Paraguay

2005 INVESTMENT CLIMATE STATEMENT -- PARAGUAY

Openness to Foreign Investment

There are no formal restrictions to foreign investment in Paraguay. National treatment of foreign investors is guaranteed, as is full repatriation of capital and profits. Historically, Paraguay's tax burden has been the lowest in Mercosur, with no personal income tax, a 30 percent earnings tax for businesses, and a 10 percent value added tax. Recent tax reform legislation will require the payment of personal income taxes beginning in 2006, and will lower the corporate tax rate to 10 percent.

Government efforts to attract foreign investment through privatization have progressed slowly because of political opposition and uncertainty about the transparency of the process. To date, four state-owned companies have been privatized: the airline in 1994; the state-owned liquor producer, bought by its workers in 1995; the state merchant marine, split into five separate entities, three of which were sold in 1996; and the state steel company, sold in late 1997. The GOP refinanced the liquor producer after privatization and now the state is again the majority shareholder. The steel company is also seeking refinancing from the government.

Political realities impede the process even further, as the large state-run companies most attractive to foreign buyers (such as telecommunications, water/sewage, and electrical companies) employ thousands of potential voters and are outlets for political patronage. The telephone and utilities company were in the process of being privatized before the government suspended their privatization in June 2002, after bowing to political pressure. In 2004, the Congress attempted to reconsider legislation that prohibited privatization but discontinued its efforts in the face of public demonstrations against privatization.

Conversion and Transfer Policies

There are no restrictions on conversion or transfer of foreign currency. In late 1994, the government permitted foreign currency contracts, legitimizing a long-standing practice. Law 60/90 permits the repatriation of capital and profits and provides guarantees against inconvertibility. Repatriated profits are subject to a five-percent tax on the amount remitted. There are no controls on foreign exchange transactions, apart from reporting requirements to banking authorities for transactions in excess of USD 10,000. The free-floating exchange rate on January 6, 2005, was guaranies 6,230 to the U.S. dollar.

Expropriation and Compensation

Private property in general has historically been respected in Paraguay as a fundamental right.

Paraguayan authorities are sensitive to the potential fallout of expropriation of land owned by foreigners.

We are not aware of any cases of expropriation or nationalization involving foreign-owned property.

Over the course of 2004, groups of “landless” campesinos, calling on the government to give them title to land for farming, carried out a series of “land invasions”, occupying large farms, owned in some cases by Brazilians or Paraguayans of Brazilian descent. This movement gained momentum over the course of the year until late 2004 when the government took strong measures, including authorizing the military to support the police in removing the campesinos from the properties.

Dispute Settlement

Law 117/91 guarantees national treatment for foreign investors. This law allows international arbitration for the resolution of disputes between foreign investors and the government. Paraguay became a member of the International Center for the Settlement of Investment Disputes (ICSID -- also known as the Washington Convention) on October 22, 1982 (Law 944/82). The Inter-american Development Bank financed the creation of a center for alternative dispute resolution.

The legal system is undergoing fundamental reform. Six of nine Supreme Court justices were removed or resigned from office and were replaced in 2003. A Council of Magistrates appoints appellate and lower court justices. A new criminal procedures code entered into affect in March 2000 and the new penal code was fully implemented in November 1998. These new codes introduced important changes, including oral arguments, more modern investigations, increased powers for public prosecutors, and a three-year limit on judicial proceedings. Other factors, such as a six-month limit on investigations hinder the prosecution of complex crimes.

These reforms are making the legal process more transparent, but will require more training for public prosecutors and judges and an increase in the number of public prosecutors. Both the commercial and civil codes cover bankruptcy and give priority for claims first to employees, then to the state, and finally to private creditors.

Historically, Paraguay’s judicial system has been characterized by a weak rule of law and corruption. While efforts are underway to strengthen the rule of law and make the judicial process more transparent, unbiased and fair, incidences of corruption, patronage and bias are part of the current judicial system.

Performance Requirements and Incentives

A number of fiscal incentives (contained in law 60/90), including a 95 percent tax exemption for five years and duty-free import of capital goods, are available to all investors. However, with the new Fiscal Adjustment Act passed in June 2004, businesses will only pay a corporate earnings tax of 10 percent.

Voting board members of any company incorporated in Paraguay must have legal residence. This has posed some obstacles to potential foreign investors. Another potential roadblock is Paraguay's law protecting agents and distributors (law 194/93). The law features strong penalties for severing relations with a local distributor or agent. This has on occasion led to expensive out-of-court settlements, since just cause must be proved for severing the relationship. However, courts have also ruled against distributors when just cause has been established.

