, the new government concentrated efforts in the reduction of subsidies to energy consumption and transportation, though not eliminating them. This adjustment of tariffs was somewhat blocked and delayed by a strong social reaction. Nothing much could be done with social welfare plans and government employment excesses.

Towards the second half of 2016 new public works programs started to be operational. Up to then, government investment showed a nominal reduction, contributing to slow down the increase of expenses in 2016, as it did in years before. The number of government employees remained the same. Then, it even started to grow again, as reported by FLyP⁶:

“The new government, inaugurated on December 10, 2015 aimed at reducing the fiscal deficit and expenditures. Nevertheless, despite good intentions, there is no clear outcome in that direction. In fact, the new government structure is the largest in the country’s history. The number of ministries grew to 20 first, then 21. According to the “Map of the State” document by the Modernization Ministry before the last changes, there were 85

⁶ Fundación Libertad y Progreso (2017); “La imprescindible racionalización y modernización del Estado”, available at: <http://www.libertadyprogresonline.org/wp-content/uploads/2017/04/La-racionalizacio%CC%81n-y-modernizacio%CC%81n-del-estado-4.pdf>

secretaries, 204 undersecretaries, 687 national and general directions and 141 decentralized agencies.

Compare this with the structure of government administrations before the 1940s, before Peronism. There were eight Ministries, no Secretaries, only one Undersecretary per Ministry to coordinate its management and the number of National Directions was less than 50. National directors depended directly from the Minister. Government expenditures were close to 8% of GDP.”

At the start of Cristina Kirchner’s term there were 10 Ministries, 50 Secretaries and 92 Undersecretaries and under her government the total went up to 16 Ministries (+60%), 70 Secretaries (+40%) and 162 Undersecretaries (+83%); but then Macri created five more Ministries (+31%), took the Secretaries to 87 (+24%) and the Undersecretaries to 207 (+22%). The National Directions grew up to 687, and Autonomous Agencies to 122.

The Ministry of Modernization, the one that is supposedly in charge of streamlining the government’s structure, has 4 Secretaries, 9 Undersecretaries and 92 Directions. Altogether, there are 43 Secretaries and Undersecretaries of Coordination, of course, to coordinate actions among the large number of organizational units.

The Presidency itself has four Secretaries, the Social Policies Advisory Committee, the Federal Public Revenues Administration (AFI), ten Undersecretaries and one hundred Directions. The newly created Federal Media System has 2 Secretaries, 1 Undersecretary and 25 Directions, plus a TV station (Canal 7), a National Radio, a news agency (Telam), an exhibition ground (Tecnópolis) and a large cultural center (Centro Cultural Kirchner).

Towards the second half of 2016 new public work programs were started. Before that, government investment was being reduced (in nominal terms), contributing to a reduction of the increase in current expenses in 2016, which grew above inflation. The size of government did not grow in 2016 as in years before, but it did not shrink either. These new public works contained the growth of unemployment. Prices for these works were lower after drastic changes against corruption and overpricing. More projects were started with the same amount of investment.

The three Kirchners’ presidential terms⁷ show an unseen growth of tax pressure, going from 28% of GDP in 2001 (the average of previous years) to 40% in 2015 (including the national, provincial, local governments and contributions to social security). Nominal tax pressure, differing between activities, individuals and companies, is higher than the real measurement due to the high level of tax evasion. Some activities suffer a tax burden of 60% on their revenues (and a higher one on their incomes). A major devaluation of the currency in 2002 allowed for the introduction of export taxes, particularly in the highly competitive agricultural exports, without reducing much their profitability, at first. The

⁷ Néstor Kirchner (2003-2008) and Cristina Fernández de Kirchner (2008-2012 and 2012-2016).

government tried to slow down the gradual overvaluation of the currency through exchange rate controls and trade barriers instead of reducing tax rates.

Up to 2015, and even in 2016, some tax distortions were not reduced or eliminated. Despite high price increases, business' balances were not allowed to make any inflation adjustment and were overtaxed on inflated profits.

The first year of the new Macri administration saw the elimination of exchange rate controls and most export taxes, with the exception of soya bean exports, which were reduced. Mining exports were also favored; but throughout 2016, tax reductions were quite limited and only focused on some specific products or activities. The difficulties to reduce government expenditures and a huge fiscal deficit has postponed any attempt to reduce taxes.

The tax base increased after a successful tax amnesty. In compensation for it, there will be a gradual reduction on the tax on personal assets. The amnesty cleared some 125 billion dollars and will bring to the Treasury around 130 billion pesos that will be channeled to the Social Security system in order to cancel pensioners' legal claims in courts. Nevertheless, this is a one shot revenue and there will be no reduction of the tax pressure if expenses are not reduced as well. Except for a few cases, there were no reduction of provincial or local taxes and valuations of property and registered durable goods (automobiles, motorcars) have increased even more than inflation, resulting in a net tax increase. (p. 16).

Major issues

The country audit consultation on this topic brought about important discussion on all the issues relevant to this area.

Size and function

There is no clear definition of the boundaries of the State, nor to its mission and functions and there is no consensus about it, nor among voters, politicians or the judiciary. Any new elected government can expand government functions into any particular area; and any interest group pushes, some of them quite aggressively and even violently, to get their share of the budget pie. A competition is started that only leads to continuous growth until the sources of financing dry up, and they do regularly one after the other: taxation, debt and inflation.

A recent editorial from a major newspaper brings some examples: a recent change of minister at the Treasury led to the creation of two Ministries, one of Treasury, the other of Finance. In the first one, besides the traditions Secretaries of Budget, and Public Revenues, a new one on "Economic Policy" was added with a corresponding Undersecretary of Macroeconomic Planning, but then a new one on Microeconomic

Planning was created with two Directions, one on Sectorial Planning, another on Information and Sectorial Analysis. At the new Ministry of Finance, two Secretaries, one for Finance, another for Financial Services were created.⁸

The editorial continues to show there is an Undersecretary of Human Rights' Protection and another on Human Rights' Promotion at the Ministry of Justice. There is an Undersecretary of Productive Development Policies and another on Development and Productive Planning at the Ministry of Production. This Ministry also has Undersecretaries for Bio industries and for Foods and Beverages, as if such specific units would be justified. The same is found in other Ministries, which, themselves, have a hard time trying to find a reason for its existence.

Despite major economic crises stemming from fiscal largesse there is no understanding among voters and leaders as well, that resources are limited and they come from producers in the first place. Argentines think in terms of what state they want to have, not on what state they want to pay.

As the EFW Index shows there are two main problems with government expenditure: the span of its activities, its sheer size, and subsidies, particularly in energy and transportation. Regarding the first, as a new government comes, priorities change, some of them are even quite understandable, but they come on top of what was spent before, not in place of inefficient expenditures.

The national and provincial governments end up funding the TV broadcasting of football matches, paying for sport events or even rock concerts, and people believe this is a natural governmental function. Conditions to access government pensions have been loosed so much that some may end up getting four of them. Regularly, one spouse gets her pension, plus the spouse's, if widowed; but then she can claim "coexistence" with another widow who also is getting two pensions, and if this last one dies (being male or female is the same), she ends up with the four pensions for the rest of her life. No wonder pensions are skyrocketing.

Local governments even start new companies whenever a local company runs into trouble and closes down. Several local governments close to a large milk factory have opened their own small operations, after this one has ran into trouble but by doing it they restrict the chances of entrepreneurs to fill that gap.

The national government has a new plan to subsidize startups where it becomes a shareholder of these new projects. There are more than one hundred national government' programs to support and subsidize entrepreneurship, and local governments even set up their own bureaus in order to help their citizens get them.

Off-budget expenditures

Despite the magnitude of the deficit problem, budget items do not even consider all government expenditures. In some government Ministries and Agencies, it was said, up

⁸ La Nación: "Ravioles que engordan", 30/4/17.

to 70% of the payroll are not part of budgetary expenses but, instead, to what have been named “cooperation agencies” (entes cooperadores). Different organizations, including NGOs, have the power to charge for certain services on behalf of the state, which then gets this funding out of the budgetary process. These off budget charges and expenses are not accounted as governmental.

As an example of this, the case of ACARA was mentioned. Formally, this is the Car Dealers Association and in their web page a “Forms” section is found, where any car dealer is addressed to the “ACARA Ente Cooperador” where the purchase of the legally binding forms to buy/sell cars are sold, with a mandate coming from two different laws, 23.283 and 23.412⁹

It was claimed there are six of these “cooperation agencies”, all of them at the Ministry of Justice, and what is called “figurative contributions” to the Social Security System, amounting to millions of dollars.

Proposals

It is unlikely that the level of government expenditures may come down to what it was before the Kirchners. A ten point of GDP reduction is not politically possible at this time. However, a five-point reduction is achievable.

If, as commented in our experts’ session, the most important problem is the understanding of the relevance of the fiscal situation, by either voters and/or their representatives, the government and political leadership should make continuous efforts to educate the public in that regard, and have them understand the magnitude of the problem. Many voters may even think government expenditures should be more efficient, but not that it should be smaller.

Some of it started to come by as the government reacted to FLYP report on the magnitude of the state (FLYP, 2017). High officials started to show plans to reduce the expansion of government expenditures and even president Macri recognized “politics transformed the State into a hideout”, and called to start check and control procedures saying the State does not belong to rulers, but to citizens. “We do not only have to open up information but we need to introduce transparency procedures because corruption brought with it wealth for a few but no drinkable water or sewers to many”.

We believe this should become a permanent task for members of the government who should additionally point out, in the face of any new claim of government support or subsidy, that the State is exhaust and any new expenditure proposal should come with another showing what already existing program or expenditure is going to be ended.

⁹ The ACARA website is <http://www.acara.org.ar/>; the ACARA Ente Cooperador website: <http://www.entecooperadoracara.org.ar/>

In this sense, discussion and approval of the fiscal budget is the most important task for Congress and it should send a clear signal of the fiscal constraints and the limitations for any new government project.

The present government also believes that a fiscal adjustment cannot take place in an election year (congressional elections will take place in October 2017), but the option should also be considered, that presenting to voters the real magnitude of the situation will bring their support. At the start of their term, the Macri administration downplayed the negative news regarding the inherited situation but, with time, it was realized that changes were made more difficult if voters did not understand the need for them. There was reaction by the President in the inauguration of the 2016 Congressional sessions, and a report was published¹⁰, but not much was made of it.

At the 2016 Congressional Inauguration address, President Macri said:

“We found a disorganized and badly managed state, with broken navigation instruments, information was hidden, documents were missing, there were no statistics, and it was even hard to find a paper.

In the years between 2006 and 2015, argentines paid to the national government almost 694 billion dollars in taxes more than in the 1990s. I repeat: from 2006 to 2015, argentines paid 694 billion dollars more in taxes than in the 1990 decade.

Despite of it, we found a state with problems to fulfill its basic responsibilities. More resources did not mean a transformation of our schools, hospitals or an improvement in personal security; more resources did not even allow for a reduction of the structural problems of poverty and indigence”.

The report itself comments many particular cases of employees in the government payroll who did not even attend the workplace, or some did not even live in the city where the workplace is located. As anecdotic examples, it mentions that in what it was the Ministry of Planning there were ten telephone operators for just one telephone; at the Chief of Cabinet office there were also ten photocopy operators (as if modern photocopiers would need one), for one photocopier. At the Secretary of Culture, 30 people were needed to make just one news clipping.

The report goes on and on describing the shabby condition of governmental administration. Nevertheless, the new administration and its government officials, or even their representatives in Congress, made no effort to divulge these results. It was archived right after it was published.

Provincial and local governments

The problem of public employment growth in provinces and local governments is an important one, and how to tame the prodigality of governors and majors becomes a

¹⁰ Presidencia de la Nación (2016); “El estado del Estado: Diagnóstico de la Administración Pública en Diciembre de 2015”. Available at: http://www.sigen.gob.ar/pdfs/el_estado_del_estado.pdf

crucial issue. Provincial governments doubled the number of their employees from 1.76 million to 3.45 million and local governments more than doubled.

The revenue sharing system should be modified in order to align the incentives towards fiscal responsibility based in the principle of fiscal correspondence, with a horizontal compensation scheme to smooth its approval, particularly from the poorest jurisdictions. Together with this, the national government's present power of authorization of debt issuance by provinces should be much stricter, setting a ceiling for each one. Therefore, local tax resources should cover any increase in provincial or local expenditures.

Provinces should get the power to collect certain taxes that are now collected by the national government.

Subsidies

In 2001, there were 7 million taxpayers and 7 million receiving different subsidies. In 2015/16, there is 4.2 million government employees, plus 6.5 million pensioners in the government's Social Security system, and 9 million in welfare plans which means that almost 20 million people get a check from the government while 8 million formally work and pay their taxes.

In 2016, subsidies to families actually grew, incorporating an additional million benefits, while those on energy were reduced, but not enough to compensate an increase in other expenditures. The reduction of these last subsidies should continue, including, as it is now, a preference rate for low-income users. Environmental concerns could also support a move like this, since cheap rates produce over-consumption of energy. Water consumption should be measured, and charged accordingly, not as related to the value of property as it is nowadays. Subsidies to families should be gradually reduced, starting from those that are evidently politically motivated and manipulated.

Regional subsidies should also be faded out, like the ones in areas like Tierra del Fuego or in other provinces.

Administrative reform

FLyP has already proposed an administrative reform, a zero-based budgeting starting from a definition of the government functions and then moving towards a modern and efficient design of the bureaucratic structure¹¹.

As the "modernization of the state" report says, the keys to this reform are:

- To concentrate government efforts and expenses in its basic functions
- To improve the quality of governmental services

¹¹ During the experts' meeting, a mention was made to another possibility: to consider an already approved budget from years back, for example, 1997 or 2000.

This reform should take place in two different areas:

1. Reform of the rules and regulations, labor norms, accounting procedures and administrative technology to improve efficiency and the quality of government services.
2. Simplification and reduction of the bureaucratic structure

The first area consists of:

- a. Reform of the public sector labor regime
- b. Introduction of a new public accounting system and managerial control based management by results.
- c. Massive introduction of IT, digitalization of procedures and files in managerial procedures, government purchases, control and tax administration.
- d. Deregulation, simplification and removal of unneeded procedures
- e. Decentralization and managerial autonomy. Demand subsidies, creating competition where possible (schools and hospitals).
- f. Outsourcing and privatization

The second area is the redrawing of the present organization chart, introducing a new simpler and more efficient one. The main criteria in this case are:

- a. To reduce the number of levels and administrative units in each area of government
- b. To reduce the number of employees and to simplify the structure of each unit
- c. To define goals, missions and functions of each administrative unit in order to avoid overlapping, conflict and absence of responsibility

The guiding criteria is the subsidiarity principle: the government will not take functions the private sector can provide, the national government will not take upon itself those provincial governments can do better, and the same for local governments.

