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# INTRODUCTION

ECONOMY AND SOCIETY AIMS TO CONTRIBUTE TO BROADENING THE SPACE FOR DEBATE BY OFFERING ITS READERS AN ANALYSIS OF PARAGUAY'S ECONOMIC PROCESS. PROFESSIONALS COMMITTED TO THE COUNTRY ADDRESS HERE THE CAUSES AND CONSEQUENCES OF EVENTS AND SEEK TO PROMOTE DISCUSSION AMONG THE VARIOUS SOCIAL ACTORS AND ECONOMIC AGENTS.

Readers' responses and suggestions are welcome. With this initiative, CADEP, consistent with its principle of not reflecting sectoral or political interests, hopes to contribute to the public debate with objective analyses that help foster critical thinking and channel citizens' demands.

Asunción, July 2026

# ELECTIONS AND POLITICAL TIMES

José Carlos Rodríguez

The ruling party and the opposition are preparing for the municipal elections (2026) and the presidential elections (2028). The recent past of Paraguayan politics may offer some clues as to the possible outcomes of these elections. However, other new factors have emerged more recently, both domestically and internationally, that will influence voters' decisions.

**The Progressive Spring**

When the Colorado Party lost the 2008 presidential election, the subsequent 2010 municipal elections became the stage for its return to power in 2013. Prior to that, there had been a progressive shift within Mercosur and Latin America, which was later followed by a conservative backlash.

During his administration, Nicanor Duarte Frutos had made some gestures of reapproachement toward progressivism. At the ANR Convention in April 2007, he asserted that the Colorado Party was nationalist, agrarian, and a proponent of "humanist socialism." He invited Fidel Castro to his inauguration, and Hugo Chávez visited Paraguay on four occasions. This was completely unusual for a party historically identified with the hard right and the political logic of the Cold War.

It was in this context that Fernando Lugo emerged—a Catholic bishop with a progressive profile and a background that dispelled fears that he might be a communist. His candidacy managed to become an acceptable alternative for both liberal sectors and some disaffected Colorado Party members.

However, internal divisions within the Patriotic Alliance for Change and Horacio Cartes' financial support for the Colorado Party reinforced the perception that, once united and reorganized, the Colorado Party could not be defeated. And that is indeed what happened. The traditional civilian-military government of the dictatorship was succeeded by a civilian-business government. Everything seemed to be stacked against the Colorado Party in the 2008 elections. Blanca Ovelar's candidacy, though marked by remarkable personal integrity, failed to bring together all the pro-government interests, which are often contradictory. Furthermore, as a woman, she faced the limitations of a patriarchal political culture. The internal dispute with Luis Alberto Castiglioni, who questioned the results of the Colorado Party primaries, deepened the division. Added to this was the candidacy of Lino Oviedo, which fragmented the pro-government vote and

garnered nearly 21.9%. On the international stage, Barack Obama's victory in the United States (2008)—associated with an image of change, the fight against racism, and economic recovery—also played a role.

But the conservative backlash was already underway across the continent. Various progressive governments began to face destabilization processes known as "institutional coups." Along with the ouster of Fernando Lugo in Paraguay (2012), similar processes had taken place against Manuel Zelaya in Honduras (2009), Dilma Rousseff in Brazil (2016), and Evo Morales in Bolivia (2019). In the United States, Donald Trump's rise to power in 2016 represented another dimension of that conservative backlash, marked by regressive tax policies, immigration restrictions, and trade conflicts.

Despite the opposition's victory in Asunción with Mario Ferreiro in the 2015 municipal elections and other local wins, the Patriotic Alliance for Change had dissolved. The prevailing political perception was that the Colorado Party had regained ground with Arnaldo Samaniego's municipal victory in 2010 and that Ferreiro's victory could be reversed. The municipal elections served as a prelude to the presidential elections that would bring Horacio Cartes to power in 2013.

**The Conservative Winter**

History is not a mechanical repetition, nor does it operate through inevitable cycles, but there are trends that recur. The 2026 municipal elections could once again become a decisive precursor to the 2028 presidential elections. At the very least, that possibility is part of both the concerns of the Colorado Party and the expectations of those seeking a change in political leadership.

However, for that to happen, several conditions must change.

The 2028 presidential candidacy will likely not emerge from an unexpected figure, as was the case with Fernando Lugo. It will need to arise from a coalition between liberalism, independent sectors, and new political movements. These independent sectors still lack a consolidated institutional framework, but they have demonstrated electoral potential, as was the case with Paraguayo Cubas. Currently, they have a figure with electoral potential in Miguel Prieto.

In this conservative winter, there are also some glimmers of hope that may signal positive changes. It is becoming increasingly difficult to win an election based exclusively on caudillismo—a traditional practice in Paraguayan politics—even in the case of Fernando Lugo.

First, because governing without a clear agenda ultimately traps the elected official in a web of patronage and cronyism. When political groups appropriate the state for their

own ends—without a vision for the common good or a government program—concentrated power becomes a burden that is difficult to manage.

Paradoxically, economic growth can become a problem when its benefits do not reach the family table or the pockets of the majority. Patronage and cronyism are never enough for everyone. The fact that a government primarily favors the wealthy is not an abstract hypothesis: it is a visible reality.

Even among opposition sectors, the very practices they once criticized in ruling parties are now being replicated. The difficulty in holding officials accountable and the reliance on constant electoral pandering reflect a form of political populism accompanied by special favors; corruption—whose economic cost has been estimated at around 3.9% of GDP—is part of this problem.

Second, because the electorate is increasingly dissatisfied. This is a global phenomenon and one that is also evident in Paraguay. Frustration can lead to a fragmentation of the vote if candidates fail to present clear proposals and an agenda for transformation. Without a government program, candidates lack substance.

Fernando Lugo had the Catholic Church as his political and symbolic framework. It was an implicit but effective framework. Traditional parties have territorial structures such as local chapters and committees. However, these mechanisms are no longer sufficient. Clientelism is also facing a crisis of legitimacy.

Sooner or later, governing to benefit primarily privileged sectors at the expense of vulnerable sectors generates resistance. When government revenue and spending perpetuate inequalities, governing becomes an unjust task. Inequalities are not natural: they are the result of political decisions and, therefore, can be altered through policies aimed at social justice. And this is more widely recognized than ever before.

Third, a new opposition alliance should learn from the mistakes of the Lugo era. An agreed-upon distribution of responsibilities and positions must be a prerequisite for avoiding subsequent rifts. A stable alliance requires not only a presidential candidate but also clear agreements on participation, continuity, and political leadership.

Once the main adversary—the Colorado Party's bloc of business and rent-seeking elites—has been defeated, a second dispute emerges: internal competition among the allies themselves. For some independent sectors, the immediate priority was to become the second-largest electoral force, displacing the Liberals, rather than channeling that energy from the allies toward deepening structural changes and transforming the economic and political foundations that perpetuate underdevelopment.

For their part, liberal factions sought to distance themselves from Fernando Lugo, their original ally. And they ultimately did so through a temporary alliance with their common adversary, Horacio Cartes. Lugo's inner circle, too, lacked sufficiently strong ties to the

Liberal Party. The appointment of a Colorado Party interior minister, Rubén Candia Amarilla, was interpreted by many liberals as a sign that Lugo was moving closer to the Colorado Party. That atmosphere contributed to the rift that ultimately led to his removal from office.

