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TRADE POLICY REVIEW

PARAGUAY

Report by the Government

Pursuant to the Agreement Establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), the Paraguayan Government's policy statement is attached.

Note: This report is subject to restricted circulation and press embargo until the end of the meeting of the Trade Policy Review Body on Paraguay.

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1. Introduction

1. Paraguay has made substantial changes in its economic and social policy since 1989. A complete overhaul of the State has been initiated since then and the conditions are being created for the country's sustainable economic development. Paraguay has unilaterally liberalized its trade, not adopting an import-substitution model.

2. Against this background of change, Paraguay, together with Argentina, Brazil and Uruguay, is pushing resolutely ahead with the creation of the Southern Common Market (MERCOSUR), thereby gaining access to those countries and generating the conditions necessary for productive activity. Since 1989 Paraguay has focused its growth strategy on attracting domestic and foreign investment through the development of a stable macroeconomic environment, the creation of a simplified tax system and the passing of laws to encourage productive activity.

3. While helping to set up and consolidate MERCOSUR, Paraguay, together with its partners, is continuing to promote regional integration through the signing of free-trade agreements with Chile and Bolivia and is initiating a series of negotiations with other countries and trading blocs.

2. Main economic reforms

4. Paraguay has undergone an intensive process of change in both the political and economic fields.

5. The process started with exchange reform. Exchange controls were abolished and there is now a freely floating exchange rate.

6. Tax reform is being carried out under Law 125/91, with the 70 taxes that existed under the fiscal system being cut to 7. This has led to greater State efficiency from the point of view of tax collection and simplicity, with consequent benefits to private activity as well.

7. In 1991 the Treaty of Asunción was signed. This initiated the process of creating a common market between Paraguay, Argentina, Brazil and Uruguay, which has now been converted into a flourishing Customs Union.

8. Paraguay has also modified its customs tariffs, eliminating excessive dispersion of rates and reducing the 1988 average of 14.8 per cent to 11.1 per cent following the introduction of the Common External Tariff.

9. Laws 60/90 and 117/91 have been passed, providing a favourable framework for the protection and attraction of domestic and foreign investment. These laws authorize important tax exemptions for imports of capital goods, as well as on profits for five or ten years, in addition to broad latitude for sending remittances abroad.

10. The National Constitution was amended in 1992 through a Constituent National Assembly composed in balanced form of representatives of all the country's political and social sectors. The main pillar of this constitution is the defence of human rights and freedoms and the establishment of sound, modern institutions designed to meet the needs of the global economy.

11. Reforms have been carried out in the financial sector. A new General Law on Banks and Financial Institutions has been passed and the Organic Charter of the Central Bank has been modified

so as to incorporate preventive supervision aspects and provide the supervisory body with greater autonomy. The criteria of the Basle Convention for the valuation of the net assets of financial bodies have been adopted. Likewise, with a view to greater transparency, comprehensive legislation has been passed to prevent money laundering, in particular Law 1015/97 setting up an executive body, the Secretariat for the Prevention of Money or Goods Laundering.

12. Reforms in the labour sector include the passing of a new Labour Code, which has expanded welfare benefits in the labour sector with a view to achieving a balance with the business sector.

13. With regard to privatization, the Government saw to the passing of Law 126/91 laying down the privatization arrangements for State enterprises. The State Airline, the State Alcohol Company and the State Merchant Fleet have been privatized, while the steel industry is in the final stages. Law 642, which will make it possible to proceed with the removal of the telecommunications monopoly, was passed in 1995. The first programmes to expand the telephone services have been successfully carried out on the basis of risk-sharing between ANTELCO and the private sector.

14. In the forestry sector - an important branch of economic activity - Law 536/95 on the Encouragement of Reforestation has been passed. Its objective is the sustainable exploitation of natural resources, and to this end it grants important tax benefits to reforestation activities.

15. Paraguay has made special efforts to protect intellectual property. In 1996 it put bills before Congress and set in motion an intensive national campaign for the protection of intellectual property rights. These actions are accompanied by controls, seizures, enhancement of civic awareness and a suitable legal framework.

16. One of the most outstanding reforms concerns the judiciary, with special reference to the setting up of the Supreme Court of Justice. The entry into force of the Law on the Magistracy Council represents a step towards the full respect for, and observance of, civic rights by the promotion of an autonomous and independent judiciary.

17. The Government is working on the further development of its detailed structural reforms and is seeking to correct and control a number of macroeconomic variables which could compromise the long-term stability and growth of the economy. The objectives of current economic policy are to:

- Encourage rapid growth of the productive sector;
- maintain the balance of the real exchange rate and avoid sudden fluctuations in the general exchange rate;
- control and restructure public expenditure by restricting current expenditure and liberalizing infrastructure expenditure; hold the level of inflation steady.

