



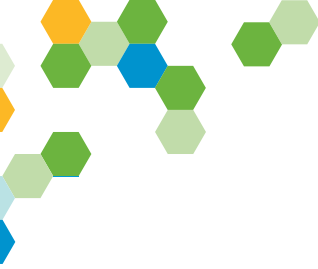
SPECIAL REPORT

# Time for change at Mercosur

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## I. INTRODUCTION

Recovery, redesign, restoration, a possible new format. It seems as though the tides of change are finally crashing upon the worn out Mercosur. Argentinian Chancellor Susana Malcorra raised the alarm when she declared “Our most urgent priority is Mercosur,” while expanding her horizons by adding “by not thinking of the options in the Pacific we would be giving up on a good number of opportunities.”

The change of command at Casa Rosada brings a breath of fresh air to a block that was losing economic ground and turning into a scene of political discussion. Or, as Malcorra declared at a press conference at Planalto Palace, in Brasilia, it is time to replace the “discursive” integration of the past few years with an “operative” one, a path that had been clearly abandoned.

President Macri also spoke about “convergence” between the South American union and the Pacific Alliance, a seductive idea that begs the attention of entrepreneurs in the countries that make up Mercosur, but divides the governments of the block, to the point of losing the initial momentum in the negotiations in order to establish a new agreement.

President Mauricio Macri and his foreign policy advisors made very clear that reconstructing ties with Latin America will be at the core of their diplomatic and commercial efforts. Argentina’s priority to the region in recent years was merely rhetoric, while in reality commercial barriers were being imposed. All this, to the ends of protecting its own depleted international reserves in the middle of a capitalistic feud that drove the country to impose a rigorous exchange control.

“We believe in unity and cooperation between Latin America and the world, in fortifying democracy as the sole solution to resolving problems between diverse societies. It is pivotal to look beyond the times of confrontation”, said Macri in his inaugural speech, observed by the presidents of Chile, Uruguay, Brazil, Bolivia, Colombia, Ecuador and Paraguay, among others in the region.

**“The focal point of Macri’s strategy is its relationship with Brazil”**

The focal point of Macri’s strategy is its relationship with Brazil, including its political and corporate system. The infamous DJAI (Declaración Jurada Anticipada de Importación), which in recent years drove the players in foreign trade mad, is going to be downgraded and before long will become a thing of the past, once Argentina normalizes its fragile financial situation - announced the new president. Tax cuts are already being implemented, giving economic agents a signal of hope that the revitalization of foreign trade is real.

In order to bring this discussion to life, it is fundamental for Argentina to open a transparent dialogue with Brazil, which Argentina has been postponing since 2012 when former Minister of Economy Axel Kicillof strengthened commercial barriers -including the exchange with members of the Customs Union- and blocked all channels of negotiation with Brazilian authorities.

Since then, Argentina has fallen to third place, behind China and the U.S., as export destination from its biggest commercial partner. Numerous investments, including those from Brazil, which looked to transform Argentina into an exporting powerhouse were paralyzed, undermined by extravagant economic and business policies.

Macri made clear he would take the lead in the discussions: he is an advocate for an open Mercosur and is urged to establish close ties with the European Union -through a Free Trade Agreement- and the Pacific Alliance, all while working in collaboration with Brazil so as to transform the exporting sector in the engine of the national economy. It is necessary to take into account the disparities in the exchange rate, which once is adjusted will benefit products that had seen their competitiveness decline, such as fruit, nuts, wine, dairy, meat and agricultural machinery.

“Brazil has been Argentina’s strategic business partner throughout history, because of possibilities and exchanges. We are countries that complement each other and we must interact with the rest of the world in a joint manner, just as Uruguay and Paraguay do”, said Macri before taking office.