Fourth, economic growth alone is not enough. That is precisely one of the achievements that the Colorado model itself has managed to sustain. What Paraguay needs is a political and social agreement geared toward more stable and shared prosperity. Seventy years of backwardness, political violence, corruption, and inequality cannot be resolved in a single term of office.

During Lugo's administration, profound reforms in areas such as education, the tax system, mafia-like structures, judicial corruption, and the concentration of economic power were either blocked or left pending. Changes in these areas could have helped transform Paraguay from a country with democratic fragility into a more solid, democratic society with greater shared well-being.

Finally, many unpredictable factors remain. International politics also shapes domestic processes. In a context where authoritarian and reactionary forces are gaining influence in both North and Latin America, the democratic process faces new challenges. But it is also possible that these trends will encounter their own limits and failures. No historical outcome is guaranteed: neither the continuation of the status quo nor the impossibility of change.

# PARAGUAY: TRENDS IN DEBT SERVICE AND THEIR IMPACT ON THE NATIONAL BUDGET

Lisa Oviedo

The sustained growth of public debt severely constrains the fiscal space of the Paraguayan economy. This is exacerbated by a simultaneous and rigid increase in current expenditures, which restricts the implementation of structural public investments. This dynamic is evident in the contraction of capital investment by the Central Government (CG) in recent years, which moves inversely to debt accumulation.

The analysis indicates that if the rate of debt growth exceeds that of Gross Domestic Product (GDP), an increasingly larger portion of the Treasury's ordinary revenues is tied up. This fact is particularly significant given that 87.9% of the Treasury's revenue is allocated to fixed expenditures—comprising public sector employee compensation, retirement benefits and pensions, and debt service—compared to a tax burden of 11.2%.

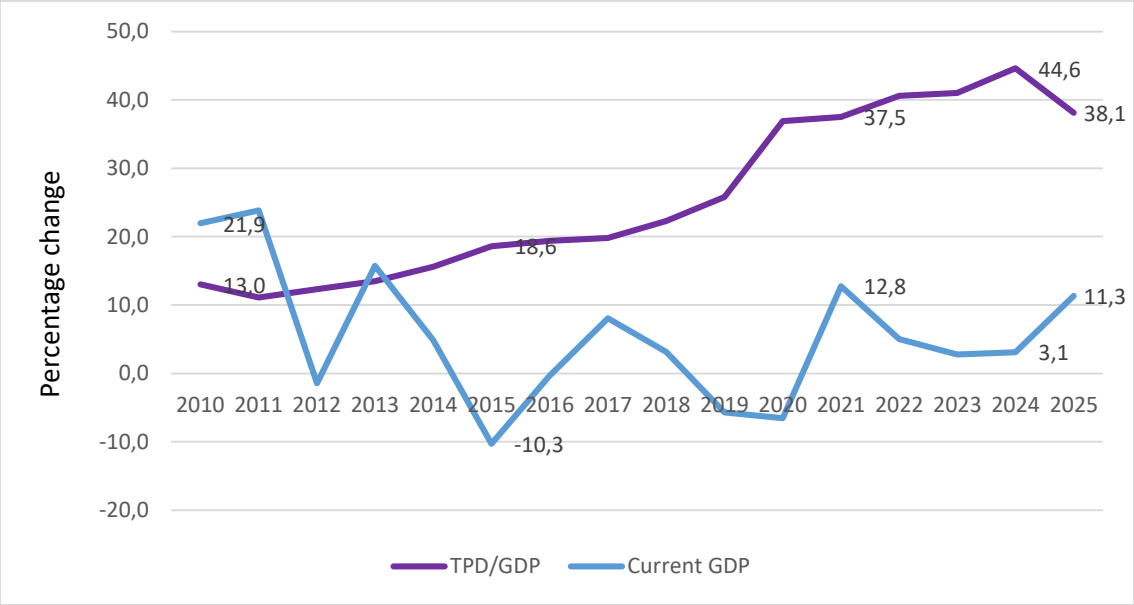
The underlying macroeconomic fundamentals remain stable. However, since 2019, the country has been unable to comply with the Fiscal Responsibility Law (FRL), which stipulates that the deficit must not exceed 1.5% of GDP. In 2025, this figure stood at 2% of GDP, but outstanding debt—which amounts to nearly 3% of GDP—places public finances in a very complex situation. This situation could become even more precarious if this debt is financed through further borrowing.

The latent risk lies not only in reaching the 45% prudential limit (total debt/GDP) recommended by the International Monetary Fund (IMF), but in reaching it without having closed the gaps in infrastructure and human capital. Unless this trajectory is reversed through cross-cutting government policies that transcend administrative terms, the country will continue to substitute public investment for debt service. This will not only limit development opportunities for the current population but will also pass on a heavy financial burden to future generations without providing compensation in the form of modern and competitive national infrastructure.

## Economic Growth and Public Debt

The importance of monitoring GDP trends, in conjunction with trends in public debt as a percentage of GDP, lies in the fact that it allows us to see the extent to which the economy keeps pace with the growth of the debt-to-GDP ratio. Although this ratio has risen steadily since 2011, it saw a significant jump starting in 2020 due to the expansionary fiscal policies implemented to mitigate the shocks of the COVID-19 pandemic. However, once the health emergency had passed, the debt-to-GDP ratio continued on a rising trajectory, partly due to the relative stability of GDP compared to a faster pace of debt accumulation.

**Figure 1. Trends in current GDP and public debt as a percentage of GDP[1]**




**Source:** Author's own analysis based on data from the IMF and the World Bank.

**Note:** For 2025 GDP, official data from the MEF[2] were used.

Official analyses argue that Paraguay's public debt is sustainable even at up to 60% of GDP, a favorable figure when compared to the 65% average among Latin American countries[3]. However, this assertion must be qualified given the structural limitations of domestic tax collection. Paraguay's tax burden stands at 11.2%, the lowest in the region. According to the Organization for Economic Cooperation and Development (OECD), the Latin American average is 21.7%, significantly higher than Paraguay's.

[1] Current GDP is used in the debt-to-GDP ratio because it compares the government's debt to the size of the economy at that particular time. Therefore, it reflects the government's actual ability to meet its obligations that year. For the same reason, current GDP is used in the chart.
[2] Ministerio de Economía y Finanzas (Ministry of Economic and Finance)
[3] MEF. Statistical Bulletins on Debt. Year 2026.

This structural weakness means that, in the absence of reforms to broaden the tax base or reduce informality, tax revenues depend exclusively on inertial economic growth. This constraint severely limited the fiscal space for adopting genuine countercyclical policies during the 2019–2020 crisis, forcing exceptional borrowing whose lingering effects persist.

The severity of this fiscal constraint becomes clearly evident when examining the rigidity of public spending. In 2025, public-sector wages financed with Treasury Resources (Source 10) accounted for 56.6% of that revenue. When other fixed expenditures are added to this—comprising the retirement and pension system, social protection transfers (such as Zero Hunger, Tekoporã, and the Elderly Program), and debt service—these items together accounted for 87.9% of total Treasury revenues.

