

# BTI 2010 | Paraguay Country Report

<b>Status Index</b>	1-10	<b>6.34</b>	# 41 of 128	
Democracy	1-10	7.00	# 37 of 128	➔
Market Economy	1-10	5.68	# 64 of 128	➔
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scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	6.1	HDI	0.76	GDP p.c.	\$	4433
Pop. growth	% p.a.	1.7	HDI rank of 182	101	Gini Index		53.2
Life expectancy	years	72	UN Education Index	0.87	Poverty <sup>2</sup>	%	14.2
Urban population	%	59.7	Gender equality <sup>1</sup>	-	Aid per capita	\$	17.6

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

## Executive Summary

Paraguay is passing through a period of political transition. On 20 April 2008, after 61 years in power, the Colorado Party lost the presidential elections. Fernando Lugo, a former bishop and candidate representing a broad coalition of parties and social organizations, won the election with 41% of the votes cast. The new president supports a far-reaching and ambitious reform program, which includes land reform, efforts to instill greater efficiency and transparency in public administration (by curbing corruption), poverty reduction and sustainable growth, as well as a renegotiation of the Itaipú dam treaties with Brazil. However, the president lacks a parliamentary majority. Moreover, the strongest party of his coalition, the Liberal Party, supports only a part of his reform agenda. The vice president, a member of the Liberal Party, is in conflict with the president, and Lugo is even in a minority position within his own party. The Colorado Party is still the strongest party in congress, and is eager to recapture the government. In this environment, the party of retired General Lino Oviedo, who was convicted in 1998 of rebellion against the civilian authorities, is in a pivotal position to provide a majority to the governmental coalition or to the Colorado Party opposition. The new president nominated a respected independent expert as finance minister, giving a clear signal to the economic elite and the international community. However, he also faces serious conflict over land, including illegal land occupations and violent clashes between landless peasants and the police. There is a real risk that the new president will fail to meet voters' expectations, creating frustration and a growing potential for protest. In the worst case, his presidency may end prematurely. A strategy to mobilize the citizens against traditional parties – as has been the case in Ecuador – is not viable in Paraguay.

## History and Characteristics of Transformation

Paraguay's transition to democracy, which resulted from power struggles within the elite, was initiated in 1989, after 35 years of dictatorship under General Alfredo Stroessner. Initially, the political opposition and civil society played no role in the transition process. Thus, the transition to democracy was characterized by extensive continuity among the elites in politics and the bureaucracy (public administration, military and judiciary). Stroessner had used the Colorado Party as a tool to safeguard his rule. Party membership was a prerequisite for a career in the administration or the military. Through the party, the country was governed by means of a tight network of control and patronage. Even after the transition to democracy, the Colorado Party remained in power. While it is true that a process of democratization in political institutions was initiated under presidents Andres Rodriguez (1989 – 1993) and Juan Carlos Wasmosy (1993 – 1998), with a new constitution in 1992, the military still played a troublesome role into the 1990s. Highly politicized, the military viewed itself as part of the Colorado Party, and it openly took partisan positions. President Rodriguez, as leader of the coup against Stroessner, was the former commander-in-chief of the army; General Lino Oviedo, the commander-in-chief under President Wasmosy, tried to use his position as a political springboard. On 28 March 1999, President Raul Cubas Grau (1998 – 1999) resigned to avoid impeachment. Cubas (Colorado Party) had taken office in August 1998 and was considered the puppet of General Lino Oviedo, who, because of a failed 1996 coup attempt, was banned from the May 1998 presidential elections that he would have otherwise presumably won. On 23 March 1999, Vice President Luis Maria Argaña was murdered. Argaña had been considered Oviedo's main opponent within the ruling Colorado Party, and Oviedo was therefore thought to have been behind the assassination. After mass protests, especially by youths, resulting in deaths and injuries, Cubas and Oviedo eventually left the country (for Argentina and Brazil respectively), seeking political asylum.

In June 2004, Oviedo returned to Paraguay, where he was immediately placed in military custody. However, his political party, the National Unity of Ethical Citizens (Union Nacional de Ciudadanos Eticos, UNACE) party, an offshoot from the Colorado Party, won representation in parliament and subsequently served as a strategic partner for both the government and the opposition parties. After the resignation of President Raul Cubas in 1999, the head of the Senate, Luis Angel González Macchi, was sworn in as the new president for the remainder of the term until August 2003. Because of his lack of democratic legitimacy (he was not popularly elected) and the fragmented nature of the ruling Colorado Party, González was in a weak position. Political stalemate, economic backsliding, widespread corruption and a clear deterioration of the social situation have characterized his presidency.

In April 2003, Nicanor Duarte Frutos of the Colorado Party won the presidential election with 37.1% of the vote and assumed office in August of that year. His party started in a minority position in both chambers of the National Congress. But because of party switches, it later controlled a majority of 43 seats in the Chamber of Deputies and 18 out of 45 senators. President

Duarte's government marked a good start; it increased tax collection in a significant way, curbed fiscal deficits, contained inflation, and started a program of structural reforms. The president received high approval ratings. However, the reform impetus ultimately dissipated, and national politics refocused on internal power struggles within the Colorado Party and Duarte's re-election plans. Political and judicial disputes over Duarte's participation in the internal elections of the Colorado Party (the opposition parties tried in vain to impeach him), along with Duarte's reelection campaign, revived political opposition and civil society organizations, which staged a massive demonstration in Asunción in March 2006. Fernando Lugo, the emeritus bishop of San Pedro, one of the poorest departments in Paraguay, emerged as the leader of the opposition movement. In February 2007, an agreement was signed between all key opposition parties and about 30 social and labor organizations to present a common front in the 2008 elections. Much political bickering followed, and some opposition parties left the alliance. But Lugo was ultimately nominated as the candidate of the Patriotic Alliance for Change (*Alianza Patriótica para el Cambio*, APC), which comprised the main opposition party, the center-right Liberal Party (*Partido Liberal Radical Auténtico*, PLRA), eight smaller leftist parties and 20 social organizations. While Lugo was to serve as the presidential candidate, the Liberal Party nominated the vice-presidential candidate (Federico Franco) in a contested internal election.

