2001 Country Reports on Economic Policy and Trade Practices
Released by the Bureau of Economic and Business Affairs
U.S. Department of State, February 2002

PARAGUAY

Key Economic Indicators

(Millions of U.S. dollars unless otherwise indicated)

	1999	2000	2001 1/
Income, Production, and Employment:			
Nominal GDP 2/	7,741	7,501	7,398
Real GDP Growth (pct)	-0.5	-0.4	-0.5
GDP by Sector (pct):			
Agriculture	27	27	27
Manufacturing	14	12	12
Services	37	36	36
Government	22	25	25
Per Capita GDP (1982 US$)	1,576	1,514	1,344
Labor Force (000s)	N/A	N/A	N/A
Unemployment Rate (pct)	12	17	20
Underemployment Rate (pct)	22	26	28
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	10.7	2.2	2.0
Consumer Price Inflation (pct)	7.0	11.0	14.0
Exchange Rate (GS/US$ Year End)	3,310	3,550	4,500
Official	N/A	N/A	N/A
Parallel	N/A	N/A	N/A
Balance of Payments and Trade:			
Total Exports FOB 3/	2,673	2,251	2,050
Exports to United States 3/	48	66	48
Total Imports CIF 3/	3,042	2,837	2,450
Imports from United States 3/	515	360	340
Trade Balance 3/	-349	-586	-400
Balance with U.S. 3/	-467	-294	-292
External Public Debt	2,108	2,354	2,180
Fiscal Deficit/GDP (pct)	-3.6	-3.9	-0.5
Current Account Deficit/GDP (pct)	-0.9	-2.2	-2.0
Debt Service Payments/GDP (pct)	3.8	4.0	4.0
Gold and Foreign Exchange Reserves	988	720	680
Aid from United States	3.0	3.0	3.0
Aid from All Other Sources	44	45	45

1/ 2001 figures are central bank preliminary data.
2/ Percentage changes calculated in local currency.
3/ Merchandise trade.
4/ External and internal public debt only. Private external debt to GDP share not yet available.

1. General Policy Framework

Over the last decade, Paraguay's economic policy framework has encouraged the re-export trade to Brazil and Argentina and provided tax and regulatory advantages as well as soft loans to non-competitive local industries. In agriculture, the government has continued non-transparent state-run cotton programs for small farmers and kept hands off large-scale private sector oil seed production, the leading source of hard currency from exports. Government investment has shrunk as spending on debt service and government salaries, to provide political patronage, drain government revenue.

The economy in Paraguay has been falling for the past three years, while population growth has continued unabated. According to the Paraguayan Central Bank, the GDP fell by 0.5 percent in 1999 and 0.4 percent in 2000. It is expected to fall by 0.5 percent in 2001. Until the mid-1990s, Paraguay largely avoided deficit spending and kept foreign debt at manageable levels. Government spending as a percentage of GDP began to increase earlier in the decade, but deficits were avoided due to revenue windfalls from taxes and tariffs on imports from the re-export trade. This windfall was not productively invested, but rather spent to swell already bloated government payrolls.

The Central Bank under the Cubas administration (August 1998 - March 1999) kept interest rates high on guarani-based bonds sold to private banks, limiting liquidity, and keeping exchange rate pressures off the guarani. In an effort to stimulate the economy, the Gonzalez Macchi government has lowered interest rates from 29 to 9.5 percent between May 1999 and September 2000. However, the regional crisis started in Argentina and the fall in the value of the Brazilian real have forced the Central Bank to bring short-term rates back up to 28 percent. A series of banking failures and political instability over the last several years has led investors to move to dollar-based deposits and loans. The Paraguayan government is heavily dependent on tariff revenue, which will continue to shrink in the near future as Mercosur adjusts downward its common external tariff rate.

Paraguay’s membership in Mercosur offers some opportunities. Efforts to improve weak infrastructure, especially in power transmission and distribution; telecommunications; road, river, and civil aviation systems; postal system; potable water; and sewage treatment provide potential markets for United States' goods and services. Privatization of state monopolies is moving forward, with the first privatization of the fixed-line telecom company expected to be completed by the end of 2001. With its partners in Mercosur, Paraguay has renewed discussions with the U.S. on promoting economic integration and business facilitation under a 4+1 formula.

2. Exchange Rate Policy

All foreign exchange transactions are settled at the daily free market rate. The Central Bank practices a dirty float, with periodic interventions aimed at stabilizing the guarani. With the recent fluctuations in the value of the Brazilian real, these interventions have become more frequent. Over the past 9 months, the guarani has depreciated by 29 percent against the dollar. On October 11, the market rate stood at 4,440 guaranies to the dollar. It is legal to hold savings accounts in foreign currency, and in October 1994 a decree was promulgated that legalized contractual obligations in foreign currencies. With a lingering recession, the failure of many local banks, and exchange rate uncertainty, the dollar has become the preferred unit for large purchases, savings, and virtually all international transactions. Two-thirds of all funds in Paraguayan savings accounts are in dollar-based accounts as of October 2001.