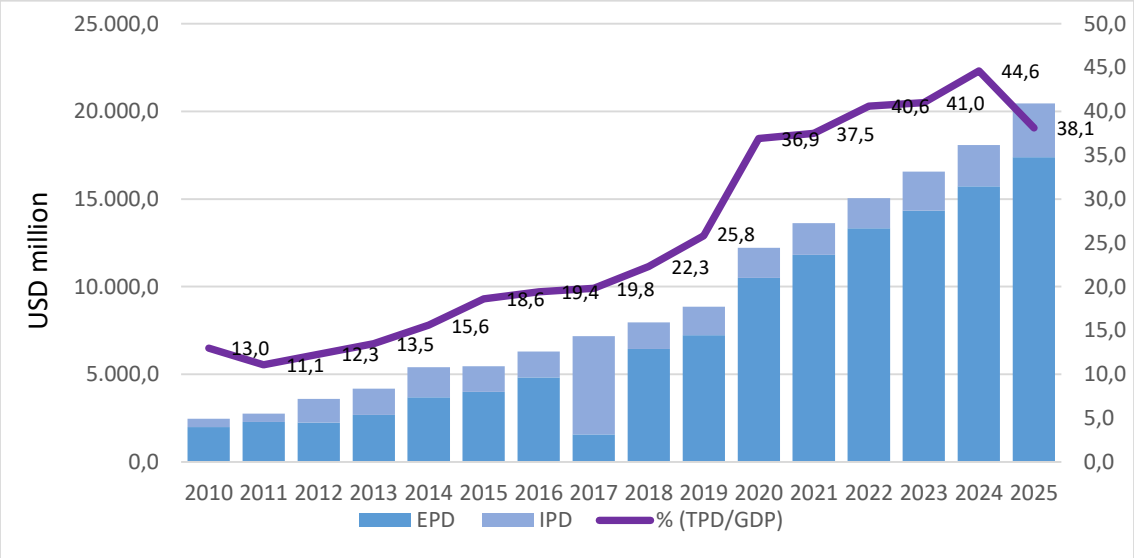
Consequently, actual tax revenue financed only 35% of the General National Budget (PGN), leaving the remaining 65% dependent on borrowing (14%, Source 20) and the government's own institutional resources (51%, Source 30)[4]. This scenario drastically reduces the margin for capital investments, which are essential for underpinning long-term potential growth.

Figure 2 details the evolution of domestic and external debt, as well as the total public debt-to-GDP ratio. Although a slight decrease in the debt-to-GDP ratio was observed in 2025, this trend was due to exogenous factors linked to the depreciation of the U.S. dollar. Given that 87.9% of total debt is held by the central government, and that 80.2% of this debt is denominated in dollars[5], Paraguay's public finances are highly vulnerable to exchange rate risk and the monetary policy decisions of the U.S. Federal Reserve.

Although traditional indicators suggest reasonable aggregate solvency, the deterioration becomes evident when examining how resources are allocated. Public investment by the Central Administration as a percentage of GDP stood at just 1.6% in 2025. This percentage is alarming when one considers that the Central Administration comprises nearly all key infrastructure through strategic ministries (MOPC, MSPBS, MEC, MDN, among others). This figure falls critically short of the 8% annual rate through 2030 recommended by the Inter-American Development Bank (IDB) to close the infrastructure gap Paraguay faces in order to meet the Sustainable Development Goals (SDGs) (Feal-Zubimendi, 2023)[6]. Furthermore, these data show that current spending fails to meet the minimum requirements for maintaining existing infrastructure or for creating new, high-quality projects.

[4] Financial Control and Budgetary Assessment. First Half of 2025. MEF.
[5] Public Debt Statistical Bulletins. Year 2025. MEF.
[6] Feal-Zubimendi, Soledad 2023. Paraguay: transitando hacia el desarrollo sostenible. https://doi.org/10.18235/0005152

**Figure 2. External and domestic public debt and the total public debt-to-GDP ratio.**



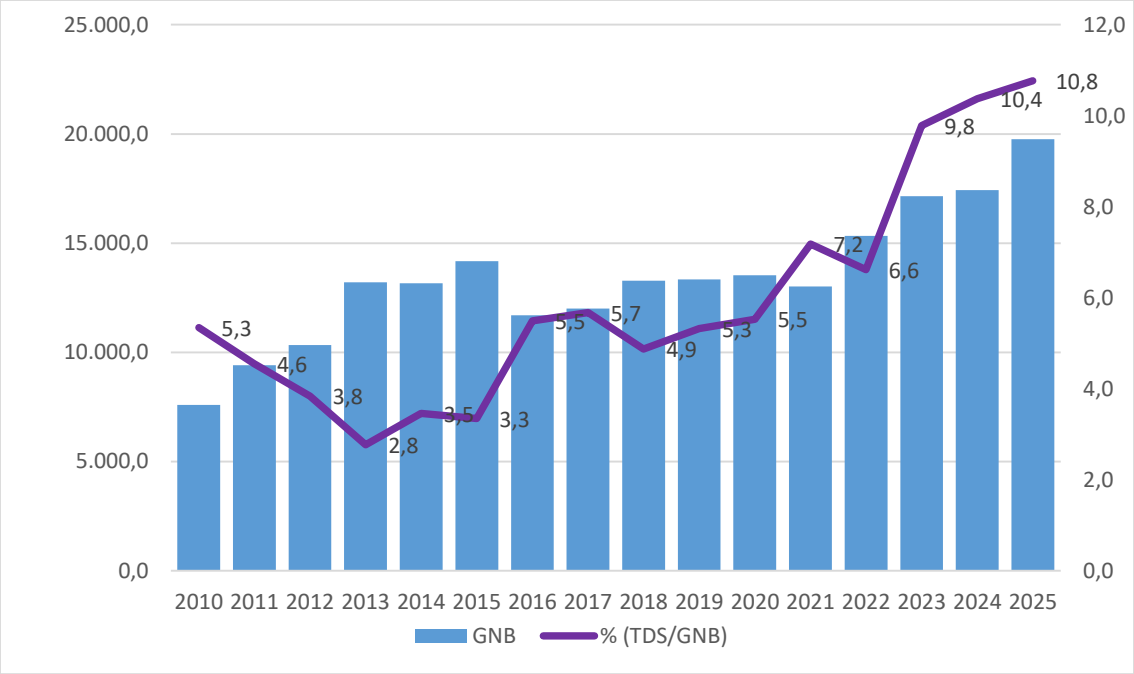

**Source:** Prepared by the author using data from the IMF, the World Bank, and the MEF.

### Debt Service and the General National Budget

The sustained accumulation of financial liabilities leads to a mathematical and inevitable increase in debt service (principal payments and interest). As a result, this item gradually displaces other expenditure categories within the General National Budget (GNB). Figure 3 illustrates how debt service rose from 2.8% of the total budget in 2013 to a significant 10.8% in 2025.

This trend confirms a concerning imbalance in public finances: while productive public investment has declined steadily since 2020, current spending and debt service have increased in parallel. This indicates that recent borrowing has not been efficiently channeled toward projects with high rates of economic return, but rather toward sustaining the government's operating expenses.