A new design, coming from zero budgeting brings a leaner and more efficient organization than just fixing an existing one.

- Fewer levels in the administrative pyramid
Up to the 1940s, the national government had only three levels. Presently, there are five: President, Minister, Secretary, Undersecretary and National Director. Our proposal brings it down to four: President, Ministers, Vice Ministers and National Directors.

These administrative units should have clear mandates and decision processes. The juxtaposing of these decision lines has been a feature at the national administration. As an example, some Secretaries at the Presidency cover areas of some of the Ministries and in this present administration, the same happens with the different Ministries covering areas of economic policy.

- FLYP's proposals defines the existence of just one cabinet at each Ministry with main responsibility over the area. Two new National Directions are incorporated with the Chief of Staff: one to oversee governmental functions and another to coordinate governmental IT
- Each administrative unit should not have many subordinated units; excessive branching should be avoided. The proposal sets a limit of eight subunits.
- Mainline functions are those producing defined governmental services and include policy formulation, planning, design of norms and regulations in general and management of public services. Support functions are those that provide services to the administration itself such as legal assistance, file management, accounting, personnel and human resources, press and IT, to mention the most important.

The first are Ministry specific and must not be multiplied in different Ministries. On the contrary, the services of support units are repeated at each Ministry.

Mainline functions will be in charge of National Directors, depending on Vice Ministers. Support functions will be in charge of General Directors, depending from a General Coordinator with a Vice Minister rank. Some Ministries could share some of these General Directions.

- Advisors do not belong to the decision lines but help officials with their knowledge. Their advice may conflict with decisions or views from officials below the structure. This conflict is more delicate the higher the level it takes place. The proposal does not consider the appointment of consultants to the President, considering the ministers are.

Ministers would have up to four advisors, and Vice Ministers two.

- Autonomous governmental agencies would have their own independent structure, although they will depend on a Vice Minister.
- Political appointments are those discretionally decided by a government official. Certainly, it is to be expected that elected officers will want to fill top positions with people they trust or people who share their political views. That should be acceptable at the highest level of government and limited within the administrative structure. Political appointments should be restricted to Ministers and Vice Ministers. National Directors and presidents of Autonomous Agencies should preferably be selected through open contests, with a few exceptions.

Human resources

One of the fundamental changes presented in FLYPs proposal is the substitution of specific time contracting for the present “administrative career”, in order to get closer to private sector HR practices. Labor contracts should cover all officials with responsibility of administrative units or employees under her command. The concept of an administrative career is kept for governmental areas requiring specific knowledge and expertise such as the Armed Forces, Diplomatic Corps, Judicial officers and security forces.

Reduction of the over bloated governmental payroll is the most important and at the same time the most difficult task. Supreme Court jurisprudence states that “stability of employment” is not absolute and cannot overran public interest. There is still some standing legislation aimed at reducing public employment, such as Law 25.164 from 1999, considering the process when a government agency is discontinued. This same procedure could now be applied after the proposed new structure of government makes many positions redundant. Redundant employees would be reassigned within the government administration or paid their salary for a certain period (12 months, for example), and subsidized their employment in the private sector by covering labor taxes and contributions. More details of the reform proposal are found at the abovementioned report.

Some consultants proposed the freezing of new appointments in the government structure is an interesting proposal. The attrition rate would be between 3-5% annually, but it has some problems because sometimes vacancies are produced in areas where the function is actually needed.

Privatization

The government owns, totally or partially, 42 companies in what makes the largest holding in the country, but 35 of them show deficits, requiring the government to transfer around 91 billion pesos, or 0.7% of GDP. Actually, this is somewhat good news: in 2015 it had to transfer 121 billion pesos, or 1% of GDP, according to a report by the Chief of Cabinet office¹².

Unfortunately, the government thinks that not all its companies should be profitable and some, like the railways or water distribution, will always be subsidized. The fact is, though, that none of them produces services that cannot be supplied by private companies in a competitive market, and that some must be subsidized does not mean the government itself must manage them since it shows it is not a good manager.

¹² Florencia Donovan, La Nación: “Sólo siete de las 42 empresas del Estado tuvieron resultado positivo en 2016”, 28/4/17.

The word privatization has become politically onerous but no matter how one calls it many governmental services should move to the private sector. The government should also disinvest from companies producing goods and services, which are essentially commercial ventures.

Decentralization

Some governmental structures are unmanageable, like the province of Buenos Aires' educational system, with thousands of schools and teachers. It should therefore be decentralized unto the local governments.

The tax burden

The other side of the coin of exuberant government expenditures is tax pressure. As mentioned, although the present government has eliminated or reduced taxes on exports and increased the lower boundary for the income tax over salaries, tax revenues still amount to 40% of GDP, and considering a 30 to 40% of informal economic activity, real tax pressure is even higher.

- According to the World Bank, Argentina's total tax rate as a percentage of commercial profits is 106%, the worst in the world except for the Comoros Islands¹³.
- Taxpayer's rights were downgraded: they are considered guilty unless they can prove otherwise, exactly the opposite of what happens with any other crime.
- Tax administration is extremely costly. Argentina ranks 178 among 190 countries in the Tax Payment item of World Bank's Doing Business Report. According to it, it takes 359 hours a year to deal with tax payments when the Latin American and Caribbean average is 342.6 and OECD's just 163.4 hours. The total tax rate measuring the amount of taxes and mandatory contributions payable by the business in the second year of operation, expressed as a share of commercial profit is 106 for Argentina, 46.3 for Latin America and the Caribbean and 40.9 for OECD countries¹⁴.

Making taxation visible would be as important, and probably enabling to, as any tax reform. Indirect taxes are hidden from view and no wonder there is no political reaction against them, as it is with the income tax over salaries. Therefore, any tax reform, which will have trouble to reduce them because of the large fiscal deficit, should stress the

¹³ <http://data.worldbank.org/indicator/IC.TAX.TOTL.CP.ZS>

¹⁴ <http://espanol.doingbusiness.org/data/exploreeconomies/argentina>

visibility of taxes, be they taxes on property and/or salaries. Take the case of the reduction of the VAT on some food products (charged with half the rate). It is a subsidy benefiting the poor and the rich alike, and it could be replaced by a general VAT rate on all products and a subsidy for the needy ones. However, such an increase in the rate would be quite visible and would be openly opposed by all political parties, including those running governments in many provinces where the “gross revenues” tax falls on all products at the same rate. In this case, this is not visible to voters and no wonder provincial governments do not care to bring the rate down for specific food products’ consumption¹⁵.

The government has announced a tax reform and it is working on it, but it will only be sent to Congress after the congressional elections this coming October. There is still no information about its contents although some government officials said it would be “revenue neutral”, which means a redistribution of the tax pressure favoring production over consumption, probably, but no reduction of the tax burden as such.

In the meantime, it has moved to change the tax burden on some activities through “sectorial agreements” including business and labor union organizations that at some point reduce the fiscal pressure (they also include new subsidies), but make the whole tax system a lot more complex and uneven.

During our experts’ meeting, they mentioned the following principles to guide such a reform:

1. A drastic reduction of the tax burden over investment, particularly for startups and all sorts of small and medium size companies. The amount of taxes to be paid just before starting production on a new venture becomes an entry barrier for new investment.
2. Taxes should rather fall on consumption than on production, investment or employment. Until voters understand the real weight of high public expenditures, we should not drown production, investment and business with taxation. Taxes on consumption reveal what taxpayers are voting for¹⁶.
3. All sorts of new and harmful taxes have been introduced, many of them creating internal custom barriers, when there is a clear constitutional mandate that internal customs should not exist. Several of these taxes fall on specific consumption and have a specific destination, like the tax on cell phones’ charges going to finance Olympic sports; or another on cinema tickets to finance local film production. Particularly, there is a provincial tax on “gross revenues” that is particularly damaging to investment and production and should be part of a general reform as

¹⁵ On the visibility of taxes: Buchanan, James M. and Richard E. Wagner. *Democracy in Deficit: The Political Legacy of Lord Keynes*. 1999. Library of Economics and Liberty. Retrieved April 28, 2017 from the World Wide Web: <http://www.econlib.org/library/Buchanan/buchCy8c9.html>. Also: Vito Tanzi, J.B. Bracewell-Milnes, and D.R. Myddelton: *Taxation: A Radical Approach* (London: Institute of Economics Affairs, 1970).

¹⁶ A revenue neutral carbon tax was proposed.

considered in the following point. Others come with the payment of services as electricity, water.

4. Fiscal correspondence should be a priority, through devolving to provinces the power to tax, and keeping at the national level only the resources needed for its own function, and some horizontal compensation to lowest revenue jurisdictions. The present federal revenue sharing system creates perverse incentives for provinces to spend in the expectation that the national government will eventually rescue them; and the incentive for the national government to politically patronize provincial governments. Incentives should be aligned and provincial governments should be directly responsible on their expenditures.
5. Inflation adjustment should be introduced. Capital gains are taxed without considering the devaluation of the currency and this works as a rate increase, distorting investment decisions.

In the case of the taxation of profits, it was recommended to introduce a flat rate. Other participants thought it would be better to reduce taxes first and this would force a reduction in expenditures.

Tax evasion is high but the idea that eliminating it could bring a reduction of taxes does not take into account that many activities could not survive with the present tax pressure, number of taxes and costs of tax administration.

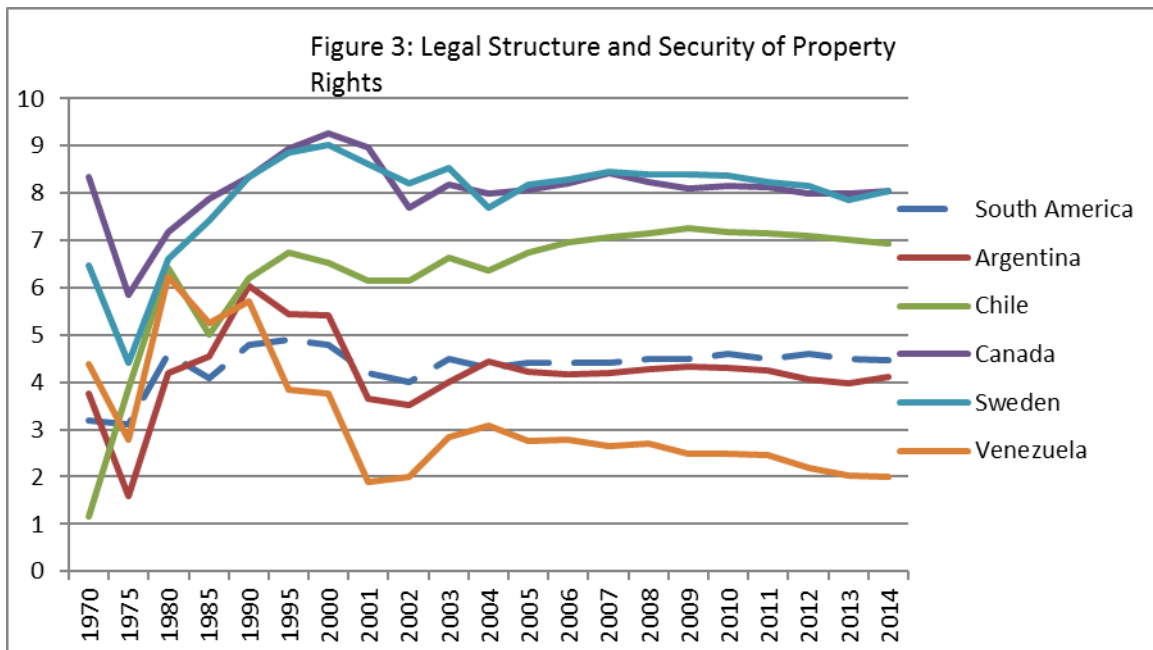
2. The Rule of Law and Property Rights

The rule of law is a crisis area for Argentina. Argentina is 134th in the world in the Rule of law. Improvements are desperately needed, though some of them were started with the new government. In four areas, Argentina has a score below one out of 10, and in three other areas, its score is below two.

The rule of law provides the infrastructure of economic freedom. Without the rule of law, the rich and the strong will use their power to protect their privileges and limit the freedom and opportunities of others in the market place. This has been the story of Argentina for decades and it limits economic dynamism and growth.

An efficient market economy is not possible without a sound and predictable legal structure that protects property rights and contracting.

Countries	2A Judicial independence	2B Impartial courts	2C Protection of property rights	2D Military interference in rule of law and politics	2E Integrity of the legal system	2F Legal enforcement of contracts	Regulatory restrictions on the sale of real property	2H Reliability of police	2I Business costs of crime	2 Legal System & Property Rights
Finland	9,3	8,0	9,0	10,0	10,0	6,7	8,1	9,6	9,2	8,9
New Zealand	9,5	7,6	8,5	10,0	9,2	7,2	9,9	9,1	7,6	8,7
Switzerland	8,8	7,6	8,9	10,0	8,3	6,1	9,6	8,7	8,0	8,5
Luxembourg	8,7	7,4	8,7	10,0	10,0	7,5	6,2	8,6	8,3	8,4
Singapore	7,6	7,8	8,8	8,3	8,3	7,8	9,0	8,6	8,6	8,3
Denmark	8,8	6,0	7,9	10,0	10,0	6,0	9,7	8,4	7,1	8,2
Netherlands	8,8	7,4	8,3	10,0	10,0	5,1	7,9	8,4	7,0	8,1
Hong Kong	8,9	8,0	8,7	8,3	8,3	6,5	6,9	8,7	8,5	8,1
Australia	6,9	6,4	8,1	10,0	10,0	6,4	8,1	8,2	8,3	8,1
Canada	8,7	6,9	8,3	10,0	9,2	4,8	8,6	8,5	7,4	8,0
Top 10 Ave	8,6	7,3	8,5	9,7	9,3	6,4	8,4	8,7	8,0	8,3
World Ave	5	4	5,5	6	6	4	7	5,4	6	6
S. America Ave	3,5	3,4	4,5	5,1	4,0	4,0	7,6	4,2	4,1	4,5
Argentina	0,21	0,64	0,99	0,83	1,67	3,21	8,20	1,21	1,06	2,00



“Despite the remarkable general principles in its Constitution, Argentina today lacks a judicial policy leading to compliance with them. Such a policy is much needed to improve the present efforts to improve the workings of the Judicial Power, and those that may come in the future. Those efforts must be systematized and aligned with predefined goals along the lines of what the country needs”¹⁷.