Right to Private Ownership and Establishment

Foreign and domestic private entities may establish and own business enterprises. Foreign businesses do not need to be associated with Paraguayan nationals for investment purposes. There is no restriction on repatriation of capital and profits. Private entities may freely establish, acquire, and dispose of interests in businesses. The following are presently state-owned monopolies: rail, petroleum, cement, electricity, water, and basic and long distance telephone services.

Protection of Property Rights

The 1992 constitution guarantees the right of private property ownership. While it is quite common to use property as security for loans, the lack of consistent property surveys and registries often makes it impossible to foreclose.

A World Bank project aimed at standardizing registration in the department (state) of Alto Parana concluded in 2000, but only covered a small area.

Intellectual Property Rights

Paraguay is recognized as a regional distribution and manufacturing center for counterfeit merchandise. The re-export trade to Brazil, catering to consumer demand for electronics, CDs/DVDs, designer clothing/footwear, among other items is rife with piracy. Based on the seriousness of industry concerns, Paraguay was designated as a priority foreign country in January 1998 by the U.S. Trade Representative. In November 1998, Paraguay and the United States signed a Memorandum of Understanding (MOU) detailing future actions to combat commerce in pirated goods and to protect intellectual property rights, and placing Paraguay on Section 306 Monitoring. That MOU expired and, to address remaining concerns, the United States and Paraguay signed a new MOU in March 2004. Trademark and copyright laws were enacted in October 1998, and the Senate passed a patent law in April 2000. Paraguay ratified all the Uruguay Round accords, including TRIPS in late 1994.

Recently seizures and destruction of counterfeit and pirated goods have increased. In addition, measures by Brazil to control the trafficking of pirated and contraband goods coming in from Paraguay are having a significant positive effect. Piracy is estimated to be at just a fraction of what it was five years ago, as large operations have been dismantled. Still, smaller counterfeiting and piracy operations continue to thrive. Education campaigns have had some measure of success, as have amnesty campaigns such as those conducted by the Business Software Alliance. Some of the successes include shutting down and destroying several high tech factories for pirated CDs and CD ROMs; passing a law to make copyright crimes public actions open to prosecution by public prosecutors; legalizing the software used on government computers; and ratifying two WIPO copyright treaties.

Since the Duarte administration came into power, there has been a concerted effort to combat intellectual property rights crimes. The government has formed new task forces and has increased cooperation among agencies in order to more effectively address the issue. In 2004 hundreds of operations and raids took place on factories and businesses suspected of trafficking contraband, resulting in multiple arrests and the seizure of millions of dollars of merchandise.

Transparency of the Regulatory System

The Civil Code and Law 1,034/83 regulate business and industrial activities in the country. Under the existing framework, the Ministry of Industry and Commerce is charged with overall industrial policy coordination; the Ministry of Finance handles tax and fiscal policy; and the Central Bank is the principal coordinator of monetary policy. All businesses need to be registered in three places: the municipality for a business permit, the Ministry of Industry and Commerce unit at the central civil registry, and the Finance Ministry for tax purposes. The multiple registration procedure often takes months to complete. The Ministry of Health and the Municipality of Asuncion both regulate food safety issues, which can include processed food imports and imports for fast food franchises.

Regulatory agencies for sectors such as telecommunications, energy, and potable water are new or in the process of being established. Conatel, the telephone regulatory agency, is only nominally independent as the president of Paraguay chooses the president of Conatel, who is also subject to influence by the Minister of Public Works and Communication. A regulatory framework for potable water has been established, but the energy sector shows little indication of establishing a regulatory framework in the near future.

Efficient Capital Markets and Portfolio Investment

The Asuncion stock market opened in 1993. In 2004 the market handled approximately USD 1 million a month in transactions. There are currently 52 companies traded and the exchange is expanding. The high cost of capital makes the market an attractive alternative, but the fear by family enterprises of losing control has tempered the enthusiasm for public offerings. Because tax evasion is widespread in Paraguay, and to keep publicly traded companies from being at a competitive disadvantage, the government previously reduced the corporate tax rate from 30 to 10 percent for companies that adopt transparent accounting practices and sell equity on the stock market. This tax benefit would have expired in the year 2008, but was superseded by the new fiscal adjustment law.

Credit is available through numerous sources. High collateral requirements are generally imposed. The banking system, though facing significant pressures and several recent closures, is generally sound, but also susceptible to political influence and the effects of negative rumors. The system-wide level of non-performing loans is about 15 percent of total loans.

Independent audits of financial statements are not legally mandatory. Paraguay's institute of accountants has adopted the international audit guidelines issued by the federation of accountants.