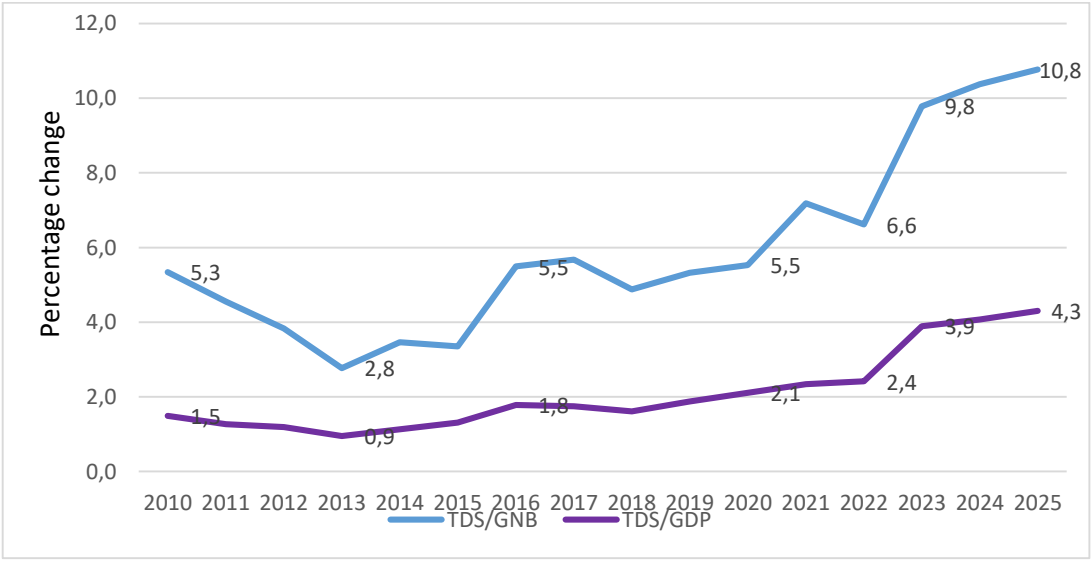
**Figure 3. Debt Service and the General National Budget**




**Source:** Author's own analysis is based on data from the Ministry of Economy and Finance (MEF) and public information from the National Congress.

When analyzing debt service in relation to both the General National Budget (GNB) and GDP (Figure 4), the trend toward greater budgetary rigidity is confirmed. The increase in both ratios corroborates the systematic loss of fiscal space for capital investments, a critical factor for a developing economy such as Paraguay's.

**Figure 4. Debt service as a percentage of the General National Budget (GNB) and GDP.**




**Source:** Prepared by the author using data from the MEF and publicly available information from the National Congress.

Added to this picture is the problem of outstanding debt (unpaid obligations to suppliers in the health and construction sectors). Currently, these liabilities represent between 2.5% and 3% of GDP. This debt often acts as an extra-budgetary financing mechanism that defers cash flow pressure, which can distort the official short-term fiscal deficit. However, once settled, it places direct pressure on the public treasury and reduces the government's financial predictability.

This lack of flexibility has prevented compliance with the Fiscal Responsibility Law (FRL) since 2019, which sets a fiscal deficit ceiling of 1.5% of GDP. In 2025, the fiscal deficit closed at 2% of GDP. Although official projections for fiscal year 2026 estimate a convergence toward the legal limit of 1.5%, the factors mentioned pose significant challenges to achieving this target.

**Final Thoughts**

Over the past 15 years, public debt as a percentage of GDP has risen from 13.0% to 38.1%. In other words, it has nearly tripled. While this figure might not seem particularly striking for a Latin American country with an average tax burden of 21.7%, in Paraguay's case this indicator stands at only 11.2%. Both of these characteristics—growing debt and low tax revenues—reflect a clear structural problem that results in increased debt service and a consequent reduction in fiscal space for public investment.

Furthermore, the doubling of debt service as a percentage of GDP between 2010 and 2025 confirms a worrying trend for both public finances and capital investment. Additionally, the fact that 80.2% of the debt is denominated in U.S. dollars highlights a high vulnerability to external shocks.

Finally, repeated noncompliance with fiscal rules and the increase in debt service not only restrict investment but also threaten to worsen the perception of sovereign risk and raise international financing costs, thereby undermining the country's progress toward achieving investment-grade status.

# STRATEGIES FOR THE USE OF ELECTRIC ENERGY IN PARAGUAY

Victorio Oxilia an Richard Ríos[1]

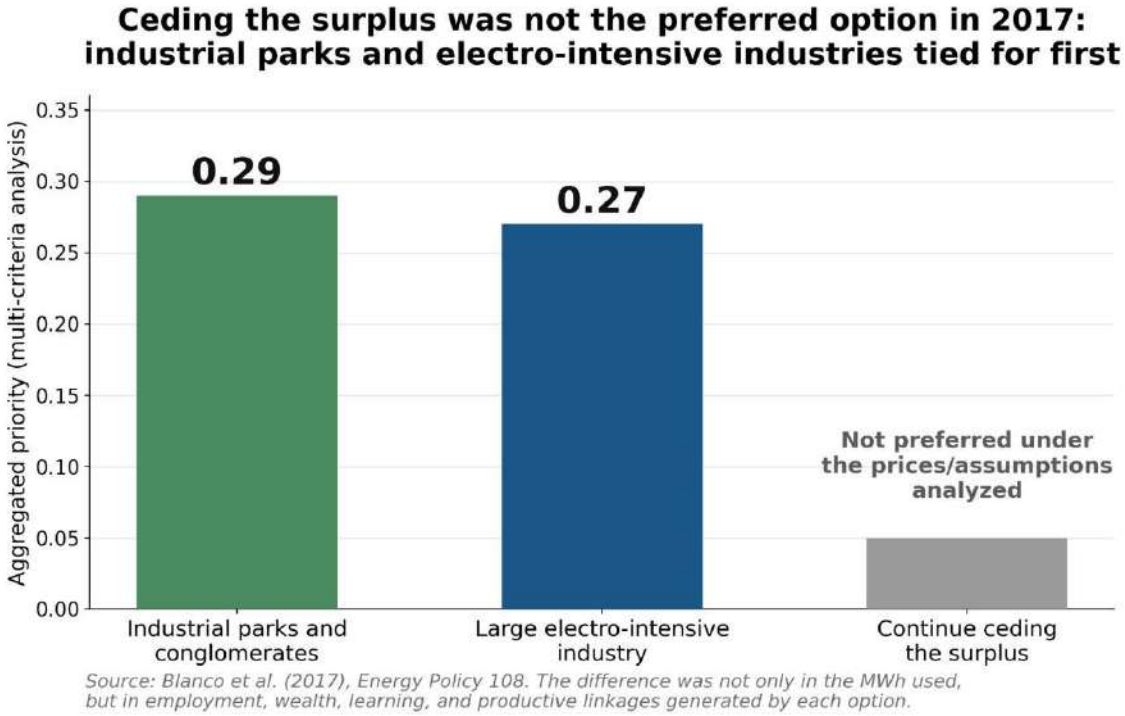
Paraguay manages an exceptional asset—one of the world's largest hydroelectric capacities per capita—at a time when this advantage is ceasing to be a comfortable surplus and is becoming a scarce resource that should be allocated with appropriate criteria geared toward the country's socioeconomic development. This article reflects on two public policy questions: What strategy for electricity use would best serve the country? What are the implications of prioritizing energy-intensive industries in terms of installed capacity and the transfer of energy to partner countries of binational entities?

**Strategies for the Use of Hydroelectricity**

This debate has been ongoing in the country since approximately the mid-1980s, when Itaipú[2] began operations. It is not a binary choice, and the available evidence advises against treating it as such. The benchmark multi-criteria analysis for Paraguay, according to Blanco et al., 2017, highlights, as shown in Figure 1, that diversified industrial parks and clusters—which would align with a historical trajectory (aggregate priority of 29% preference)—and large electricity-intensive industry (27% preference) were virtually tied at the highest levels of preference, while continuing to transfer hydroelectric surplus ranked last. The difference between the two highest-ranked options lies not in the megawatt-hours consumed, but in the employment, wealth, technological learning, and production linkages associated with each option.