The subject of property rights in the modern State has its roots in thinkers like John Locke (1632-1704), to whom the right of each man to the fruits of his labor in the state of nature and the right to defend it faced the constraint of a similar right in others, putting property at risk. The State was, therefore, organized to defend the right to property and its use and disposition. Among us Juan Bautista Alberdi emphasized the State should also be constrained since it was the most dangerous of thieves.

That is the reason why a somewhat rigid Constitution was designed and enacted as the highest point of our legal system to secure property. It would only be taken through expropriation by a law declaring it of public interest and with previous compensation. Confiscation, even in crime law, is not acceptable, including personal, intellectual property, and rights of invention and discovery.

Furthermore, the Constitution assures the use and disposition to avoid that the right may become void of any content, and it secures due process to defend it as well as stating that laws cannot alter this right and the regulation through laws cannot alter its spirit.

A blind justice was guaranteed through a complex process for the appointment of judges: by the President with Senate agreement, originally, and presently through the Council of

¹⁷ Fundación Libertad y Progreso (2016), M. Solanet (ed); *Progresar en Libertad: Propuestas para salir de la decadencia*, Cap. 8: “Una política de Justicia”, p. 108.

the Judiciary); their tenure (now up to 75 years) and the intangible character of their remunerations.

Such constitutional protection of the right to property was the most complete at the time (1853), even more than the US Constitution in its Fifth Amendment.

Nevertheless, it is now obvious that the right to property is not protected enough now and it is much less than in the US and other countries.

Contracts among private parties have been affected in their term, currency, value and balance of benefits through policy actions validated by the Courts. Contracts with the State suffered the same and their compliance was postponed with no date without Justice limiting and remedying it. There were also confiscatory taxes validated by Justice.

Goods subject to expropriation have been dispossessed and the use and disposal of property has been deprived in different ways, without Justice preventing it. The execution of verdicts among private parties and against the State has been suspended for unusually long periods, also validated by the courts.

Rulings from foreign courts were not accepted, even though the country had voluntarily submitted to them, denying recognized rights in the elected jurisdiction, both to foreign and local savers. The expropriation of the large oil company YPF was carried out without following a basic constitutional principle of compensation before taking.

Inflation, endemic since 1930, with a drastic increase in 1975 and hyperinflation in 1989 is another source of institutional decay since it brings revenues to the State that were not approved by Congress, confiscate wealth to citizens and increases taxation if, as it happens, assets and liabilities are not allowed to adjust to increasing prices. In addition, when, exceptionally, inflation adjustment is permitted, manipulation of inflation indexes turned into a sibylline confiscation of property.

The regulation of basic rights through laws and subsequent decrees in open violation of the right to property reverts the constitutional mandate setting that no one is forced to do what the law does not command, nor prevented from doing what it does not forbid. Citizens restrict themselves what is allowed to them, no full principle of liberty is present. The jurisprudence of the Supreme Court though has included as part of the right to property any interest that an individual may possess outside of herself, her life and freedom. It was not enough.

Although the new government has made efforts to repair the damage and some rights to foreign exchange and public debt holders, exporters and importers were restored, they have not been ambitious enough to remove the dangers, restrictions and unconstitutional limits on property. Certainly, it has a limited power and no majority in Congress, and their own short-term interests push it to move gradually.

Altogether, there is a clear contradiction between the width, spread and pretended efficacy of the constitutional protection to property and effective one; the Supreme Court itself has been a sources of it through doctrine setting rulings since 1922 (Ercolano - 1922-, Russo -1959-, Cine Callao -1960-, Peralta -1990-, Brunicardi -1996-, Bustos -2004-,

Galli -2005-, Claren -2014-, among many others). Some were based on emergency doctrine though many others were just a violation of the limitations the same SC introduced to exceptional powers.

There is disturbing lack of protection of property from Courts, which affects mainly non-physical property such as currency, bonds, stocks, contracts, intellectual property and others, the most valuable in the modern world and with the greatest potential impact in development and the reduction of poverty.

“The Argentine government has become the largest defaulter of norms it itself dictates... As an example, the national government sanctions private business who hide as service contracts what in fact are labor contracts, and it does not have remorse to do the same with its own employees who are hired under a contract but get no social or pension benefits”¹⁸

The International Property Rights Index¹⁹ confirms this picture. Argentina is ranked 105 from 128 countries and 17 from 22 in the Latin American and Caribbean region. In 2016, it reports:

“Argentina experienced an increase in its IPRI score by 0.1 to 4.1 placing it 17th in Latin America and Caribbean and 105th globally. Argentina is classified by the IMF as part of the Latin American and the Caribbean group and by the World Bank as a high-income nation. It is a member of the Common Market of the South (MERCOSUR). Argentina’s Sub index of Legal and Political Environment decreased by 0.1 to 3.6 with scores of 3.2 in Rule of Law, 3.8 in Control of Corruption, 5.2 in Political Stability, and 2.4 in Judicial Independence. The Physical Property Rights Sub index increased by 0.1 to 4.2 with scores of 3.1 in Property Rights, 1.2 in Ease of Access to Loans, and 8.3 in Registering Property. The Intellectual Property Rights Sub index increased by 0.3 to 4.5 with scores 3.3 in Intellectual Property Protection, 7.1 in Patent Protection, and 3.1 in Copyright Piracy Level.”

¹⁸ Mairal, Héctor A. (2007); *Las raíces legales de la corrupción*; (Buenos Aires: Res Publica Argentina), p. 40.

¹⁹ <http://internationalpropertyrightsindex.org/country?s=argentina>

Year	Score
2007	4,3
2008	4,4
2009	4,4
2010	4,4
2011	4,7
2012	4,6
2013	4,6
2014	4,4
2015	4
2016	4,1

	Score	Globally	Regionally
Overall	4.1	105 of 128	17 of 22
Legal and Political	3.6	98 of 128	13 of 22
Physical	4.2	122 of 128	20 of 22
Intellectual	4.5	82 of 128	14 of 22

No greater challenge faces Argentina than improving its overall score and all aspects of the rule of law and property rights.

Major issues

LyP (2016) already covered this area and made proposals for reform. The basic principles include:

1. The Judicial Power should aim to recover trust and credibility from argentines
2. Honesty and ethical behavior by members of the Judiciary should be a model of inspiration and an example for all argentines.
3. Members of the Judiciary should be selected among the most able lawyers in the country, and those with commitment to service the community and the judicial system.
4. The Judiciary should act with total independence from political power of private lobbies of any sort.

5. It should be efficient and offer citizens a reliable and timely service for the preservation and protection of their liberties and rights sanctioning any violation of them.
6. The Judiciary should bring Justice all over the country, as a safeguard of the Rule of Law.

Constitutional issues: During the Audit, some experts argued the changes introduced in the Constitution in 1994, restrict, contradict, or limit the clear definition of this right in article 17 of the 1853 Constitution. Others commented that these changes come with the times and they may not be a matter of concern, but their implementation is. There was much concern about changes in constitutional control, this is, how the judiciary could strike down legislation or decrees and regulations if it considers them in violation of the Constitution. Originally, the courts could only decide it for a specific case, but now the door has been opened for a judge to declare the unconstitutionality of a law or regulation in general, therefore changing the constitutional balance of power without a constitutional process considering it.

Emergency decrees: Before 1994, it was clear that emergency decrees were accepted only for such “functional” issues as related to the working of government, like a delayed budget approval. Such a reform was aimed at taming, in a way, the concentration of power in the Presidency, but some argued that this, in fact, strengthened it. It is of much concern the power of the President to legislate through emergency decrees, which is used regularly, despite the fact that the reformed Constitution clearly says it is not allowed, and only then brings some exceptions. Unfortunately, these exceptions became the rule. The Supreme Court has often approved these emergency decrees. Some of them have introduced new taxes, or changed procedural crime law even when the new constitutional article specifically denies the power to issue emergency decrees on these matters. The right to property is not even included among the areas where these decrees are not allowed. Emergency legislation should be strictly limited and regulated.

Communal property: introduced as a right to aboriginal people, this right to “communal property” has not yet been regulated but it has already created a lot of abuse. There is no definition of what an “original people” is, who are members of them, and what groups have a right that must be restituted.

Jurisprudence: Judicial review of the right to property has moved towards an interpretation weakening them. Criminals are considered a “social victim”. This requires changes in the Judiciary and some changes in regulation.

Taxation: Jurisprudence set a limit at the power to tax after which it is considered a violation of the right to property, an expropriation of the resource. This limit is now 35%, but it does not consider the additivity of different taxes. Taken all taxes into account, the percentage could be much higher for a taxpayer, and there are cases when the taxes take as much as 90% of the profits of a specific company. Isn't it expropriation? Should it not be a general limit to all tax pressure over a specific company or individual?

Future threat to property rights: the largest violation of property rights during the last years was the default on the debt, which was efficiently sorted out by the present government just a few months after inaugurated. Nevertheless, it is also clear that any unlimited increase in debt spells a potential new violation of creditor's property rights in the future. As commented in the Size of the State section, a lot more effort should be aimed at curbing the need for new debt.

Changes in the Judiciary Council:

The composition of this Council was originally made of:

- Five members of the Judiciary, one from the Supreme Court who acted as chairman)
- Eight members of Congress, four from each Chamber (two from the majority, one from the first minority, one from the second minority)
- One member from the Executive Power
- Four practicing lawyers
- One academic
- One professor of Law

Political representatives (Congressional and Executive) had 45% of the total, against 25% from the Judiciary and 20% from active attorneys. However, in 2006 the total number was reduced from 20 to 13, increasing political representation to 53.8%, the Judiciary was reduced to 23% and active attorneys to 15.3%. The composition now is:

- Three members of the Judiciary (no representative of the Supreme Court)
- Six members of Congress, three from each Chamber (two from the majority, one from the first minority)
- One member from the Executive Power
- Two practicing lawyers.
- One academic

This new composition gives the party in power, if it has a majority in Congress, as much as 5 representatives and the chance to block any decision requiring a two-thirds majority, as it happened during the last Kirchner administration.

LyP (2016, p. 136) already presented proposals to change this, including:

- To restore equilibrium at the Judiciary Council among representatives coming from the political side (Congress and the Executive) with those of the Judicial side
- To restore representation of the second minority in Congress
- To balance the composition of committees within the Council
- To restore the presence of the Supreme Court representative at the Council
- Full-time dedication for those representatives appointed, who could not be members of another branch of government. That is, a member of the Legislature cannot be a member of the Judiciary at the same time. Nevertheless, this is what happens.
- Reevaluation of the present composition of the Jury Tribunal
- Other measures to improve the selection of judges through open competition in regular and clear contests.

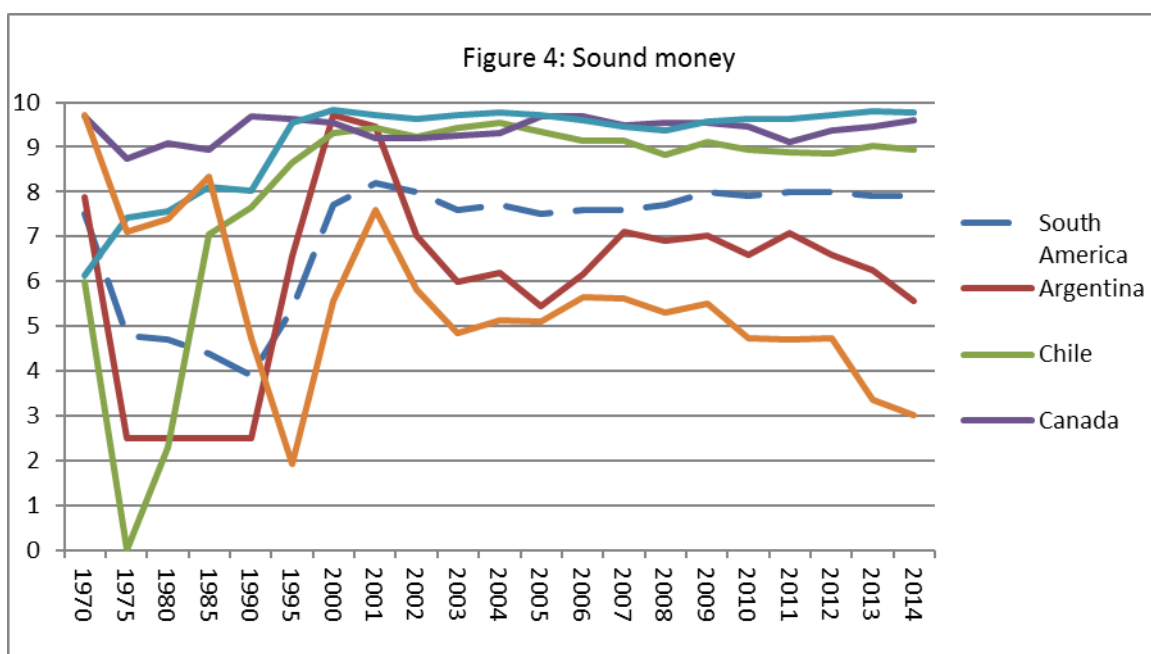
3. Sound money

While most of the world has tamed inflation (and indeed many face a deflationary problem), this disease still plagues the people of Argentina. Argentina has the fourth worst record in the world behind Malawi and ahead only of Ethiopia, Syria, and, of course, Venezuela.

Inflation erodes the value of rightfully earned wages and savings. Sound money is thus essential to protect property rights. When inflation is not only high but also volatile, it becomes difficult for individuals to plan for the future and thus effectively utilize economic freedom.

Argentina's decline in sound money is almost parallel to Venezuela. Sounder monetary policy is desperately needed.

Countries	3A Money growth	data	3B Standard deviation of inflation	data	3C Inflation: Most recent year	data	3D Freedom to own foreign currency bank accounts	3 Sound Money
Netherlands	9,5	2,6	9,9	0,2	9,8	1,0	10	9,8
Switzerland	9,2	4,1	9,9	0,4	10,0	0,0	10	9,8
United Kingdom	9,5	-2,4	9,8	0,5	9,7	1,5	10	9,8
Denmark	9,5	2,6	9,5	1,3	9,9	0,6	10	9,7
Taiwan	9,6	1,9	9,2	2,1	9,8	1,2	10	9,6
Ireland	9,1	4,3	9,4	1,4	10,0	0,2	10	9,6
Malta	8,8	6,1	9,8	0,6	9,9	0,3	10	9,6
Austria	8,9	5,6	9,9	0,3	9,7	1,6	10	9,6
Germany	8,9	5,7	9,7	0,6	9,8	0,9	10	9,6
Canada	9,1	4,3	9,7	0,8	9,6	1,9	10	9,6
Top 10 Ave	9,2	3,5	9,7	0,8	9,8	0,9	10,0	9,7
World Ave	9	5,5	9	4	9	4	6,5	8
S. America Ave	8,2	8,8	8,3	4,3	7,9	11,5	7,1	7,9
Argentina	2,77	36,16	4,31	14,23	0,00	62,17	5,00	3,02



Although the new government removed exchange controls at the end of 2015, it was a determinant factor for 2016. Monetary authorities showed much needed courage to quickly move out of controls and a fixed exchange rate and in a reasonable period removed all exchange controls. The outcome was very positive; the demand for the local currency reacted favorably and there were no lines at foreign exchange dealers nor large purchases of foreign currency at banks. Certainly, the Central Bank was cautious enough to raise interest rates and took notice that the demand for pesos is strong during the month of December, what helped it to compensate the large issue of money left from the previous government.