3. Structural Policies

Consumer prices are generally determined by supply and demand, except for public sector utility rates (water, electricity, telephone), petroleum products, pharmaceutical products, and public transportation fares. The Ministry of Finance oversees all tax matters. Under current law, the corporate income tax rate is 30 percent. There is no personal income tax. As an incentive to investment, the tax rate on reinvested profits is 10 percent. The existing Investment Promotion Law (Law 60/90) includes complete exemption from start-up taxes and customs duties on imports of capital goods. There is a 95 percent corporate income tax exemption for five years on the income generated directly from investment approved for fiscal incentives under law 60/90. The Ministry of Finance, at the urging of the IMF, is currently studying the elimination of a variety of tax breaks, including Law 60/90, to help balance the budget. Implemented in 1992, the value-added tax (IVA) stands at ten percent. Some analysts have estimated that IVA compliance hovers around 30 percent. Charges of corruption among tax officials are endemic. Nearly half of all tax revenues are collected at customs on imported merchandise. Agriculture makes up over 25 percent of GDP, but contributes less than one percent of government revenue. Even though land taxes are low, chaotic land title records make land tax evasion the norm.

4. Debt Management Policies

In 1992 the government reduced external debt with both official and commercial creditors through a drawdown of foreign reserves. Since that time, however, increasingly large public deficits have nudged public debt back upward. Foreign reserves stood at $680 million at the end of August 2001. The government's debt at the end of July 2001 totaled $2.160 billion. Nearly all of this is bilateral or multilateral debt with minimal outstanding loans to private sector banks. Although the World Bank had initially announced that it would close its office in Paraguay at the end of 2000, the office has remained open, though staffed only part-time. A recent IMF survey showed that Paraguay was generally on target with the IMF plan, though the pace of state reform was still deemed to be too slow. Paraguay continues to meet its obligations to foreign creditors in a timely fashion.

5. Significant Barriers to U.S. Exports

Paraguay is a member of the World Trade Organization (WTO) and has a relatively open market that does not require import licenses, except for guns and ammunition. However, the United States prohibits the export of U.S. guns and ammunition to Paraguay. U.S. companies have fared poorly in non-transparent government procurement tenders. Paraguayan regulations require country of origin designation on domestic and imported products. Expiration dates must be printed on medical products and some consumer goods. Imported beer is required to display detailed manufacture and content information, labeled in Spanish at the point of bottling. A similar regulation was put in place for shoes, clothing, packaged food, and other consumer products. However, labeling of imported goods at distribution centers within Paraguay is still commonplace. MERCOSUR-wide labeling requirements are currently being developed.

Law 194/93 established the legal regime between foreign companies and their Paraguayan representatives, and has been described by executives of U.S. companies represented by local firms as increasing the risk of doing business here. This law requires that to break a contractual relation with its Paraguayan distributor, the foreign company must prove just cause in a Paraguayan court. If the relationship is ended without just cause, the foreign company must pay an indemnity. Rights under this law cannot be waived as part of the contractual relationship between both parties. Foreign companies have paid large sums when ending distributor relationships in Paraguay to avoid lengthy court cases or have maintained relationships with underperforming representatives to avoid such payments. A case currently before the Supreme Court challenges the constitutionality of this law.

Decree 7084/00 prohibits the importation of used clothing. This follows years of virtual prohibition under a system in which importers were required to obtain a permit to import used clothing from the Ministry of Industry and Commerce. However, the Ministry of Industry and Commerce never issued any permits.

Decree 235/98, later modified by Decrees 2698/99 and 8366/00, created a multiplier increasing the base value on imported beer prior to calculating excise tax. The same multiplier was not applied to domestic products. Income tax must be pre-paid on presumed profit margins of ten percent for imported cigarettes and thirty percent for imported beer prior to removal from customs. Local manufacturers of cigarettes and beer pay income taxes only on reported profit margins and at year-end.

6. Export Subsidies Policies

There are no discriminatory or preferential export policies. Paraguay does not subsidize its exports. However, Paraguay exports 90 percent of its cotton crop, and government-subsidized credit to small-scale producers signifies an indirect export subsidy. The government provides small-scale farmers with subsidized inputs, such as seed and pest control products.