Macri’s plans for a new Mercosur sound like music to the ears of the most liberal and pragmatic ministers in Dilma Rousseff’s government, such as Joaquim Levy, Minister of Finance, Kátia Abreu, Minister of Agriculture, Armando Monteiro, Minister of Industry, and Chancellor Mauro Vieira, who considers that, given the political and institutional crisis the country is going through, the real

task at hand for Brazilian diplomacy is mending its economic policy and restoring the tax balance. The premises of the new Argentinian leader also swayed the Brazilian business community, as became clear at the reception held at FIESP's (Federação de Industrias do Estado de São Paulo) headquarters before he took office.

Levy welcomed the change of pace in Argentina and emphasized it will benefit his country. "Argentina's dynamics could change. It is going to take a lot of work to fix many things. But obviously, because of the country's potential, along with its human capital,

the whole scenario could change if they choose to embrace economic liberalism. This new pattern becomes favorable for Brazil," said Levy.

Monteiro, Minister of Development, Industry, and Trade, who in 2014 was able to transform Brazil's trade balance deficit into a surplus that could reach close to 15 billion dollars this year, also considered Macri's arrival as good news for the relationship between Brazil and Argentina.

"All the signs are positive. Macri believes in Brazil as a strategic partner and in Mercosur being more open to other international networks.

Figure 1. Commercial Relations Argentina - Brazil

<b>ARGENTINIAN COMPANIES IN BRAZIL</b>
They represent 8,400 million dollars in productive investments and 44,000 direct jobs created.
<b>BRAZILIAN COMPANIES IN ARGENTINA</b>
They represent 17,600 million dollars in investments and 51,000 direct jobs.
<b>ARGENTINA STOPS BRAZILIAN EXPORTS</b>
It maintains its position as the first Latin American market, although it loses some place.
Brazilian sales to Argentina fell 42.4% in the period January-October this year in comparison to the same period in 2011.
<b>INVESTMENTS</b>
Chile overcame Argentina as the major destination for the Brazilian investment flow in 2014.
Chile received 41.6% of the Brazilian capital, whereas Argentina received just 25.5%.
In the biennium 2010-11 the proportion was 46.5% to Argentina and 27.4% to Chile.
<b>REASONS TO SUCH HALT</b>
Macroeconomic instability, external capital restrictive policies, expropriations and nationalizations.

**“All the signs are positive. Macri believes in Brazil as a strategic partner”**

For us, this is music to our ears," Monteiro said on a recent trip to Chile to promote trade between Brasilia and Santiago.

Everton Vargas, Ambassador of Brazil in Argentina, recently evoked that the two countries are connected by bilateral trade that has already approached 40 billion dollars, although it felt to about 30 billion this year; 8.4 billion dollars in capital investment; 44,000 direct jobs generated by Argentine companies in Brazil; and 17.6 billion dollars in investment and 51,000 direct jobs generated by Brazilian companies in Argentina.

"Building, maintaining and strengthening ties between our countries is a process that requires political will, firm decision making and long-term vision. If, as the saying goes, "all politics are local," democracy is a force that crosses borders and helps societies keep control of their destiny. Likewise, integration is both a consolidated achievement and a dynamic process at the same time: there is no final conclusion, only new phases to be assessed," Vargas wrote. He claimed that the new phase in the process of regional integration will begin in the first semester of 2016. Mercosur, and especially the most dynamic sectors within Brazil's and Argentina's business communities, will benefit from these changes.

## 2. STARTING WITH THE INFRASTRUCTURE

Of all the promises made by the new Argentine president Mauricio Macri during his electoral campaign, the most significant one has to do with infrastructure renewal, which he described as "the largest infrastructure plan in Argentine's history".

Designed to be a Buenos Aires version of the Growth Acceleration Program (Programa de Aceleración del Crecimiento - PAC) launched by president Luiz Inácio Lula da Silva, the plan will be supervised by economist Guillermo Dietrich, Minister of Transport. He has organized four teams to develop the project, which will count on the participation of Brazilian companies. Macri's Growth Acceleration Program (PAC) will aim at renovating the damaged Argentinian roads, dredging waterways, facilitating the access of trucks to the strategic port of Rosario, which hosts the largest soya processing center, and upgrading the airports, some of which are collapsed.

