



Ministerio de
**RELACIONES
EXTERIORES**

**GOBIERNO
NACIONAL**

*Paraguay
de la gente*

*Embajada de la República del Paraguay
Berna, Suiza*

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The Embassy of the Republic of Paraguay presents its compliments to the President of the Latin American Chamber of Commerce of Switzerland – LATCAM - and has the honor to refer to the news published in a Paraguayan newspaper, entitled "The IMF compares Paraguay with Switzerland"¹.

It mentioned that in the last 15 years, Paraguay has been one of the fastest growing economies in South America, which has allowed the reduction of the country's poverty levels from 58% in 2002 to the current 26%, as highlighted in a report prepared by the experts of the International Monetary Fund (IMF), Bas Bakker and Natasha Che. Real GDP growth was more than 4.5% annually, much higher than the average of 1% corresponding to Latin America as a whole. In addition, per capita income increased from USD 1,300 in 2002 to almost USD 6,000 in 2018.

However, it suggested that maintaining this solid growth could be more difficult, since the factors that underpinned growth in the past will be less favorable in the future. Policies that boost investment and productivity can help Paraguay sustain inclusive growth for future generations.

The Economic transformation, the results of growth, have left clear traces in Asunción, the nation's capital. Glowing apartment buildings and busy shopping centers have emerged. Elegant industrial-style hotels and new corporate headquarters radiate a cosmopolitan atmosphere. The growth has been so rapid that traffic bottlenecks, rare 15 years ago, are now a daily reality for city residents.

Likewise, although Paraguay's economic cycle used to follow the trend of its neighbors, over the past decade the country has become much more resilient and has continued to grow in the face of volatility and significant external shocks. When Brazil - one of its main trading partners - suffered one of its deepest recessions in 2015 and 2016, Paraguay grew at a rate of almost 4%.

It is considered that the reason for the vigorous growth, in part, was the result of a recovery from a previous crisis. In the late 1990s and early 2000s, Paraguay was affected by a banking crisis, a deep recession and a sharp depreciation of the exchange rate. For 2003, per capita income was lower than in 1980.

To the

President of the Latin American Chamber of Commerce of Switzerland - LATCAM

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¹ <https://www.macrofinanzas.com.py/fmi-compara-paraguay-suiza/>





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The recovery was favored by a change in the economic policies. First, economic stability was restored, with the help of two IMF programs. Then economic policies remained prudent, even during good times. Inflation and exchange rate volatility declined when the central bank began setting inflation targets. The fiscal deficit was reduced, and the public debt was reduced from 52% of GDP in 2002 to around 20% of GDP today. In 2015, a fiscal responsibility law entered into force to keep deficits and debt low. As a result, Paraguay avoided the boom and bust cycle that affected other countries in the region.

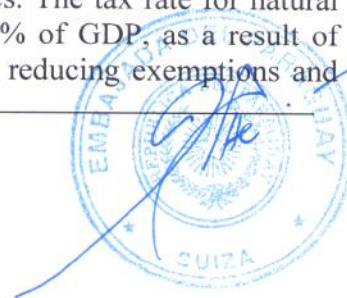
The rise in prices of soybeans and other agricultural raw materials boosted growth even more. Dollar prices of soybean exports tripled between 2000 and 2014. This not only led to a sharp increase in export values, but also triggered a considerable increase in volumes, since agricultural investment became very profitable. The export boom spread to the rest of the economy thanks to an appreciation of the real exchange rate, which boosted real income and domestic demand.

The challenge of maintaining strong growth could be more difficult, since the factors that sustained growth in the past will be less favorable in the future. In 2014, soybean prices reached their highest level and since then they have fallen by a third. Agricultural land destined for main crops has doubled in the last 15 years, and it will be difficult for significant new increases to occur. In addition, to a large extent, growth has originated in the use of more inputs rather than more efficient use of them. Employment has grown rapidly, but productivity growth has remained moderate.

Since the agricultural sector is likely to grow more slowly than in the past, rapid growth will only continue if other sectors can progress. The positive aspect is that new export sectors are beginning to emerge, such as exports from the manufacturing industry under the maquila regime. However, they are still small. Non-agricultural and non-hydroelectric energy exports reach only 7% of total exports.

Making Paraguay a more attractive investment destination could help accelerate the transformation. As discussed in the latest economic evaluation for Paraguay and its accompanying reference documents, an improvement in the business climate and governance indicators would facilitate diversification and productivity growth. Policies that focus on improving transport infrastructure, the rule of law and governance, and the quality of education would be particularly useful.

Public spending levels in Paraguay are low. Setting new priorities in spending could create some possibilities, since the composition of spending is unbalanced, with a significant proportion devoted to wages. The increase in income would create a greater margin for spending related to reforms and investment needs. Tax rates in Paraguay are low, but tax revenues are even lower than would be expected, given the rates. The tax rate for natural persons is 10%, but the tax collection corresponds only to 0.1% of GDP, as a result of exemptions and deductions. A tax reform that would focus on reducing exemptions and





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deductions and improving tax compliance would help.

When it comes to fiscal policy, it is not only important to consider the short term, but also the longer-term challenges. The population of Paraguay is still young. However, given that the population is gradually aging, in the future there will be high deficits in the pension system. To avoid this, it would be more appropriate to make small changes in the pension system now (for example, a moderate increase in the retirement age) than large changes in the future.

Paraguay has had a good performance in the last 15 years. It recovered from a previous crisis, decoupled from his most important neighbors and made great progress in reducing poverty. These achievements were favored by a change of course in macroeconomic policies, as well as by an increase in prices of agricultural raw materials. If you continue to apply what has worked well (prudent macroeconomic policies), while implementing other reforms that focus on the supply side, solid growth may continue.

These are all reasons why when people think of a small, landlocked and economically successful countries with a lot of hydropower, they usually think of Switzerland. However, if its extraordinary economic results are maintained, people will soon be able to think of Paraguay.

The Embassy of the Republic of Paraguay avails itself of this opportunity to renew to the President of the Latin American Chamber of Commerce of Switzerland – LACTAM -, the assurances of its highest consideration.

Bern, July 25, 2019

