

# BTI 2008 | Paraguay Country Report

<b>Status Index</b>	1-10	<b>6.14</b>	# 52 of 125	
Democracy	1-10	6.75	# 47 of 125	➔
Market Economy	1-10	5.54	# 61 of 125	➔
<b>Management Index</b>	1-10	<b>5.75</b>	# 41 of 125	

scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. 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 125 transformation and developing countries are evaluated.

The BTI is a joint project of the Bertelsmann Stiftung and the Center for Applied Policy Research (C•A•P) at Munich University.

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Please cite as follows: Bertelsmann Stiftung, *BTI 2008 – Paraguay Country Report*. Gütersloh: Bertelsmann Stiftung, 2007.

## Key Indicators

Population	mn.	5.9	HDI	0.76	GDP p.c.	\$	4,130
Pop. growth <sup>1</sup>	% p.a.	1.9	HDI rank of 177	91	Gini Index		58.4
Life expectancy	years	71	UN Education Index	0.86	Poverty <sup>3</sup>	%	29.8
Urban population	%	58.5	Gender equality <sup>2</sup>	-	Aid per capita	\$	8.3

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

The conditions for a transformation toward a market-based democracy were inauspicious in the case of Paraguay. Democracy was not achieved by means of legitimate struggle, but was merely the peripheral outcome of power struggles among the elite in the Stroessner regime. The result was a broad continuity among the elites in politics and bureaucracy. In economic terms, at the beginning of its transition, Paraguay exhibited a comparatively low density of regulation and a very open economy. Handicaps included low productivity, a large sector of inefficient state enterprises, a large informal sector and institutional conditions that inhibit growth. These include an inefficient, politicized state administration and a defective and corrupt judicial system. The weakening of the military, which had been an actor with veto powers since the late 1990s, can be considered an advancement toward democratic transformation. However, support for democracy has waned; a high percentage of the population is open to authoritarian solutions. The political parties remain highly inadequate in their functions of articulating and aggregating interests. Their electoral success is based on a close-knit patronage network. The government of Nicanor Duarte Frutos, which came into office in August 2003, got off to a good start. The government launched a reform of the tax administration, broadened the tax base, began a reform of the social security system, and tried to curb corruption in the public administration, state enterprises and the judicial system. International financial organizations and donors supported this reform drive. Afterwards, the reform impetus dwindled, and politicians focused on internal power struggles within the Colorado Party and President Duarte's re-election plans. The president has largely spent his political capital and there is no broad reform coalition. Therefore we shouldn't expect new reform initiatives until the end of his mandate in August 2008. It is quite probable, however, that reforms that have been implemented can be consolidated.

## 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 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 covered with a tight network of control and patronage. Even after the transition to democracy, the Colorado Party remained in power. It is now the longest-governing party in Latin America, having been in power since 1947. 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, in the 1990s, the military still played a troublesome role. Highly politicized, the military viewed itself as part of the Colorado Party, and it openly took partisan positions. President Andres 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 Juan Carlos Wasmosy, tried to use his position as a political springboard. On 28 March 1999, President Raul Cubas Grau resigned to avoid impeachment. Raul 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 Argana was murdered. Argana 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. Still in prison, he is trying to overturn a 10-year sentence and refute other charges, as he continues to hope for a political comeback. His political party, Union Nacional de Ciudadanos Eticos (UNACE), an offshoot from the Colorado Party, is represented in parliament and is a strategic partner of 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. His party started in a minority position in both chambers of Congress (37 out of 80 deputies; 16 out of 45 senators). But because of party switches, it now controls 43 seats in the chamber of deputies and 18 out of 45 senators (February 2007). But the Colorado Party is fragmented in different factions. President Duarte's government marked a good start. Beginning in 2003 and 2004, there was an economic upswing, the government increased tax collection in a significant way, curbed fiscal deficits, contained inflation, and started a program of structural reforms. The president received high approval rates. Afterwards, the reform impetus dissipated, politics refocused on internal power struggles within the Colorado Party and President Duarte's re-election plans. In 2005, economic growth slowed down and inflation rose again. Even so, in 2005, President Duarte dominated the political agenda, and the opposition was divided and outmaneuvered by the government. In the internal elections of the Colorado Party (February 2006), President Duarte crushed his adversaries, a group with strong links to the Stroessner family. Based on this triumph, President Duarte intensified his re-election campaign. But political and judicial disputes about President Duarte's participation in the internal elections of the Colorado Party (the opposition parties tried in vain to impeach him), along with his re-election campaign, revived the political opposition and civil society organizations, which staged a massive demonstration in Asunción in March. Fernando Lugo, the emeritus bishop of San Pedro, one of the poorest departments in Paraguay, emerged as the leader of the opposition movement. Nevertheless, the Colorado Party won the municipal election in November (including the mayoralty of Asunción). While the governing body of the Colorado Party approved a resolution to reform the constitution, this proposal attracted strong criticism by some of its senators. At the end of the year, President Duarte declared that he would abandon his re-election plans. 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. President Duarte started with high approval rates. But, political stagnation and re-election plans had a negative impact on his popularity. At 33% (October 2006), the approval rate of President Duarte's government is now one of the lowest in Latin America (39% August 2005; 57% June 2004) (Latinobarometro 2006). The next general elections will be held in May 2008.