On 20 April 2008, after 61 years of Colorado Party hegemony, Fernando Lugo won the presidential elections. In Paraguay the president is elected by a plurality electoral system. Thus, Lugo won with 41% of the votes cast, against the candidate of the ruling Colorado Party, Blanca Ovelar (31%), and Lino Oviedo (22%). The new president has defined four main objectives: a reform of political institutions aimed at improving the efficiency of the public administration and a curbing of corruption (especially in the judiciary); the creation of new jobs and a reduction in poverty; land reform; and a renegotiation of the Itaipú dam treaty with Brazil. However, the new president lacks a parliamentary majority: His APC coalition holds only 31 of 80 seats in the lower chamber and 17 out of 45 seats in the Chamber of Senators. The coalition may perhaps be supported by the Beloved Fatherland Party (*Partido Patria Querida*, PPQ) with 4 seats in each chamber. The Colorado Party is still the strongest party (with 30 seats in the lower house, and 15 in the upper). So in a certain sense, the UNACE party of retired General Lino Oviedo, with nine seats in the senate and 15 seats in the Chamber of Deputies, is in a pivotal position.

## Transformation Status

### I. Democracy

In transforming its political order, Paraguay has made progress in strengthening political institutions. There are still shortcomings with regard to the quality of its democratic institutions, and the rule of law. Progress has been made in stabilizing democracy (in particular, the military's veto powers have been neutralized), but this progress has to be consolidated further. The election of President Fernando Lugo in May 2008 represents an important step in the process of democratic consolidation, because for the first time there has been a democratic transfer of power, with the dominant Colorado Party losing power after 61 years.

#### 1 | Stateness

In principle, the state's monopoly on the use of force has been established nationwide, but is not in effect everywhere, especially in border areas. Large areas of the country are sparsely populated, with no control of the borders or national airspace. In the "tri-border area," where Paraguay, Argentina and Brazil meet around the border city of Ciudad del Este, the state's power and resolve have failed in the battle against smugglers (i.e., arms), drug trafficking and illegal immigration. The U.S. government perceives Paraguay as a significant transit country for drugs (cocaine) and a principal center for money laundering. There could be some fundraising activities related to terrorist organizations in the sizable Muslim communities in the border region. In the conflict between landowners and landless peasants from time to time both sides act outside the law by illegally occupying land or organizing armed groups.

Monopoly on the use of force

All citizens share the same set of civil rights in theory. However, indigenous groups cannot in practice assert their rights adequately, and are neglected by the government. This is partly because they are few in number (90,000 people, or 1.5% of the population), and partly because they are a poorly organized minority. The property interests of the indigenous populations are not adequately protected, and they have been displaced from their ancestral lands. In the 2008 Latinobarómetro survey, 20% of respondents identified indigenous people as the group facing the greatest amount of discrimination in Paraguay (40% said the poor are the most discriminated-against group). Ninety-five percent of the population is "mestizo," or

State identity

of mixed parentage. The constitution recognizes Paraguay as a multicultural, bilingual country, with Guarani and Spanish as the official languages. In the 2007 Latinobarómetro survey, 31% of Paraguayan respondents declared that they spoke an indigenous mother language. There is a significant population of between 300,000 and 600,000 Brazilians in the border area (the so-called Brasiguayos), many of them landowners in possession of great stretches of arable land used for soybean production. Their loyalty lies more with Brazil than with the Paraguayan state, and the Brazilian government defends their interests against expropriation and expulsion. The possession of large tracts of land by foreigners gives a special twist to the conflict over land in Paraguay. Some activists in the landless peasants' movement in Paraguay have called for the expulsion of the Brazilian landowners.

Church and state are largely separate, and religious dogma has no noteworthy influence on policy or law.

No interference of religious dogmas

The state has a functioning basic infrastructure throughout most of the country, including administrative institutions, officials, the fundamental administration of justice, and the making and implementation of political decisions. However, there is low state presence in the San Pedro and Chaco regions. Corruption and political colonization of the administration have affected the functioning of the state.

Basic administration

## 2 | Political Participation

National elections largely satisfy the requirements of democracy. But patronage and political dependencies (particularly in the civil service) influence the election process, so that in the past the Colorado Party has been structurally in a favored position. Nonetheless, the internally divided Colorado Party lost the 2008 presidential elections, leading to the first change of governing party since the democratic transition. The political parties' internal procedures for candidate selection are not always respected. The selection of the Colorado Party's presidential candidate and the Liberal Party's vice-presidential candidate for the 2008 election were each highly contested. The defeated candidates questioned the results of the internal elections. In the case of the Colorado Party, the members of the internal electoral tribunal were involved in the internal quarrels and therefore not able to take a decision. The conflict thus had to be decided by the national electoral tribunal, which was itself suspected of favoring the candidate supported by outgoing president Duarte.

Free and fair elections

Democratically elected representatives have the effective power to govern, and the influence of actors with veto powers, especially those in the military, has declined. The military is today almost wholly subordinated to civilian control. Due to the mobilization power and economic influence of the landowners, any land reform and taxation of agricultural exports may be blocked in advance before the topics enter

Effective power to govern

the ordinary political decision-making process. The Brazilian government meddles in the internal affairs of Paraguay in defense of the interests of its citizens, mainly landowners, who live in Paraguay's border area.

Independent political and civil society groups are generally allowed to form freely. However, there are legal and bureaucratic barriers to union organization, due to a high minimum membership requirement. Private sector employers oppose the formation of unions. Laws that prohibit discrimination against unions are not always enforced. The level of unionization is around 15% of the formal labor force (with 1600 unions and 121,000 members in total). Farmers and landless peasants are also organized. Their mobilization in favor of state subsidies, land allocation and land ownership is sometimes suppressed violently by the state or by private actors. The government has positioned army units in the regions where peasant protest movements have been strongest.

Association /  
assembly rights

The freedoms of opinion and of the press are constitutionally guaranteed. There is a pluralistic media sector, including private and public radio and TV broadcasters. However, media pluralism is greatly threatened by the growing concentration and influence wielded by political parties (especially the Colorado Party) over the media. Critical journalists are sometimes physically threatened and even assassinated, especially if they report on corruption and organized crime. Defamation and libel laws are applied quite arbitrarily and are used to intimidate journalists and media owners. There are no government restrictions on the Internet. However, only 22% of Paraguayan respondents in the 2008 Latinobarómetro survey said that they had used the Internet at least once in their life.

