

# BTI 2012 | Paraguay Country Report

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

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

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### Key Indicators

Population	mn.	6.5	HDI	0.665	GDP p.c.	\$	5181
Pop. growth <sup>1</sup>	% p.a.	1.8	HDI rank of 187	107	Gini Index		52.0
Life expectancy	years	72	UN Education Index	0.643	Poverty <sup>3</sup>	%	13.2
Urban population	%	61.5	Gender inequality <sup>2</sup>	0.476	Aid per capita	\$	23.4

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

In transforming its political order, Paraguay has made progress in strengthening its political institutions, yet there are still shortcomings with regard to the quality of its democratic structures and the rule of law. Progress has been made in achieving a more stable democracy (veto powers of the military, for example, have been neutralized), but more progress is needed. The 2008 elections represented an important step as for the first time the elections represented a democratic transfer of power. On 20 April 2008, after 61 years in power, the Colorado Party lost the presidential elections. Fernando Lugo, a former bishop and candidate of a broad coalition of parties and social organizations, won the election with 41% of the vote.

The new president has enacted an ambitious reform program, which includes land reform, a program toward more efficiency and transparency in the public administration (by curbing corruption), poverty reduction and sustainable growth, as well as a renegotiation of the Itaipú dam treaty with Brazil. However, the president's coalition does not claim a majority in the National Congress. Moreover, the strongest party of his coalition, the Liberal Party, is internally divided and supports only a part of his reform agenda. The vice president, a member of the Liberal Party, is in constant conflict with the president and also is in a minority position within his own party. The Colorado Party is still the strongest party in the National Congress and is eager to return to government. At the beginning of his presidency, Lugo pursued a strategy of putting pressure on the opposition and the political institutions, such as the legislature and the judiciary, by mobilizing his supporters in public demonstrations. However, such a strategy, as in the case of Ecuador, has not proved viable in Paraguay. Later in his presidency, Lugo was forced to compromise and participate in traditional give-and-take politics.

President Lugo was successful in renegotiating the Itaipú treaty with Brazil. However, the Brazilian Senate delayed the ratification of the treaty that would give the Paraguayan government more money for its reform agenda. In other policy areas, such as long overdue land

reform, Lugo has had little success. However, his government has been partially successful in modernizing public administration (implementing a new public procurement system and taking steps toward the professionalized recruitment of staff) and has taken initial steps in improving public health care. From time to time the opposition has considered the idea of impeaching the president, but the parties are at odds over who could profit from a successful impeachment. At the same time, the opposition is anxious to limit the government's financial lifeline for reforms by blocking, for example, long overdue tax reforms or international credits.

## History and Characteristics of Transformation

Following elite power struggles, Paraguay's democratic transition began 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). General Stroessner had used the Colorado Party as a tool to safeguard his rule. Party membership was a prerequisite for a career in government administration or the military. Through the party, the country was bound by a tight network of control and political patronage. Even after the democratic transition the Colorado Party still remained in power. While it is true that a process of democratization in political institutions was initiated under Presidents Andrés Rodríguez (1989–1993) and Juan Carlos Wasmosy (1993–1998) with a new constitution in 1992, in the 1990s, the military still played a powerful role. Highly politicized, the military viewed itself as part of the Colorado Party and it openly took partisan positions. President Rodríguez, as leader of the coup against General 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 Raúl Cubas Grau (1998–1999) resigned to avoid impeachment. Raúl Cubas (Colorado Party) had taken office in August 1998 and was considered the puppet of General 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 María 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 Unión Nacional de Ciudadanos Éticos (UNACE), an offshoot from the Colorado Party, won representation in the National Congress and had been a strategic partner of both the government and the opposition parties. After the resignation of President Raúl Cubas in 1999, the head of the Chamber of Senators, Luis Ángel 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 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 push dissipated and politics refocused on power struggles within the Colorado Party and President Duarte's re-election plans. 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. Fernando Lugo, the emeritus bishop of San Pedro, one of the poorest departments in Paraguay, emerged as the leader of the opposition movement. Finally he was nominated as the candidate of the Patriotic Alliance for Change (Alianza Patriótica para el Cambio; APC), that was composed of 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 the presidential candidate, the Liberal Party in a contested internal election nominated the candidate for vice-president (Federico Franco).

On 20 April 2008, after 61 years of Colorado Party domination, Fernando Lugo won the presidential elections. In Paraguay the president is elected by a plurality electoral system. So 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 defined four main objectives of his government: a reform of the political institutions to improve the efficiency of the public administration and to curb corruption (especially in the judiciary); the creation of new jobs and poverty reduction; a land reform; and the renegotiation of the Itaipú dam treaty with Brazil. The president's main problem is that he claims no majority in the National Congress; his coalition at the start claimed only 31 of 80 seats in the Chamber of Deputies and 17 out of 45 seats in the Chamber of Senators. The Colorado Party is still the strongest party (holding 30 and 15 seats respectively in the two chambers); while the UNACE party of retired General Lino Oviedo (with nine Senate seats and 15 deputies) is in a pivotal position.

Most of the legal initiatives of President Lugo in the area of social politics were blocked. His coalition is internally divided, and some factions of the coalition often vote with the opposition. The strategy to ignore major opposition parties and mobilize supporters (floating the idea of a referendum) against the legislature and the Supreme Court failed. Several times his adversaries in the National Congress threatened to impeach him. The fact that his vice president comes from the minority faction of the Liberal Party acts as a kind of political life assurance, as the Colorado Party, the major opposition party, has no interest in substituting Lugo with a Liberal president. In the November 2010 municipal elections, the Colorado Party presented a united front and

recovered from its defeat in the 2008 presidential elections. The party won in 57% of all municipalities (mayors). The party has now a good chance to win the next presidential elections, scheduled for 2013. The credibility of President Lugo has been undermined not only by his lack of political achievement but also by scandals over paternity claims when he was still a Catholic bishop. In August 2010, President Lugo was diagnosed with lymphoma; yet in spite of chemotherapy treatments he continued his term of office and largely fulfilled his tasks as president.