## Transformation Status

### I. Democracy

In transforming its political order, Paraguay has made slow progress in strengthening its political institutions. There are still shortcomings at the level of political participation and representation, the quality of its democratic institutions, and the rule of law. Some progress has been made in stabilizing democracy (veto powers of the military have been neutralized), but this progress has to be consolidated further. The re-election plans of President Duarte have been a destabilizing factor in a political environment that is characterized by authoritarian traits in the political culture and a tradition of caudillo rule.

#### 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 and 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 trafficking) and illegal drug dealers. The U.S. government perceives Paraguay as a significant transit country for drugs (cocaine) and a principle money-laundering center. Security experts are concerned that the region could be converted into a refuge for international terrorists; their fears, however, have not been realized. There could be some fundraising activities related to terrorist organizations in the sizable Muslim communities in the border region.

Monopoly on the use of force

All citizens share the same civil rights. In practice, however, indigenous groups cannot assert their rights adequately and are neglected by the government. This is partly because they are few in number (90,000, 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. Ninety-five percent of the population is "mestizo," of mixed parentage. The constitution recognizes Paraguay as a multicultural, bilingual country, with Guarani and Spanish as the official languages. There is a significant population of Brazilians in the border area (so called "Brasiguayos"),

State identity

many of them landowners in possession of great stretches of arable land that is used for soybean production. Their loyalty lies more with Brazil than with the Paraguayan state. The possession of large tracts of land by foreigners gives a special twist to the conflict over land in Paraguay.

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

No interference  
of religious  
dogmas  
Basic  
administration

The state has a functioning basic infrastructure throughout most of the country, including administrative institutions, officials, fundamental administration of justice, making and implementing 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.

## 2 | Political Participation

National elections largely satisfy the requirements of a democracy. But patronage and political dependencies (particularly in the civil service) influence the election process, so that the Colorado Party is structurally in a favored position. Internal procedures of candidate selection in the political parties are not always respected. Defeated candidates often question the results of the elections of party leaders and party directions. Only 20% - the lowest percentage in Latin America - of Paraguayans think that the elections in their country are clean and not rigged. Around 30% of those interviewed personally knew of cases of vote-buying (Latinobarometro 2006).

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 subordinated to civilian control.

Effective power  
to govern

Independent political and civil society groups are generally allowed to form freely. However, there are legal and bureaucratic barriers to the possibilities of union organization due to a high minimum membership requirement. Private sector employers oppose the formation of unions. Laws that prohibit anti-union discrimination are not always enforced. The level of unionization is around 15% of the formal labor force (1600 unions and 121,000 affiliated). Farmers and the landless 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 more army units in the departments where peasant protest movements have been strongest.

Association /  
assembly rights

Freedoms of opinion 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 of

Freedom of  
expression

press ownership, which is heavily tied to the intermingled Colorado party and business elite. Politicians and the administration occasionally restrict press access to information. 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. The Freedom of the Press Index classifies Paraguay as partly free and ranks it at 30 out of 35 Latin American and Caribbean Countries. Paraguay ranks 118th in a world wide comparison (with a score of 57).

### 3 | Rule of Law

Constitutionally, Paraguay has the separation of powers and mutual checks and balances in place. This is particularly the case in relations between the president and Congress, which has been more balanced in the review period under the conditions of divided government.