Freedom of  
expression

### 3 | Rule of Law

Constitutionally, Paraguay has a system of separation of powers and checks and balances in place. This is particularly true in situations in which the president's party lacks a majority in the National Congress. In this combination, the Supreme Court too may act in an independent manner, even though judges are selected according to political criteria and quotas. There has been a tendency for each new elected president to attempt to change the composition of the Supreme Court. In comparison with other Latin American peers, the Paraguayan president is not a strong president.

Separation of  
powers

The judiciary, especially the Supreme Court, has a relatively independent position in principle, though it cannot be considered politically neutral. Judges are appointed according to political as well as professional criteria. Approximately 60% of judges are members of the Colorado Party. At all levels, there are problems with professionalism, as well as a severe vulnerability to corruption and political influence in the course of trials. After his inauguration, President Duarte sought to

Independent  
judiciary

change the character of the Supreme Court, justifying the near-clean sweep by calling for a crackdown on judicial corruption. Four members of the tribunal resigned voluntarily, and two were removed through impeachment proceedings. Only three judges of the Supreme Court remained in office. Party-based quotas heavily influenced the selection of new judges. The Supreme Court came under political pressure by Congress and by street demonstrations when it agreed in March 2006 to hear a challenge filed by President Duarte against an article of the constitution barring the president from holding another private or public office simultaneously. President Duarte had just won the internal election for the presidency of the Colorado Party. There have been some controversial decisions related to former army chief Lino Oviedo, who was sentenced to a ten year prison term for rebellion in 1996, and who was accused of masterminding the assassination of Vice President Argaña in 1999. In July 2007 the Supreme Court granted Oviedo habeas corpus and lifted the preventive imprisonment in the pending Argaña case. Two month later, on 6 September 2007, a military tribunal freed him, basing the decision on the generous interpretation that he had served half of his sentence without fomenting political unrest. Moreover, a short time after his release from prison, the Supreme Court absolved Oviedo in November 2007 of the charge of having plotted a coup against President Wasmosy in 1996. Thus, he was able to be a candidate in the 2008 presidential election. It was speculated that President Duarte had used his influence over the judiciary to set Oviedo free with the objective of splitting the opposition and improving the chances of the Colorado Party.

At the level of political leadership, corrupt officials have been prosecuted in isolated cases, but they often take advantage of legal and procedural loopholes, or can count on political connections. The vast majority of cases of political corruption are not prosecuted. In 2007 the Supreme Court absolved two ex-presidents (Wasmosy and González Macchi) of corruption charges. President Duarte's administration began with a purge of corrupt officials in the tax collection services, the customs administration, the police and the courts. However, the impetus to combat corruption and to strengthen the judiciary ran out of steam, and the second half of Duarte's presidency was focused rather on his reelection bid and on efforts to secure the power of the Colorado Party. For that reason, he had no interest in creating an independent judicial power or in confronting vested interests that could put his own power base at risk. Among the main objectives of the new Lugo government are the efforts to combat corruption (especially in the judiciary) and ensure more transparency. But it will be difficult to achieve these objectives with a weak parliamentary power base. On the one hand, there is no majority for an impeachment of the serving Supreme Court judges, while on the other, new judges would be selected in any case according to political criteria and quotas.

Civil liberties, and especially basic political rights, are largely secure. There are no political prisoners. Although the introduction of a new code of criminal procedure (1999) has helped to better protect the rights of the accused, deficiencies in the rule

Prosecution of  
office abuse

Civil rights

of law result from the prolonged duration of proceedings and investigative arrests. Conditions in the hopelessly overcrowded prisons have repeatedly sparked criticism. However, some progress has been made with the construction of new prisons. There have been repeated reports of excesses by the security forces, including torture and extralegal executions of prisoners, crime suspects and draftees. Human rights organizations have reported killings and illegal arrests by security forces and armed civilian patrols responding to land invasions. The creation of these “Neighborhood Security Commission” patrols had been allowed for by a 2003 law which has since been abolished via decree by President Lugo. Human rights defenders working to promote peasants’ rights have been harassed and threatened. In a few exceptional cases, human rights violations from the Stroessner era have been criminally prosecuted. However, most such cases have not yet been processed, even though the Office of the Prosecutor General includes a special advisor for human rights who actively works to prosecute crimes perpetrated under the dictatorship.

#### 4 | Stability of Democratic Institutions

Democratic institutions perform their functions, but frictions arise in the interplay between the president and congress. The current president lacks a majority in parliament. The governing coalition is very heterogeneous, including some minor parties and the Liberal Party, which is divided into factions and opposed to some of the president’s reform proposals (such as land reform or the imposition of an income tax). But the opposition too is divided between the party of retired General Oviedo (UNACE) and the Colorado Party, which is itself split between different factions (for example between the supporters of ex-President Duarte and former Vice President Castiglioni). Thus, coalitions in Congress shift regularly, and there is much conflict over petty politics. Nevertheless, 47% of Paraguayan respondents in the 2008 Latinobarómetro Survey evaluated the work of the National Congress, as good or very good (as compared to a Latin American median of 41%), and 41% had some or much trust in congress (compared to a Latin American median of 32%). In addition, 84% of respondents expressed confidence in the government, 87% in the direction of the country, and 86% approved of the government. These are by far the highest values for any Latin American country in the Latinobarómetro. So, for the moment, it seems that the perception of political institutions is much better than their performance.