While the government did not advance its plans of land reform it did renegotiate the Itaipú Treaty with Brazil in July 2009. The renegotiation will triple the annual compensation payments from Brazil from \$120 million to \$360 million (or from 0.8% of GDP to 2.3% of GDP). And Paraguay will be allowed, gradually, to sell surplus energy for a competitive price on the Brazilian market. However, the Brazilian Congress did not approve the agreement until the end of the term of Brazilian President Luiz Inácio Lula da Silva (December 2010). In the first two years of Lugo's presidency, police and armed forces did not manage to neutralize the small guerilla group Paraguayan People's Army (Ejército del Pueblo Paraguayo, EPP). The EPP had effectively pushed the government into a defensive stance with regard to domestic security. The EPP's activities became a hot topic when the group kidnapped a wealthy farmer in October 2009, who was released after his family paid a ransom. Subsequent police and military operations produced no tangible results in stemming the group's activities. Shortly after the EPP killed a police officer and three farm workers in April 2010, the government and the National Congress declared a state of exception in five northern departments for 30 days and deployed more than 4,000 police and military officers into the regions. However, security forces were not able to capture a significant number of EPP members and the push in general revealed the inefficiency of security forces.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 10 (best) to 1 (worst).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

Question  
Score

In principle, the state maintains a monopoly on the use of force nationally, but especially in border areas state presence is weaker. Large areas of the country are sparsely populated, border controls as well as airspace controls are few. In the tri-border area where Paraguay, Argentina and Brazil meet, near the border city of Ciudad del Este, state power and general resolve have failed to curb arms smuggling, drug trafficking and illegal immigration. The government of the United States sees Paraguay as a significant transit country for drugs (primarily cocaine) and as a center for money laundering. There may be fundraising activities related to terrorist organizations in the sizable Muslim communities that exist in the border regions. Paraguay is the principal producer of marijuana in South America. In the conflict between landowners and landless peasants often both sides act outside the law by illegally occupying land or organizing armed groups. For a few years the Paraguayan People's Army (EPP) has led attacks in the countryside (and with isolated acts in Asunción); there may be some connection between the EPP and the Revolutionary Armed Forces of Columbia (FARC) guerillas. The EPP attacks military outposts, extortions ransom following kidnappings and has organized bomb attacks. In April 2010 President Lugo declared a state of exception in five departments in northern Paraguay in response to the attacks. While the EPP poses no real threat to the state or government, it has effectively revealed the ineffectiveness of state and local security forces (police and military). In April 2010, a murder attempt against a senator of the Liberal Party failed (the politician's driver and guard were killed), an attack that was presumably committed by drug traffickers believed under order by Brazilian criminal elements.

Monopoly on the  
use of force

7

All citizens enjoy civil rights protections in theory yet in practice indigenous groups' rights are often neglected by the government. This is partly as indigenous groups are small (at 108,000 individuals, or less than 2% of the population) and partly because they are poorly organized. Property interests of the indigenous

State identity

9

peoples are not adequately protected and many have been displaced from ancestral lands. Some 20% of the respondents in the 2008 Latinobarómetro survey identified indigenous people as a group most discriminated against in Paraguay. Nonetheless, some 40% of Paraguayans consider that the poor are the most discriminated against. Mestizos, or citizens of mixed racial background, make up 95% of the population. The constitution recognizes Paraguay as a multicultural, bilingual country, with Guarani and Spanish as the official languages. The numbers vary strongly, but between 40% and 60% of Paraguayans communicate predominantly in Guarani and between 60% and 90% are bilingual. There is a significant population of Brazilians in the border area (the so-called Brasiguayos), with estimates between 300,000 and 600,000 people; many are landowners in possession of large parcels of arable land (about 14% of all farms with more than 1,000 hectares are owned by Brazilians; 9% by other foreigners) used for soybean production. The loyalty of such landowners 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 adds a special dimension to the conflict over land in Paraguay. Some activists from the landless peasant movement in Paraguay have called for the expulsion of Brazilian landowners. In a nutshell, apart from the few state conflicts based on issues of social exclusion, the nation-state is widely accepted.

Although the president during the period under review, Fernando Lugo, is a former bishop, in general the church and state are largely separate, and religious dogma has no noteworthy influence on policy or law.

No interference of religious dogmas

10

The state maintains a functioning basic infrastructure throughout most of the country, including staffing administrative institutions, hiring officials, administering justice and making and implementing government policies. But corruption and the political colonization of the administration (historically based on the dictatorship of General Alfredo Stroessner) have affected the functioning of the state. The courts and law enforcement are heavily compromised because of structural corruption. As well, there is a low state presence in the San Pedro and Chaco regions. The administration of basic infrastructure such as roads, water services, education and health care generally functions but is flawed and even lacking in some rural areas.

Basic administration

6

## 2 | Political Participation

Internal procedures of candidate selection within political parties are not always respected. 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 has been structurally in a favored position. Also, in past elections there have been complaints about practices of buying votes in some rural areas, and irregularities in the registration of members of

Free and fair elections

8

the Colorado Party have repeatedly been subject to criticism. Nonetheless, internally divided in 2008, the Colorado Party lost the presidential elections; this represented the first time the ruling party was unseated from power since the country's democratic transition. Twenty political parties and three political movements participated in the 2010 municipal elections. These elections demonstrated that the Colorado Party is still the strongest party in Paraguay and that both traditional parties (Colorado Party and the Liberal Party) still dominate Paraguayan politics.

Democratically elected representatives have the power to govern, and the influence of veto actors, especially those in the military, has declined. The military currently is plainly subordinated to civilian government control. Due to the mobilization power and economic influence of landowners, land reform and a taxation of agricultural exports may be blocked in advance before such plans are seriously debated. The country's low rate of taxation (as a percentage of GDP) corroborates the veto power of economic pressure groups. The postponement of the introduction of a personal income tax and the watering down of the respective law demonstrates the power of the economic sectors that are against the widening of the formal economy. Moreover, in July 2009 as a result of the protest of commercial farmers, the government repealed legislation that regulated the use of agrochemicals (with regard to healthcare, food safety and environmental standards). The Brazilian government occasionally meddles in the internal affairs of Paraguay to defend the interests of its citizens (mostly landowners) who live within Paraguay's border areas.

Effective power to govern

7

Freedom of association and assembly is guaranteed by the constitution. Social dialogue has been strengthened under the government of President Lugo. 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 union discrimination are not always enforced. Rights violations and anti-union practices remain commonplace, both in the private and public sectors. Labor legislation does not promote trade union activities. The level of unionization is around 11% of the formal labor force (350 labor unions and 317,000 affiliated). Farmers and the landless are also organized. Their mobilization in favor of land allocation and land ownership is sometimes suppressed violently by the state or by private actors.