Separation of powers

The judiciary, especially the Supreme Court, has a relatively independent position in principle, though it cannot be considered politically neutral. Apart from professional criteria, judges are appointed according to political criteria as well. At all levels, there are problems with professionalism and a severe vulnerability to corruption and political influence in trials. After his inauguration, President Duarte initiated a crackdown on corruption in the Supreme Court; 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 in the Supreme Court. The Supreme Court came under political pressure by Congress and by street demonstrations when it agreed in March 2006 to hear an unconstitutionality suit filed by President Duarte against an article of the constitution that bars the president to simultaneously hold another private or public office. President Duarte had just won the internal election for the presidency of the Colorado Party.

Independent judiciary

While the introduction of a new code of criminal procedure (1999) better protects the rights of the accused, deficiencies in the rule of law result from the prolonged duration of proceedings and investigative arrests. At the level of political leadership, corrupt officials have been prosecuted in isolated cases – for example, in December 2006 former President González Macchi was sentenced to eight years in prison for illicit enrichment – but they often take advantage of legal and procedural loopholes or simply bribe the judges. Therefore, the vast majority of cases of political corruption are not prosecuted. The government of President Duarte began with a purge of corrupt officials in tax recollection, customs administration, police and the courts.

Prosecution of office abuse

Civil liberties are largely secure, especially basic political rights. There are no political prisoners. Conditions in the hopelessly overcrowded prisons have repeatedly sparked criticism. However, some progress has been made with the construction of new prisons. There are repeated reports of excesses by the security forces, including torture and extralegal executions of prisoners, those suspected of crimes, and draftees. Human rights organizations have reported killings and illegal arrests by security forces and armed civilian patrols (their creation has been promoted by the Interior Ministry) responding to land invasions. Human rights defenders working to promote peasants' rights were harassed and threatened. The forcible draft of minors, which is against the law, has decreased. In a few exceptional cases, human rights violations from the Stroessner era were criminally prosecuted. However, most cases have not been processed yet, 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.

Civil rights

#### 4 | Stability of Democratic Institutions

Democratic institutions perform their functions, but frictions arise in the interplay between the president and Congress. This is because the ruling Colorado Party, lacking an absolute majority in both chambers, is splintered into several factions, and except for election periods, intra-party competition undermines the party's coherence, thus hampering government action. The opposition rarely acts in cohesive ways based on common programmatic positions. Only 29% of Paraguayans think that Congress is performing well or very well, which is one of worst public evaluations in Latin America (Latinobarometro 2006). The same is true with regard to the approval rates of the government (33%) and the judiciary (25%). Freedom House classifies Paraguay as partly free.

Performance of democratic institutions

Democratic institutions are supported by the relevant actors, but in the case of the governing party or some of its factions, some doubt remains as to whether this support is a matter of principle. There has been no transfer of power between the government and the opposition at the national level. Additionally, in Paraguay, there is a latent risk that free and fair elections might bring anti-democratic politicians into power. The party of the imprisoned General Oviedo is courted both by the governing party and the opposition party. In the governing Colorado Party, an important sector still has high regard for ex-dictator Stroessner, who died in 2006. In his ambition for re-election and for control of the Colorado Party, President Duarte stretched the constitution. The constitution is explicit in its proscription against the president holding another political or private office. Nevertheless, President Duarte sought a decision of the electoral court and the Supreme Court to overturn this clause. Finally, he was elected president of the

Commitment to democratic institutions



Colorado Party, handing the post over the very next day to the party vice president (March 2006). Only 10% of the Paraguayans described their country as very democratic, 43% as not democratic at all; these are the worst scores in Latin America (Latinobarometro 2006).