Democratic institutions are supported by the relevant actors. However, informal structures undermine the functioning of democratic institutions. President Duarte pursued a strategy of “stretching” the constitution, capitalizing on a politically compliant supreme court. Thus, in 2006 he was elected president of his party, although the constitution unambiguously prohibits the president from holding

Performance of  
democratic  
institutions

Commitment to  
democratic  
institutions

another office. In 2008 he was candidate for an electoral senatorial seat, although former presidents automatically become lifetime senators without voting rights. As an elected senator he would have been protected against judicial prosecution. There is a certain risk that President Lugo's political adversaries will try to bring him down before the end of his term. This is a real risk, because Lugo does not have a parliamentary majority. His main ally, the Liberal Party, is internally divided in several factions. Vice President Franco from the Liberal Party would benefit if Lugo should be forced out office. However, Franco is supported only by a minority of Liberal deputies and senators. The Colorado Party is eager to get back in power, and retired General Lino Oviedo may be a willing ally in bringing down the president. Lugo accused Duarte and Oviedo of conspiring together when they held a secret meeting at Oviedo's house in September 2008 with the senate president (a member of Oviedo's party), the attorney general, the vice president of the electoral court and the military liaison officer between congress and the commander of the armed forces. Likewise, a serious land reform or more violent farm occupations could put the democratic commitment of the landowner organizations to a test. Finally, disappointment on the part of the president's supporters could lead to mass demonstrations against the government.

## 5 | Political and Social Integration

Despite the fact that the election of Fernando Lugo may point to change, the Paraguayan party system is still dominated by the two traditional parties, the Colorado Party and the Liberal Party. Each is more than 100 years old. They will continue to form the axis of the country's political system at least through the medium term. Lugo would not have won the presidential elections without the support of the Liberal Party. From time to time, splits have occurred within the Colorado Party or new parties have emerged, but today only one has survived with a significant electoral basis: the UNACE of retired General Lino Oviedo. The Colorado Party is still the strongest party. During its 61 years in power, the party created a close-knit patronage network. Many of the 190,000 government employees owe their jobs to their party affiliation. The future will demonstrate whether the party can maintain this clientelistic network following its loss in the 2008 presidential elections.

The effective number of parties was 2.57 in the Chamber of Deputies after the 2003 election, and increased to 3.42 in 2008. In the Senate the number of effective parties was nearly the same in 2003 (4.0) as in 2008 (3.89). But this index may be misleading, as party discipline is low and parties consist of different factions. Both traditional parties have a broad social base. Eight percent of Paraguayan respondents in the 2005 Latinobarómetro survey worked for a political party. Direct elections for party executive offices and the nomination of candidates for elective office generate possibilities for mobilization in both traditional parties. However,

Party system

the parties only sometimes work as instruments for articulating and aggregating social interests; they are more likely to serve as tools to mobilize voters. Internal fragmentation of the two parties between competing party leaders is also typical, though stronger in the Colorado Party. The UNACE is united behind Lino Oviedo. President Lugo's political support base is only partially articulated through parties represented in Congress.

Compared to the political parties, the system of social interest groups is weak, because it is (politically) fragmented and dominated by only a few interest positions. There is no link to the parties in terms of collateral organizations, although one of the umbrella labor organizations is close to the Colorado Party. The manufacturers are organized in the Industrial Union of Paraguay (Union Industrial Paraguaya, UIP). The labor movement is weak and fragmented. There are currently seven competing trade union federations. The rate of unionization is less than 5% of the overall workforce. However, contacts exist between labor and the movement of landless peasants. Strong organizations represent the interests of rural landowners (cattle ranchers and soybean producers), including the Rural Association of Paraguay (Asociación Rural del Paraguay, ARP), Coordinadora Agrícola de Paraguay (CAP), the Association of Soy Producers (Asociación de Productores de Soja, APS) and the Paraguayan Confederation of Cooperatives (Confederación Paraguaya de Cooperativas, CPC). Landless peasants and small farmers are mainly organized in the National Coordinating Committee of Campesino Organizations (Mesa Coordinadora Nacional de Organizaciones Campesinas, MCNOC), which represents about 40,000 families, and is part of the Patriotic Alliance for Change (Alianza Patriótica para el Cambio, APC) and in the National Campesino Federation (Federación Nacional Campesina, FNC).

Support for democracy has traditionally been low among Paraguayan citizens (33% in 2007), but rose after the election of Fernando Lugo to 53% (a little bit less than the Latin American mean of 57%), according to the October 2008 Latinobarómetro survey. It remains to be seen whether expectations with regard to the new president can be fulfilled, and support for democracy can be stabilized at this high level. There are also some critical indicators of potential unrest. Only 22% of the citizens are satisfied with how democracy is working in their country, though this is much better than 2007's figure of 9%. Compared to the rest of Latin America, a high percentage of the population remains open to the idea of an authoritarian solution. In 2008, 69% of Paraguayans agreed that it does not matter whether an authoritarian government comes to power, if it can solve the country's economic problems. Voter turnout in presidential and parliamentary elections rose from 64% in 2003 to 75% in 2008.

Autonomous organization in civil society is uneven. It faces socioeconomic barriers and suffers from a lack of civic culture. Trust among the population is rather low. In 2007, only 6% of Paraguayans trusted their fellow citizens (Latinobarómetro), the

Interest groups

Consent to  
democratic norms

Associational  
activities

lowest such percentage in Latin America. At the same time, only 10% of Paraguayans stated that they had never belonged to a social or political organization – again, one of the lowest such percentages in Latin America. The question is whether they participated in independent or clientelistic organizations.

## II. Market Economy

### 6 | Level of Socioeconomic Development

Paraguay was ranked 98th out of 179 countries in the 2008 Human Development Report. The country's HDI score in 2006 was 0.752 (down from 0.757 in 2004). Social exclusion is quantitatively and qualitatively extensive, and structurally ingrained. Indices of income inequality improved since 2000, but are still high (with a Gini coefficient of 0.536 in 2005). This improvement was due not to a successful policy of redistribution, but to an economic crisis and recession in which rich people had higher income losses than poor ones. The richest 10% of the population still has 65 times as much disposable income as the poorest 10%. Just 10% of the major landowners own 66% of all land, while 66% of the rural population owns only 6% of the land, and 24% own no land at all. According to 2007 national poverty statistics, 35.6% of the population lives below the poverty line (down from 38.2% in 2005), and 19.4% live in extreme poverty (up from 15.5% in 2005). In the urban areas, poverty is more prevalent, affecting 36.1% of the population, but less intense (with an extreme poverty rate of 15.8%). Paraguay is among the worst-performing Latin American countries with regard to reducing poverty between 1990 and 2007 (as assessed with reference to the Millennium Development Goals). According to 2005 figures from the International Labor Organization, more than 60% of the urban labor force works in the informal sector. The lower GDI (0.749) as compared with HDI (0.752) reveals inequalities in achievements for women. However, the GDI value is 99.6% of the HDI value. Out of the 157 countries with both HDI and GDI values, only 30 countries have a better ratio than Paraguay.