3. Economic and trade environment

18. As a farming country by tradition, Paraguay has historically based its economic growth on agricultural production. Although this economic model is still being followed, the Government has made great efforts as regards agricultural diversification and is encouraging the country's industrialization. The GDP has remained highly sensitive to fluctuations in agricultural production and in 1996 suffered

the impact of the 1995 financial crisis. However, a considerable recovery in growth has been achieved in 1997.

19. The Government has succeeded in continuously reducing levels of inflation from 44.1 per cent recorded in December 1990 to 8.2 per cent in December 1996 (the lowest inflation rate of the last 15 years). The Government has set a target of 8 per cent for 1997.

20. Productive investment has been increasing since 1989 to date, most of it being of foreign origin. Between 1989 and 1996 the average annual growth in total investment was around 30 per cent, while foreign investment in that period - the most dynamic component - showed an annual average growth of 49 per cent.

21. The marked increase in imports over the last five years is due mainly to the sharp rise in trade and tourism generated in the frontier cities of Paraguay with Brazil and Argentina, resulting in a trade imbalance. Within MERCOSUR, Paraguay is becoming an important trade centre, with this sector developing important marketing channels to the outside. As a result of the convergence of tariffs within MERCOSUR, considerable pressure is being brought to bear in favour of the relocation and local production of products, leading to major private initiatives like the establishment of industrial parks.

22. The balance of external public debt fell by about 20 per cent in the period 1990/96, going from nearly US\$1,670 million in 1990 to US\$1,336.3 million in December 1996. On the latter date the debt balance accounted for 14 per cent of GDP and represented a per capita debt of US\$270, which is among the lowest figures in Latin America. This level of debt compares with a per capita GDP of approximately US\$1,933 (current rates) in the same year.

23. The level of international reserves has risen significantly in this decade, from US\$675 million at the end of 1990 to US\$1,062 million in December 1996 and thus staying at a prudent level (40 per cent of total imports recorded in that year).

Macroeconomic situation

Indicators	1993	1994	1995	1996*
Annual inflation (%)	20.4	18.3	10.5	8.2
Variation in exchange rate (%)	13.8	5.3	3.1	6.7
Balance of international reserves (millions of US\$)	697.7	1,044.1	1,106.5	1,062.0
External public debt (millions of US\$)	1,218.0	1,240.0	1,328.0	1,303.0
Central Government (millions of ₡)	-84,029.0	143,635.0	-50,227.0	-140,713.0

*The 1996 figures are provisional.

Source: Central Bank of Paraguay and Ministry of Finance.

4. Present outlook for the economy

24. Although the structural changes in the Paraguayan economy have in many respects been gradual and non-traumatic, they now make for a scenario differing from that prevailing in early 1989. Industrial infrastructure is growing strongly, agricultural diversification is in full swing and the 1995 financial crisis has been overcome with a full recovery in trade operations.

25. The Government will stick to a prudent debt policy with adequate international reserves. The necessary efforts will be made to maintain the present macroeconomic stability and to strengthen growth in the economy.

26. The great energy potential available provides the State with substantial revenue from the export of electricity, amounting in 1996 to around 43 per cent of recorded exports of products.

27. In the light of a growth in central government expenditure of almost zero during the first quarter of 1997 in nominal terms - which amounts to a negative real variation - the greater level of activity has led to a budget surplus, with an accumulated surplus of G 114,879 million being recorded during the quarter. This result has enabled the external debt to be amortized up to an amount almost double the outgoings and even to generate an increase in current-account deposits amounting to G 106,053 million.

28. The increase in money supply both before and during the first quarter of 1997 appears to indicate the existence of a greater level of economic activity, since with a money supply greater than in the previous year prices have reacted slightly more quickly. The retail price index shows an increase of 5.3 per cent for the quarter, exceeding the figure of 4.9 per cent for the same period in 1996, whereas producer prices are down owing to the trend of agricultural prices and oil, *inter alia*.

29. In addition to being reflected in a greater rise in prices, the higher aggregate demand has led to an increase in the trade-balance deficit which, according to Central Bank projections for the first quarter of 1997, has not resulted in a bigger balance-of-payments current-account deficit thanks to a positive trend in the performance of unrecorded exports and imports. As regards the financing of the current-account deficit, the greater part relates to variations in international reserves. Although there has been a net capital inflow it is less than in the previous year before, but has a more favourable composition, with a greater share of long-term capital and from an increase in direct foreign investment.