Although the present monetary authorities have announced a dirty flotation policy, the exchange rate fell drastically at the beginning of their mandate to 13 pesos to the dollar, and then moved to 16 pesos. This volatility did not help to build trust at first, in a country where exchange rate shocks are usual. Therefore, the Central Bank faced a fall in the demand for pesos, on top of the seasonal fall during the first quarter each year.

The Central Bank assumed an inflation targeting policy and though there were some critics arguing if it were not too early, there was a general consensus on its need to align inflation expectations in a country that had lost all guidance in that regard. The first half of 2016 showed the impact of the adjustment of relative prices in the price index after the removal of exchange rate controls, subsidies to public services and the fall of the real demand for pesos mentioned before. Prices, as measured by the City of Buenos Aires Price Index (IPC-CABA) grew at a 4.4% monthly rate, removing any chance to comply with a 20-25% inflation target. Nevertheless, it was 1.5% monthly average in the second half of the year which, projected, leaves a 20% annual inflation rate, a substantial reduction from the year before.

Today, the debate centers on whether the Central Bank should play hard at the foreign exchange market to avoid a revaluation of the local currency or if an annual inflation rate of 12-17% should be its goal. There are strong pressures for an easing of monetary policy since,

- a. The government absorbs a great deal of local credit to finance its huge fiscal deficit, raising rates and reducing access of the private sector to the loan market.
- b. As those resources are not even enough, the national and provincial governments are issuing debt in foreign markets, flooding the exchange market with dollars.

Some are pushing for an expansion of monetary aggregates to keep the forex parity and to increase local credit, arguing this would bring back economic growth, although the inflation goal would have to be given up.

However, if inflation targets are not achieved it does not make much sense to align expectations. This would lead to third transitional year in 2018 to show how the targets may eventually be achieved in the future.

Argentina has still not addressed a serious debate on what goal should the Central Bank be pursuing. In principle, it has a double mandate including to keep stable the value of the currency and the level of economic activity and employment. Nevertheless, some believe the only tool it has is monetary policy, and it should not have two goals at the same time. Others believe it does have an additional tool: foreign exchange policy, but it is the local monetary policy that determines the value of the currency and its corresponding exchange rate with foreign currencies. Debates like this create a certain uncertainty regarding the future evolution of the peso.

Solvency of the Central Bank is another issue to be noted. The previous government was leading it to bankruptcy. Removal of exchange rate controls changed this fate but the government still finance itself through it, although it as reduced the amount of resources coming from monetary expansion. Nevertheless, this and the need to buy forex to keep the local currency from revaluating has increased its debt in more than 300 billion pesos. This debt was less than 60% of the monetary base at the end of 2015 and it reached more than 80% at the end of 2016. Despite this, forex reserves went up from 26 to 35%. Nevertheless, there is much to be done to get a solid central bank.

Major issues

In a recent report, FLyP commented:

“The fiscal gap is covered with a growing debt and monetary expansion, generating three problems: very high inflation, revaluation of the currency and an increase in interest rates and country risk. The Central Bank absorbs part of the excess of money through by placing bonds in the market, but, as the graph below show, this is growing at a fast exponentially.

The growth of Central Bank's remunerated liabilities generates a cost we call quasi-fiscal deficit, now around 2.3% of GDP, which takes the total fiscal deficit to around 10% of GDP. Monetary policy may reduce inflation this year to a little over 20%, after reaching 40% last year but that is not sustainable. If the primary fiscal deficit is reduced, as expected, to 4.2% this year, the total deficit keeps on increasing the volume of debt and, therefore, the financial deficit and the quasi-fiscal deficit in a way that will not make the total deficit be smaller and we run the risk of a new crisis.

Furthermore, the money supply is growing at y-o-y rates of more than 35%, way above the target inflation rate for this year between 12 and 17%.”²⁰

Experts at the audit mentioned:

- The Central Bank does not have a target for monetary aggregates, using as an instrumental target an interest rate. This means growth of M1 is exogenous to CB's policies. This means that today, money expansion factors are huge and will not come out reflected in an endogenous M1. These factors include a 1.75% of GDP of transfers to the Treasury to help it pay expenses; two more percentage points for payment of its own debt services; and purchases of the inflow of dollars coming from new Treasury debt issues. This is another two points of GDP.
The Central Bank has a professional team in charge that is acting correctly, but they urgently need a fiscal adjustment. It must keep the inflation target goal, and a positive real interest rate. Present rates would probably have to be higher to force such an alignment. It cannot do much more than that.
It cannot do much over the factors of monetary expansion: financing the Treasury, paying its own debt, and buying up dollars in the forex market. It urgently needs the help of the Treasury through control of its expenses and reduction of the fiscal deficit.
- Inflation is in a clear downward path, and despite some problems during the first half of this year, it will average 1.8 monthly. Market expectations hover around 21% for the whole year but they still do not fall towards the Central Bank goal.
- Although the Central Bank has a two goal mandate, as commented, CB authorities have made it clear that lowering inflation is the most important and the one they are concentrated on.
- The present Central Bank authorities act independently, and an independent CB is an important institutional feature for sound money. Nevertheless, this outcome is the result of a political decision by the present government, but the fact also is that each government in the last decades has been able to appoint a CB Board of its own preference. That present monetary authorities act independently, but the

²⁰ Fundación Libertad y Progreso; “Reseña Financiera”, 2/5/2017.

institutional independence is weak, since it cannot secure independence for the future. This is a difficult problem to solve, since many attempts to confirm independence have failed in the past, the laws governing the CB were changed and it has been impossible for monetary authorities to survive a change of government, even if, as in this case, the change was for the better.

Maybe a solution to this problem depends on a political evolution away from populism, since all formal barriers to guard CB independence were, sooner or later, overcome. In the meantime, a discussion of potential institutional constraints would be much valuable.

- An altogether different approach and proposal was made, to turn the local currency into an international one, be it the US dollar or another major world currency, like Ecuador, Panama or El Salvador in Latin America, or even like European countries, like Spain for example, towards de Euro.
- As the forex market was deregulated, though, a small gap between the legal and the black market exchange rate still exists and it is still somewhat of a mystery, unless it reflects transactions over non-declared funds. Nevertheless, there was no gap in the 1990s despite the fact that such funds were as important then as they are now. It may be the result of the struggle against money laundering and drug money that avoids the legal banking circuit, something that did not happen in the 1990s.

Concluding, experts were generally supportive of the present monetary policy of the Central Bank, pointing that its weakness comes not from it, but from the fiscal side, which prevents the agency to reach its targeted goals, and, at the same time, lowering inflation and contributing to economic growth.

4. Freedom to Trade Internationally

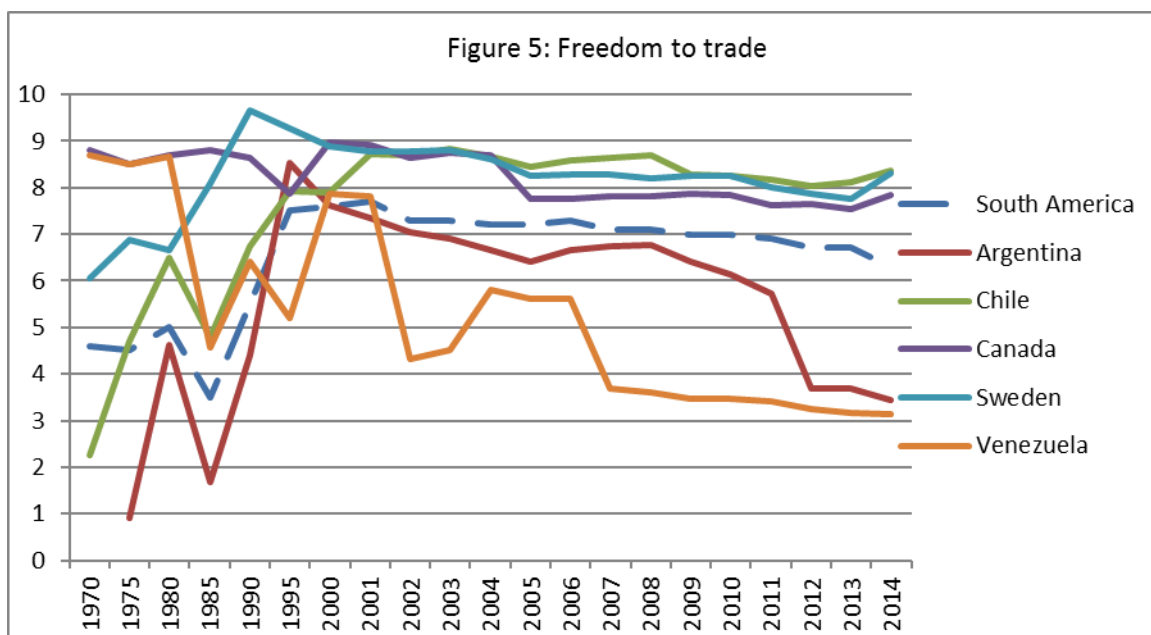
Just as individuals and businesses should be able to buy from and sell, to whom they wish in Argentina, they should to buy from and sell to everyone in the world.

Argentina needs the world as its market place. This is particularly important for relatively small nations like Argentina. Trade has been shown to be the great generator of growth.

This is another crisis area for Argentina. It has the third worst score in the world, ahead only of Venezuela and Iran—and that is truly worth contemplating. See table 4.

Argentina has been on a virtually steady decline in openness since the first data becomes available in 1970.

Countries	4Ai Revenue from trade taxes (% of trade sector)	data	4Aii Mean tariff rate	data	4Aiii Standard deviation of tariff rates	data	4A Tariffs	4Bi Non- tariff trade barriers	4Bii Compliance costs of importing and exporting	4B Regulatory trade barriers	4C Black market exchange rates	4Di Foreign ownership/ investment restrictions	4Dii Capital controls	4Diii Freedom of foreigners to visit	4D Controls of the movement of capital and people	4 Freedom to trade internationally
Singapore	10,0	0,0	10,0	0,2	10,0	0,0	10,0	8,9	9,1	9,0	10,0	9,2	6,9	10,0	8,7	9,4
Hong Kong	10,0	0,0	10,0	0,0	10,0	0,0	10,0	9,2	9,3	9,2	10,0	9,2	6,9	8,6	8,2	9,4
Ireland	9,8	0,3	8,9	5,3	6,5	8,6	8,4	7,8	9,1	8,5	10,0	9,0	8,5	6,7	8,1	8,7
Netherlands	9,8	0,3	8,9	5,3	6,5	8,6	8,4	7,3	10,0	8,7	10,0	7,5	9,2	5,9	7,5	8,7
New Zealand	8,9	1,6	9,6	2,0	9,0	2,6	9,2	8,7	8,7	8,7	10,0	7,4	6,9	5,9	6,7	8,7
Mauritius	9,8	0,3	9,8	1,0	8,6	3,4	9,4	6,8	7,9	7,4	10,0	7,6	4,6	10,0	7,4	8,5
Denmark	9,8	0,3	8,9	5,3	6,5	8,6	8,4	7,4	10,0	8,7	10,0	7,3	7,7	5,9	7,0	8,5
Georgia	9,8	0,3	9,7	1,5	8,3	4,3	9,3	7,4	8,1	7,7	10,0	7,1	6,2	7,2	6,8	8,5
Luxemburg	9,8	0,3	8,9	5,3	6,5	8,6	8,4	8,3	10,0	9,1	10,0	8,6	3,8	5,9	6,1	8,4
Estonia	9,8	0,3	8,9	5,3	6,5	8,6	8,4	7,9	9,9	8,9	10,0	7,4	5,4	5,9	6,2	8,4
Top 10 Ave	9,8	0,4	9,4	3,1	7,9	5,3	9,0	8,0	9,2	8,6	10,0	8,0	6,6	7,2	7,3	8,7
World Ave	8	3	8,3	9	6	11	8	6,0	6	6	10,0	6	3,6	5	5	7
S. America Ave	8,3	2,6	8,0	10,1	6,6	8,4	7,6	5,2	3,8	4,5	8,3	5,6	3,7	5,6	5,0	6,3
Argentina	8,45	2,33	7,42	12,90	6,85	7,87	7,57	3,67	0,00	1,83	0,00	3,12	0,77	5,45	3,11	3,13



Considering the Freedom to Trade Internationally category of the Economic Freedom of the World Index, Argentina comes at the bottom of the table. Of 159 countries, Argentina is 157th; only Venezuela and Iran (two former political partners) are below it.

Argentina has a score of 3.44; Singapore, in the first place, 9.43. Brazil, our large Mercosur partner, has a score of 6.73; Chile, 8.35; Paraguay, 6.92; Uruguay 7.43.

As of 2012, Argentina's imports per capita were \$1,545.90, taking place 127th among 214 countries.²¹ Chile imports \$4,286.33 per capita, Uruguay \$3,610.92; Paraguay \$1,653.87 and Brazil \$1,123.55.

Trade has been a route to prosperity for many nations. Economic research shows open economies grow much faster and have much greater success in reducing poverty than closed economies. The challenge for Argentina is to open its borders to trade to take advantage of these opportunities.

Trade and other restrictions to imports and exports (either at Customs or at the forex market) have not been a source of substantial fiscal revenues for many years now, to become tools for promoting or punish different local production. Among these policies, we find import tariffs, export duties, quantitative restrictions and all sorts of non-tariff barriers imposed on importers and exporters in the forex market. (FLyP, 2016, p. 71)

²¹ <http://www.nationmaster.com/country-info/stats/Economy/Imports-per-capita>

Argentina's regression in this field started with the reintroduction of duties on exports and exchange rate controls in 2002. Such measures could have been justified because of the deep economic crisis that year but were perpetuated afterwards, and even deepened. In 2008, the highest export duty was taken to 35%, from 25%, and even though there were no increase in import duties a new non-automatic license system was introduced that was under the discretion of the Secretary of Commerce. From 2012 to 2015 foreign exchange controls were spread to the sale of foreign exchange to travelers, remittance of profits and purchases of forex for savings.