Socioeconomic  
barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	6949.8	7473.2	9275.2	<b>12222.3</b>
Growth of GDP	%	4.1	2.9	4.3	<b>6.8</b>
Inflation (CPI)	%	4.3	6.8	9.6	<b>8.1</b>
Unemployment	%	-	-	-	<b>5.6</b>
Foreign direct investment	% of GDP	0.5	0.7	2.0	<b>1.6</b>
Export growth	%	1.8	12.1	14.6	<b>9.6</b>
Import growth	%	6.2	9.0	16.5	<b>10.8</b>
Current account balance	\$ mn.	143.0	16.0	127.7	<b>165.0</b>
Public debt	\$ mn.	2430.5	2265.2	2234.6	<b>2194.9</b>
External debt	\$ mn.	3607.4	3228.5	3422.3	<b>3569.5</b>
Total debt service	% of GNI	7.0	6.4	4.3	<b>3.5</b>
Cash surplus or deficit	% of GDP	-	1.1	1.2	<b>1.8</b>
Tax Revenue	% of GDP	-	11.9	12.1	<b>11.5</b>
Government consumption	% of GDP	9.9	10.9	11.2	<b>10.8</b>
Public expnd. on edu.	% of GDP	4.0	-	-	-
Public expnd. on health	% of GDP	2.6	3.2	2.9	-
R&D expenditure	% of GDP	0.1	0.1	-	-
Military expenditure	% of GDP	0.9	0.8	0.8	<b>0.8</b>

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

## 7 | Organization of the Market and Competition

Market competition operates within a weak institutional framework. Free competition and the protection of property rights are limited by endemic corruption and political influence in the administration and judiciary. Regulations are sometimes inconsistent and often go unimplemented. There is a strong state presence in the telecommunications, electric power generation, gas and oil refining, cement production, railways, and water utilities sectors. The government controls the price of fuel and public transport. In addition, the government sets minimum

Market-based  
competition

wages, through these rules are often ignored. Around 12% of the employees work in the public sector (2007). The informal sector is large and substantial and includes activities such as cross-border smuggling and the illegal production and sale of narcotics, pirated music, stolen automobiles and weapons. The Index of Economic Freedom ranks Paraguay 16th out of 29 countries in the Americas, and 79th in the global ranking. According to the index, the Paraguayan economy is 61.0% free.

The formation of monopolies and oligopolies is neither regulated nor impeded. Paraguay is the only country in Latin America aside from Haiti without legislation to protect competition. Soon after his election, national entrepreneurs began pressing the Lugo government to introduce an anti-monopoly law which would also protect national firms against the abusive market positions held by multinational firms.

Anti-monopoly  
policy

Paraguay's membership in Mercosur has largely liberalized trade with Argentina, Uruguay and Brazil. The weighted average tariff rate is 3.2% (2006), but non-tariff barriers exist as well. In addition, cumbersome and time-consuming customs procedures, along with burdensome labeling procedures, add to the cost of trade.

Liberalization of  
foreign trade

Banking supervision has improved, but it is still inadequate and falls short of international standards due to both a paucity of qualified personnel and to political influence over banking decisions. International financial organizations have demanded that Paraguay strengthen the independence of the central bank. Even so, the non-performing loan ratio has declined in the banking sector (to less than 3% of total loans). There is a strong presence by foreign banks. The two largest banks are foreign-owned, and foreign banks control 29% of assets and 40% of deposits.

Banking system

## 8 | Currency and Price Stability

Controlling inflation and the establishment of an appropriate foreign exchange policy are recognized goals of economic policy. However, they have not been consistently pursued and are not supported by an adequate institutional framework. The inflation rate rose to 12.5% in 2006, went down to 6.0% in 2007 and increased again to 8.3% in 2008 (the projection for 2009 is 5.6%). Paraguay has a floating exchange rate. Because of the close ties to its two big neighbors in Mercosur, the Paraguayan currency (the guarani) depends on economic development and the currency exchange rates (measured against the U.S. dollar) in Argentina and Brazil. The guarani appreciated against the U.S. dollar and the Argentinean peso in 2007, and depreciated against the Brazilian real. The guarani appreciated 28% against the U.S. dollar in the year-long period ending in July 2008, then fell 22% in nominal terms against the dollar between August and November.

Anti-inflation /  
forex policy

There are signs of a consistent policy aimed at economic stability. The budget deficit has been eliminated since 2004, and public debt is now less than 30% of GDP (2007). President Lugo named the independent Dionisio Borda to be his finance minister. Borda was also finance minister in President Duarte's cabinet (2003 – 2005), where he received most of the credit for eliminating the budget deficit. Borda's nomination sent a strong signal that the new government is committed to economic stability.

Macrostability

## 9 | Private Property

Property rights and the regulation of the acquisition of property are fundamentally well defined, but there are problems with their implementation under the rule of law, particularly with regard to deficiencies in the judicial system. Land titles are often ill defined, especially in the agricultural sector. A latent and sometimes violent conflict exists between the interests of large agricultural corporations (some of them foreign-owned) in consolidating and expanding their holdings, and the demands of the landless and small farmers for agrarian reform and land redistribution. Protesters frequently occupy land, which generates conflicts that both sides often conduct outside the rule of law.

Property rights

Private activities represent the backbone of the economy, but concentration of market power is tolerated by the state. In some sectors, such as telecommunications, electric power generation, oil refineries, cement production and water utilities, state enterprises exercise a monopoly or subvert fair competition. Privatization programs came to a halt during the government of President Duarte, because they proved to be very unpopular. It is unlikely that President Lugo's new government will resume the privatization of state companies. Foreign investors are guaranteed equal treatment.