Association / assembly rights

8

Freedoms of opinion of the press are constitutionally guaranteed and in general citizens can express their opinions freely. There is a pluralistic media sector, including private and public radio and TV broadcasters. However, media pluralism is threatened by concentration and by the influence that political parties exert on the media. Critical journalists are sometimes physically threatened and there have even been assassinations, especially if reporters focus on corruption or organized crime.

Freedom of expression

7



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 8% of the Paraguayan respondents in the 2010 Latinobarómetro survey said they went online daily, while some 74% said they never used the Internet.

### 3 | Rule of Law

Paraguay has enshrined the separation of powers and mutual checks and balances in its constitution. This is particularly the case when the president does not have a majority in the National Congress. The Supreme Court may also act independently, even though the judges had been selected according to political criteria and quotas; often each new elected president attempts to change the composition of the Supreme Court. In comparison with the constitutional attributes of other Latin American presidents, the Paraguayan president is not a strong president.

Separation of  
powers

9

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. Party-based quotas heavily influence the selection of new judges in the Supreme Court. In the first year of his presidency, Lugo tried to reform the Supreme Court (including the demission of all judges), later he blocked with his veto the appointment of a new judge to fill a vacancy. There were two vacancies on the Supreme Court until the end of 2010. Finally, President Lugo had to accept political quotas with regard to the nomination of Supreme Court judges as a bargaining chip in political negotiations with opposition and government parties.

Independent  
judiciary

5

Officeholders who break the law and engage in corruption are not prosecuted adequately under the law. 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 they can count on political connections. The vast majority of supposed cases of political corruption are not prosecuted. However, corruption charges have also been used politically, creating a significant difference between actual prosecuted cases of corruption and accusations in the mass media. One of the main objectives of the government of President Lugo is to combat corruption (especially in the judiciary) and to push for more transparency. But it is difficult to achieve these objectives with a weak congressional power base. Legislators themselves enjoy immunity, which protects some of them from prosecution and which only can be removed through a two-third majority. While there is no majority

Prosecution of  
office abuse

4

to impeach Supreme Court judges, new judges still are often selected according to political criteria and quotas.

Civil liberties are largely secure, especially basic political rights. There are no political prisoners. While the introduction of a new code of criminal procedure in 1999 better protects the rights of the accused, deficiencies in the rule of law result from the prolonged duration of proceedings and investigative arrests. Conditions in the country's 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, suspects and draftees. Human rights organizations have reported killings and illegal arrests by security forces. Human rights defenders working to promote peasants' rights have been harassed and threatened. In a few exceptional cases, human rights violations from the General Stroessner regime were criminally prosecuted. However, most cases have not yet been processed. Human rights organizations criticize that the fight against the guerrilla group Paraguayan People's Army (EPP) has been militarized and human rights not sufficiently respected. During the state of emergency in April-May 2010, some basic civil rights were restricted; the police's right to arrest was expanded and the right of assembly heavily restricted. Whereas more laws and international treaties protect the rights of indigenous people, these laws have not been sufficiently respected. Sentences of the Inter-American Human Rights Court in favor of indigenous communities have not been executed.

Civil rights

7

#### 4 | Stability of Democratic Institutions

Democratic institutions perform their functions, but frictions arise in the interplay between the president and the legislature. The president's party has no majority in the National Congress. The governing coalition is very heterogeneous and includes some minor parties and the Liberal Party, which is divided in factions and is opposed to some of the president's reform proposals (as for example land reform or an income tax). But the opposition is also divided between the party of retired General Oviedo (UNACE) and the Colorado Party, which is split between different factions. So there are shifting coalitions in the National Congress and much conflict over petty politics. In addition, the effect of politics in public administration is another serious flaw in the interplay of democratic institutions. According to the 2010 Latinobarómetro survey, only 35% (2009: 33 %; 2008: 22%) of Paraguayans are satisfied with how democracy is working in their country (while the Latin American mean is 44%). The public administration is highly politicized and is quite inefficient, which in turn hampers public sector reforms, such as the professionalization of the administration. There is not much trust in political institutions like the National Congress and parties, but in this Paraguay does not

Performance of democratic institutions

7

deviate much from the Latin American mean. The government and the armed forces are perceived as being more trustworthy.

Democratic institutions are supported by the relevant actors. However, informal structures undermine the functioning of democratic institutions. There is a certain risk that the political adversaries of President Lugo will try to remove him from office before the end of his term. But this would be put into effect within the constitutional framework through impeachment. This is a real risk, as President Lugo's governing party does not control a majority in the National Congress. His main ally, the Liberal Party, is internally divided in several factions. Vice President Luis Federico Franco, a member of the Liberal Party, would benefit if Lugo should be forced out of office. However, Franco is supported only by a minority of Liberal deputies and senators. While the Colorado Party is eager to return to power, it is not interested to replace Lugo with Franco; this in essence may be an assurance for the political life of Lugo. At the beginning of his presidency, Lugo played with the idea to mobilize his followers in order to put pressure on Congress and the judiciary, to force constitutional reform initiated by a referendum. But he backed off when the opposition threatened to impeach him. Likewise, serious land reform or more violent farm occupations could put the democratic commitment of landowner groups to the test. Also the disappointment of Lugo's own supporters with the postponement of land reform could lead to mass demonstrations against the government. In 2010 there have been several rumors about secret meetings of high-ranking military officials, fueling fear of a possible coup. Although there seemed to be no immediate threat, Lugo replaced 19 high-ranking officials from the Air Force and the Marines in September 2010. Currently the Paraguayan People's Army (EPP), a small guerilla group, poses no risk to Paraguayan democracy; the same is true for the overreactions of the government and the security forces with regard to this threat.

Commitment to  
democratic  
institutions  
8

## 5 | Political and Social Integration

Even though the election of Fernando Lugo may point to a change in party politics, the Paraguayan party system is still dominated by two traditional parties, the Colorado Party and the Liberal Party. Each party has been operational for more than 100 years. These parties will continue to form the axis of the country's political system in at least the medium-term. For example, President Lugo would not have won the election without the support of the Liberal Party. Occasionally there have been splits within the Colorado Party or new parties have emerged, but today only one has survived with a significant electoral basis, the National Union of Ethical Citizens (Unidad Nacional de Ciudadanos Éticos, UNACE) of retired General Lino Oviedo. The Colorado Party is still the strongest party. During 61 years in power, the party has created a close-knit patronage network. In the 2010 municipal

Party system  
7

elections, the Colorado Party and the Liberal Party together won almost 70% of the vote and 80% of all municipal councilor seats. The fragmented left won around 12% of the vote, and UNACE suffered heavy losses compared to the presidential and legislative elections, falling to 7% of the vote.