"Waterways, trains, airports, energy... There are many areas to invest in," Macri said. "There is always credit for such infrastructures." According to Macri, "The Rosario hub needs to be addressed. The time wasted because of blocked trucks are paid by the producer.

**“The BNDES has allocated 1.5 billion dollars towards these burying works”**

There is no entry to the port. That is going to change.”

Macri has already talked to the President of the Inter-American Development Bank (IDB), Luis Alberto Moreno, and to the head of the Andean Development Corporation (CAF), Enrique García, on financing. He has also talked to Dilma Rouseff about the payment of funds that have already been approved by the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), the largest development bank in Latin America.

“President Dilma told me we have plenty of funds approved by the BNDES, a large Brazilian development bank, to invest in burying the Sarmiento railway and in power lines”, Macri said.

The BNDES has allocated 1.5 billion dollars towards these burying works, which will be crucial to integrate a large part of the metropolitan region of Buenos Aires by burying a railway that links the western periphery of the city to the downtown area. Another BNDES credit, which has already been allocated but has not been paid yet, aims at enhancing the capacity of 470 km of high-voltage power lines in the province of Buenos Aires. This project is known as Regional Electricity Forum of the province of Buenos Aires (FREBA), a job that has already been awarded and once it is completed it will benefit 1.6 million people.

Parallel to the Brazilian contribution to the infrastructure plan, the new Argentinian agrarian authorities expect the country to be once again a reliable wheat supplier to Brazil, eliminating the barriers to trade that had held this market captive, relying instead on Canadian, Ukrainian and American producers. Brazil does not produce enough wheat, so it needs a reliable provider that contributes to the central bank’s mission of seeing a convergence in prices, hoping to meet its inflation

Figure 2. Commercial exchange Argentina - Brazil

YEAR	EXPORTS FROM ARGENTINA TO BRAZIL (IN MILLION US\$)	EXPORTS FROM BRAZIL TO ARGENTINA (IN MILLION US\$)
2003	4.666.335	4.561.146
2004	5.605.067	7.373.218
2005	6.335.068	9.915.423
2006	8.140.942	11.713.819
2007	10.497.885	14.384.822
2008	13.272.361	17.605.621
2009	11.379.426	12.784.967
2010	14.424.644	18.596.234
2011	17.347.028	22.709.344
2012	16.486.582	17.997.706
2013	16.216.124	19.615.414
2014	13.881.338	14.281.998



**“Argentina could represent a great opportunity for Brazilian damaged infrastructure companies”**

goals for 2016, with a current ceiling of 6.50% that has long been surpassed.

If Macri keeps his enthusiastic promises about modernization, Argentina could represent a great opportunity for Brazilian damaged infrastructure companies.

In the meantime, the game of diplomacy, which had been crippled by the centralization of decisions in the past few years, will reemerge.

Proposals may even aim at transforming Mercosur so that its members gain flexibility to negotiate commercial agreements with third countries or blocks, which is currently prohibited by the customs union regulations.

Certain members of Macri's foreign policy team are convinced that immediate efforts can be taken by Mercosur to make South America a free trade area. They also believe that Brazil and

Argentina could work together to reach a consensus on how to help Venezuela carry out a democratic transition.

Those who are optimistic think that the debate may help reopen certain issues that had not been part of the discussion for more than fifteen years, including the once much needed macroeconomic convergence for which goals were set back in 2000, although it was casted into oblivion by the Argentinian financial crisis of 2001/2002.

Macri's determination to open the economy while reducing the intervention of the government, restoring the credibility of public statistics, liberalizing trade and negotiating with external creditors, pave the way for Argentina to reintegrate in the global economy, which, in turn, will create a virtuous circle that will serve to kick start the recovery of Brazil's economy, Argentina's major regional partner.

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