Private enterprise

## 10 | Welfare Regime

There are rudimentary measures in place to ameliorate social risks, but they are sharply segmented in terms of territory, class and sector. The social security system extends only to those employed in the formal sector of the economy. In 2007, only 47.5% of urban wage earners (in the formal sector) were covered by some kind of social security (pensions and/or health care coverage). Coverage for women was higher than for men. The pension system is organized on a pay-as-you-go basis. Social insurance for employees in private business is still a relatively new concept. This system manages to keep its budget balanced, though it has been adversely affected by recurring banking crises. Because of the demographic structure of the population (high fertility rates and high population growth rates), there is less

Social safety nets

necessity for a general overhaul of the pay-as-you-go pension system. More immediately critical are an increase in administrative efficiency and a curbing of corrupt practices.

Society is severely segmented, and there are hardly any institutions to make up for vast social discrepancies. Social expenditures are low in comparison to other South American countries. There are particularly marked differences in the delivery of health care. Social expenditures as a percentage of central government expenditures did not increase in a significant manner during the Duarte presidency. Violations of labor law and other workplace regulations, such as those protecting children or health standards, are not adequately monitored or penalized by the government. At the operating level, collective bargaining agreements are often impossible because of opposition by the business class. Only 10% of private sector employees and 60% of public sector employees are covered by collective bargaining agreements.

Equal opportunity

## 11 | Economic Performance

In 2008, the Paraguayan economy grew for a seventh consecutive year. GDP growth was 6.8% in 2007 – a bit higher than the Latin American mean – and 5.0 % in 2008. Most of this growth was due to commodity price increases. Preliminary figures for 2009 predict a growth rate of 2.0%. Urban unemployment rose to more than 10% at the beginning of the decade, but went down to 7.2% in 2007. However, underemployment (approximately 26% in 2007), rather than unemployment, is the main problem of the Paraguayan economy. The budget deficit has been eliminated since 2004, and public debt is now less than 30% of GDP (as of 2007). The value of investment and trade has grown. Low productivity and underdeveloped technological capacities are still the greatest challenges for the Paraguayan economy. Only 86.5 per 1,000 people (or 8.4 people, in the case of broadband) use the Internet (2007). High-technology exports accounted for 8% of manufactured exports (2006). The Global Competitiveness Index (GCI) ranks Paraguay 124th out of 134 countries (2008). The tax base is quite low, with corporate taxes at 10%. Tax revenue as a percentage of GDP is around 12.0%. Overall government expenditures including transfer payments are around 18% of GDP.

Output strength

## 12 | Sustainability

To date, ecologically sustainable growth has been given only sporadic attention, and has a weak institutional framework. This is particularly evident concerning the ecological impact of the country's large hydroelectric plants. But there are positive signals. The new strategic economic and social plan (2008 – 2013) of the Lugo government explicitly favors an integral approach combining economic, social and environmental policies. There has been little control of deforestation in the border

Environmental policy

regions, which has accelerated because of the recent soybean boom. Reducing air and water pollution has not been a high priority. From time to time organizations of small farmers and landless peasants protest against the indiscriminate fumigation of soybean plantations and the use of herbicides because of the environmental damage and water pollution caused by such practices.

In spite of an improving school enrollment rate, the educational system still has great qualitative deficiencies. Research and development facilities are rudimentary. Quantitatively, investment in education and training, as in research and development, is rather low. While public expenditures on education reached 4.3% of GDP in 2005, research and development expenditures that same year were just 0.1% of GDP.

Education policy /  
R&D

## Transformation Management

### I. Level of Difficulty

The structural constraints on governance are high. Paraguay lacks an outlet to the sea and its geography presents challenges. The Chaco region is arid and sparsely populated. These characteristics make the construction and maintenance of road infrastructure more expensive and render integration with other countries more difficult. Therefore Paraguay's transportation costs for foreign trade activities are higher than the average cost for other South American countries. The country is unable to combat poverty systematically on its own. Future development is hampered by persistent gross social inequality, the lack of an educated labor force, an inefficient and overstaffed public administration, widespread corruption in politics and society, and deficiencies in infrastructure. While forces for reform in politics and society were strengthened by the electoral victory of President Lugo, there still exist many veto points where political and economic transformations can be blocked.

Structural  
constraints

After a long phase of authoritarian rule, the democratization process in Paraguay began in 1989 with a weak autonomous civil society, a weak political opposition, and broad continuity among the elites in politics and officialdom. Politics has been based on patronage networks, which subvert civil society. However, there has been a strong human rights movement. As an example, the Paraguayan Human Rights Coordinator (CODEHUPY) is made up of 37 organizations, and in total there are around 50 domestic and international human rights groups in Paraguay. There is a network of civil society organizations that could be used for mobilization processes in times of crisis. This happened in 2006, when President Duarte attempted to circumvent the constitution and utilize the Supreme Court in order to take office as president of the Colorado Party. Civil society groups formed the core of the political movement and alliance that finally brought President Lugo to power.

Civil society  
traditions

Great ethnic homogeneity is certainly an advantage for the Paraguayan government. There are no religious differences that could be seen as sources of conflict. Political parties do not articulate social rifts between the poor and the rich. A growing class conflict between landowners and organized landless peasants in the rural areas has surfaced since the beginning of this decade. For decades the policy of expanding

Conflict intensity

agriculture land was an important source of GDP growth. Now there is almost no additional arable land left in eastern Paraguay. The land conflict receded for some time during the Duarte presidency because of government repression and cooptation strategies. But conflicts resurfaced in 2008. After the elections in April 2008, landless peasants organized new land invasions to put pressure on the incoming government. There were violent clashes between the police and the peasants. At the end of December 2008, members of an armed group (Ejército del Pueblo Paraguayo, EPP) attacked a small military base in one of the conflict-prone departments (San Pedro) and stole weapons. In response, the government deployed troops in the region.

## II. Management Performance

### 14 | Steering Capability

The government changed in August 2008. In 2007 and 2008 the outgoing government did not set strategic priorities. It was mainly interested in conserving its power, primarily by trying to change the constitution to allow President Duarte to stand for reelection. Duarte later pushed through his chosen presidential nominee in the Colorado Party, and attempted to win a senatorial seat for himself in the parliamentary elections. President Lugo's new government appears committed to constitutional democracy and a socially responsible market economy. As a clear signal of his reform impetus and a balanced economic policy, Lugo named an independent, Dionisio Borda, as his finance minister, who is well connected with international finance organizations, and is respected by the opposition and parts of the NGO sector. The government claims to be focused on long-term aims. It presented a five year (2008 – 2013) economic and social strategic plan for sustainable growth with social justice. At the beginning of his government Lugo set four priorities: the reform of the public sector, poverty reduction, land reform and the renegotiation of the Itaipú dam treaty with Brazil. The government plans to tax soya exports to gain resources for social programs.