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 has remained nearly the same from 2003 (4.0) to 2008 (3.89). But this index could be misleading, as party discipline is low and parties consist of different factions. In 2009 there were two Colorado factions and two Liberal factions in the Senate, while there were three Colorado factions and three Liberal factions in the Chamber of Deputies. 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 traditional parties. However, due to patronage networks, the parties only sometimes work as instruments for articulating and aggregating social interests. The internal fragmentation of the two parties among competing party leaders is also typical, though stronger in the Colorado Party. The political support base of President Lugo is only partially articulated through the parties represented in the National Congress.

Compared to political parties, the system of social interest groups is weak as it is (politically) fragmented and dominated by only a few positions. Although there is a large number of small-scale organizations at the community level (such as neighborhood organizations), they are poorly interconnected and few ties exist between them and nationwide associations, limiting their ability to articulate common interests. There is no link to political parties in terms of collateral organizations, although one of the umbrella labor organizations has a relationship with the Colorado Party. Manufacturers are organized under the Unión Industrial Paraguaya (UIP). The labor movement, however, is weak and fragmented. There are currently seven competing trade union federations (and another one in formation). 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 is part of the Alianza Patriótica para el Cambio (APC) and in the Federación Nacional Campesina (FNC).

Voter turnout in presidential and congressional elections rose slightly from 64% (2003) to 66% (2008). Turnout was 55% in the 2010 municipal elections (2006: 50%). Support for democracy has traditionally been low among Paraguayan citizens (33% in 2007), but rose after the election of Fernando Lugo to 53% in October 2008 (slightly less than the Latin American mean of 57%) according to a

Interest groups

6

Approval of  
democracy

5

Latinobarómetro survey. Afterwards, support fell to 46% (2009) and rose again to 49% in 2010. Only 35% (2009: 33 %; 2008 22%) of citizens are satisfied with how democracy is working in their country (while the Latin American mean is 44%). Compared to the rest of Latin America, a high percentage of the population is open to the idea of an authoritarian solution or has nostalgia for the former authoritarian regime. Some 39% (2010) of Paraguayans agree that the prior military government was good or very good. Only 40% (with a Latin American mean of 63%) of respondents said they would never, under any circumstances, support a military government. Some 57% (with a Latin American mean of 39%) concur, that in a difficult situation it would be permissible if the government acted above the law. And 45% (with a Latin American mean of 29%) of respondents agree that the president controls the media.

Autonomous organization in civil society is uneven, as groups face various socioeconomic barriers to organizing and in general, there is a lack of civic culture. The question remains too whether citizens participate in independent or clientelistic organizations. There is large number of small scale organizations at the community level, however, and more than two-thirds of the Paraguayan population is active in such organizations. But their main objectives are usually limited to immediate measures, such as road building or improving the local water supply. A characteristic of Paraguayan organizing is the strong division between small-scale social groups and solidarity on a community level, and other types of civic engagement that is oriented toward common goods. Trust among the population is rather low; according to the 2010 Latinobarómetro survey, only 14% of Paraguayans trusted their fellow citizens, the second lowest percentage in Latin America.

Social capital

5

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Paraguay is a lower middle-income country with a gross national income per capita (PPP) of \$4,820 (2008); it is ranked 96 out of 169 countries in the 2010 Human Development Report and is classified as a Medium Human Development country. There was no change to Paraguay's HDI rank, at 0.640, between 2005 and 2010. If adjusted for inequality, Paraguay fell by 6 ranks. As per the Human Development Report 2010, the country's Gender Inequality Index ranking was 85 out of 138 countries, with a score of 0.643 (the best performer being the Netherlands at 0.174, and the worst performer Yemen at 0.853).

Question  
ScoreSocioeconomic  
barriers

4

Social exclusion is quantitatively and qualitatively extensive and structurally ingrained. The indices of income inequality have improved since 2000, but are still high (Gini Index 53.2). In 2009, 56% of the population lived in poverty (2008: 58.2%) and 30.4% in indigent conditions (2008: 30.8%) (Comisión Económica para América Latina y el Caribe (CEPAL), Social Panorama 2010). Inequality in land distribution increased during the last decade. Farms with less than 50 hectares account for 91% of all farms, but only for 6.3% of all farm land. From the opposite point of view, 8.7% of farms account for 94% of farm land. Half of the farm land redistributed through land reform from 1991 to 2008 was later resold to medium-sized and large agricultural producers. Almost 50% of the rural population is poor (63% extremely poor and 37% moderately poor). Around 70% of the employment in the rural sector is informal, and more than 60% of the urban labor force works in the informal sector. The adult literacy rate is 94.6%. Paraguay will probably be able to only achieve two of the Millennium Development Goals; that is, universal primary education and the promotion of gender equality and empowerment of women. However, according to statistics from the country's education ministry, the percentage of Paraguayans enrolled in secondary education institutions remains poor in urban areas (74%) and very low in rural areas (30%). The level of political and economic exclusion based on gender has also remained very high.

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	12222.4	16873.2	14239.6	<b>18333.2</b>
GDP growth	%	6.8	5.8	-3.8	<b>15.0</b>
Inflation (CPI)	%	8.1	10.2	2.6	<b>4.7</b>
Unemployment	%	5.6	5.6	-	-
Foreign direct investment	% of GDP	1.7	1.7	1.4	<b>2.3</b>
Export growth	%	9.6	10.5	-12.8	<b>34.3</b>
Import growth	%	10.8	15.9	-13.2	<b>29.3</b>
Current account balance	\$ mn.	184.2	-304.1	66.6	<b>-641.2</b>
Public debt	% of GDP	21.9	19.1	18.0	<b>15.0</b>
External debt	\$ mn.	3568.3	4159.2	3983.8	<b>4937.6</b>
Total debt service	\$ mn.	423.7	460.9	442.2	<b>463.7</b>