[1] Research Professors at the Polytechnic School, National University of Asunción
[2] Binational hydroelectric dam shared with Brazil

**Figure 1. Aggregate priority of options for using the hydroelectric surplus (Blanco et al., 2017).**




This discussion lies at the heart of the current debate on electricity uses, given new options for electricity-intensive industries that possess a high-tech component related to artificial intelligence, the emergence of digital assets, or new low-carbon industries. In all cases, regulatory pressures for green or low-carbon development of the electricity system intensify when high-electricity-consumption industries are proposed. In this regard, three dimensions underpin any green industrial electricity policy (Anzolin & Lebdioui, 2021): consumption orientation (rates and incentives that shape demand), corporate sustainability criteria (efficiency and the circular economy), and innovative production (creation of low-carbon industries and capabilities). To ensure that an institutional, market, or technological window of opportunity does not close, leaving behind only isolated investments and temporary profits, these policies must be accompanied by training, certification, R&D, infrastructure, and financing (Lema et al., 2020).

The data that anchors this discussion in the Paraguayan reality of 2025–2026 pertains to the group of special intensive loads, which are considered outside the ANDE[3] Tariff Schedule as a Special Intensive Consumption Group (SICG), receiving special treatment through contracts with ANDE that expire in December 2027. This initiative, which attracted almost exclusively cryptocurrency mining operations (around 47 users), accounted for ~25% of the electricity system's energy consumption in 2025 (ANDE,

[3] Public electric company

2025), with no direct contribution recorded in GDP accounting. In reality, cryptocurrency mining operations are considered among the industries with the least benefit to society, compared to green fertilizers or digital services for artificial intelligence. Table 1 provides a brief classification of policies regarding electricity use and support for production related to that use, in which cryptocurrency mining operations are virtually excluded due to their low socioeconomic impact. On the other hand, electric mobility is included, as it is proposed to play a role in the supply and value chains of electric vehicles—and not merely as a substitute for fossil fuels.

**Table 1. Matrix of instruments by uncertainty and position in the chain**

| Objective | Low uncertainty | Moderate/High Uncertainty |
|---|---|---|
| Build a national ecosystem | Targeted policy: verifiable goals, more established market (whether external or internal). E.g., green fertilizers, forestry-pulp industry, electric mobility | Exploratory policy: pilot projects, R&D, phased scaling due to market immaturity. E.g., green hydrogen, synthetic fuels |
| Integrate into mature global supply chains | Policies to improve quality and boost infrastructure, export targets. E.g., advanced agribusiness, logistics, manufacturing | Policies to drive technological advancement: innovation funds, modular projects. Examples: digital services, data centers, software, etc. |

**Source:** Prepared based on Allan & Nahm, 2025

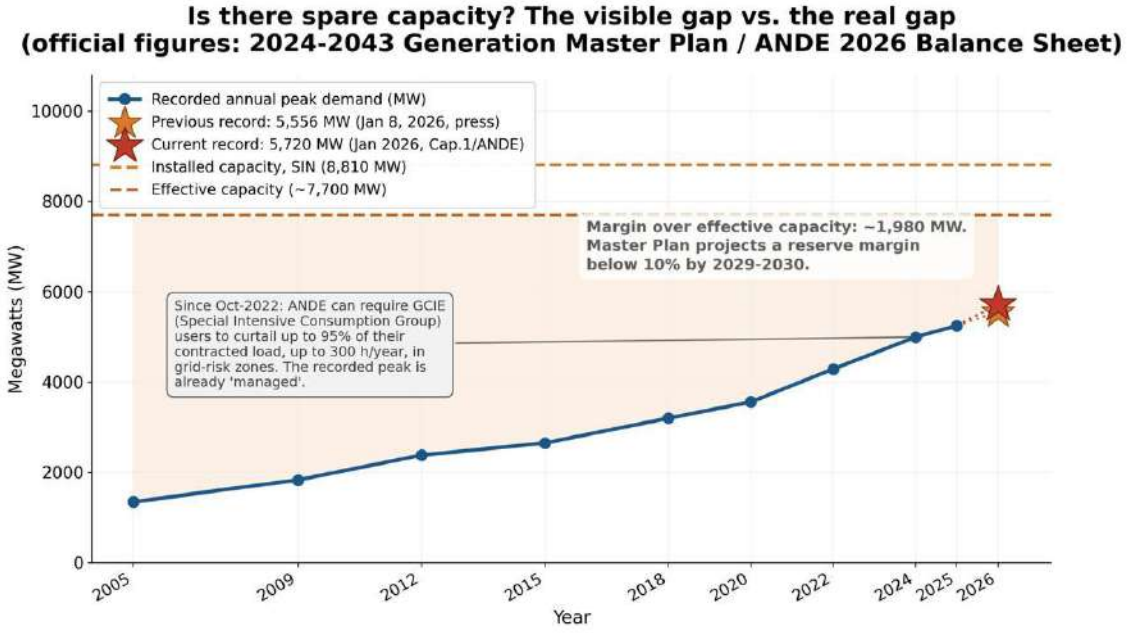
The strategic recommendation that emerges from the above, as well as from the literature on green industrial policy, is clear: reserve capacity for energy-intensive anchor projects only under enforceable and measurable conditions (grid investment, skilled employment, local procurement, technology transfer); sustain a diversified core of sectors that generate more value per MWh (agribusiness, forestry supply chains, chemicals, logistics, software); and to rule out a general, permanent, and unconditional promotional rate, which is incompatible with capturing the value of an increasingly scarce resource.

**Electricity Use in the Domestic Market and the Transfer of Energy**

After briefly reflecting on various policies related to electricity consumption, we now address the issue of surplus energy transfer as an alternative to domestic consumption. The discussion regarding the National Interconnected System (NIS) involves a wider range of considerations. It branches out into at least five distinct dimensions: i) actual grid capacity, ii) usage statistics, iii) the mechanics of energy transfer, iv) fiscal

distribution, and v) a growing constraint on generation. The magnitude of each of these dimensions becomes clearer with the most recent data available: on January 26, 2026, at 2:25 p.m., the National Interconnected System recorded a new peak demand record of 5,752 MW, against an effective installed generation capacity that has not increased in two decades (~7,700 MW). The margin that once seemed ample has shrunk to just 2,000 MW (see Figure 2). With this data as a starting point, it is worth examining the five dimensions closely.

**Figure 2. Installed capacity (8,810 MW) and effective capacity (~7,700 MW) compared to the highest recorded demand, including the record set in January 2026.**




**Source:** ANDE

The first dimension of analysis corrects an overly optimistic interpretation of the reserve margin: since October 2022, through contracts in effect until the end of 2027, ANDE may require large consumers in the Special Intensive Consumption Group (SICG, primarily cryptocurrency mining) to interrupt up to 95% of their contracted load for a period of up to 300 hours per year when the grid enters a risk zone (Annex to ANDE Resolution P/No. 49238, Art. 2.2). In practice, this means that a SICG user may be limited to only 5% of their usual consumption during those hours. The record of 5,752 MW is therefore—in part—a figure that can be managed relatively easily, not the actual demand of the entire system. It should be noted that currently the greatest constraint lies in the transmission grid, not in generation (that will be a problem in the short term). This observation is not made transparent or published with the same clarity as installed capacity.