## 5 | Political and Social Integration

The Paraguayan party system is dominated by two 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 for at least the medium term. From time to time, splits occur within the Colorado Party or new parties emerge, but it is doubtful that they will survive with a significant electoral basis. The effective number of parties has been 2.57 in the Chamber of Deputies and 4.0 in the Senate after the general election in 2003. Because of party switches, at the end of 2006 the effective number of parties was 2.7 in the Chamber of Deputies and 3.7 in the Senate. But this index could be misleading, because party discipline is low and parties consist of different factions. The Colorado Party is still the dominant party. After 60 years in power, the party has a close-knit patronage network. Many of the 190,000 government employees owe their jobs to their party affiliation. Both traditional parties have a broad social base. Direct elections for executive offices in the party and the nomination of candidates for elective office generate possibilities for mobilization in both parties. However, the parties only sometimes work as instruments for articulating and aggregating social interests; they are more likely to serve as tools to mobilize voters for party caudillos. Hence, the internal fragmentation of the two parties among competing party leaders is also typical, though stronger in the Colorado Party.

Party system

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 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 with the movement of landless peasants. Strong organizations represent the interests of rural landowners (cattle ranchers and soybean producers), like the Asociación Rural del Paraguay (ARP), Coordinadora Agrícola de Paraguay (CAP), the Asociación de Productores de Soja (APS) and the Confederación Paraguaya de Cooperativas (CPC). Landless peasants and small farmers are mainly organized in the Mesa Coordinadora Nacional de Organizaciones Campesinas (MCNOC), which represents about 40,000 families, and in the Federación Nacional Campesina (FNC).

Interest groups

Support for democracy is low among Paraguayan citizens (between 30% and 50%), but has been rising in 2006 after a sharp drop in 2005. Compared to the rest of Latin America, a high percentage of the population is open to the idea of authoritarian solutions (between 30% and 44%). Only 12% (2006) of the citizens are satisfied with how democracy is working in their country. Voter turnout is low at 64% in the last presidential and parliamentary elections (only 53.5% of the population in voting age cast their vote). Less than 50% of the registered voters participated in the municipal elections in November 2006.

Consent to democratic norms

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 2006, only 13% of Paraguayans trusted their fellow citizens (Latinobarometro); this is one of lowest percentages in Latin America. Eight percent work for a political party (Latinobarometer 2005). There are around 200 NGOs in the country.

Associational activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

Paraguay is ranked 91st out of 177 countries in the 2006 Human Development Report. The HDI is 0.757 (2004; in 2000, 0.753). Social exclusion is quantitatively and qualitatively extensive and structurally ingrained. The indices of income inequality improved since 2000, but are still high (Gini Index 2005: 0.536). The richest 10% of the population has 70 times as much disposable income as the poorest 10% (2002). According to 2005 national poverty statistics, which include an estimation of the value of housing and real estate, 38.2% of the population lives below the poverty line, and 15.5% live in extreme poverty. In the urban areas, poverty is more prevalent (39.4%) but less intense (extreme poverty: 11.6%). The CEPAL data of 2005, which includes only monetary income, classifies more than 60% of the population as poor (32.1% indigent). Paraguay is one of the worst performing Latin American countries with regard to reducing extreme poverty between 1990 and 2006 (Millennium Development Goals). More than 60% of the urban labor force works in the informal sector (2005; ILO). The urban average wage (2005: \$227) is quite low. The lower GDI (0.742) compared with HDI (0.755) reveals inequalities in achievements for women (data for 2003).

Socioeconomic barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	4,844	4,608	5,109	<b>7,328</b>
Growth of GDP	%	0.0	3.8	4.1	<b>2.9</b>
Inflation (CPI)	%	10.5	14.2	4.3	<b>6.8</b>
Unemployment	%	10.8	8.1	-	-
Foreign direct investment	% of GDP	0.2	0.6	0.9	<b>0.9</b>
Export growth	%	15.9	4.4	1.8	<b>2.7</b>
Import growth	%	-6.2	3.6	6.2	<b>4.6</b>
Current account balance	\$ mn.	92.6	125.3	138.2	<b>-22.4</b>
Public debt	\$ mn.	2,045.4	2,200.6	2,431.0	<b>2,263.6</b>
External debt	\$ mn.	2,947.9	3,186.0	3,409.2	<b>3,120.1</b>
External debt service	% of GNI	7	7	9.8	<b>6.7</b>
Cash surplus or deficit	% of GDP	-	-	-	<b>1.1</b>
Tax Revenue	% of GDP	-	-	-	<b>12.1</b>
Government consumption	% of GDP	11.4	10.5	9.9	<b>10.4</b>
Public expnd. on edu.	% of GDP	4.4	4.3	-	-
Public expnd. on health	% of GDP	2.8	2.3	2.6	-
R&D expenditure	% of GDP	0.1	-	-	-
Military expenditure	% of GDP	0.9	0.7	0.7	<b>0.7</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