Prioritization

As early as 2005, President Duarte's reform impetus became intertwined with his personal ambitions, focusing on winning the internal Colorado Party elections and then the municipal elections in 2006, and then clearing the way for his reelection (by reforming the constitution). As a result, economic policy lost some of its coherence. Many planned reforms, such as a far-reaching tax reform, were not pursued. Dionisio Borda, President Lugo's finance minister, will resume the tax

Implementation

reform that he started during Duarte's presidency. Lugo's new government has defined a comprehensive reform agenda, but reform politics are hampered by a fragile political power base, including conflicts within the alliance that supported Lugo in the presidential election.

The authoritarian and populist traits in President Duarte's governing style limited his willingness to change policies. Many times it was not clear if policy changes were the result of a learning process or were simply a tactical maneuver (for example, to support his reelection proposal). Lugo's new government lacks a parliamentary majority, and its reform agenda is confronted with many obstacles. Thus, out of necessity it must adapt to changing opportunity structures and impediments.

Policy learning

## 15 | Resource Efficiency

The government uses only some of the state's available resources efficiently, but is committed to increasing efficiency. Ministers and higher public officials are often recruited not only on a partisan basis but also with regard to their technocratic profile. In September 2008 the new finance minister created a technical unit for public modernization. The state bureaucracy is still oversized, with civil servants extremely difficult to dismiss. Recruitment of administrative personnel is still done with a heavy emphasis on political loyalty. Nevertheless, the state budget is balanced. Tax evasion has been curbed and fiscal revenue has increased significantly. Tax revenue as a percentage of GDP is around 12.0%. Overall government expenditures, including transfer payments, are around 18% of GDP.

Efficient use of assets

The government tries to coordinate conflicting objectives and interests. But this is quite difficult. The Patriotic Alliance for Change (Alianza Patriótica para el Cambio; APC) is a very heterogeneous coalition, which supported a center-left presidential candidate, while the Alliance's major party, the Liberal Party, is a center-right party. Moreover, the Liberal Party is split into different factions, with Vice President Franco's faction in the minority. In addition, the heterogeneous alliance lacks a parliamentary majority and must negotiate with a strong but also divided opposition. It remains to be seen whether Lugo will be able to coordinate his policy in an efficient way in this very complicated political environment.

Policy coordination

Corruption is still endemic in state and administrative culture; many of the state's resources are distributed based on patronage networks. Some mechanisms ensuring integrity are effective, while others do not work. However, the new government has provided positive signals and is committed to more transparency.

Anti-corruption policy

## 16 | Consensus-Building

The main political actors agree that the establishment and maintenance of a market-based democracy is a desirable goal. Nevertheless, there are problems with implementation, because there are many veto points in the political system, and economic reforms threaten the vested interests of the political elite. Formal democratic institutions are subverted by informal and clientelistic practices. The outgoing Duarte government exerted significant influence over the judiciary, and sometimes manipulated the law. Lugo's new government lacks broad consensus on the direction and the tempo of political and economic reforms. For the moment, the government lacks a parliamentary majority on the highly contested issues of land reform and taxation of agricultural exports. The Liberal Party, the biggest government party and the party of Vice President Franco, does not support a far-reaching land reform. There is a lack of consensus-building mechanisms, for example between business owners and unions, or between landowners and landless peasants.

Consensus on goals

The military is under control, and is not an independent political actor. Shortly after assuming the presidency, Lugo replaced 33 high officials with the objective of modernizing the armed forces. There is thus little risk of open subversion of the democratic order. However, there are risks that social conflicts could get out of control and put pressure on political institutions. In such a constellation, some political actors could be tempted to bring down the president by means of a mixture of legal proceedings and social pressure.

Anti-democratic  
veto actors

Although the political leadership seeks to prevent political rifts from escalating into conflicts, it cannot reduce existing divisions. Conflict over farmland has been on the rise. Landless peasants are organized in a broad movement and are represented by a variety of organizations. However, the conflict over land is only partially articulated along party lines. When landless peasants invaded large landholdings, the mobilization resulted in violent evictions. The Duarte government initially made an effort to mitigate the conflict, opening talks with the peasants' movement. Later on, it sought to placate agricultural exporters and large landholders, using police forces and military to expel farm occupiers. In the end Duarte left the land problem to his successor. Lugo's government has attempted to mediate between the peasants' movement and the powerful group of landowners. This is quite difficult, because the large landowners and soya producers are important and influential economic actors. Moreover, the Brazilian landowners in Paraguay are strongly supported by the Brazilian government. On the other hand, the landless groups are radicalized, and expect a measure of land redistribution from Lugo. The government has tried to reframe the land reform topic from land redistribution to rural development, putting the focus on the provision of assistance to small landowners and on infrastructure

Cleavage /  
conflict  
management

investments in the countryside (including roads, schools and medical clinics). However, there may not be enough available revenue or management capacity for a large scale land reform.

President Duarte preferred a populist top-down approach to social problems. The political leadership frequently ignored civil society actors and formulated its policy autonomously. Lugo started his political career in a civil society movement, and is more open to civil society participation in politics. Because he lacks a strong partisan power base, he may need the support of civil society organizations to implement his political agenda, and to put pressure on a recalcitrant political opposition.

Civil society participation

The political leadership recognizes the need to deal with acts of injustice and human rights violations perpetrated during the Stroessner dictatorship, but the process of reconciliation has been slow. Only a few victims of the dictatorship have been comprehensively indemnified, and compensation has been quite low. A memorial museum has been created in one of the Stroessner era's torture facilities. The Ombudsman office supports the investigation of human rights abuses from the Stroessner era. As a response to civil society pressures, the Commission of Truth and Justice was created, commencing work in the second half of 2004. However, the Commission was underfunded, and depended on international assistance for its work. Its mandate was extended several times. Finally, on 28 August 2008, the Commission presented a final 1000-page report that included 178 recommendations. In the ceremony, Lugo offered an apology to the victims of human rights violations, and promised to implement the commission's recommendations.