Economic indicators		2007	2008	2009	2010
Cash surplus or deficit	% of GDP	1.1	2.4	0.1	-
Tax revenue	% of GDP	11.4	11.8	13.0	-
Government consumption	% of GDP	10.8	9.7	11.8	<b>9.3</b>
Public expnd. on edu.	% of GDP	4.0	-	-	-
Public expnd. on health	% of GDP	6.2	6.0	7.1	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	0.8	0.8	0.9	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

## 7 | Organization of the Market and Competition

Market-based competition operates under a weak institutional framework. Free market competition and the protection of property rights are limited by endemic corruption and political influence in government administration and the judiciary. Regulations are sometimes inconsistent and often not implemented. There is a strong state presence in telecommunications, electricity production, gas and oil refineries, cement production, railways and water industries. The government controls the price of fuel and fares on public transport. In addition, the government sets the minimum wage, which is often not adhered to. Around 240,000 employees work in the public sector (2007). In June 2010, President Lugo vetoed a law that would have reduced the number of hours in the working day of public sector workers from eight to six. The informal sector is large 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 at 16 of 29 countries in the Americas, and at 81 in a global ranking. According to the index, the Paraguayan economy is 61% free.

Market-based  
competition  
4

The formation of monopolies is generally prohibited by Article 107 of the national constitution, but in practice monopolies are rarely split up. Monopolies exist in many areas, such as cement production (Industria Nacional Del Cemento, INC) and electricity (Administración Nacional de Electricidad, ANDE). In 2009 the Internet monopoly of COPACO (Compañía Paraguaya de Comunicaciones), the state-owned telecommunications company, was finally split up.

Anti-monopoly  
policy  
3

Membership in the Southern Cone Common Market (Mercosur) has largely liberalized trade with Argentina, Uruguay and Brazil. The weighted average tariff rate is 3.3 (2008), but non-tariff barriers exist. In addition, cumbersome and time-

Liberalization of  
foreign trade  
8

consuming customs procedures, as well as burdensome labeling procedures, add to the cost of trade. In the World Bank 2011 Doing Business Report, Paraguay ranks at 106 out of 183, but in the specific ranking of “trading across borders” it ranks only at 152 out of 183. Paraguay reported several anti-dumping measures in 2010 to the WTO and has so far been involved in 15 trade disputes as a third party.

The legal and regulatory framework of banking supervision has improved; compliance with Basel Principles stands now at 27% and may improve further, up to 50%. Public financial institutions, such as the National Development Bank (BNF) and the Development Financial Agency (AFD), and the financial position of the Central Bank have been strengthened. A new penal code with enhanced penalties for money laundering crimes came into effect in July 2009. A new electronic information system to report suspicious financial transactions has been introduced. However, international financial organizations still demand a better supervisory and regulatory framework for cooperatives, as cooperatives now account for a quarter of the total of financial system assets. There is a strong presence of foreign banks. The two largest banks are foreign-owned, and foreign banks control 30% of assets. Banks are well capitalized. Non-performing loans represent only 1.9% of all loans. However, capital markets are considered underdeveloped.

Banking system

7

## 8 | Currency and Price Stability

Controlling inflation and a suitable foreign exchange policy are recognized goals of government economic policy. The inflation rate fell to 1.9% in 2009 and rose to 6.1% in 2010. Paraguay has a floating exchange rate. Because of close ties to its two big neighbors in the Southern Cone Common Market (Mercosur), the Paraguayan currency (guaraní) depends on the economic development and currency rates (measured against the U.S. dollar) in Argentina and Brazil. The guaraní depreciated more than 10% against the dollar in 2009, but appreciated slowly again in 2010 (2.6% as of September 2010, on a year-on-year basis). The guaraní depreciated both against the Brazilian real (7.4%) and the Argentinean peso (2.6%). The Central Bank (Banco Central del Paraguay, BCP) coordinates monetary policy, taking into account the baseline of government economic policy. The BCP’s independence from political pressures has been strengthened over time, though the IMF has demanded further reforms (as well as improvements in cooperation with the finance ministry).

Anti-inflation /  
forex policy

8

There are signs within the government of a consistent policy for macrostability. Until 2003, the government ran a budget deficit; since 2004 it has run surpluses and public debt is now less than 25% of GDP. President Lugo named Dionisio Borda, an independent, as his finance minister. Borda had been finance minister in the cabinet of President Duarte (2003–2005), where he received most of the credit for

Macrostability

8



eliminating the budget deficit. The nomination of Borda sent a strong signal that the government is committed to economic stability. State revenues increased because of better tax collection and a curb on tax evasion. There exists a risk that in the future the opposition will block government initiatives to increase state revenues and at the same time boost spending for electoral purposes. For example, in mid-2009 the oppositional majority in the National Congress created a state pension for low-income citizens and doubled the salaries for departmental councilors and the national electoral commission. Against the suggestions of international financial organizations (World Bank and the IMF) in October 2010 an oppositional majority in Congress overrode a presidential veto and postponed again (for the fourth consecutive time) the introduction of a 10% personal income tax until 2013 (the end of Lugo's presidential term). An income tax would strengthen the tax base, contribute to a fairer tax system and foster the formalization of the economy.

## 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 due to inefficiency and corruption. Land titles are often ill-defined, especially in the agricultural sector. A latent and sometimes violent conflict exists between interests, in which large agricultural corporations (some of them foreign-owned) look to consolidate and expand holdings while the landless and small farmers seek agrarian reform and land redistribution. Protesters often occupy land, which generates conflicts that often encourage conduct outside the rule of law. Acquiring the necessary documents for land titles takes much time. There is a weak enforcement of property rights. However, the World Bank ranks Paraguay 60 out of 183 in registering property. The distribution of counterfeit or pirated goods is not sufficiently sanctioned.

Property rights  
6

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, state enterprises exercise a monopoly or subvert fair competition. Privatization programs came to a halt during the administration of President Duarte. They proved to be very unpopular because of repeated major irregularities, a lack of transparency and a number of corruption charges. It is clear that such programs also have no future under the Lugo presidency. However, in 2009 the government signed an agreement with the IMF to regularly monitor the performance of state companies. Foreign investors are guaranteed equal treatment and most sectors are open to private investment. There are plans by RTA (Canada) to construct an aluminum plant close to Itaipú. The government is opening the mining sector for exploration licenses.

Private enterprise  
7

There are major investment projects by foreign companies (for example, CIC Resources in titanium dioxide) in the mining sector.