The aforementioned potential management of peak power demand in the NIS does not dilute the SICG's effect on consumption over the entire year: the curtailment covers barely 3.4% of the hours in the year, so on the annual energy balance (gigawatt-hours, not instantaneous megawatts), the impact of energy-intensive industries is direct and almost unfiltered. The growth rate of national consumption accelerated significantly after 2022, coinciding with the creation of the SICG and the boom in cryptocurrency mining. By mid-2026, it reached around 1,300 MW, very close to the capacity of two ITAIPU generating units.

The other three factors explain why this is not merely an infrastructure issue. In the energy balance, the amount of energy allocated to the SICG is equivalent to the surplus currently transferred to Brazil. As that consumption increases, the transfer to Brazil will decrease, approaching zero during the 2030–2035 period. This situation has an impact on the Paraguayan Treasury; it is not insignificant. In 2025, Paraguay received approximately USD 165 million from the transfer of energy to Brazil for 10,456 GWh of energy[4]. Losing this transfer margin is not just a minor figure: these resources fund strategic development projects such as the National School Meals Fund (Fonae), created by the Zero Hunger Law, tuition-free university education, and others. This directly affects the general budget, which is not fully offset by domestic tax revenue (the sale of electricity generates VAT).

Based on the points raised in this section, one might conclude that the question guiding a strategy should not focus solely on comparing energy exports versus the domestic market, but rather on how to sustain future expansion of the electricity supply and how to create conditions to support the national government's strategic and highly socially sensitive programs.

**Final Reflections**

The information presented leads to a general conclusion: Paraguay can no longer manage its hydroelectricity as an abundant and permanent surplus, but rather as a strategic, increasingly scarce resource, whose allocation must simultaneously maximize economic value, employment, technological learning, security of supply, and fiscal sustainability.

The most appropriate strategy for utilizing the remaining hydroelectricity would be a selective combination. On the one hand, it is important to preserve a diversified core of economic activities that generate significant employment, foster productive linkages, generate tax revenue, drive innovation, and boost export capacity—such as advanced

[4] The amounts received from energy transfers in a given year may not match the total amount of energy transferred due to a time lag between the year in which the energy is calculated and the amounts actually transferred to the Paraguayan Treasury.

agribusiness, certified forestry supply chains, logistics, and digital services. On the other hand, large-scale energy-intensive projects may be permitted when they function as anchor industries—such as green fertilizers and data centers for artificial intelligence—provided they are subject to verifiable obligations regarding investment in infrastructure, skilled employment, domestic procurement, energy efficiency, technology transfer, and strong environmental performance.

Within this framework, incentive rates should not be conceived as general, permanent, or performance-unlinked subsidies. They must be temporary, subject to review, and conditional on development commitments. The treatment afforded to cryptocurrency mining operations illustrates the risk of allocating a substantial portion of energy to activities with a low multiplier effect: the Special Energy-Intensive Consumption Group came to account for a very significant fraction of national consumption without a direct contribution equivalent to GDP.

This analysis demonstrates that the strategic issue is not simply a choice between exporting energy or consuming it domestically. The real decision is how to transform a declining hydroelectric revenue stream into a sustainable productive base, without compromising system security or weakening public revenues. Paraguay should adopt a policy of selective capacity allocation, based on multi-criteria evaluation, performance-based contracts, and transparency regarding the costs and benefits of each project. Priority must be given to activities capable of generating more development per MWh, and not merely to those that require large blocks of power. This suggests that energy policy must move away from the criterion of maximizing electricity sales and adopt that of maximizing public value per unit of energy.

This strategy requires, simultaneously, strengthening transmission, expanding and diversifying generation, gradually reforming tariff signals, improving ANDE's financial capacity, and establishing inter-institutional governance with verifiable goals. Under these conditions, modern electricity-intensive industries can represent an opportunity; without them, they may become a mechanism for rapidly absorbing available energy, with limited benefits and rising costs for the electric system and for the country.

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# PARAGUAY, MERCOSUR, AND THE AGREEMENT WITH THE EUROPEAN UNION

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Few dates will have as profound an impact on South American trade policy as May 1, 2026. On that day, the trade pillar of the Association Agreement between Mercosur and the European Union (EU) entered into force on a provisional basis. This is the largest bi-regional treaty ever negotiated, encompassing a region of more than 700 million people that accounts for nearly 20% of global GDP and one-third of international trade. For Paraguay, the agreement offers both the promise of preferential market access and a challenging test of institutional maturity.

**The Political and Trade Context of the Signing and Entry into Force**

Nothing about this agreement happened quickly. After more than twenty-five years, negotiations on the trade pillar were politically concluded in December 2024, and the formal signing took place on January 17, 2026, in Asunción. It is important to distinguish between two instruments that are often conflated: the provisional trade agreement, which has been in effect since May 2026, and the full Association Agreement, which includes the protocols on political dialogue and cooperation. Although all three form a delicate negotiating balance, the entry into force of the latter two is contingent upon ratification by the twenty-seven member states—a slow process with an uncertain outcome.

The backdrop could not be more hostile to free trade. According to ECLAC[1], global merchandise trade grew by 4.6% in volume during 2025, but the outlook for 2026 is clouding over—the WTO projects a slowdown of up to 1.9%, due to Donald Trump's unilateral tariffs and disruptions to value chains linked to the conflict between the United States and Iran. In this environment, the weakening of trade multilateralism is

[1] Economic Commission for Latin America and the Caribbean (ECLAC), *MERCOSUR Foreign Trade Bulletin No. 9. The Agreement with the European Union: An Opportunity for Growth, Productive Development, and Institutional Consolidation for MERCOSUR* (LC/BUE/TS.2026/2) (Santiago: ECLAC, 2026), https://www.cepal.org/es/publicaciones/90112-boletin-comercio-exterior-mercosur-9-acuerdo-la-union-europea-oportunidad

driving the search for new bilateral or regional alliances. “Diversification” and “value chain resilience” are the buzzwords of international trade.

The process, however, was far from smooth. Following its approval by the European Council, the European Parliament referred the text to the Court of Justice of the European Union in January 2026, delaying its ratification, and tightened safeguards on sensitive agricultural products—beef, poultry, honey, sugar, and ethanol— and confirmed that the European Regulation on Deforestation will take effect in 2027. As a counterbalance, an unprecedented rebalancing clause was successfully introduced, which protects both blocs against unilateral measures that nullify the negotiated trade benefits. If a subsequent unilateral law disrupts the balance, the aggrieved party may demand compensation, and if the issue remains unresolved, the agreement allows for retaliation or the suspension of concessions. Mercosur demanded this provision to neutralize the impacts of European environmental legislation on negotiated tariff advantages and market access.

Subsequently, the 68th Summit of the Common Market Council, held in Paraguay in late June, highlighted the disagreement over the allocation of agricultural quotas secured with the EU. While Paraguay advocates for an equal distribution of 25% for each country, the criteria under discussion for allocating the quotas appear to be converging: those of Argentina and Uruguay (average exports of the assigned product to the EU) and those of Brazil (average global exports of the assigned product) [2]. In the hypothetical case of beef, and using 2025 volumes as an illustrative reference, the Brazilian criterion would give Paraguay about 7% of the Mercosur quota, while the Argentine-Uruguayan criterion would be even lower: about 3%. Between 3% and 25%, there remains a huge gap to be negotiated. It is no coincidence that Brazil recently announced its intention to increase its annual contribution to the Mercosur Structural Convergence Fund (FOCEM) to US$100 million, when at the beginning of the year it had intended to reduce it to US$35 million: the timing can be interpreted as a compensatory offer to finalize the internal distribution of quotas.