Reconciliation

## 17 | International Cooperation

President Duarte's government worked with multilateral international donors and financial organizations, including the IMF, the IADB and the World Bank, with the aim of integrating international assistance into the domestic reform agenda. In May 2006, the IMF approved a 27-month standby arrangement (about \$97 million) for Paraguay in support of the country's economic program. Various new projects have been developed with the Inter-American Development Bank (IDB) and the World Bank, the latter of which funds projects worth a total of \$153.5 million and is preparing a new cooperation strategy with Paraguay for the years 2009 – 2013. President Lugo's new government is interested in continuing cooperation with the international financial organizations.

Effective use of support

President Duarte's government tried to act as a credible and reliable partner, and received more external support than did former governments. The credit flows from

Credibility

international financial institutions could be taken as an indicator for the increasing credibility of the Paraguayan government. In the last year of his presidency Duarte was more occupied with his own political future and the 2008 elections than with steering a clear political course. He made some changes in foreign policy, diplomatically distancing the country from the United States and strengthening ties with Venezuela and Cuba. President Lugo's new government is still developing its foreign policy. The government is expected to follow a more independent foreign policy with regard to Brazil. Here the question of a renegotiation of the Itaipú treaty will likely strain this relationship. The government is also expected to strengthen relations with the smaller Mercosur countries (including Bolivia as an associated member).

Paraguay is a member of Mercosur, along with Argentina, Brazil, Uruguay and Venezuela. Asunción is the headquarters of the Mercosur Court of Arbitration. The Paraguayan economy is closely tied to those of the neighboring states, so that economic crises in Argentina and Brazil have direct consequences in Paraguay. Membership in Mercosur has helped stabilize Paraguayan democracy in the sense that these two big neighbors have intervened diplomatically in active ways during periods of political crisis (e.g., the points at which coups appeared possible or likely in 1996, 1999 and 2000). The population generally supports inclusion in this common market, even if some voices loudly advocate the country's own path during periods of political or economic crisis. Along with Uruguay, the Paraguayan government has taken a critical stance toward Brazil and Argentina, because the interests of the smaller member states of the Mercosur have not been sufficiently taken into account. Moreover, President Lugo intends to renegotiate the 1973 Itaipú dam treaty with Brazil, which is otherwise slated for expiration in 2023. Itaipú supplies 20% of Brazil's total demand for electricity. According to the treaty Paraguay and Brazil share the energy generated by the Itaipú hydroelectric power plant in equal parts. Each has to sell its energy surplus to the other partner at below market prices. Paraguay uses only 5% of its energy share and sells the rest to Brazil for some \$100 million. The Paraguayan government claims that the price at current market value would be \$2 billion. Against this background President Lugo has sought to strengthen relations with Uruguay, Bolivia and Venezuela. Venezuela is perceived to be a counterbalance against Brazil. Former President Duarte for some time cultivated a special relationship with the U.S. government. However, in 2007 he began to distance himself from the Bush administration, because he was dissatisfied with the results of U.S. policy towards Paraguay. At the same time, a closer cooperation with left-wing governments promised greater electoral dividends in the impending presidential elections. In the last year of the Duarte presidency, Paraguay expanded its relations with Venezuela (resulting in oil at a reduced price) and Cuba (Paraguay sent 600 students to Cuba to study medicine). The Lugo government does not thus promise a radical shift in Paraguayan foreign policy. Through Mercosur, Paraguay is also involved in negotiations on a free-trade

Regional  
cooperation

agreement with the European Union. Together with the Mercosur countries, it is conducting parallel negotiations on easing trade with the United States within the now stagnant Free Trade Area of the Americas (FTAA) process.

## Strategic Outlook

Paraguay's presidential democracy is characterized by a strong parliament with a bicameral structure and a fragmented party system. Consequently, many issues in the political decision-making process are vulnerable to vetoes. Comprehensive political and economic reforms must therefore draw on broad coalitions. At the same time, Paraguay's democracy still suffers from the longtime dominance of the Colorado Party, which was in power for 61 years. A successful modernization of the state and the economy would undermine the power base of the still-influential Colorado Party, which remains the strongest party in parliament. President Lugo has no majority in parliament. The main party in his governing coalition, the Liberal Party, does not totally support his reform agenda. Especially the topic of land reform is highly contested. The party of retired General Lino Oviedo is in a pivotal position in parliament, because UNACE and the Colorado Party have a majority in both houses of Congress. Thus, Lugo faces many potential political stumbling blocks. While he may become a great reformer, there is also a high risk that he will become a failed president. He has no majority in parliament; his vice president is from the Liberal Party, which would capitalize on a premature end to his presidency. It is also quite possible that the Colorado Party and UNACE will join forces to bet on a Lugo failure. There is a high risk that Lugo followers will become disenchanted if there is no real progress in the reform agenda. For example, in November 2008 the Social and Popular Front (Frente Social y Popular), a civil society group that supported Lugo's candidature, organized a three day protest in Asunción to express its disillusionment with the president's reform policy, which at that time consisted only of plans and announcements. Social conflict in the countryside could become more radicalized or violent, putting strain on the governing coalition. As the example of Argentina demonstrates, massive protests by the landowners against the government (for example against the plan to tax soya exports) can become a destabilizing factor. Economically, Paraguay is dependent on the world economy and demand for its most important (agricultural) export products, as well as on developments in the neighboring Mercosur countries. Any leeway for independent action is rather limited. There remains the possibility of renegotiating Paraguay's \$19.6 billion debt associated with the hydroelectric plant with Brazil, which would in turn reduce the country's debt service and liberate funds for other purposes. The Paraguayan government has already indicated its demand for a renegotiation of the 1973 Itaipú treaty. However, the signals from Brazil with regard to this renegotiation are negative. Brazil also serves as defender of the interests of the considerable number of Brazilian farmers in Paraguay's border areas. Both conflicts will strain relations between Paraguay and Brazil in the near future. It would be a great help for the new Paraguayan government if Brazil takes a more flexible position with regard to the renegotiation of the Itaipú dam treaties. However, it is doubtful whether such a policy is viable in Brazil, where it would need the support of a parliamentary majority in the Brazilian congress.