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Re-exports change face of Paraguay's foreign trade

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Paraguay's premier think tank, CADEP, has published the first-ever comprehensive analysis of the country's foreign trade data. The report shows the diminishing role of the 'triangular' trade through towns on the Brazilian border -- and that Paraguay is now the most open economy in Latin America and the Caribbean.

What next

According to CADEP, Paraguay's 'trade openness' indicator (total exports plus total imports as a share of GDP) doubled from 41% in 1991 to 88% in 2013, when it easily exceeded Mercosur (25%), the Pacific Alliance (55%) and the rest of Latin America and the Caribbean (53%). However, as CADEP notes, the downside is that, as a small land-locked country, Paraguay is now more vulnerable than ever to sudden shifts in the global economy over which it has no control.

Impact

- Paraguayan official export statistics do not calculate the size of re-exports to Brazil via border towns.
- Triangular trade responds to exchange rate movements between the US dollar and the Brazilian real and Argentine peso.
- Brazilian customs controls have had limited effect; rapid IT advances have rapidly made the controlled product list outdated.

Analysis

Paraguay is becoming an increasingly globalised economy. The share of official exports in GDP averaged 13% from 1991-2002, rising to 23% from 2003-13. Stagnating an at average of only 884 million dollars between 1991-2002, by 2013 exports had reached nearly 7.2 billion dollars, thanks to soaring growth in commercial agriculture. Paraguay is now the fourth largest exporter of soya and the seventh largest meat exporter in the world (see PARAGUAY: Titanium discovery could transform economy - November 10, 2010).

However, these official export figures do not include re-exports. For decades Paraguay has developed an important 'triangular trade' based around towns on the Brazilian border:

- Goods (previously mainly cigarettes, whisky and perfumes from Europe but now overwhelmingly IT products from China) are imported at a highly preferential tax rate and then re-exported to its large neighbour.
- In the case of Ciudad del Este, this is mainly carried out by commercial Brazilian buyers ('sacoleiros'); in the case of Pedro Juan Caballero and the new boom town of Saltos del Guaira, it takes the form of 'shopping tourism' by Brazilian day visitors.
- Most goods under this favourable 'tourism regime' enter the country duty free, with the only taxes being a 1.5% VAT rate, a 0.6% advance on company tax, and a 1.0% special excise duty in the case of IT goods.

Recalculating foreign trade

Due to this triangular trade, the total level of Paraguayan imports is strongly influenced by macroeconomic factors in Brazil, and to a lesser extent Argentina. When the Brazilian economy slows and its currency depreciates faster than the Paraguayan guarani, the growth in total Paraguayan imports falls quickly. However, when these imported goods are sold for re-export in Paraguayan border towns, they are registered as local sales and do not appear on any customs declarations when they leave the country. Although the Central Bank makes an annual estimate, the scale of the shadowy triangular trade has for decades produced a major distortion in the published national accounts, giving an under-estimation of the size of both GDP and per capita GDP.

22%/51%

Import-to-GDP ratio in 1991-93 and 2006-13

The increasing globalisation of the Paraguayan economy is also reflected in the import-to-GDP ratio. CADEP calculations show that this rose from 22% during 1991-93, to 35% during 1994-2005, and to 51% during 2006-13. However, the relative importance of triangular trade is on the decline. Imports destined for re-export under the tourism regime fell from 72% of total imports in 1993-99 to only 40% by 2013. In contrast, the share of imports destined for domestic use rose from 28% to 60% over the same period.

This is also reflected in the decline in the estimated ratio of re-exports-to-GDP, which fell from 27% in 2006 to 18% in 2013. There are three reasons for the relative decline of the triangular trade:

- the recent dynamism of the Paraguayan economy, fueled by rapid commercial agriculture;
- increasing clampdown by the Brazilian authorities on the size of duty-free exemptions for its shopping tourists and sacoleiros; and
- continuing sub-estimation of the size of triangular trade as its illegal component becomes more significant in the face of greater Brazilian controls on duty-free exemptions.

Nevertheless, although its relative importance has diminished, the absolute size of the triangular trade has continued to increase, albeit very slowly in the past few years, because of the dramatic growth of imports over this period.

Brazilian controls

In August 2006, new Brazilian customs laws introduced a strict computer-based control over the 25,000 to 30,000 trippers or 'sacoleiros' (officially reclassified as 'micro-enterprises') who daily cross into Paraguay, from where they are allowed to import duty-free goods:

- In an effort designed to formalise the sacoleiros, in January 2009, then President Luiz Inacio Lula da Silva promulgated a law that regulates shopping tourism in Paraguay.
- The Brazilian Congress proposed an average 42.3% import duty on such purchases but the executive then sought to apply the final rate, as well as the product list that will benefit from the law and the limit on such import purchases by Brazilian citizens, currently standing at 300 dollars per day for purchases in Paraguay. (For Argentine citizens the limit is 150 dollars per day.)
- After a long delay, the Brazilian government finally introduced the Border Trade Regime (RFC), known as the Ley de los Sacoleiros, on February 8, 2012 at a single rate of 25% on a range of electronic and IT goods and household appliances.

However, by October 2013, only 856 'micro-enterprises' (sacoleiros) had been registered who paid duty on goods imported to a value of only 1.2 million reais (514,000 dollars). In the first half of 2013, the seventh combined security exercises on Brazil's 10,000 kilometre land border, Agata VII, deployed 25,000 members of the armed forces and police. As in the cases of previous exercises aimed at combating cross-border crime, it temporarily wrought havoc with the triangular trade around Ciudad del Este, Pedro Juan Caballero and Saltos del Guaira.

Deceptive deficit

In order to get a truer picture of the Paraguayan foreign trade sector, it is necessary to add together official exports and re-exports. In 2013, this gives a figure of nearly 12.12 billion dollars, comprising 60% of goods originating in Paraguay (7.2 billion dollars) and 40% of goods originating elsewhere (4.9 billion). Interestingly, most exports that "originate in Paraguay" (eg soya and meat) are destined for the EU and China. By contrast, CADEP calculates that no less than 80% of Paraguayan exports to Mercosur are comprised of goods that "originated elsewhere" (ie re-exports). By making this adjustment, the true export-to-GDP ratio in 2013 is 44% instead of 26%.

44%/26%

Export-to-GDP ratio including/excluding re-exports

The study also offers a convincing explanation for the economy's ability to sustain exceptionally high trade deficits in a context of exchange rate stability and low inflation, and without requiring the introduction of harsh adjustments measures. For example, the official 2013 trade deficit is equivalent to a sizeable 18% of GDP. However, when re-exports are factored in, the deficit drops to only 0.3% of GDP.