Political Violence

Paraguay has not traditionally been affected by political violence. The March 23, 1999, assassination of Vice-President Argana and the following political clashes resulting in eight deaths were unprecedented. Two deaths occurred in 2004 when the army and police were mobilized to control nationwide demonstrations and land invasions by landless campesinos. Separately, while Paraguay has been relatively spared the large number of kidnappings that occur in neighboring Latin American countries, the high profile kidnapping of the daughter of former Paraguayan President Cubas has caused concern over the security situation in the country.

Corruption

One of the most serious problems facing Paraguay is the legacy of institutional corruption after decades of dictatorship. There have been mechanisms created to combat corruption, such as the comptroller's office, but investigations often become political and are seldom completed. The slow pace of judicial reform and the continued lack of transparency are barriers to development. Corruption remains a serious problem in Paraguay, although the current government has taken several important steps, including the creation of a transparent, internet-based government procurement system.

Paraguayan President Duarte was elected to office in 2003 largely on a platform to fight corruption. The President identified respected apolitical officials to head the Ministries of Finance and Industry. The Ministry of Industry has created a transparent, internet-based government procurement system that has won the praise of the private sector. IPR violations still occur on a significant scale but the government has stepped up investigations and prosecution of violators. Six new Supreme Court justices were selected with input from civil society and public hearings in the Congress, both a first for Paraguay.

Bilateral Investment Agreements

Paraguay has bilateral investment agreements (BITs) or treaties with the following countries: Argentina, Brazil, Chile, France, South Africa, Taiwan, United Kingdom, and Uruguay. Paraguay has signed other investment agreements with Austria, Benelux, Costa Rica, Ecuador, El Salvador, Germany, Hungary, Korea, Netherlands, Peru, Romania, Spain, Switzerland, and Venezuela.

Paraguay has signed the following agreements with the United States: Agreement relating to investment guaranties (OPIC), 1955; Agreement relating to investment guaranties (OPIC), 1992. Paraguay, along with its Mercosur partners Argentina, Brazil, and Uruguay, also signed the 1991 "Rose Garden Agreement," a framework agreement to encourage trade and investment.

OPIC Investment Insurance Program

In 1992 the United States and Paraguay signed an investment guaranties agreement, which replaced the agreement signed in 1955. In addition, the Paraguayan government issued a decree on the same day delegating the authority to approve cases to the Ministry of Industry and Commerce. This allowed OPIC to begin full operations in Paraguay. OPIC has financed telecommunications and forestry projects.

Labor

The labor force is estimated at 2.5 million, and increases by approximately 100,000 new entrants annually.

Unemployment officially stood at 13.4 percent in 2003, but underemployment for the same year was 24.1 percent. With a population growth rate above two percent annually, a key challenge is the creation of enough jobs to meet increasing demand. Local businesspersons cite the lack of a skilled work force as a major obstacle to growth.

Foreign Trade Zones/Free Ports

Paraguay is a landlocked country with no seaports. However, it has been granted free trade ports and warehouses in neighboring countries' seaports for the reception, storage, handling, and transshipment of merchandise transported to and from Paraguay. The Paraguayan port authority manages the free trade ports and warehouses. Paraguayan free trade ports are located in Argentina (Buenos Aires and Rosario); Brazil (Paranagua, Santos, and Rio Grande do Sul); Chile (Antofagasta); and Uruguay (Montevideo and Nueva Palmira). To date, only the Brazilian free trade ports and Nueva Palmira in Uruguay are in full operation.

Foreign Direct Investment

The United States has the largest foreign investment in Paraguay, with total U.S. investments in Paraguay exceeding USD 440 million. Foreign investment laws are among the most liberal in Latin America. Private property has historically been respected in Paraguay, and we are not aware of there having been a case of nationalization or expropriation of foreign property in Paraguay. Despite the incentives, private investment has been insufficient to maintain a sustainable pace of growth.

Large U.S. investments over the past years include nearly USD 200 million by Millicom, a mobile phone operator with shares listed on the NASDAQ exchange, and USD 37 million invested by Mastec to develop another wireless communication network (this network has since been sold to Hutchison Communications Ltd. of Hong Kong). Other investments include the USD 25 million purchase of a grain crushing facility by Cargill; approximately USD 60 million invested in a river transportation company; USD 27 million invested by Exxon; and several million dollars worth of investments by fast food companies (Pizza Hut, Burger King, McDonald's).

During the period August 2003 through July 2004 the Paraguayan government approved foreign investment projects worth USD 45.2 million, which represented 29 percent of all investment projects, foreign and national, approved during that period. Investments from Argentina represented 47.6 percent of the total foreign investment, followed by the US with 23.8 percent, Brazil with 5.1 percent, and Uruguay with 3.6 percent. Foreign investment was strongly concentrated in the services sector, mainly cellular telephones and hotels.