Market competition operates under 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 not implemented. There is a strong state sector in telecommunications, electric power generation, oil refineries, cement production, railways, and water utilities. The government controls the price of fuel and public transport. In addition, the government sets minimum wages, which often are not adhered to. The informal sector is large and substantial and

Market-based  
competition

includes activities such as cross-border smuggling and the illegal production and sale of narcotics, pirated music, stolen automobiles and weapons. More than 60% of the urban workforce is occupied in the informal sector. The Index of Economic Freedom ranks Paraguay 22nd out of 29 countries in the Americas, and 99th in the global ranking. According to the Index, the Paraguayan economy is 56.8% free. The Business Competitiveness Index (BCI) ranks Paraguay 119th out of 121 for the sub-index National Business Environment (2006). While Paraguay ranks 106th (2005: 102) out of 125 countries in the Global Competitiveness Index, it ranks 122nd with regard to the quality of public and private institutions.

The formation of monopolies and oligopolies is neither regulated nor impeded.

Anti-monopoly  
policy

Membership in Mercosur has largely liberalized trade with Argentina, Uruguay and Brazil. The weighted average tariff rate is 6.3 (2004), but non-tariff barriers exist. In addition, cumbersome and time-consuming customs procedures, as well as 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 because of both a paucity of qualified personnel and political influence over banking decisions. International financial organizations have demanded that Paraguay strengthen the independence of the central bank. The two largest banks are foreign-owned. The National Development Bank (BNF), a public bank, possesses a high percentage of non-performing loans. In April 2006, a Development Finance Agency (AFD) was created to perform second-tier banking functions, channeling public-sector credit to intermediate financial institutions.

Banking system

## 8 | Currency and Price Stability

Controlling inflation and an appropriate foreign exchange policy are recognized goals of economic policy, but have not been consistently pursued and do not have an adequate institutional framework. The inflation rate has been reduced to 2.1% in 2004 but rose again to 9.9% in 2005 and to 12.5% in 2006. 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 the economic development and the currency rates (measured against the U.S. dollar) in Argentina and Brazil. The guarani appreciated against the U.S. dollar in 2005 and depreciated against the Brazilian real, which in part reflects the strength of the currencies in the neighboring country. In 2006 (up to October), the guarani appreciated more than 12% with regard to its main trade partners. An important factor for the guarani's appreciation was the higher inflow of currency from meat exports and from remittances. This had an impact on the inflation rate, which was moderately high in 2006.

Anti-inflation /  
forex policy

There are signs of a consistent policy for stability, but there is a permanent risk of policy changes in response to domestic lobby groups and electoral strategies. Irrespective of the change of the finance minister in May 2005, the basic parameters of the economic stability policy remained unchanged. The stand-by arrangements with the IMF function as an external control on fiscal policy.

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, not least of all because of deficiencies in the judicial system. Land titles are often ill defined, especially in the agricultural sector. A latent and sometimes violent conflict exists between interests, which large agricultural corporations (some of them foreign-owned) have in consolidating and expanding their holdings on the one hand, and the demands of the landless and small farmers for agrarian reform and land redistribution on the other. Protesters often 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, because they proved to be very unpopular. An attempt to reintroduce a privatization bill that was blocked in Congress was doomed to failure when, in June 2005, the Chamber of Deputies rejected the bill with a clear majority. Government plans to attract private capital for joint ventures with state enterprises were not realized.

Private  
enterprise

## 10 | Welfare Regime

There are rudimentary measures to avoid 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 2005, only one third of urban wage earners were covered by some kind of social security (pensions 19.6%; health 32.1%; OIT). Health coverage for women was higher than for men, and pension coverage was almost identical. 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, which 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 necessity for a general overhaul of the pay-as-you-go pension system. More important are an increase in

Social safety nets

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. But there are improvements in social expenditures. President Duarte's government spent some additional \$140 million in 2005 (in comparison to 2004). Violations of labor law and other legal protections, such as for children and health care, are not adequately monitored or sanctioned by the government. At the operating level, collective bargaining agreements are often impossible because of opposition of the business class. The GDI is 0.742 as compared to the HDI 0.755 (data for 2003).