The degree of discrimination was such that the final exchange rate (that is, including import tariffs) for an import that had to be cancelled through the purchase of dollar denominated bonds tripled the final exchange rate an exporter of soybeans would get. The system also created many controversies with trade counterparts and the regular complaints with international organization such as the WTO and others.

The negative impact of these protectionist trade policies was not immediately evident, as with accelerating inflation, but there is a long term correspondence between Argentina's faltering GDP growth (with regard to developed countries) and the closing of its foreign trade if we consider the foreign trade to GDP ratio. Only the high price of our exporting commodities allowed the country to sustain the dollar value of its exports, despite the stagnation of its volume.

The distortion of protectionism and forex control inhibited investment in competitive sectors of the economy and promoted them in uncompetitive ones, preventing these last ones from exporting. Uncertainty over the rules of the game was another factor.

At the end of Cristina Fernández de Kirchner's administration exchange rate controls were introduced, requiring approval by the Public Revenue Agency to get forex at the legal market. Imports were subject to previous approval, which was not always granted. Licenses had to be approved by the Secretary of Trade. Other non-tariff barriers either blocked or restricted specific imports. Industrial factories would stop or reduce production for lacking imported inputs. This opened the door to corruption.

The consequences of a closed economy are easy to spot just by looking at the price differential and the diversity of consumer goods with those of neighboring countries. No wonder there is a stampede of local consumers, and particularly those living close to the borders with Chile, to travel and shop.

At the end of 2015 and after removing forex controls licenses were eliminated and a new system to track imports was introduced. There is now no need of a previous authorization.

Online purchases from abroad were allowed again with a limit of \$1,000 and 50 kilos up to three units of a specific product and no more than five purchases a year. Home delivery was limited to 200 dollars and two kilos.

The Macri administration has shown an interest in opening the economy and international trade but there was no reduction of import tariffs, nor it was announced a

program to do it gradually in the future. A “free trade” agreement with the European Union, through Mercosur, is now moved on and new such agreements are being considered.

One of the first measures this government took was the elimination of export duties. They subsist though in the case of soybeans and its byproducts with somewhat lower duties.

Export procedures have been eased but there is still a lot to do.

The real exchange rate has deteriorated during 2016 with the inflow of dollars occasioned by the fiscal deficit, as it was commented before. This hurts local competitiveness.

In brief, there was a clear improvement in freedom to trade during 2016 but following a very close economy with intense government intervention. There is much deregulation needed just to get closer to developed countries and more opened ones in the region, such as Chile.

Major issues

At the audit meetings some of the experts commented on different issues

- The most important concern relates to the absence of any plan for a general and gradual reduction of import tariffs in the future. The present ad hoc policy of bringing down barriers case by case may be too slow and, in a way, unfair. Import tariffs for computers, for example, were drastically reduced. Why not other items? Case by case micromanagement creates a corruption hazard and discriminates. Experts agreed there should be a general policy. Any preference punishes the rest; the protected industry is able to transfer part of the “argentine cost” unto the other industries and services. The government should present a schedule of general tariff reductions. Certainly, and this relates to subjects considered in other sections, such a schedule should come together with a reform program aimed at reducing local costs (regulatory costs, transportation, labor, etc.) since, without it, any opening would entail a major disruption to local producers. Some even argued the reductions should come first, putting pressure to reduce local costs; and input costs would be lower and the exchange rate better. Such a general reduction should probably take a larger step at the beginning, and then move gradually down.
- Participation at the Mercosur must be open to debate. The regional group has become a way to protect certain economic activities, adding up the protectionist lobbies of member countries, which are quite powerful particularly in Brazil and Argentina.

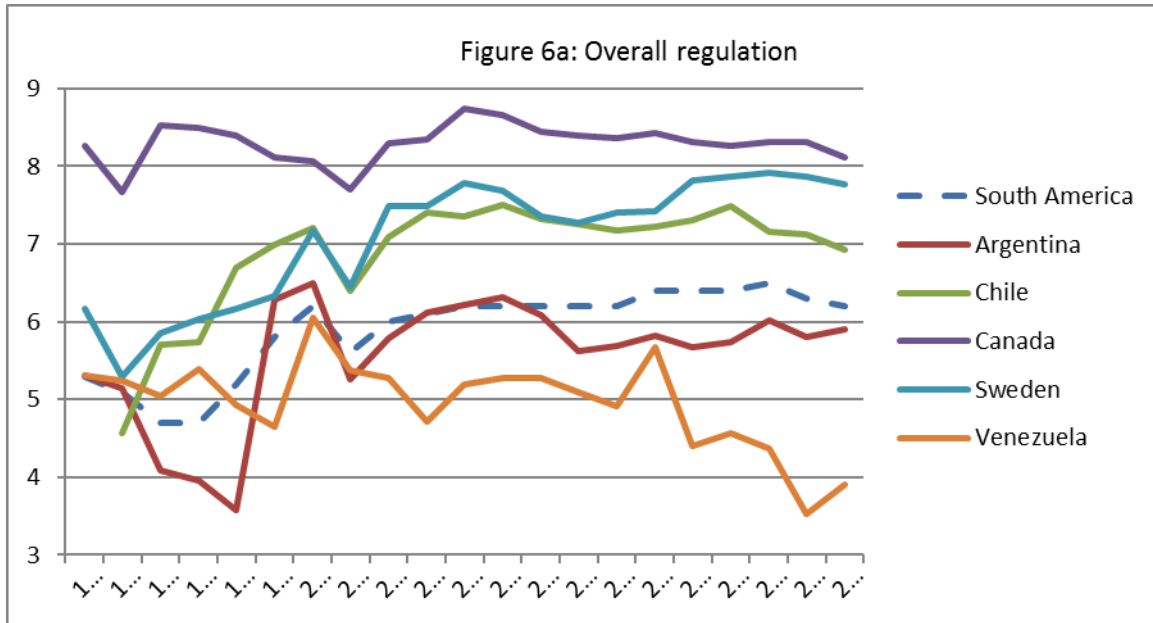
Chile is a good example of a country unilaterally moving towards free trade, a path that was followed by different government from different sides of the political spectrum. After this, Chile signed a large number of bilateral free trade agreements with the largest trade partners in the world.

Mercosur negotiations with the European Union were blocked by Argentina during the last government and are now pushed forward by the present one. Nevertheless, Argentina was not the only roadblock. If Argentina wants now to move forward at a faster speed it should check the support of its partners or question the very existence of a trade block that has not done much in favor of free trade. As expected, it should move to negotiate free trade agreements with other countries.

- The need for a follow-up on imports was questioned. The new SIMI system, introduced in place of import licenses was considered a potential threat. It may bring updated statistics on the volume of imports but the final purpose of it is not clear. Even now, around 17% of all tariff positions require a non-automatic license
- The specific trade regime in the province of Tierra del Fuego should be ended. It has just created incentives to assemble products from imported parts with no major local value added at a tremendous cost to consumers. Cell phones are bought in Asia, disarmed before going to Tierra del Fuego, assembled back there and moved to the local markets where consumers pay for cell phones three or four times the price in any other market.
- Exporters are supposed to get from government the VAT back, once they export a product. Nevertheless, and for many years now, the government does not comply with the norm, or only does it months after the goods were exported. With high inflation, this is another cost to local exporters. The same happens with drawbacks.
- Specific cases of trade limitations in different areas are: managed trade for the car industry within the Mercosur; the importation of medicines that require technical approval of the drug when it was already been approved in major developed countries; sanitary controls to import some goods such as cattle; imports of used machinery.
- On an entirely different subject, foreign investment into land is still restricted as a percentage limit in certain areas, which becomes larger closer to the borders.
- Finally, the movement of people is open, but a policy of visa reciprocity does not make much or any sense.

5. Regulation

Argentina's regulatory regime seems always to have been unnecessarily cumbersome and costly, impeding growth and creating opportunity for corruption. (See figure 6a.)



Overregulation is a source of corruption in Argentina. Despite a whole set of norms to punish corruption of government officials, and the signature of the Inter American Convention Against Corruption in 1996 and the OECD Convention in 1995, laws and regulations contribute to it in the following ways²² :

1. The very existence of the norm is unknown to many to should be abiding by it.
2. Continuous changes in regulation make it harder to know the text in force
3. Norms are usually obscure and admit several interpretations; some increase the cost of compliance, others reduce it.
4. Norms are usually of dubious validity
5. Legally or de facto, norms tend to allow government officers much leeway to determine what degree of compliance citizens should follow.
6. Many times it is difficult or even impossible to fully comply with the norm, or the cost of compliance is too high, putting at risk a certain private activity.
7. Control is usually lax, reducing the chances to detect non-compliance

²² Mairal, Héctor A. (2007); Las raíces legales de la corrupción; (Buenos Aires: Res Publica Argentina), p. 21.

8. Even when it is not lax, authorities may allow some part of society to act in violation of the norm and only punish a small percentage of defaulters, not always selected through transparent and politically neutral criteria.
9. In some cases, it is cheaper to pay the penalty fee than to perform what the norm requires
10. Although punishment may be hard, the benefit of defaulting a norm maybe higher

Regarding discretion by public officers:

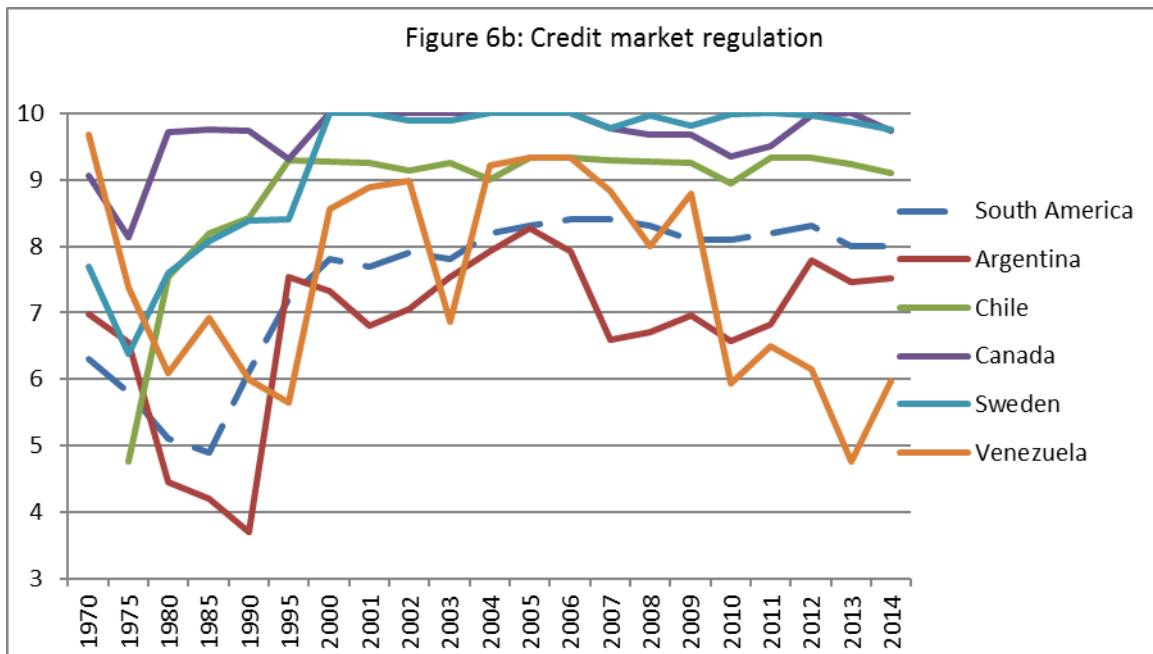
11. Citizens cannot always get a legal intervention to confirm the sense or validity of the norm without the risk of being punished as a defaulter
12. The sanction could be as hard as to put the defaulter in jail, or in bankruptcy
13. Judicial control over government officials is ineffective.

5. A) Regulation of Credit

Access to credit is essential for entrepreneurs and to allow businesses to grow and to build a successful economy.

Argentina has erected unnecessary barriers to obtaining credit. Credit is so important for growth that, as table 5A shows, a number of top nations have nothing but 10s in this area.

Countries	5Ai Ownership of banks	5Am Private sector credit	5An Interest rate controls/n	5A Credit market regulations
Hong Kong	10	10,0	10	10,0
Singapore	10	10,0	10	10,0
Qatar		10,0	10	10,0
Estonia	10	10,0	10	10,0
Denmark	10	10,0	10	10,0
New Zealand	10	9,7	10	9,9
Lithuania	10	9,6	10	9,9
Canada	10	9,2	10	9,7
Romania	10	9,2	10	9,7
Malta	10	8,9	10	9,6
Top 10 Ave	10,0	9,7	10,0	9,9
World Ave	7,7	8	9	8
S. America Ave	7,1	7,6	9,3	8,0
Argentina	5,00	2,90	10,00	5,97



As in other middle income countries where scarcity, instability and a high cost of financing are roadblocks to further development, Argentina shows the same symptoms: there is a volume of aggregate local savings that would be enough to finance a reasonable accumulation of capital but the ultimate cause of a pale financial performance is its legal, fiscal and monetary instability. Among the factors contributing to this are:

- Continuous tax, spending and debt policies distort the real interest rate, relative prices, real exchange rate and the whole competitiveness of the economy
- The absence of a local currency acting as a unit of account for medium and long term assets and liabilities, and the subsequent costly and risky use of a foreign currency
- Unstable and volatile general conditions in the economy, including legal instability and frequent violation of contracts after political decisions
- Lack of deep secondary markets offering liquidity to medium or long-term securities.

Experience has clearly shown how these factors have inhibited both investors and creditors from financial markets, as well as debtors.

- Devaluations, confiscations, blockades, have always been a threat to the real value of creditors and investors rights, promoting capital flight to safer markets.
- The same problems have affected debtors and debt takers, threatening their very survival. (FLyP, 2016, p. 158).

Major issues

During the audit meetings, experts also mentioned:

- Deregulation of the credit and forex markets has been extensive. Experts mentioned banks still have a mandate to offer a share of their deposits through loans at a 17% rate.
- There are only few institutional investors in Argentina, and the capital markets is quite small, which makes the impact of government debt larger. Foreign investors in local capital markets have hard time complying with all the regulations, taxation and other costs in order to open a local account.
- Money laundering controls become a burden to all, with increasing regulatory requirements for all kinds of banking transactions. High transactions costs prevent some transactions to take place. Drug dealers and evaders should be tracked down but without interfering the forex market.