7. Protection of U.S. Intellectual Property

Paraguay belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention, Berne Convention, Rome Convention, and the Phonograms Convention. In August 2000, Paraguay ratified the WIPO Copyright Treaty (LAW 1582) and the WIPO Performances and Phonograms Treaty (LAW 1583). In January 1998, the U.S. Trade Representative designated Paraguay as a "Special 301" Priority Foreign Country. On February 17, 1998, the U.S. government initiated a 301 investigation of Paraguay as a result of its inadequate enforcement of intellectual property rights, its failure to enact adequate legislation, its status as a distribution center for counterfeit merchandise, and the large illicit re-export trade to other MERCOSUR countries.

On November 17, 1998, USTR concluded a bilateral Memorandum of Understanding (MOU) and Enforcement Action Plan that contain specific near-term and longer-term obligations to improve the intellectual property regime in Paraguay. The agreement contains commitments by Paraguay to take action against known centers of piracy and counterfeiting; pursue amendments to its laws to facilitate effective prosecution of piracy and counterfeiting; coordinate the antipiracy efforts of its customs, police, prosecutorial, and tax authorities; implement institutional reforms to strengthen enforcement at its borders; and ensure that its government ministries use only authorized software.

As a result of this agreement, the U.S. government has revoked Paraguay's designation as a Priority Foreign Country and terminated the Special 301 investigation. Implementation of the MOU is being monitored under Section 306 of the U.S. Trade Act. On September 20, 2000, the United States and Paraguay signed a Memorandum of Agreement under which the U.S. government agrees to jointly develop and fund a program to improve Paraguay's IPR protection regime. Since then, progress has been made in the enforcement of intellectual property rights, though much still remains to be done.

Patents: The Senate is currently considering the final version of comprehensive patent legislation. Domestic industry has successfully lobbied to weaken the law. Paraguay also has patent obligations as a member of the WTO.

Trademarks: On August 6, 1998, a new Trademark Law was promulgated that includes a broader definition of trademarks. The law prohibits the registration of a trademark by parties with no legitimate interests. Provisions provide specific protection for well-known trademarks. The law also includes stronger enforcement measures and penalties for infractions. In practical terms, trademark violation is still rampant in Paraguay, and resolution in the courts is slow and nontransparent. The new law provides an important first step, but must be followed by increased enforcement and modernization of the judicial system to become fully effective.

Copyrights: A new Copyright Law was signed on October 15, 1998, which follows international conventions to protect all classes of creative works. Software programs receive the same treatment as literary works under the law. The law contains norms that regulate contracts related to copyrights. Law 1444, passed on June 25, 1999, made copyright violations "public actions," allowing public prosecutors to take legal action without requiring the offended party to seek redress. Practical application of copyright protection suffers the same systemic challenges as trademark protection.

8. Worker Rights

In October 1993, the Paraguayan Congress approved a new Labor Code that met International Labor Organization standards.

a. *The Right of Association:* The constitution allows both private and public sector workers, except the armed forces and police, to form and join unions without government interference. It also protects the right to strike and bans binding arbitration. Strikers and leaders are protected by the Constitution against retribution. Unions are free to maintain contact with regional and international labor organizations.

b. *The Right to Organize and Bargain Collectively:* The law protects collective bargaining. When wages are not set in free negotiations between unions and employers, they are made a condition of individual employment offered to employees. Collective contracts are still the exception rather than the norm in labor/management relations.

c. *Prohibition of Forced or Compulsory Labor:* The law prohibits forced labor. Domestics, children, and foreign workers are not forced to remain in situations amounting to coerced or bonded labor.

d. *Minimum Age for Employment of Children:* Minors from 15 to 18 years of age can be employed only with parental authorization and cannot be employed under dangerous or unhealthy conditions. Children between 12 and 15 years of age may be employed only in family enterprises, apprenticeships, or in agriculture. The Labor Code prohibits work by children under 12 years of age, and all children are required to attend elementary school. In practice, however, many thousands of children, many under the age of 12, work in urban streets in informal employment.

e. *Acceptable Conditions of Work:* The Labor Code allows for a standard legal work week of 48 hours, 42 hours for night work, with one day of rest. The law also provides for a minimum wage, an annual bonus of one month's salary, and a minimum of six vacation days a year. It also requires overtime payment for hours in excess of the standard. Conditions of safety, hygiene, and comfort are stipulated.

f. *Rights in Sectors with U.S. Investment:* Conditions are generally the same as in other sectors of the economy.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category		Amount
Petroleum		18
Total Manufacturing		18
Food & Kindred Products	0	
Chemicals & Allied Products	0	
Primary & Fabricated Metals	0	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	0	
Transportation Equipment	0	
Other Manufacturing	18	
Wholesale Trade		(D)
Banking		(D)
Finance/Insurance/Real Estate		0
Services		0
Other Industries		(D)
TOTAL ALL INDUSTRIES		432

(D) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.