## 10 | Welfare Regime

There are rudimentary measures to moderate social inequities, but efforts 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. Only 39% of the urban workforce is covered by social security, and 45% have access to health care services (2008). The pension system is organized on a pay-as-you-go basis. Social insurance for employees of private companies is still a relatively new concept, a system which has managed to maintain a balanced budget, though the system has been adversely affected by recurring banking crises. Because of the country's demographics (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 is an increase in administrative efficiency and a curbing of corruption. Public spending for health rose from 1.5 % of GDP in 2008 to 2.4% of GDP in 2010. In December 2009 the administration of President Lugo introduced free medical visits and free dental treatment in public hospitals, which resulted in more than 8 million visits in 2010. The government pays conditional cash subsidies (in exchange for commitments regarding health and education of children) to about 110,000 poor households (up from 15,000 at the beginning of Lugo's presidency). Life expectancy is relatively high, at an average of 72 years. In some rural areas, self-regulated and small scale "social pharmacies" operate to improve primary health care in remote areas.

Social safety nets  
5

Society is severely segmented, and there are few institutions with the mandate to alleviate social discrepancies. Accordingly, surveys reveal that most Paraguayans perceive an individual's social background (membership in a family or clan or contacts to higher social classes) as the main source of opportunities. Social expenditures are low in comparison to other South American countries. There are particularly marked differences in the delivery of health care. During the administration of President Lugo, access to public health services improved. Violations of the labor law and other legal protections, such as for children and health care access, are not adequately monitored or sanctioned by the government. At the operating level, collective bargaining agreements are often impossible because of the opposition of the business class. Only 10% of private sector employees and 60% of public sector employees are covered by collective bargaining agreements. Women are disadvantaged both economically and politically. The country's Gender Inequality Index rank is 85. Some 10% of women in rural Paraguay are illiterate, and 20% of women in the workforce operate in the domestic services sector. Only 15.6% of seats in the Chamber of Deputies and

Equal opportunity  
4

12.5% of seats in the Senate are occupied by women. Of newly elected mayors, only 7.5 % (2010) are women (2006: 5.6%). Of 36 appeal court judges, 10 are women; one woman is a member of the Supreme Court. Apart from inequalities based on gender, a lack of equal opportunities exists mainly with respect to the indigenous population.

## 11 | Economic Performance

In 2009, the Paraguayan economy after six years of consecutive growth contracted by 3.8%. The slowdown was a result of the worldwide financial crisis and shrinking demand for Paraguayan agricultural exports. At the same time, agricultural production fell because of a severe drought. Urban unemployment rose to 8.2% and fell slightly to 7.8% in 2009 and 2010 respectively. But underemployment, not unemployment, is the main problem of the Paraguayan economy. Some 26.8 % of the workforce is underemployed (2009). The Paraguayan economy recovered in 2010 with a record growth of 14.5%, according to the Paraguayan Central Bank. This result was due to the rising demand and high prices for agricultural exports (especially soybeans) and an exceptionally good harvest. But growth was also stimulated by an anti-cyclical expansionary public spending policy. Agriculture accounts for a one-quarter of the country's GDP, and approximately 60% of industrial activities are linked to this primary sector. A budget deficit has been eliminated since 2004 (last data from 2010). Public debt is now less than 25% of GDP. Inflation rose to 6.1% (October 2010) compared to 1.9% in 2009 and 7.5% in 2008. While the guaraní depreciated around 10% against the U.S. dollar in 2009, it appreciated slightly in 2010. The value of investment and trade has grown. However, low productivity and underdeveloped technological capacities are still the greatest challenges for the Paraguayan economy. There are also deficits for lack of public investment in infrastructure (for example, electricity transmission lines). The Global Competitiveness Index (GCI) ranks Paraguay at 120 out of 139 countries (2010–2011), at 132 with regard to innovation and sophistication, and at 137 with regard to the quality of institutions. The tax base is quite low; corporate taxes are 10%, the lowest corporate tax rate in the region. Tax revenue as a percentage of GDP is around 12%. Income taxation accounts only for 17.7% of all tax incomes (while the South American average is 30.4%). While commercial agriculture accounts for 25% of GDP, its contribution to tax revenue is very small (0.02% of GDP).

Output strength

7

## 12 | Sustainability

Environmentally sustainable growth has been given only sporadic attention by the government and has a weak institutional framework. This is particularly evident concerning the environmental impact of the country's large hydroelectric plants. The new strategic economic and social plan (2008–2013) of the Lugo government explicitly favors an integral approach combining economic, social and environmental policies. However, there has been little control of deforestation in border regions, which has accelerated because of the recent boom in soybean production. Reducing air and water pollution has not been a priority. Organizations of small farmers and landless peasants as well as indigenous groups occasionally 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. However, as a result of protests by commercial farmers, in July 2009 the government repealed legislation to regulate the use of agrochemicals (with regard to healthcare, food safety and environmental standards). Anti-smoking legislation has been diluted in Congress due to the pressure of the tobacco lobby.

Environmental  
policy  
5

Despite rising school enrollment rates (net primary enrollment rate 2001–2009: 92.4%; secondary enrollment rate, 57.7%; tertiary enrolment rate, 25.5%; percentage of the population with at least a secondary education, 26.4%), the educational system still has significant qualitative deficiencies. Challenges are sometimes as basic as the need to provide food and school supplies for young pupils. Research and development facilities are rudimentary; there are almost no independent or publicly funded research structures within universities and most locally conducted research happens through short-term consultancies funded by international donors. Quantitatively, investment in education and training, as in research and development, is rather low. While public expenditures on education reached 4% of GDP (2000–2007), research and development expenditures were 0.1% of GDP (2000–2007). The literacy rate is quite high at 94.6%, while the rate between men and women is somewhat unequal (male literacy rate, 95.7%; female rate, 93.5%). However, there are large inequalities between urban and rural areas with respect to enrollment rates and above all, concerning tertiary education. Public spending per primary and secondary school student was \$244 (at constant 2000 prices), the fifth-lowest in Latin America. Mean schooling years total 7.8.

Education policy /  
R&D  
5

## Transformation Management

### I. Level of Difficulty

The structural constraints on governance are high. Paraguay has no coast and its geography is challenging. 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 the forces for reform in politics and society were strengthened by the electoral victory of President Lugo, the first two and half years of his presidency demonstrate that there still exist many veto points where political and economic reforms can be blocked. The main constraint is that within a weak presidential role President Lugo cannot rely on a stable majority in either body of the legislature. This situation has seriously restricted national reform efforts, such as land reform and the introduction of a personal income tax. Also, the management of public sector reforms is hampered by a politicized public administration, which also lacks professionalism.