5. Development of trade negotiations

30. Given its small internal market, the Government has encouraged the development of an outward-looking growth model through the opening up of external markets and production switching.

31. As part of its new foreign-policy strategy, Paraguay has taken an active part in regional integration processes such as MERCOSUR, while at multilateral level it joined GATT in 1993.

32. Paraguay has been an active partner in the process of setting up the MERCOSUR customs union and in the latter's negotiations with third countries and trading blocs.

33. After MERCOSUR was set up, a series of renegotiations was initiated covering the bilateral agreements of members of MERCOSUR with the other members of the Latin American Integration Association (LAIA), for the improvement and development of their partial-scope agreements.

5.1 Uruguay Round - World Trade Organization

34. Paraguay joined GATT in 1993, fulfilling its accession commitments. The Paraguayan National Congress ratified the GATT Accession Protocol by means of Law 260 of 1993.

35. Paraguay took part in the setting up of the World Trade Organization which emerged from the Uruguay Round. In this connection, it carried out the necessary internal reforms regarding standards and procedures relating to customs valuation, intellectual property, elimination of prohibitions, and mechanisms to counter unfair competition, especially anti-dumping and countervailing measures. Paraguay has reduced its levels of tariff and non-tariff protection.

36. Paraguayan policy regarding services is very open. It has entered into broad GATS commitments regarding transport, communications, tourism and finance.

37. Paraguay has taken great interest in environmental matters. At domestic level, it has extensively modified all its procedures regarding anti-dumping mechanisms, agriculture, health standards, plant and animal health standards and technical standards. Nevertheless, the Government is continuing to prepare regulations covering the inclusion in its legislation of other procedures provided for in the WTO framework, for example safeguards.

5.2 MERCOSUR

38. Paraguay is a founder member of the Southern Common Market (MERCOSUR), in which it has been participating since it signed the Treaty in Asunción in 1991.

39. Since it signed the Asunción Treaty, Paraguay has encouraged the implementation of a Common External Tariff with levels matching its extensive commercial openness and in a continuing spirit of consensus and analysis.

40. The MERCOSUR Common External Tariff (CET) has an average level of 11.1 per cent.

41. The need to adapt to the new tariff structure has necessitated the creation of transitional instruments which allow each signatory State to maintain a national list of exceptions to the CET, which in the case of Paraguay comes to 399 tariff items. The national exceptions are defined individually and a linear convergence timetable has been set for each of them. On 1 January 2006 the items mentioned will reach the tariff levels laid down for the CET.

42. In addition, MERCOSUR has a common list of capital goods and of informatic and telecommunications goods to which a timetable for convergence with the CET also applies. Under this pre-established timetable, capital goods will have a modal tariff of 14 per cent for Brazil and Argentina in 2001, and for Paraguay and Uruguay in 2006, while in the informatics and telecommunications sectors the CET will be attained in 2006.

43. A list of products has likewise been drawn up for each MERCOSUR member country involving intra-zonal tariffs, with automatic linear tariff cuts ending in the year 2000, at which date all tariffs will be at zero per cent for products originating in any MERCOSUR member.

44. Involved as it is in this intensive integration process, Paraguay is working very hard, in accordance with its WTO commitments, and together with its trading partners, on matters such as

competition-protection policy, technical standards, consumer protection and intellectual property among others, in order to consolidate and strengthen the Customs Union.

45. As a result of this integration process, Paraguay has been able to carry out important trading operations with its partners and thus to bring about a continual increase in its exports within MERCOSUR.

46. As part of its outward-looking development strategy, Paraguay has promoted within MERCOSUR, in conjunction with its trading partners, an external policy aimed at the conclusion of trade agreements with third countries.

47. In this context, MERCOSUR is taking the first steps towards the signing of a trade agreement with the European Union, the initial results of which are expected to appear towards the end of 1997. Guidelines are also being drawn up concerning the preparation of other trade agreements with Mexico and the Andean Group. In addition, MERCOSUR is also playing an active part in the American Free Trade Area process.

48. MERCOSUR has signed trade agreements with Chile and Bolivia for the establishment of free-trade areas. The agreements include rules of origin, safeguard mechanisms, and a schedule for the total liberalization of sensitive products over a total of 18 years in both cases.

5.3 Latin American Integration Association (LAIA)

49. As an instrument for encouraging the integration process, the LAIA has for years confronted major challenges.

50. As a relatively less economically developed member of the LAIA, Paraguay has been placed by the other members on their market-opening list (NAM), which gives it preferential access to them.