Equal opportunity

## 11 | Economic Performance

Real per capita income shrank in the 1990s, and growth of per capita GDP was negative from 2000 to 2002, with a modest recovery since 2003. On a per capita base, the economy is still stagnant. Per capita growth is much lower than in most of the other Latin American countries. Urban unemployment had risen by over 10% at the beginning of the decade, but went down to 7.6% in 2005. But underemployment, not unemployment, is the main problem of the Paraguayan economy. There are some positive signs, though. The budget deficit has been reduced and public debt is now less than 40% of GDP. The volume of investment and trade has grown. Low productivity and underdeveloped technological capacities are still the greatest challenges for the Paraguayan economy. High technology exports were 7% of manufactured exports (2004). The Business Competitiveness Index (BCI) ranks Paraguay 120th out of 121 countries (2006).

Output strength

## 12 | Sustainability

Ecologically sustainable growth is 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. There is little control of deforestation in the border regions, which has accelerated because of the recent soybean boom. Reducing air and water pollution is not a priority. Despite the appointment of an environment secretary, coordination on ecological issues in the government is lacking. 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.

Environmental policy

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 2002-2004, research and development expenditures were at 0.1 % of GDP (2000-2003).

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 has a difficult geography. 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. With regard to per capita growth, Paraguay is an under-performer in Latin America. At the beginning of the presidency of Nicanor Duarte, Paraguay showed marked recessive tendencies in the economy and great social disparities. The country is unable to combat poverty systematically on its own. Future development is hampered by the persisting gross social inequality, the lack of an educated labor force, an inefficient and overstaffed public administration, widespread corruption in politics and society, and severe deficiencies in infrastructure. Only 50 per 1,000 people own a landline telephone (cellular subscribers number 294 per 1,000), and 50 per 1,000 use the Internet (2004). While the forces for reform in politics and society are weak, many veto points that block political and economic transformations exist.

Structural  
constraints

The democratization process in Paraguay began in 1989 after a long phase of authoritarian rule, with a weak autonomous civil society, a weak political opposition, and broad continuity among the elites in politics and officialdom. Politics is based on patronage networks, which subvert civil society. But 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 to permit him to take office as president of the Colorado Party. But in general, protest movements are transitory. Civil society activities are hampered by low interpersonal trust (13%).

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

Conflict intensity



rich. A growing class conflict between landowners and organized landless peasants in the rural areas has surfaced since the beginning of this decade. But the conflict receded in 2005 and 2006 because of government repression and co-optation strategies.

## II. Management Performance

### 14 | Steering Capability

The political leadership is committed to constitutional democracy and a socially responsible market economy, but it has to compromise its power base. It claims to pursue long-term aims. As a clear signal of his reform impetus, President Duarte named an independent candidate, Dionisio Borda, as his first finance minister, who is well connected with international finance organizations, and he is respected by the opposition and parts of the NGO sector. The minister and his colleagues received most of the credit for the elimination of the budget deficit. President Duarte and the finance minister set clear strategic aims. The first aim was to cut down the budget deficit by curbing tax evasions and reforming the public pension system. The second aim was to normalize relations with international donors and finance organizations as a condition for new credits and grants. The third aim was to reform the administration and create a broader tax base (including new progressive taxes on property and income). Finally, the fourth aim was to use new fiscal revenues to combat poverty and confront the demands of landless peasants. While critics approve of President Duarte's reform policy, they point to certain authoritarian and populist traits in his governing style. Consequently, his plan to reform the constitution so as to allow a consecutive re-election has become a destabilizing factor. There were concerns that President Duarte would subordinate his economic policy to the preservation of his personal power. But in the end, he steered the course of economic and administrative reforms. For the first time, the government requested external audits of public sector corporations, and afterwards it presented a restructuring plan that includes results-based management. In order to contain spending in 2006, the government froze the hiring of new staff until the end of year.

