

Tte. Vera 1761  
Villa Morra  
Asunción – Paraguay  
Emprendimientos Nora Ruoti SRL

Tel.: 595 21 660088  
Celular (0981) 405.373  
[nrc@noraruoti.com.py](mailto:nrc@noraruoti.com.py)  
[www.ruoti.com.py](http://www.ruoti.com.py)

### **Brief on Paraguay's Economy – South America**

The Republic of Paraguay is located in the heart of South America, surrounded by Argentina, Bolivia and Brazil. It is one of two landlocked South American countries, Bolivia being the other.

Despite this, and despite the relatively small size of its economy, Paraguay benefits by its location at the confluence of important river systems and the crossroads of two oceans, a situation that offers the potential for uniting the major ports and markets of South America.

Paraguay, together with Argentina, Brazil and Uruguay, form the major commercial block in the region, MERCOSUR, an integrated market of more than 200 million consumers. MERCOSUR has as its near term goal achieving the free movement of goods, services, and production inputs throughout the four-country area.

#### *The Paraguayan Economy*

The Paraguayan economy can be characterized as small and open, with wide dependence on international trade and commerce. It is modeled on the production and export of only a few primary agricultural products, as well as on commerce associated with the import and re-export of consumer products, much of which occurs in the informal economic sector.

#### ***The Structure of the Economy by Sector***

Agriculture and agro-industry have a comparative advantage over other sectors of the economy, accounting for 28% of the country's production.

The agricultural sector is characterized by the split between the traditional sector, cotton, and the modern sector, soybeans. Soybean cultivation represents 32% of the gross value of all agricultural production. In the year 2000, soybean exports accounted for 33% of the total value of export receipts. Cotton cultivation, meanwhile, represents 5% of the gross value of all agricultural production and 11% of export income. At the beginning of the 1990s, cotton represented 43% of all exports, but began falling in the mid 1990s.

Industry represents 14% of GDP, concentrated primarily in the processing of local raw materials. There is little value added in the production process at present, with primary products or those with a low grade of processing representing 90% of the exports in this sector. Food, beverages and wood are the principal industrial sector products, which are mostly produced by small and medium-sized businesses using agricultural raw materials found locally. Small businesses represent 80% of the total of all industries, but only account for 14% of total production.. Large companies constitute only 2% of the total number of companies, yet generate 48% of the GDP in this sector. The food sector is the most important single category accounting for approximately 40% of gross production in the industrial sector, followed by wood (13%); alcoholic and non-alcoholic beverages

*Estudio Nora Ruoti & Asoc.  
Asesoría Jurídica Tributaria Contable Integral*

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(11%); handicrafts, paper and stamping or printing (7%); leather and shoes (6%), non metallic mineral products (5%); and textiles and clothing manufacturing (4%), among the most important sectors.

The services sector makes up 53% of the gross domestic product, reflecting this area's growing importance. During the decade of the 1990s, the sub-sector of basic services comprised of electricity, water, transport and communications was the most dynamic, growing at an average yearly rate of 7%. Deregulation and the opening of this sector to private sector participation offers an excellent opportunity for even greater growth over the coming years.

For its part, the commerce and finance sector grew at an average annual rate of 3.3% during the first half of the 1990s, experiencing a mild contraction over the last five years, with its contribution to the GDP falling from 27% in 1994 to 21% in the year 2000. This was due primarily to the reduction in the volume of international trade and adjustments in private spending in recent years.

***Capital Mobility and Investment Incentives:***

There are no restrictions on the movement of capital, nor are there sectors of the economy that are restricted to foreign investment. The exchange rate fluctuates freely. Be that as it may, however, remittances of profits by foreign businesses to beneficiaries who do not reside in the country, are taxed at an additional rate of 5%.

The law 60/90, which deals with investment incentives, establishes conditions favorable to foreign direct investment, extending those same incentives and corresponding benefits to domestic sources of investment. Projects that fall within the purview of this law are exempted from all taxes pertaining to the investment in addition to exemptions on the importation of capital goods, raw materials and other inputs. It also provides for the reduction of corporate taxes by 95% for a period of up to ten years.

***Financial System***

Paraguay's financial system is comprised of 20 banks, one of which is state owned, with the remaining 19 in private hands. Eight of these are foreign owned. In addition, there are 27 financial credit agencies, six savings and loan institutions which offer credit for housing and 28 insurance companies.

***Foreign Commerce***

The Paraguayan economy is relatively open. Import tariffs are comparatively low with imports representing 27% of GDP in 2000. Together with Argentina, Brazil and Uruguay, Paraguay is a member of MERCOSUR, a Customs Union whose objective is to integrate the four economies.

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Intra-MERCOSUR trade is fairly significant, representing 56% of the country's foreign trade. Brazil was the destination for 39% of Paraguay's exports in 2000, being at the same time the origin of 25% of its imports. For its part, Argentina was the origin of 24% of Paraguay's imports, and was the destination for 11% of its exports during the same period.

The trade balance was negative for 2000. The deficit of US\$ 1,186 million was equal to 16% of GDP. Exports increased at a rate of 17% for the year 2000, slightly less than the rate observed for imports, which increased by 19%.

During the course of the year 2000, exports to MERCOSUR partners recuperated, increasing by 74% over the previous year. However, this was offset by a drop in exports to the rest of the world by 27%.

Commodities represent the major exports, meaning that fluctuations in world commodity prices significantly effect total Paraguayan exports, as is the case with soybeans, the major export, representing 43% of the total, and cotton, 9% of total exports.

Imports of consumer goods registered a 20% increase in 2000 over 1999, driven mainly by imports of foodstuffs. Petroleum and its derivatives registered the single greatest increase in imports of goods in dollar terms due to the effect of international price increases.