51. Within the LAIA framework, Paraguay is a signatory to Economic Complementarity Agreement (ECA) No. 18 with Argentina, Brazil and Uruguay, through which the first stage of MERCOSUR comes into force. As a result of the Ouro Preto protocol, MERCOSUR has acquired legal personality under international law.

52. MERCOSUR as a bloc is currently renegotiating its bilateral and multilateral trade agreements in the LAIA framework with the other members.

6. Institutional and regulatory framework

6.1 Trade protection

53. In accordance with Paraguay's WTO commitments, the institutions connected with their implementation have been updated and overhauled. Thus, as regards the application of trade-protection measures, Decree 15286/96 set up the Trade Protection Commission, an interministerial body responsible for applying the procedures concerning dumping and subsidies, with the support of an office dealing specifically with trade distortion.

6.2 Intellectual property

54. In the field of the protection of intellectual property rights, the Government has issued Decree 14870/96 setting up a National Council for the Protection of Intellectual Property Rights, composed of representatives from five Ministries and the three chief municipalities. The Council is launching an intensive and effective national campaign to combat the counterfeiting of products in general and to raise civic awareness.

55. Paraguay has signed the Agreement on Trade-Related Intellectual Property Rights and within this framework has prepared a reform of its legislation on trade marks, inventions, copyright and related rights, which has been submitted by the Government to Congress for study.

6.3 Competition protection and consumer protection

56. Following the Presidential Summit in December 1996 in Fortaleza, the process of strengthening MERCOSUR has led to the adoption, together with the other partners, of a Joint Protocol on the Protection of Competition and of a number of resolutions on consumer protection. The Government is working on the introduction of a competition policy and of ad hoc measures for consumer protection, and legislation to this effect is being prepared for submission to Congress.

6.4 Customs modernization

57. The WTO Agreement on Implementation of Article VII was incorporated in Paraguayan legislation under Law 444/94, "ratifying the Final Act of the GATT Uruguay Round", while Decree 7403/95 sets out the additional rules needed for its full enforcement at internal level. The customs authorities have also introduced an up-to-date computer system named "Sofia" which is making customs administration more flexible and effective.

7. Directions of future policy

58. In 1997 an effort will be made to strengthen achievements so far in boosting the productive sector, with a view to reaching levels of sustained growth over the long term against a background of price stability. The goals are a real GDP growth of not less than 3 per cent, 8 per cent inflation and maintenance of international reserves at around US\$1 billion.

59. As regards regulating the size of the State administration, the Government is working on labour reforms appropriate to this end.

60. Regarding geological and energy resources, Paraguay possesses one of the greatest energy potentials in the region and has in operation or under construction a number of hydro-electric dams including that operated by ITAIPU, the greatest undertaking of this type in the world. Paraguay is carrying out substantial reforms aimed at encouraging the private exploration and exploitation of natural resources such as oil, natural gas and various metals. The mining sector in Paraguay has been regarded as relatively new and not very active in the past owing to obstacles in the relevant Paraguayan legislation, but this situation has now been changed following the submission to Congress of a series of contract laws on mining concessions as well as on the exploitation of electricity and natural gas. The hydrocarbons sector has been reformed by Law 779/95 on Hydrocarbons.

61. In the financial sector, the Government has concentrated its activities on drawing up rules involving significant modifications in the money and capital markets, with the aim of boosting their development and creating favourable conditions for an expansion in domestic savings and for channelling these savings to the various sectors of production. In this context, bills will be introduced proposing the setting-up of a Financial System Consolidation Fund, the purpose of which will be to furnish financial assistance to intermediary institutions experiencing difficulties and provide appropriate measures to minimize the impact of leaving the market for institutions with imbalances and with suitable coverage for liabilities. Bills have also been put before Congress on rules governing securitization, on amendments to the Capital Market Law and on reform of the social insurance market.

62. With the backing of the private sector, the Government has supported the Maquila (in-bond processing) law which complements the legal arrangements for shifting production towards export.

63. In the agricultural, livestock and forestry sector, the Government has introduced changes in its institutions and activities aimed at:

- The permanent updating and modernization of scientific research and the transfer of approaches and new methods through autonomous institutes;
- thorough reform of the Rural Welfare Institute, the body dealing with land-reform policy and land-tenure problems, with a view to tackling social problems in the countryside;
- overall reform of the Ministry of Agriculture and Livestock by creating five autonomous institutes from former offices of the Ministry. These institutes will cover requirements regarding breeding and technology transfer, plant and animal health control and the outsourcing of technical assistance, with the Ministry retaining only the role of regulatory body and maker of agricultural policy.

Against the background of its foreign policy, Paraguay sees the American Free Trade Area as a far-reaching initiative which will bring about greatly improved market access and enhanced economic conditions for the region.