Prioritization

The government is committed to democracy and a market economy. It largely achieved its reform goals for the first two years (2003 – 2004) by balancing the budget, avoiding a debt default, attracting investment, reforming the pension system for public employees and creating new taxes. Finance Minister Borda

Implementation

had purged the tax administration of corrupt officials to combat tax evasion. The customs and tax administrations increased tax collection by a cumulative 20% in real terms between 2003 and 2005. Tax income continued to increase in 2006. In July 2004, the Congress passed a new fiscal law (Ley de Adecuación Fiscal). It introduced, for the first time, an income tax for high-income earners, which still had not been approved at the end of 2006. With the declared objective of combating corruption in the judicial sector, the government and Congress pushed through the retirement and/or impeachment of six of the nine Supreme Court justices. However, quotas based on party affiliation tainted the installation of the new nominees for the Supreme Court, and new corruption scandals erupted in the courts afterwards. In 2005 and 2006, the President Duarte's reform impetus became intertwined with his personal gain, namely to win the internal Colorado Party elections and then the municipal elections, while at the same time clearing the way for his re-election (by reforming the constitution). So economic policy lost some of its coherence, and Finance Minister Borda left the cabinet in May 2005. The new finance minister continued most of the politics of his predecessor, however, and negotiated a new standby arrangement with the IMF. At the same time, the re-election strategy damaged the constitution and the Supreme Court.

The political leadership responds to mistakes and failed policies with changes; learning processes take place more frequently than in former times. However, the authoritarian and populist traits in the governing style of President Duarte set a limit to his willingness to change policies. Many times it is not clear if changes of policies respond to a learning process, or if they are a tactical maneuver (for example, his re-election proposal). The government has been quite successful in combining co-optation strategies with repression. When President Duarte realized that he would not get a majority in Congress for his re-election plan, he abandoned this project; it remains to be seen whether this decision will be irrevocable.

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. The state bureaucracy is still oversized, civil servants being almost invulnerable to dismissal. Recruitment of administrative personnel still puts a heavy emphasis on political loyalty. Nevertheless, the state budget seems to be balanced. Tax evasion has been curbed and fiscal revenue has increased significantly. This is in part due to a formalization process in the economy. The administration promotes the external auditing of public enterprises (not always

Efficient use of assets

in a successful manner), and it changed the management of several state enterprises and institutions responsible for social security. A new procurement law reduces the scope of corruption in the public sector.

The government tries to coordinate conflicting objectives and interests but with only limited success. There are significant intra-governmental friction, redundancies and lacunae. A conflict of interest existed between former Finance Minister Dionisio Borda and the governing party. Although the finance minister had attempted to reduce the costs of the public administration, the governing party sought to buy support for future elections. Borda resigned in May 2005 because he perceived a relaxation of the fiscal and monetary policies in anticipation of the upcoming internal elections (Colorado Party) and the municipal elections in 2006.

Policy coordination

The government seeks to provide more integrity mechanisms. Some mechanisms ensuring integrity are effective, while others do not work. Corruption is still a central feature of state and administrative culture; many of the state's resources are distributed based on patronage networks. However, the government has provided positive signals with the purging of the tax administration, the national police, the directors of state enterprises, customs and social security institutions, the impeachment of corrupt judges (sometimes politically motivated), and its commitment to more transparency in government procurements.

Anti-corruption policy

## 16 | Consensus-Building

The main political actors agree on establishing a market-based democracy. Nevertheless, there are problems with implementation, because there are many veto points in the political system, and economic reforms harm the vested interests of the political elite. The formal democratic institutions are subverted by informal and clientelistic practices. There is no broad consensus on the direction and the tempo of political and economic reforms. There is a lack of consensus-building mechanisms, for example between business owners and unions, or between politicians and actors from civil society.

Consensus on goals

Reformers can successfully neutralize or at least co-opt anti-democratic veto actors. The military is under control, and potentially anti-democratic political factions are co-opted into the political game. But the forces of reform are few in number and often in disagreement with regard to economic and political reforms.

Anti-democratic veto actors

Although the political leadership is trying to prevent the escalation of political rifts into conflicts, it cannot reduce existing divisions. Conflict over farmland has been growing. The landless are organized in a broad movement and represented by different organizations. However, the conflict over land is not articulated

Cleavage / conflict management

along party lines. When landless peasants invaded large landholdings, the mobilization resulted in violent evictions. At first, the government made an effort to mitigate the conflict and started talks with the movement of landless peasants. Later on, it sought to placate agricultural exporters and large landholders, using police forces and military to expel farm occupants. The government was successful in reducing the conflicts in the countryside by a mixture of co-optation and repression, which included an increased presence of the army in conflict-ridden rural areas.

