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What a new Argentina could do for Brazil

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During the past dozen years, Argentina has been a destabilizing economic force within South America. While the governments of Néstor (2003-07) and Cristina Kirchner (2007-15) have not meddled in the internal affairs of other countries in the way that Venezuela did under the late Hugo Chávez, their highly populist and nationalistic policies have had adverse repercussions on Argentina's neighbours.

For example, a decade ago Argentina defaulted on a 1995 commitment to export natural gas to Chile, and did so in order to keep its domestic market amply supplied and thus at lower gas prices. As a result, Chile had to scramble to find alternative energy providers, and the country had to increase its dependence on then-expensive imported oil.

Uruguay has been negatively affected ever since Argentina imposed currency controls in 2012, which have discouraged the arrival of Argentine tourists seeking to vacation in Punta del Este and other beach resorts. In order to entice Argentines to keep coming, the government exempted from VAT all spending by tourists, and granted a partial rebate on property rental expenses. These measures have had a fiscal cost, and yet tourist arrivals from Argentina have never fully recovered.

Brazil has been hit in various ways. In early 2012, Argentina imposed an import control system requiring prior approval of nearly every purchase from abroad, a regime since found to be illegal by the World Trade Organization – but one which has not been dismantled.

Relative to the peak import year of 2011, Argentine imports through mid-2015 have since dropped by over twenty percent, yet despite the preferential access provided by Mercosur, the supposedly free-trade area to which both countries belong, Brazil's exports to Argentina have since collapsed by over forty per cent.

Brazilian-owned banks and companies resident in Argentina have also suffered in recent years because of the country's economic stagnation since 2011, the imposition of price controls on retailers since early 2013, the difficulty to obtain imported inputs, and a de facto prohibition on profit remittances to parent companies.

By now capital controls have blocked many billions of dollars of intended remittances by multinational companies operating in Argentina. The Brazilian business community is angry that both exports to, and sales within, Argentina have taken such a turn for the worse, and it has been lobbying Brasília to get tough with Argentina.

Brazil has also been thwarted by Argentina in its decade-long attempt to reach a free-trade deal with the European Community. Paraguay and Uruguay, the other Mercosur partners, have been willing to make the necessary trade-liberalising concessions, but Argentina has been recalcitrant, effectively vetoing any progress.

This has caused enormous frustration in Brazil's business community, which regards a trade deal with Europe as low-hanging fruit. This is why Renan Calheiros, the president of Brazil's Senate, has recently proposed to Finance Minister Joaquim Levy that Brazil should move ahead in these negotiations on its own.

Moreover, Brazil has expended substantial political capital defending Argentina's rogue behaviour in various multilateral venues. At the IMF, for instance, Brazil's representative has had to work overtime in recent years to build a coalition of emerging countries supportive of minimal sanctions on Argentina for its persistent violations of Articles IV and VIII of the Fund's Articles of Agreement.

These spell out that member countries are obligated to allow for Fund surveillance over their exchange-rate and related policies, and to submit accurate economic data to enable the Fund to carry out its duties. As a result, Brazil has come to be perceived as tolerant of rule-breaking attitudes.

Given the recent downward spiral in investor and rating-agency confidence in Brazil – a plunging currency, widening bond spreads, stubborn inflation expectations, and the threat of a downgrade to "junk" status – it would be to the advantage of the embattled government in Brasília to encourage the front-runners for the presidency in Argentina (Daniel Scioli and Mauricio Macri) to signal that they will behave in a sensible and constructive manner once one of them is voted into office in October and takes charge in December.

The quickest potential win for Argentina and its neighbours would be for the new government in Buenos Aires to open negotiations, and reach a settlement, with all of its defaulted creditors – the ones who have won court judgments as well as those who have sought justice in arbitral tribunals like the International Centre for Settlement of Investment Disputes (ICSID).

Reaching such a settlement would enable the new administration to regain access to the international capital markets and to stop relying on the central bank of Argentina for pesos to finance the budget deficit and for dollars to make debt-service payments. The former has been feeding inflation and the latter has been undermining the country's international reserves.

The private sector in Argentina, including multinationals operating there, would also benefit greatly from a normalisation of financial relations. Banks and companies would again be able to obtain credit and sell shares abroad, and the resulting capital inflows would pave the way for the new government to abolish the tangled web of controls on imports, remittances, and other transactions involving foreign exchange. Such a sensible liberalisation, in turn, would greatly deflate most of the tensions between Argentina and its neighbours – especially vis-à-vis Brazil.

Justified optimism on the emergence of a new, business-friendly Argentina would also have the potential to improve investor attitudes toward Brazil. Of course, said attitudes are largely dependent on what happens inside of Brazil in the months to come, but it is not inconceivable that good news coming out of Argentina could rub off on sentiment about Brazil. Contagion effects are not always negative.

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