**Challenges and Opportunities for Mercosur and Paraguay**

The economic analysis offers an uncomfortable lesson: the magnitude of the gains from the agreement with the EU is not predetermined; it depends on what Paraguay does within its own borders. This is demonstrated by the Inter-American Development Bank’s computable general equilibrium model[3]. Left to its own devices, trade liberalization would raise Paraguay’s GDP by a mere 0.1%, but when accompanied by productivity

[2] *La Diaria*, “Quota Negotiations in the Mercosur-EU Agreement: Lubetkin Highlighted Differences in Approaches but Noted Common Ground Between Uruguay and Argentina,” May 14, 2026, https://ladiaria.com.uy/politica/articulo/2026/5/negociacion-de-cuotas-en-acuerdo-mercosur-ue-lubetkin-marco-problema-de-criterios-pero-destaco-coincidencias-de-uruguay-y-argentina/

[3] Paolo Giordano, *Mercosur–European Union Agreement: Ex-ante Assessment of the Aggregate Economic Effects on Paraguay* (PowerPoint presentation, Inter-American Development Bank, July 1, 2026).

reforms and deeper regional integration, it would jump to 1.1%, with a 1.6% drop in unemployment, a 3.5% reduction in poverty, and a 1.7% increase in private consumption. What is revealing is the breakdown: of that 1.1%, only 0.07 percentage points come from trade liberalization alone, and 0.61 from productivity gains. More than half of the benefit, then, does not come from the treaty itself, but rather from the domestic reforms it should spur. Institutions and policies matter: weak state capacity exacerbates the negative effects of the implementation. The agreement should catalyze domestic and intraregional efforts, which is why deepening Mercosur is a strategic asset.

The liberalization schedule is deliberately asymmetrical and favors Mercosur: the EU liberalizes 74% of its trade immediately and 92% within ten years, while the South American bloc liberalizes 72% only after ten years and 91% after fifteen, leaving 9.1% out of the agreement compared to the EU's 0.3%. Mercosur secured substantial quotas—99,000 metric tons of beef, 45,000 metric tons of honey, plus sugar, ethanol, rice, and grains—and Paraguay obtained its own quotas for organic sugar, pork, and ethanol. But having the benefit on paper does not mean taking advantage of it, and the "first come, first served" system exacerbates the risk for Paraguay.

The underlying problem for Paraguay is not so much European competition as its dependence on a handful of non-traditional manufactured goods that are sold almost exclusively to Brazil and Argentina. Therefore, it must continue to advance a coordinated trade defense system with the other Mercosur countries, while simultaneously strengthening and diversifying its instruments for productive financing and industrial policy, both at the national and regional levels. With a view to achieving more stable intraregional trade and strengthening the capacity for sectoral adaptation and adjustment in the face of the distributional effects of extraregional agreements with major partners such as the EU, deviations from intraregional trade must be monitored, and the Competitive Adaptation Mechanism and Program—agreed upon by Brazil and Argentina but never formally implemented—must be regionalized. To make these mechanisms effective, they should be linked to long-term concessional credit lines and automatic approval by FOCEM, the La Plata Basin Development Fund (FONPLATA), the Development Bank of Latin America (CAF), and/or the European Investment Bank (EIB).

Some figures clearly illustrate the scale of the challenge. Paraguay ceased to benefit from the unilateral preferences granted by the EU through the Generalized System of Preferences (GSP) upon graduating as a middle-income country in 2019. Despite its growth under that regime, only 3.5% of our sales to the EU actually utilized those preferences[4]. This recent example illustrates that the real bottleneck, ultimately, is not tariffs but the ability to meet European technical requirements.

[4] Gustavo Rojas and Lucas Arce, *From the Generalized System of Preferences to the Association Agreement: Paraguay and the European Union* (Asunción: Center for Analysis and Dissemination of the Paraguayan Economy [CADEP], June 2019).

The Cooperation Protocol seeks to facilitate the adaptation of vulnerable economic actors in Mercosur (MSMEs, women, small farmers, indigenous peoples, and local communities) so that they can compete and benefit from the trade pillar. The EU committed to a financing program to channel preferential cooperation, using new resources not currently available in other programs.

For the sustainability agenda, the fact that the Protocol is not yet in force represents a major challenge[5]. There is a risk that the agreement's environmental commitments, if not accompanied by adequate financing and cooperation mechanisms, will result in asymmetric access to trade benefits, favoring large companies with greater capacity for regulatory adaptation and progressively excluding small and medium-sized producers, family farmers, and regional economies. In turn, the lack of technical, institutional, and technological capacity to meet the new European standards could result in a loss of competitiveness, underutilization of quotas, and an erosion of Mercosur's export interests in key agri-food sectors. The bloc's governments must demand compliance with the political commitment made during the negotiations, regardless of the Protocol's current legal status.

The EU participates with specialized technical teams, impact assessments, and coordinated positions. Without a legal mandate for technical preparation, accountability, and the institutionalization of participation by the productive, social, and academic sectors, Paraguay runs the risk of adopting a reactive stance. This institutional asymmetry could prove decisive in realizing the agreement's benefits.

**Geoeconomic Outlook: Strategic Autonomy, Critical Minerals, and Neo-Industrialization**

Viewed from a strategic perspective, the agreement is much more than just tariffs and quotas. It fits into Europe's concept of "open strategic autonomy"—the desire to operate with its own leeway in a multipolar world without renouncing open markets—an idea that runs through the reports by Draghi[6] and Letta[7]. The numbers explain why Europe is once again looking south: once the treaty is ratified, its network of agreements will cover 97% of the GDP of Latin America and the Caribbean, compared to 44% for the

[5] Esteban Actis, *The Mercosur-European Union Agreement: Challenges Ahead of Its Entry into Force* (Buenos Aires: ICBC Foundation, 2026).
[6] Mario Draghi, *The Future of European Competitiveness: A Competitiveness Strategy for Europe* (Brussels: European Commission, September 9, 2024), https://commission.europa.eu/topics/competitiveness/draghi-report_en
[7] Enrico Letta, *Much More Than a Market: Speed, Security, Solidarity. Empowering the Single Market to Deliver a Sustainable Future and Prosperity for All EU Citizens* (Brussels: Council of the European Union, April 2024), https://research-and-innovation.ec.europa.eu/document/download/5e8c2ecf-0679-4a89-a9bb-fd2219d2f9d4_en

United States and 14% for China[8]. Excluding the United States, Mercosur accounts for the largest stock of Foreign Direct Investment (FDI) from the EU outside of Europe[9], surpassing China, Japan, and India. For Mercosur, the benefit is of a different nature—acting as a bloc: this is its first comprehensive treaty with a partner outside the region, with a ripple effect on agreements with Singapore, EFTA, and the United Arab Emirates.

The most contested area is that of critical raw materials for the green and digital transitions. Agramont-Lechín[10]points out that Latin America is the second-largest supplier of minerals to both China and the EU—accounting for about one-third of each power's imports—and a region where the two sides' interests clash head-on. Over the past two decades, China has displaced European and Japanese competitors to secure the bulk of the region's mineral exports. Nevertheless, the region offers Europe a path to diversification, particularly in lithium and antimony. It is no surprise that Europe passed its Critical Raw Materials Act in 2024 and, in December 2025, the RESourceEU Action Plan, with an eye on Brazil's rare earths[11]. At the same time, Paraguay's Pro Tempore Presidency has just presented the Roadmap for the Mercosur Critical Minerals Plan[12].