President Duarte seems to prefer a populist top-down approach to social problems. The political leadership frequently ignores civil society actors and formulates its policy autonomously. However, it takes into account and accommodates the interests of civil society organizations when these organizations can put pressure on the government, or when they form part of the power base of the government party. Under pressure, President Duarte and Vice-President Luis Castiglioni started a dialogue with movement of landless peasants and created a social crisis cabinet (2004), but later on, when mobilization and open conflicts in countryside receded, nothing more was heard about this initiative.

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 is slow. Only a few victims of the dictatorship have been comprehensively indemnified, and compensations are quite low. As a response to pressures from civil society, the Commission of Truth and Justice was created by law, and it commenced work in the second half of 2004. Its mandate ended in February 2006 and was extended first for six months and later for 24 months. The Commission is under-funded and depends on international assistance. A museum of memory was created in one of the torture centers of the Stroessner era.

Reconciliation

## 17 | International Cooperation

President Duarte's government works predominantly with multilateral international donors and financial organization, 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 to support the country's economic program. This decision was based on the achievements of another 15-month standby arrangement from December 2003, the first IMF program for Paraguay since 1960, which, from the IMF's perspective, was highly successful in helping to stabilize Paraguay's economy. Various projects have been developed with the IADB (disbursements of \$28 million in 2005 and \$45.8 million in 2006), and the

Effective use of support

World Bank, which in 2006 financed seven active projects for a total of \$191.5 million.

President Duarte's government tries to act as a credible and reliable partner, and it receives more external support than former governments. The credit flows from international financial institutions could be taken as an indicator for the increasing credibility of the Paraguayan government. However, major international actors still express some doubts on the sustainability of reforms. In 2005, the United States tried to intensify military cooperation with Paraguay, and Defense Secretary Rumsfeld visited Asunción in August 2005. In May 2005, the Paraguayan Congress voted to allow U.S. forces to conduct joint military exercises in Paraguay. The Mercosur partners feared that the United States could set up a permanent military base in the Chaco. These suspicions faded later on when the Paraguayan government joined its partners in the Mercosur and refused to prolong the legal immunity granted to the U.S. troops operating in Paraguay.

Credibility

Paraguay is a member of Mercosur, along with Argentina, Brazil and Uruguay. Asunción is the headquarters of the Mercosur Court of Arbitration. 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. Together with Uruguay, the Paraguayan government has taken a critical stance vis-à-vis Brazil and Argentina, because the interests of the smaller member states of the Mercosur have not been sufficiently taken into account. 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 threat of coups in 1996, 1999 and 2000). Through Mercosur, Paraguay is also involved in negotiations on a free-trade 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 FTAA process. From time to time, Paraguay flirts with the idea of a separate free trade agreement with the United States.

Regional cooperation

## 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 suffers from the presence of a hegemonic party that was in power during the dictatorship and still exhibits authoritarian qualities. A successful modernization of the state and the economy would undermine the power base of the governing Colorado Party. The party landscape – including internal party factionalism and a divided opposition, which will only be able to maintain a united front with great difficulty – will change little in the near future and will hinder the formation of stable majorities. In addition, the heavy legacy of authoritarianism in political culture, combined with the country's unresolved social problems, can foster authoritarian tendencies in politics. There are many challenges ahead for President Duarte until the end of his term in August 2008. To accomplish its social agenda, the government needs much higher per capita growth rates, and these are not on the economic horizon. Conflicts over land and violent clashes in the countryside could yet again intensify. Economically, Paraguay is dependent on the world economy and the 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 debt on the Itaipú y Yacyretá hydroelectric plants with Brazil and Argentina, which would reduce the country's debt service and liberate funds for other purposes. As the president has, for the most part, already spent his political capital, and no broad reform coalition exists, we shouldn't expect new reform initiatives. It could be difficult for the government to consolidate fiscal stability, because the country is entering an electoral period. But the standby arrangement with the IMF will function as an external control on fiscal policy. President Duarte may restart his re-election campaign, which could provoke political protest and unite the opposition. Without the re-election option, political infighting in the governing party will increase, because candidates will seek to consolidate their power base. President Duarte could become a lame duck.