5. B) Regulation of Labor Markets

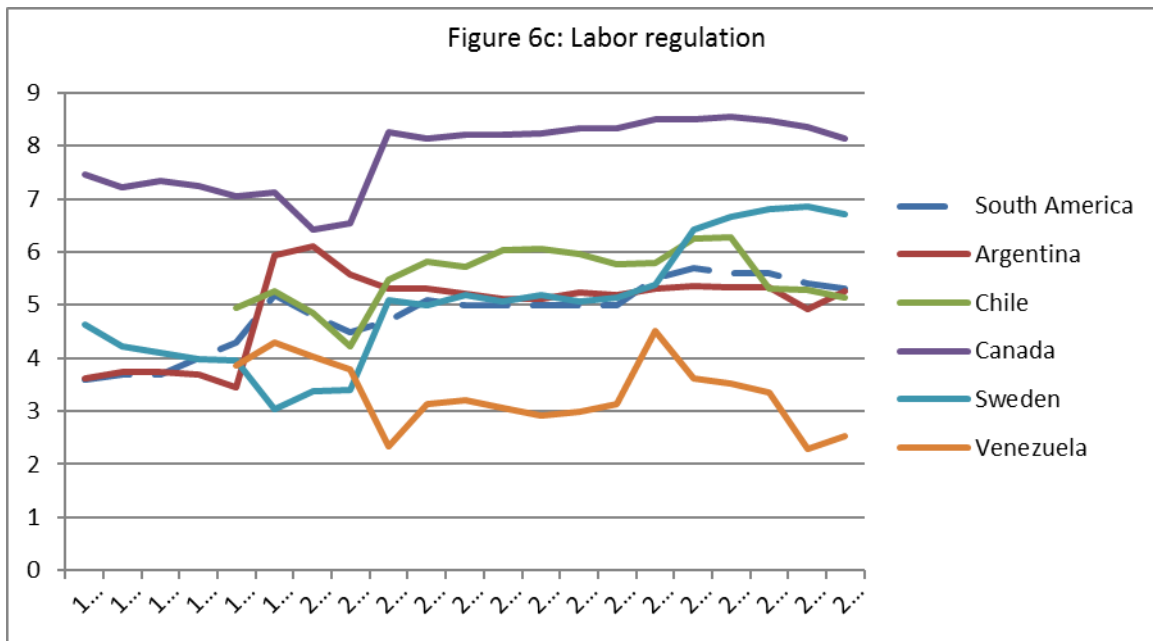
You should be able to hire whom you wish and work for whom you wish and not have to wait through needless delays and cut through miles of red tape.

This is another crisis area for Argentina because of its importance in opening the doors to employment for Argentines.

When the cost of hiring or employing workers is too high, businesses are reluctant to hire. Creating jobs for future generations is a key priority for Argentina, and yet its own laws, regulations, and regulators stand in the way.

Argentina does abysmally here and policy much be improved if young people are to obtain the jobs necessary for a brighter future.

Countries	5Bi Hiring regulations and minimum wage	5Bii Hiring and firing regulations	5Biii Centralized collective bargaining	5Biv Hours Regulations	5Bv Mandated cost of worker dismissal	5Bvi Conscription	5B Labor market regulations
Hong Kong	10,0	7,9	8,9	10,0	9,5	10	9,4
United States	10,0	7,3	7,9	10,0	10,0	10	9,2
New Zealand	8,9	4,1	7,8	10,0	10,0	10	8,5
Canada	8,9	6,1	7,6	8,0	8,3	10	8,1
Bahrain	8,3	4,3	8,0	8,0	10,0	10	8,1
United Kingdom	8,9	5,2	7,8	8,0	8,5	10	8,1
Australia	8,9	5,0	6,3	10,0	7,9	10	8,0
Lithuania	8,3	4,4	8,2	10,0	6,3	10	7,9
Singapore	10,0	8,1	8,7	10,0	10,0	0	7,8
Jordan	8,9	4,0	7,8	6,0	10,0	10	7,8
Top 10 Ave	9,1	5,6	7,9	9,0	9,0	9,0	8,3
World Ave	6,3	5	7	8	7	6,6	6
S. America Ave	5,1	3,4	5,8	8,2	4,5	5,0	5,3
Argentina	2,23	1,90	4,49	4,00		0,00	2,52



Creating employment is a central task of a market economy. However, like anything else, the more costly it is to do something, the less it is done.

High hiring costs clearly reduce employment but restrictions on firing or high costs on firing are often seen as a way to save jobs. They are in fact destroyers of jobs. An employer will be very reluctant to hire if, in the case the company hires poorly, the company is unable to dismiss the employee or, if in the case of an economic downturn, the company is unable to adjust its workforce appropriately.

When employers are unable to reduce their work force, they become afraid to hire, job growth is undermined. The OECD Indicators of Employment Protection²³ show that Argentina has the second most restrictive labor regime among Latin American and Caribbean countries, except for Venezuela.

The challenge is to find ways to reduce obstacles to employment creation in Argentina. Labor market regulation show a high degree of parsimony, with minor changes, except in periods when attempts are made some of its basic legal institutes (e.g., 1983-89 or the 1990s, and some changes in the 2000s). There were only minor changes during 2016 that do not show a change of view towards labor regulation from government authorities. They did reject some congressional initiatives to introduce even more rigidity, though. The most important of these events was a ‘job emergency’ bill to introduce temporary redundancy restrictions, approved by a majority at the Labor Committee of the House of Representatives. The initiative banned dismissals up to December 31, 2017, or required a double compensation. The bill had a precedent: a similar legislation voted favorably in 2002 but vetoed by the president.

The Macri administration promoted debate over a “first job bill”, in order to make it easier for 18 to 24 years old to find jobs. Nevertheless, the House’s Labor Committee never considered the bill and, therefore, it never got to the floor.

During 2016, the administration also promoted a reform to the Labor Accidents Law that was finally approved in February 2017 after a troubled process including its sanction through a presidential emergency decree (later replaced by the law).

In the second half of 2016, a new oil industry labor agreement was signed for the shale oil resources at Vaca Muerta. The new agreement between investor companies, the union and national and provincial governments promotes flexibility and reduces the costs of labor. The new agreement was signed at the end of January 2017.

The minimum wage was adjusted by 33.2%, the largest average nominal increase since 2005, but adjusted for inflation it fell 3.3%. In real terms, the highest minimum wage was in 2011, falling 9.4% since then. Minimum salary in dollars averaged 448.10, below the 546 dollars of 2015. Minimum salaries as part of industry labor agreements were similarly adjusted.

The problems of labor regulations are compounded by a union regime with historical fascist undertones. Although any group of workers can start a union organization, only one of them is approved and gets “union representation”, which means it is the only one legally entitled to represent all workers in an industry, be they members of the union or not. Not only that, in many cases, all workers are deducted the union fee, even if they are not members of it. This has created a monopoly and it has turned electoral competition

²³ <http://www.oecd.org/els/emp/oecdindicatorsofemploymentprotection.htm>

within unions into a mafia selection process. Besides, the unions manage millionaire health insurance funds, which turns control of the union into a profitable business. Many union leaders become wealthy businesspersons and have strong political power.

One of their weapons is the organization of “general strikes” to turn the path of economic policies they dislike or just to ascertain their power.

The right to strike is enshrined in the Constitution but according to Supreme Court jurisprudence (case “Orellano”); only a union can organize it, not any group of workers. The decision to strike must be taken by the representative union according to the law and its own bylaws. The national and provincial governments can request a cessation of conflictive acts to promote a negotiation between the parts. The most contestant unions defy this, and are not punished. In some essential services (hospitals, water distribution, air traffic control, for example), any strike must guarantee a minimum supply of the services, but this is not kept

Workers participating on strikes may have their day salary deducted and they are legally responsible, also their union representatives, for any damages occasioned.

Nevertheless, this right is permanently abused and a certain majority organizes strikes without compliance with minimal requisites of forewarning, conciliation and arbitration, respect for a certain quorum and support.²⁴ Unions regularly demand, and some judges even acquiesce, that salaries on a strike day not be deducted, turning days of strike and even general strike into a holiday, not a reliable measure of the real support the strike gets. Strikers block streets, bridges and access to companies, they celebrate assemblies on the company’s premises during working hours; they block machinery and facilities at factories to prevent those willing to work to do it.

“We are number one in the ranking of most expensive labor taxes, number one on highest labor costs and last in productivity, and first regarding group and union unrest, and we have the most arbitrary and costly regulations in the region, particularly those related to risks at work”²⁵

²⁴ More on this recently at: Julián de Diego, “Asambleas, autoconvocados y el estado de alerta distorsionan el derecho de huelga”, *Cronista*, 18/4/17; José Zabala, “Punto por punto, en qué consiste el ejercicio democrático del derecho a huelga”, *La Nación* 16/4/17, and Daniel Funes de Rioja and Juan José Etala (h), “El ejercicio del derecho de huelga versus manifestaciones que son sólo el ‘mero hecho de la huelga’ .”, *La Nación*, 30/4/17.

²⁵ Julián de Diego, “La reforma laboral que requiere el país debe ser integral y revolucionaria”, *Cronista*, 3/5/17.

Major issues

During the audit meetings, experts commented on the following:

- Argentina shows high levels of labor regulation with very small improvements after some changes in jurisprudence (for example on the definition of what counts as regular employment).
- The reform of labor legislation should be comprehensive and, basically consist of:
 1. A return of the culture of work and effort shown originally by the local population and immigrants. In this way, it is a good step to start a process to turn welfare plans into workfare, by promoting employment for those now receiving social subsidies.
 2. The government should do something similar with its own employees, controlling assistance and productivity, and moving excess employees to the private sector with similar incentives.
 3. The present Law of Labor Contracts should be updated, respecting its basic principles, to accommodate the changes brought by new technologies: telework, home office, virtual work, incentive compensation and flexibility in workdays and hours.
 4. The right to strike must be regulated. The new norm must stipulate what is a legal strike, who are active and passive actors and participants, what is the goal of the action and the need to go through a process of voluntary or mandatory conciliation and arbitration. Blockades and picketing must also be regulated.²⁶
- There is a serious problem with absenteeism, both in government and private jobs that statistics are not reflecting.
- There have been attempts in the past to reduce taxes and other charges on labor, but this may not be effective now for the following reasons: a) with the present fiscal urgencies there is no certainty that they will last, they may be reduced today but raised again tomorrow and b) because all the other costly regulations on labor will still be in place.. That is what happened in the 1990s.
- Sectorial agreements pick the winners; the rest cannot enjoy its benefits. It may well be a political way to introduce some changes but they do not always make labor contracts more flexible. Many times, they just consist of fiscal benefits given up by the government.
- That is, it is not just to reduce taxes and charges on labor, but a reduction and easing of existing regulations. That is the case of the Vaca Muerta agreement, but not with textiles.

²⁶ Julián de Diego, “El derecho de huelga y los piquetes deber ser reglamentados para evitar excesos”, Cronista, 12/4/17

FLyP has already offered proposals for reform in this field (2016, p. 59):

“It becomes essential to have negotiations over salaries and workplace conditions under a frame of modernity and productivity, between authentic parts with different interests but aligned with success for the venture.

Labor negotiations should be transparent and should assure union freedom, both at the individual and groups level. Union democracy should be guaranteed at all levels, not only for elections but also to assure the real participation of workers in the union’s affairs.

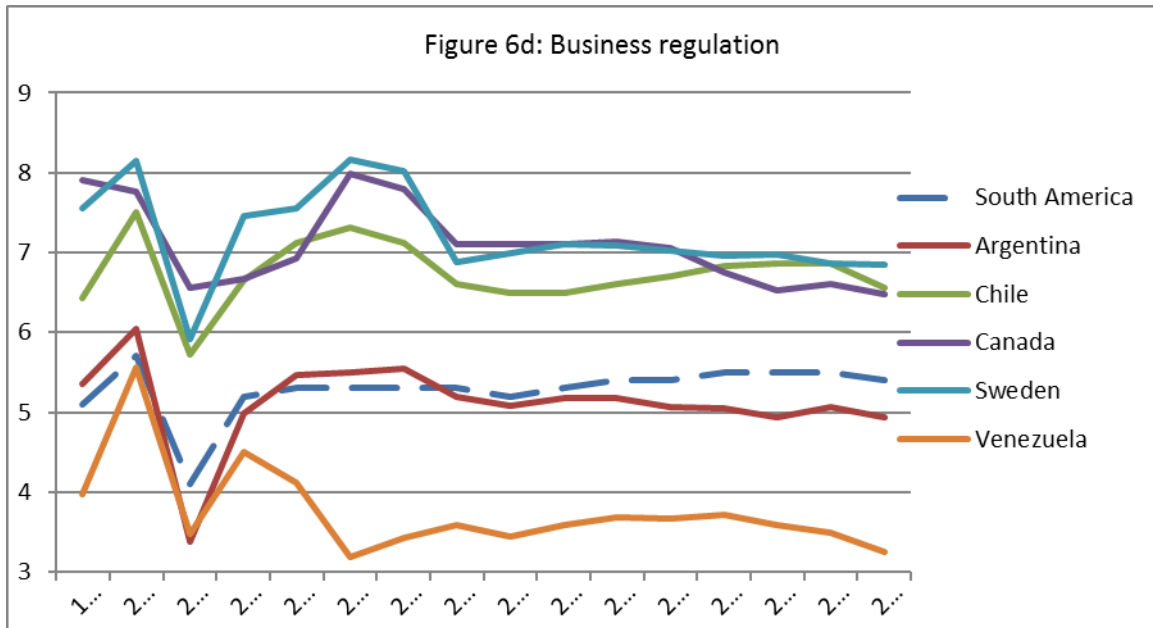
Preference should be given to lower level agreements (at the company level, or a certain geographical area). Convergence of interests between employers and employees can more easily be achieved at the company level. Administrative controls, regulatory agencies and controls must be changed to make them compatible with a new model of labor negotiations. Superposition of agencies and controls should be avoided, they generate inefficiencies, conflicts among jurisdictions and leave with no protections both employers and employees.”

5. C) Regulation of Business

Overly stringent regulation can slow business expansion and weaken profits, which are both the means of further investment and the motivation for further investment—and thus job creation.

The sort of regulation afflicting Argentina is not merely a problem for business—it damages all society. Difficult tax compliance and administrative requirements are a source of corruption and bribes. This is reflected in the “extra payments” variable.