Structural  
constraints  
7

The democratization process in Paraguay began in 1989 after a long phase of authoritarian rule, and was built on 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 essentially subverted civil society, resulting in a weak and limited civic participation in public life. The NGO sector in Paraguay depends strongly on support from international donors. Nevertheless, more than a million Paraguayans (25% of the population) participate in some kind of organization. There is a network of small civil society organizations that could be used for mobilization processes in times of crisis. On an everyday basis, the connection between small, limited organizations and wider social movements is difficult and poorly developed. However, civil society groups formed the core of the political movement and alliance that finally brought President Lugo to power. There has been a strong human rights movement in

Civil society  
traditions  
6

Paraguay. As an example, the Paraguayan Human Rights Coordinator (Coordinadora de Derechos Humanos del Paraguay, CODEHUPY) is comprised of 25 organizations (and eight supporting organizations).

Great ethnic homogeneity is certainly an advantage for the Paraguayan government. There are no religious differences that could be viewed as a source of conflict. The great majority of political parties, such as the Colorado Party and the Liberal Party, do not articulate or draw attention to social cleavages between the poor and the rich. A growing class conflict between landowners and organized landless peasants in rural areas has surfaced in the last decade. For years the policy of expanding agriculture lands was an important source of the country's GDP growth. Now there is almost no arable land left in eastern Paraguay. There have been violent clashes between the police and rural peasants. The small guerrilla group, Paraguayan People's Army (Ejército del Pueblo Paraguayo, EPP), while active in the countryside, constitutes no real challenge for the Paraguayan state or for general political stability. Widespread insecurity and violence related to drug trafficking, kidnapping and assaults are not structured along ethnic or regional factors.

Conflict intensity

4

## II. Management Performance

### 14 | Steering Capability

The government administration changed in August 2008. The government of President Lugo is committed to constitutional democracy and a socially responsible market economy. As a clear signal of his reform impetus and balanced economic policy, President Lugo named an independent, Dionisio Borda, as his finance minister, an individual well-connected with international finance organizations and respected by the opposition and parts of the NGO sector. The government claims to pursue long-term aims. It presented a five-year (2008–2013) economic and social strategic plan for sustainable growth with social justice goals. At the beginning of his administration, President Lugo set four priorities: the reform of the public sector; poverty reduction; land reform; and the renegotiation of the Itaipú dam treaty with Brazil. In his first year, the government put much energy into the Itaipú negotiations and it seems that the talks will result in increased budgetary resources for other political priorities. The government created a new institution for land reform (Coordinadora Ejecutiva para la Reforma Agraria, CEPRA), but the organization does not have enough funds for a cadastral survey, which is the outcome of a lack of political support in the National Congress and the veto power of the industrial agrarian sector. Other reform efforts, such as the

Question  
Score

Prioritization

7

professionalization of public administration, are advancing but are held back by politicized staff and loyalty to Colorado Party networks.

The government of President Lugo defined a comprehensive reform agenda, but reform politics are hampered by the president's fragile power base, including conflicts within the alliance that supported Lugo in the presidential election. President Lugo was criticized in his first year in office over weak leadership and his inability to reach a political consensus for the passage of critical legislation. Dinonisio Borda, the finance minister, resumed the tax reform project that he started under the Duarte presidency. While the introduction of an income tax is still blocked by an oppositional majority in Congress, tax revenues rose because of better tax collection. With regard to poverty reduction and land reform, results have been more modest. The government was able to renegotiate the Itaipú treaty with Brazil in 2009, but the Brazilian Congress had not yet ratified the treaty by December 2010. Modernization of the public administration has advanced as well (e.g., shortening the time to open a business and improving public administration efficiency), but is far from being completed.

Implementation  
6

The President Lugo administration lacks a majority in the National Congress and its reform agenda is confronted with many obstacles. Out of necessity it must adapt to changing opportunity structures and impediments. At the beginning of his presidency, Lugo pursued a strategy to put pressure on political institutions and the opposition, by mobilizing his constituency in public through street demonstrations. This strategy did not succeed. Afterwards Lugo reverted to more traditional forms of coalition building and cooptation to pursue his political objectives. Since this is the first time since the transition to democracy (i.e., in 60 years) that a government has not been run by the Colorado Party, its experiences from the past are limited (with the exception of the finance minister, Dionisio Borda). Consequently, institutionalized policy learning cannot be easily assessed. In addition, the government was expected to change things rather than perpetuate the status quo, including the former government routines. However, international cooperation has a long tradition in Paraguay and has served as a supporter of continuous reform efforts from one government to another.

Policy learning  
7

## 15 | Resource Efficiency

The government is committed to increasing efficiency. In September 2008 the new finance minister created a technical unit for public modernization. However, the state bureaucracy is still oversized, civil servants being almost impossible to dismiss. The main problem is rather the inability of dismissal overall than a threat of politically motivated dismissals. Recruitment of administrative personnel still puts a heavy emphasis on political loyalty (especially at the municipal level). However, the recruitment system is subject to reform under state secretary Lilian

Efficient use of  
assets  
6

Soto and recruitment based on merit has expanded to roughly a third of public administration. Still, there are several challenges with respect to the modernization of the public sector, such as intra-administrative coordination to implement new steering processes. The state budget is balanced. Tax evasion has been curbed, smuggling has been reduced and fiscal revenue increased significantly. The combat against the guerrilla group Paraguayan People's Army (EPP) is hampered by institutional rivalries between the police and the armed forces.

The government tries to coordinate conflicting objectives and interests, although it is difficult. The Patriotic Alliance for Change (Alianza Patriótica para el Cambio, APC) is a very heterogeneous coalition that supported a center-left presidential candidate, while the major party of the Alliance, the Liberal Party, is a center-right party. Moreover, the Liberal Party is split in different factions, and the faction of Vice President Franco is in the minority. In addition, the heterogeneous alliance has no majority in Congress and has to negotiate with a strong but also divided opposition. However, the fragmentation of the opposition and the government has led to a cobbled implementation of policy priorities rather than to genuine policy chaos.