This is where complementarity ceases to be a slogan and becomes a development decision. The formula—Mercosur provides critical minerals and renewable energy, while Europe provides capital, technology, and know-how—only benefits the region if it translates into neo-industrialization with technology transfer, rather than yet another round of raw materials without added value[13]. In that sense, the agreement maintains the flexibility to adopt industrial policy tools, such as offsets, technology procurement requirements, preferential margins, and measures targeting small and medium-sized enterprises.

Both Europe and Mercosur stand to gain from this arrangement, which faces one of its main immediate challenges in the automotive sector. Much of Mercosur's intra-industry trade revolves around automobiles, which are largely built on investments by European-owned assembly plants and auto parts manufacturers—investments that remain focused on combustion-engine vehicles. However, the rapid advancement of the

[8] Cornejo, R., Estevadeordal, A., and Talvi, E. (2025). *Towards an integrated EU–Latin America economic area: A policy proposal*. Georgetown Americas Institute. Retrieved from https://americas.georgetown.edu/publications/towards-an-integrated-eu-latin-america-economic-area-a-policy-proposal

[9] AQUÍ Europa. (2024). *The EU's external actions totaled 9.160 trillion euros in 2023*. Retrieved from https://aquieuropa.com/las-acciones-externas-de-la-ue-alcanzaron-los-9-160-billones-de-euros-en-2023/

[10] Agramont-Lechín, D. (2026). *Europe's quest for critical raw materials in Latin America: The clash with China and diversification opportunities*. *Latin American Journal of Economic Development (LAJED)*, 45, 11–46.

[11] Bloomberg Línea. (2026). *Why Latin America Is Gaining Importance in Europe's Strategy for Critical Minerals and the Green Transition*. Retrieved from https://www.bloomberglinea.com/economia/por-que-america-latina-gana-peso-en-la-estrategia-de-europa-de-minerales-criticos-y-la-transicion-verde/

[12] Eixos. (2026). *Mercosur to Have a Roadmap for Critical Minerals*. Retrieved from https://eixos.com.br/newsletters/dialogos-da-transicao/mercosul-tera-mapa-do-caminho-para-minerais-criticos/

[13] Cornejo, R., Estevadeordal, A., and Talvi, E. (2025). *Towards an integrated EU–Latin America economic area.*

Chinese automotive industry—with more innovative and affordable electric cars—is shifting consumer preferences and diverting regional intra-industry trade toward extra-regional inter-industry trade with China[14]. The same shift is occurring in European intra-regional trade. The vehicles that will dominate the sector—electric (18 years), hydrogen (25 years), and new technologies (30 years)—benefit from an extended tax relief schedule. Transforming the Mercosur and European automotive industries through joint efforts on both sides of the Atlantic, in a "mutually beneficial partnership," is the challenge at hand.

Paraguay offers a promising testing ground. With electricity generation that is almost entirely renewable thanks to Itaipú and Yacyretá[15], it aims to produce green hydrogen: the Atome project although iy is mired in controversy over subsidized electricity rates[16]. In July 2026, the Itaipú Technology Park sought to certify its first experimental clean hydrogen unit[17], while the country courts German capital in food technology, artificial intelligence, and renewable energy, with Germany willing to view it as an industrial partner, not merely a source of raw materials[18].

At the same time, the rise of Asian economies and their integration with Mercosur is forcing the bloc to play on two fronts. Mercosur announced formal negotiations with Japan and plans to hold its first round of negotiations with Vietnam this semester. Uruguay, currently holding the pro tempore presidency, issued a blunt warning to Brussels: ratify Mercosur or risk losing South America to China[19]. The European strategy of "mutually beneficial partnership," channeled through the Global Gateway, remains limited in scope compared to large-scale Chinese cooperation rooted in finance, energy, and infrastructure—and which is moving toward greater diversification into sectors such as artificial intelligence and the electric vehicle industry. The outcome will depend on whether Europe (co)develops commitments aligned with the region's priorities. This requires not only receiving cooperation but also verifiable mechanisms for technology transfer and value chain integration that serve its own neo-industrialization project—and not just European security of supply.

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[14] Rodríguez Díaz, J. D. (2026). *From Fordlandia to BYDlandia: China's Automotive Hegemony in Latin America. The Case of Mercosur TONGDAO. Latin American Journal of Contemporary Chinese Studies, 3(1), 1–21.*

[15] Binational Hydroelectric dams

[16] La Nación. (2026, June 23). *ANDE–Atome Negotiations: "We Will Wait for the Conclusion of Those Talks," Says Peña*. Retrieved from https://www.lanacion.com.py/politica/2026/06/23/negociaciones-ande-atome-esperaremos-la-conclusion-de-esa-conversacion-senala-pena/

[17] ABC Color. (2026, July 5). *Green hydrogen: Itaipú seeks to certify its first clean production unit*. Retrieved from https://www.abc.com.py/economia/2026/07/05/hidrogeno-verde-itaipu-busca-certificar-su-primera-unidad-de-produccion-limpia/

[18] *Mundo Fluvial Marítimo*, "EU–MERCOSUR Alliance: Paraguay Seeks to Attract German Capital to Industrialize Agriculture, Develop Artificial Intelligence, and Revamp Its Energy Mix," 2026, https://mundofluvialmaritimo.com/alianza-ue-mercosur-paraguay-busca-captar-capitales-alemanes-para-industrializar-el-agro-desarrollar-inteligencia-artificial-y-renovar-su-matriz-energetica/

[19] *Euronews*, "Ratify Mercosur or Risk Losing South America to China, Uruguay Warns EU," July 7, 2026, https://www.euronews.com/my-europe/2026/07/07/ratify-mercosur-or-risk-losing-south-america-to-china-uruguay-warns-eu

The agreement with Europe does not replace the task of deepening intra-bloc integration; rather, it makes it more urgent. There is a lack of a coordinated mandate among Mercosur member states to manage trade defense and act within the agreement's governing bodies, which treat the bloc as a single entity. Uncoordinated action weakens the bloc's collective negotiating position and reopens the debate on strengthening regional institutions: common technical capacities, regulatory coordination, and permanent consultation mechanisms as conditions for Mercosur to act as a bloc rather than as a sum of national interests.

The persistent decline in intraregional trade reveals a lag that no expansion of trade outside the region can resolve on its own. We must expand the dynamic advantages of a stronger joint presence in Europe and Asia by reducing non-tariff barriers, facilitating intra-block trade, implementing self-certification, and expanding regional rules of origin; by bringing the Mercosur Customs Code into force; and by extending the Most-Favored-Nation clause to services. Member and Associate States must advance an agenda focused on the quality of goods and institutions: complying with stringent European rules opens access to any other market—such as the Asian market—and enhances the systemic competitiveness of the private sector.

For Paraguay, a landlocked country that directs the bulk of its foreign sales to Mercosur, the message is clear: to shore up regional integration while taking advantage of market access, attracting more European investment—the primary source of investment in the country—and contributing to the future physical (Bioceanic Route) and institutional architecture of Mercosur's integration with the Asia-Pacific region, the epicenter of the global economy.

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