Countries	5Ci Administrative requirements	5Cii Bureaucracy costs	5Ciii Starting a business	5Civ Extra payments/ bribes/fav oritism	5Cv Licensing restrictions	5Cvi Tax compliance	5C Business regulations
UAE	7,0	3,0	9,7	8,1	10,0	9,9	7,9
Singapore	7,3	2,2	9,9	8,3	10,0	9,1	7,8
Qatar	7,1	2,1	9,5	8,3	10,0	9,5	7,8
Hong Kong	7,1	3,1	9,9	7,3	9,7	9,2	7,7
Georgia	6,2	6,4	9,9	5,9	10,0	5,9	7,4
Finland	5,3	1,5	9,5	8,4	9,9	9,0	7,3
Estonia	5,0	3,3	9,8	6,6	9,3	9,1	7,2
Ireland	5,6	2,4	9,8	7,6	8,5	9,1	7,2
New Zealand	4,8	2,0	10,0	8,4	9,4	8,3	7,2
Jordan	4,9	4,8	9,4	5,3	9,9	8,3	7,1
Top 10 Ave	6,0	3,1	9,7	7,4	9,7	8,7	7,4
World Ave	4	5	9,1	4	8	7	6
S. America Ave	2,9	5,3	8,3	3,5	7,3	4,8	5,4
Argentina	0,53	5,66	5,73	1,47	5,00	1,12	3,25



“Regulatory overshoot in Argentina derives from considering the law and regulations as a tool for social improvement and not as a minimum of required conduct. The combination of a political class willing to “improve” society through new obligations and prohibitions, but actually indifferent to control for its compliance, with badly paid government officials, overburdened and not controlled, is an ideal recipe for corruption” (Mairal, 2007, p. 52).

Regulations are unrealistic or overly ambitious; government agencies and officials have too much discretionary power; they are able to discriminate who to control; there are multiple special permits and agencies take too much time to decide on them.

Obscure norms can be interpreted by government officials in many different ways, and rules are particularly obscure in the small letter of a second or third level of regulation. Facing a difficult interpretation of a norm, it is usual for the regulated to take the more lenient interpretation, but then they are at the mercy of the regulatory agent, that may eventually say the strict interpretation of the norm is the correct one. Tolerance with the lax view may stay for years, creating an understanding that it is the correct one; until a new government or official comes in with the strict one and most are then found not compliant.

Rules and regulations are badly written, but many times ambiguity is deliberate, both at the legislative and the administrative levels. This favors political deals in the first case and breeds discretionality in the second.

Interference with the freedom to make decisions in business has taken different ways:

1. Start of a new business: the new government has taken up the commitment to reach the goal of starting a new company in just one day. It has not been achieved yet but there have been advances in simplification of procedures at the Federal

- Revenue Agency, the Legal Person Inspectorate, the Social Security Administration and other national agencies. It has not been the same with provinces and local governments under whose jurisdiction fall environmental, health, security, sanitary and building regulations
2. Purchase of an existing company: it is still required to get the approval of the Defense of Competition Commission in specific cases of potential market dominance. There is no automatic approval after the required terms expire.
 3. Relocation of expatriates: it is not flexible but there have been advances
 4. Price controls: they have been removed in many cases and softened in others, but they have not disappeared. They persist in food and hygiene products, health insurance, energy, transportation and others.
 5. Tax and pension procedures have not been reduced. Information requirements and procedures generate high costs in companies, with a larger impact in small and medium size business.
 6. The fiscal amnesty will reduce tax evasion, but there is still large number of taxes and bureaucratic procedures requiring professional advice even for a single person. The three levels of government multiply procedures.
 7. Pre-control of mergers and acquisitions is too bureaucratic and overextended. The value of operations considered should be updated. (FLyP, 2006, p. 102).

In April, Congress approved a “Law of Entrepreneurship” with two major news:

- a. A new, and simplified, kind of commercial partnership was created (called SAS, for Simplified Anonymous Society)
- b. Enabling the creation of new vehicles to channel investment into startups.

Although a positive move, it does not bite into some of the most important roadblocks to entrepreneurship and business in general: it does not bring any tax relief, and it does not bring a reduction on labor costs and regulation that suffocate many initiatives. On the positive side, the regulation of crowdfunding operations may eventually promote this financial channel. Unfortunately, the government will now finance venture capitalists to find promising startups, a task they can clearly do with their own money. Taking into account the magnitude of the fiscal constraints described before, it does not seem rational to start a new subsidy to business, even though the amount spent could not make a dent into the fiscal hole.

The government has also sent a bill to Congress to regulate lobby. It should cover all kinds of lobby, but it will certainly be of interest to business organizations. Altogether, there are 910 business organizations, 797 organized as “chambers”, and 113 as “associations”. This shows the need business had to deal with extensive government regulations but also the “opportunity” they also found to obtain privileges or restrict entry to competitors. The original goal of the bill is to encourage open information on meetings

and audiences with government officials, but we will have to see how it comes out of Congress.

Major issues

At the audit meetings, experts made the following comments and proposals:

1. New agencies and a great number of regulations were created during the last years. Some that even regulate strictly private decisions. For example, the last government that regulates even the use of private sources of water, created a new Water Management Authority requiring registration and approval of every single pump in private land. Regulation also came with the corresponding rate paid to the regulatory agency.
2. Regulations were linked one to the other: an agency requires a certificate from another agency before starting a certain procedure, and this other agency does the same with a third, or even with the first one, multiplying the costs and time of many regulatory processes.
3. The present government has a praiseworthy intention to promote business, particularly small and medium size, and startups, but instead of reducing the roadblocks entrepreneurs find in their way has started several programs to subsidize new ventures, even becoming a shareholder on some of them, or funding venture capitalists with government money, a function the market is exceedingly good at.
4. A deregulation of some banking regulations took place: banks can now open branches without a previous approval, just reporting the opening to the Central Bank.
5. Although some price controls exist, they are now more neutral, in the sense that they are no longer used to punish certain activities or companies following political considerations. In some areas, like oil & gas for example, deregulation is moving on gradually and production prices will eventually be freed in a few years.
6. Corruption has now been substantially reduced and this has lifted a heavy moral and economic burden on business.
7. Governmental negligence on maintenance and improvement of infrastructure fall on business as another heavy cost.
8. Local governments are not doing much, if anything at all, to ease business regulations, and they do not even have the human resources needed for the task.
9. A partial solution would require all government agencies to keep an ordered and updated register of all regulations standing, available for consultation to anyone. Changes in regulations should be reduced and once a new regulation is approved,

it should take some time to become enforceable, allowing all affected parties to learn of its existence and requirements²⁷.

FLyP made its own proposals for change in this area (2016, p. 103):

“We believe intervention by the Mergers and Acquisitions Tribunal should not be required for banks and insurance companies that are already supervised by the Central Bank or the Superintendent for Insurance. In fact, the Defense of Competition Commission has approved operations when the regulatory agency did. Present legislation allows the extension of its powers to consider governmental services. This would be a positive step.

The National Tribunal for Defense of Competition was never set up, only once a contest was called but to no effect. Its dependence from the Presidency has derived in a strong political influence in the consideration of cases. This could repeat itself in the future, no matter what the government is.

In this context, and considering that independence and authority is essential to a good working of markets, we propose the transfer of this Tribunal to the Judiciary. Appeals and superintendence should be in charge of the National Appeals Court for Civilian and Commercial Affairs. It is an experienced and well-respected tribunal. Personnel at the Commission would be transferred with the same perquisites and would keep functions under the new order, being able to become part of the judicial staff.”

Although the government thinks, and it may probably be right, that the only way to deregulate business is gradually and partially, sector by sector, the truth is that a general approach would reduce bargaining costs and time lost. Others thought that a piecemeal approach was the only possible way to go/

At a less ambitious level, government agencies, at least, should not be able to request information from the private sector that they already have. That is, if a government agency needs a certain document (a balance, a tax declaration, for example), it should ask for it at the respective agency, not to the private company or individual.

At the audit meeting, the creation of special economic zones was suggested. Following the example of China, and considering the barriers to move towards general and countrywide deregulation, this proposal would designate a specific region where economic activity would be largely deregulated, with low taxes, privately-supplied services and an independent judiciary with foreign jurisdiction contracting and dispute resolution.

The challenge is to simplify regulations and make them timelier. Business is the generator of prosperity and employment.

²⁷ Mairal, Héctor A. (2007); *Las raíces legales de la corrupción*; (Buenos Aires: Res Publica Argentina), p. 27.

6. Appendix - Economic Freedom: An Overview

Individuals have economic freedom when property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and they are free to use, exchange, or give their property as long as their actions do not violate the identical rights of others. An index of economic freedom should measure the extent to which rightly acquired property is protected and individuals are engaged in voluntary transactions.

Gwartney, Lawson, and Block, 1996.

This is the classic definition of economic freedom, given in the first edition of the *Economic Freedom of the World Report: 1975—1995*. The Economic Freedom project is on the cutting edge of today's economic research on developing prosperity and other positive outcomes, but the practice of economic freedom itself as ancient as human history and as common as the village market found everywhere.

Because of the commonality of economic freedom through world history and culture, the Economic Freedom of the World Project has generated similar reports around the world, including studies of economic freedom among India's states, China's provinces, European states, Arab nations, and Mexican, Canadian, and US states and provinces among many other sub-national and regional reports.

The *Economic Freedom of the World* uses 42 variables in 5 key areas to measure economic freedom. The index thus provides both a description of an economy and, by examining the individual variables, a prescription for policy improvement. The index has been designed to measure how free individuals and families are to make their own economic decisions. Economic freedom unleashes the drive and ingenuity of individuals and has positive and dynamic consequences throughout the economy. Nobel Laureate Douglass North has called the economic freedom index the best available description of "efficient markets."

The Economic Freedom Network of the world has independent member research institutes in almost 100 nations and territories. It is covered by some of the world's most prestigious media outlets.

The genesis of the *Economic Freedom of the World: Annual Report* itself traces back to 1984. Fraser Institute Executive Director Michael Walker, in conjunction with Milton and Rose Friedman, started the Economic Freedom project to enhance understanding of the

connection between it and political and civil freedoms, and their collective role in influencing economic performance.

The initial research phase of the project involved 60 of the world's most astute thinkers, including several Nobel Laureates. In the intervening years, top economists, political scientists, philosophers and sociologists have refined the understanding of freedom and, in particular, our ability to identify when freedom exists in a place and when it does not.

This better understanding – developed in economic freedom reports by James Gwartney, Robert Lawson, and Joshua Hall in cooperation with others – has led to a number of important conclusions. Some of these conclusions are represented by charts included in this overview. The charts are simply snap shots in time, but they are backed by fact-based research in the world's top academic journals. (Go to www.freetheworld.com for a sampling of these articles.)

For a comprehensive review of the literature, see Hall and Lawson, 2014.

The Impact of Economic Freedom

Fact-based studies in top academic journals have shown that economic freedom promotes growth, prosperity, and other positive outcomes. The relationship of economic freedom to prosperity is unsurprising. Individuals and families are best able to look after themselves when free to do so, without external constraints.

Moreover, economic freedom has intrinsic value and is inextricably linked to the full range of human freedoms. Individuals and families should have the inherent right to make their own economic decisions. When they do, that economic freedom liberates them from government dependence and opens the door to other freedoms.

With economic freedom, the biggest gains are achieved by people who increase the size of the pie for everyone; without economic freedom, the biggest gains are by those who cut a bigger slice of the pie for themselves to the disadvantage of others. This is a key reason that economic freedom has been shown to promote democracy and other freedoms (Griswold, 2004).

Since the publication of the first edition of the Economic Freedom of the World in 1996 and, more recently, national and regional indexes, there have been about 600 scholarly and policy articles that have used the economic freedom indexes to explore the relationship between economic freedom and other socioeconomic outcomes. Here, we

will focus briefly on the relationship of economic freedom to economic growth and prosperity.

Intuitively, one would expect that economic freedom would have a positive impact on economic growth because economic freedom creates a climate that allows individuals and business to allocate their resources to the highest end use. However, the question is ultimately an empirical one. One of the first studies, Easton and Walker (1997) found that changes in economic freedom have a significant impact on the steady-state level of income even after the level of technology, the level of education of the work force, and the level of investment are taken into account.

De Haan and Sturm (2000) show empirically that positive (negative) changes in economic freedom lead to positive (negative) changes in economic growth rates. Using the economic freedom index published in Gwartney, Lawson, and Block (1996) and per-capita GDP data for 80 countries, their results indicate that, after educational level, investment, and population growth have been taken into account, changes in economic freedom have a significant impact on economic growth.

Gwartney and Lawson (2004) examined the impact of economic freedom on economic growth but with a specific focus on investment and productivity. They found that economic freedom strongly promotes investment. Nations with a score below 5 for economic freedom (on a scale from zero to 10, where a higher value indicates a higher level of economic freedom) attracted US\$845 in investment per worker over the period from 1980 to 2000 and only US\$68 per worker in foreign direct investment. Nations with an economic freedom score above 7 attracted US\$10,871 in investment per worker, including US\$3,117 of foreign direct investment.

Moreover, investment is more productive in economically free nations. Holding constant factors thought to affect growth and productivity, such as initial per-capita GDP, tropical location, coastal location, change in human investment, and public investment, Gwartney and Lawson found that an increase of one percentage point in the ratio of private investment to GDP leads to increases in the growth rate of per-capita GDP by 0.33 percentage point in an economically free country. The same increase in private investment in a less economically free country increases the growth rate of per-capita GDP by 0.19 percentage point.

In other words, investment in economically free nations (with a score above 7) had a positive impact on growth that was 70% greater than investment in nations with poor levels of economic freedom (score below 5).

Using the same regression model, Gwartney and Lawson also calculated the impact of economic freedom on overall growth through both direct and indirect effects. They found that, if a nation increased its economic freedom by one unit (on a scale from zero to 10) in the 1980s, it would have seen increased growth of 1.9 percentage points a year over the period from 1980 to 2000. Because of the high rates of growth associated with economic freedom, they also found that over the long term economic freedom explains over two thirds of the cross-country variation in GDP.

Increases in economic freedom also reduce poverty (Norton and Gwartney, 2008). Specifically, the weighted \$1-per-day poverty rate was 29.7% in 2004 for countries with EFW ratings of less than 5 but only 7.7% for countries with EFW ratings between 6 and 7; the \$2-per-day poverty rate declines from 51.5% to 46.2% to 38.9% as one moves from the least-free to the most-free economies. Moreover, a one-unit increase in the EFW rating between 1980 and 1995 was associated with a 5.21 percentage-point reduction in the \$1-per-day poverty rate and a 5.22 percentage-point reduction in the \$2-per-day poverty rate.

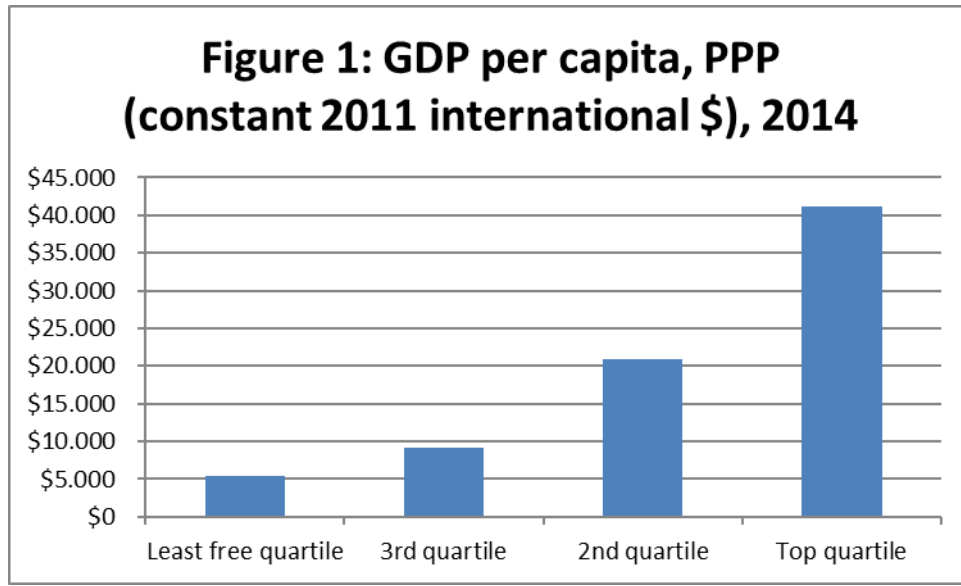
Norton and Gwartney also examined the relationship between economic freedom and other measures of well-being. In the least free economies, 72.6% of the population had access to safe water compared to nearly 100% in the freest economies. Life expectancy of people in the mostly free group was over 20 years greater than it was for those in mostly unfree economies. Mostly free economies had more than twice as many physicians per 1,000 population than mostly unfree economies. For every 1,000 births, 64 more babies survived in mostly free economies per year than in the mostly unfree countries. For every thousand children under age of five, 109 more children survived in mostly free countries each year than in those countries that are mostly unfree.

Illustrative tables

The following figures illustrate important findings on research based on the world index.

Economic Freedom and Prosperity

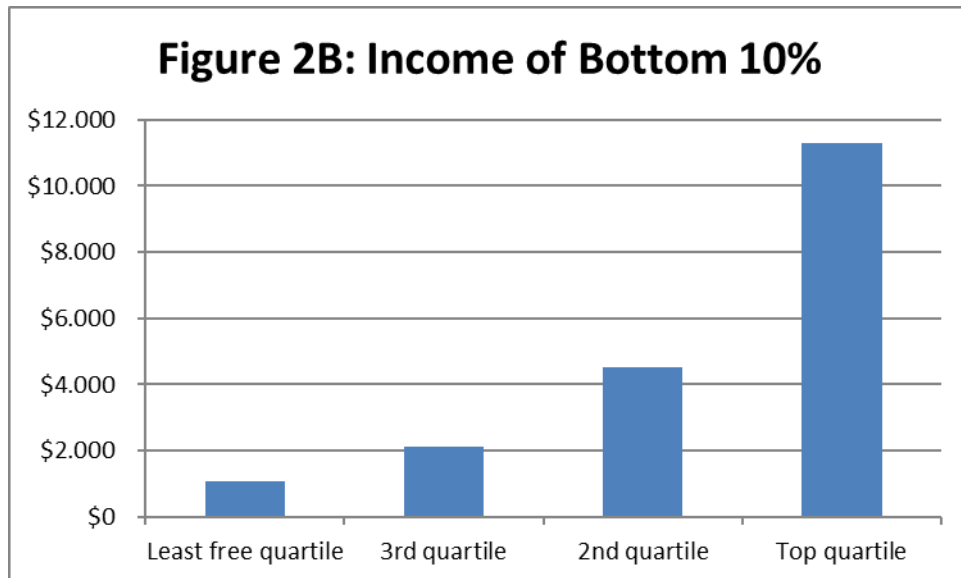
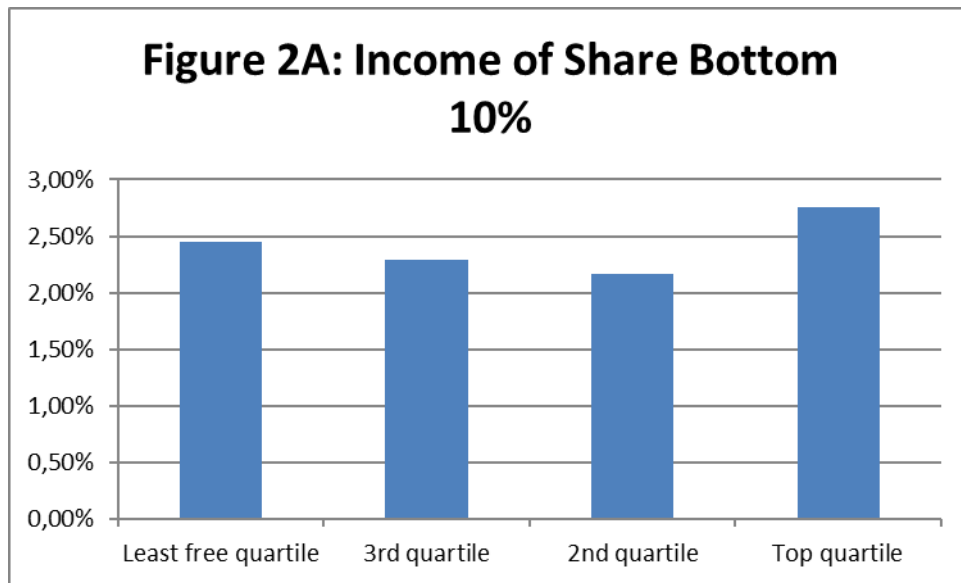
Quartile charts, like these, can help illustrate important findings. The nations included in the *Economic Freedom of the World Report*, are broken down in four quartiles based on their level of economic freedom. The figure shows that nations in the top fourth of the economic freedom index have a per capita GDP of about \$41,228 per year compared to GDP of \$5,471 in the least free nations. This probably overstates the per capita GDP of the world's least free nations. There is not enough data available to include in the index many nations which appear to have abysmal levels of economic freedom and widespread misery, such as North Korea.



Even if a rising tide lifts all boats, does it lift the richest more than the poorest, worsening inequality? Income distribution appears to be largely unaffected by economic freedom and open markets, as much economic research has shown. (See Sala-i-Martin, 2002.) In fact, in the least economically free nations, the poorest 10% receive a slightly lower share of the national income, 2.45% than they do in the freest nations, 2.75%.

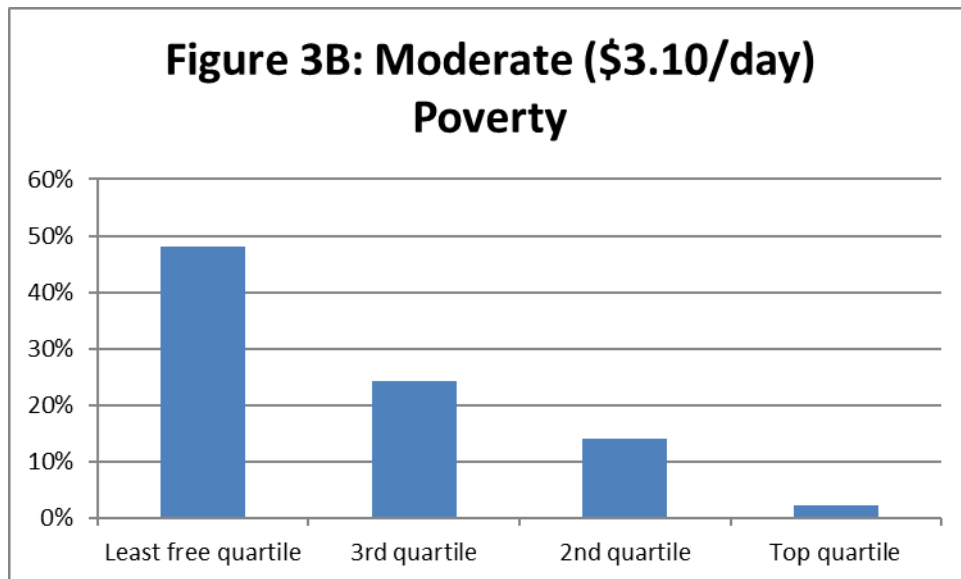
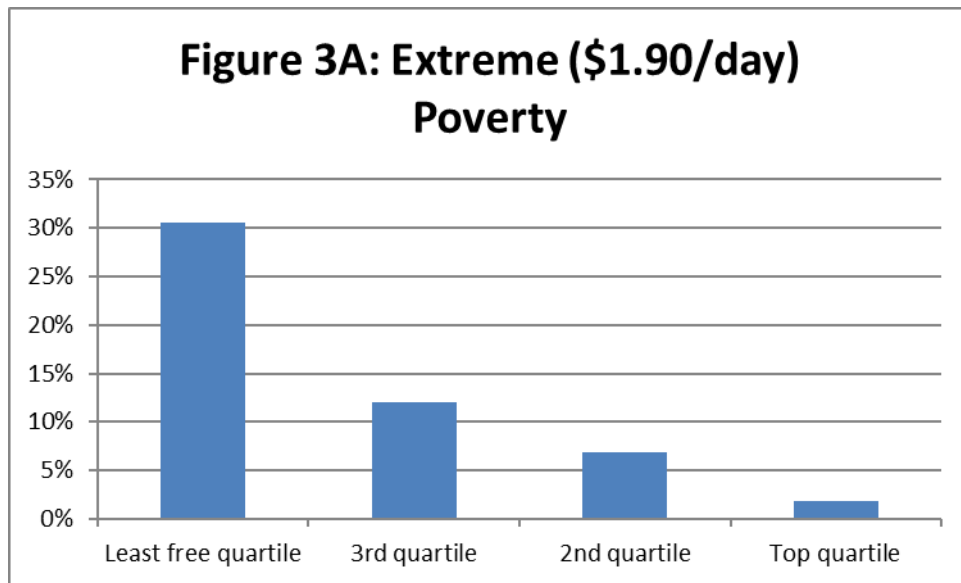
Economic Freedom and Inequality

More importantly, because of the prosperity economic freedom creates, similar shares of the national income produce dramatically different results for the poor in free nations versus those in unfree nations. The poorest 10% have an average income of just \$1,080 a year (though this again over states the average income in least free nations, like North Korea and Cuba, which are not included in the index due to lack of data) while the poorest 10% in the most free nations have an average income of just under \$11,283, six times the income of the least free nations.



Economic Freedom and Poverty

As figure 2b suggests, economic freedom dramatically reduces poverty. In the least free nations, 31.1% of the population suffers \$1.90 a day poverty and nearly fifty per cent (48%) suffer \$3.10 poverty. In the least most free nations, only 1.9% of the population suffers \$1.90 a day poverty and 2.3% per cent suffer \$3.10 poverty.

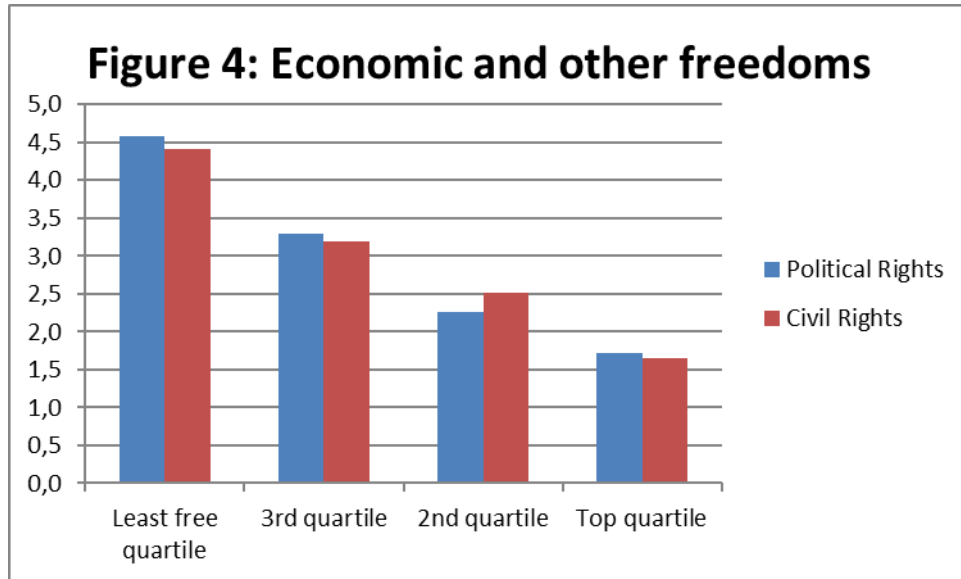


Economic Freedom and Other Freedoms

When a government has the power to determine individuals' ability to feed, cloth, house, and educate their families; to hold a job and get a promotion; and to restrict their ability to move ahead in other ways, government has all the tools it needs to suppress other freedoms, at least until life becomes bearable and recourse is made to violence. When economic freedom is lacking, individuals and families must depend on the kindness of government to get ahead. Economic freedom gives people economic independence and lessens dependence on government, opening the way for increases in other freedom. Empirical studies support the connection between Economic Freedom, other freedoms

and democracy.²⁸ No nation that lacks economic freedom has ever supported stable political and civil freedoms. On the other hand, no nation that has adopted economic freedom has ever failed to evolve towards civil and political freedoms, albeit sometimes with a gap of many years, with only two exceptions, Singapore and Hong Kong.

The data used for the this figure are from Freedom House, which measures freedom on a 1 to 7 scale, with 1 being the greatest amount of freedom and 7, the lowest amount.



²⁸ See, for example, Griswold, Daniel T. (2004). Trading Tyranny for Freedom: How Open Markets Till the Soil for Democracy. Cato Institute: Washington, DC. *Trade Policy Analysis* No. 26, January 6, See also Dawson, John W. (1998). Institutions, Investment, and Growth: New Cross-Country and Panel Data Evidence. *Economic Inquiry* 36 (October): 603-19.

References and Reading List

The articles on this reference page are largely restricted to those quoted in the text. Please go to www.freetheworld.com for a more comprehensive list of some of the over 400 research and policy articles which utilize the economic freedom index.

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