Policy  
coordination  
6

Corruption is still a central feature 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 simply do not work. A positive example is the reformed public procurement system, which produced a credible shift in public sector procurement procedures. Also, credible efforts have been undertaken by state secretary Lilian Soto to modernize the public sector's recruitment system toward a meritocratic system. Attempts to modernize the public administration via coherent informational systems have proven to be difficult, but efforts are in motion. A serious roadblock in the effective containment of corruption is the absence of personal income tax, which would help formalize the economy and limit the possibilities of handling illicit money flows. Overall, the new government has provided several positive signals and is committed to more transparency, integrity and efficiency in public administration. As part of the 2010 Latinobarómetro survey, some 16% of respondents said that they or relatives had heard of acts of corruptions in the last 12 months (2009: 10%; 2008: 9%; Latin American mean 2010: 11%), while 37% of respondents agreed that there has been progress in reducing corruption in state institutions (2009: 40%; 2008: 26%).

Anti-corruption  
policy  
5

## 16 | Consensus-Building

The main political actors agree on establishing a market-based democracy. Nevertheless, there are problems with implementation as there are many veto points in the political system and economic reforms harm the vested interests of the political elite. Formal democratic institutions are subverted by informal and

Consensus on goals  
7



clientelistic practices. In the administration of President Lugo there is no broad consensus on the direction and the tempo of political and economic reforms. The government party maintains no congressional majority on highly contested issues of land reform and agriculture taxes. The Liberal Party, the major government party and party of Vice President Franco, does not support 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.

The military respects the democratic legitimacy of the government and is not an independent political actor. However, the government of President Lugo maintains a continuous distrust of the armed forces. Shortly after assuming the presidency, Lugo replaced 33 high-ranking officials with the objective to modernize the armed forces. From time to time there have been rumors of civilian-military coup plots. In September 2010 President Lugo reshuffled the upper echelon of the armed forces for a fifth time. Yet still there is no danger of an open subversion by the military of the democratic order. However, there is still the risk that social conflicts could get out of control and put the political institutions under pressure. In such an event, some political actors could be tempted to unseat the president through a mixture of legal proceedings and social pressure. Anti-democratic actors are not openly visible but the historically grown systems of clientelism and patronage are essentially anti-democratic and are largely associated with the traditional political parties of the Colorado Party and the Liberal Party. In sum, while neither of the two main political parties oppose democratic norms, clientelistic practices of these organizations partly hamper democratic reforms.

Anti-democratic  
actors

7

Although the political leadership tries to prevent the escalation of political cleavages into conflicts, it cannot mend existing divisions. Conflict over available farmland has been growing. The landless are organized into a broad movement and represented by different organizations. However, the conflict over land is only partially articulated along party lines. At the end of its term, the Duarte government essentially left the land problem to its successor. Land reform was a central topic of the electoral campaign of now President Lugo. But there is only weak congressional support to put into effect a land reform. The Lugo government has attempted to mediate between the landless movement and the powerful group of landowners. This approach has been difficult as large landowners and soya producers are important and influential economic actors. Moreover, Brazilian landowners in Paraguay receive the strong support of their government in Brazil. 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 infrastructure investments in the countryside (roads, schools, medical clinics and so on). However, it may be that there is not enough available revenue or managing capacities, not to mention political support, even for watered-down land

Cleavage /  
conflict  
management

7

reform. In the case that the Brazilian Congress ratifies the renegotiated Itaipú treaty, the Paraguayan government will at least have more funds for social reforms.

President Lugo began his political career in the civil society movement, “Tekojoja.” He is more open to civil society participation in politics, and reforms have been accompanied by numerous participative forums. Because he lacks a strong partisan power base, however, he needs the support of civil society organizations to implement his political agenda and to put pressure on a recalcitrant political opposition. The municipal law was reformed in 2009 to open up more space for civil society participation and control. However, political parties and their clientelistic networks are still quite strong in Paraguay, which limits the space for civil society actors.

Civil society  
participation  
8

The political leadership recognizes the need to deal with acts of injustice and human rights violations perpetrated during the General Stroessner dictatorship, but the process of reconciliation has been slow. Only a few victims of the dictatorship have been comprehensively indemnified, and compensations are quite low. A museum of memory was created in one of the torture centers of the Stroessner era. The office of the ombudsman supports the investigation of human rights abuses from that time. As a response to civil pressures, a Commission of Truth and Justice was created and it started its work in the second half of 2004. Finally, on 28 August 2008, the commission presented its final 1,000-page report, that includes 178 recommendations. In a ceremony President Lugo offered an apology to the victims of human rights violations and promised to implement the recommendations of the commission. As a result of the report, a Truth, Justice and Reparation Department was created within the office of the ombudsman.

Reconciliation  
8

## 17 | International Cooperation

After a short period of internal reflection on reform priorities, President Lugo’s government has worked with multilateral international donors and financial organizations, including the IMF, the Inter-American Development Bank (IDB) and the World Bank, with the aim of bringing in international assistance to assist the domestic reform agenda. While Paraguay regularly receives technical assistance from the IMF, there are no outstanding purchases and loans with the IMF. The World Bank approved a five-year country strategy in 2009, which has an envelope of \$500 million. In 2010 a new country strategy for 2009 to 2014 was approved by the IDB board with an envelope of \$1 billion. The strategy is aligned with a government program (Programa Estratégico Económico y Social, PEES) that puts special emphasis on social programs for poverty alleviation, infrastructure and institutional capacity in the public sector. As part of its confrontation with the government, Congress has blocked loans from international financial organizations (including loans earmarked for the modernization and strengthening of the tax

Effective use of  
support  
8

administration). Apart from financial cooperation Paraguay cooperates above all with organizations based in the United States (United States Agency for International Development, USAID), Germany (Deutsche Gesellschaft für Internationale Zusammenarbeit, GIZ) and Japan (Japan International Cooperation Agency, JICA) on technical issues. Especially the public sector, reform is developed in cooperation with USAID under the program, “Umbrella I + II.”

The government of President Lugo mostly acts as a credible and reliable partner. The lack of a majority in Congress gives the president little leeway in establishing new foreign policy initiatives. So the possibilities of a more leftist foreign policy, to for example forge closer links with Venezuela, are quite limited. However, President Lugo maintains good relations with President Hugo Chávez, and Lugo made visit to Cuba. In general relations are good both with Latin American countries as well as with the United States and Europe. The U.S. government and Paraguay collaborate extensively on anti-narcotics and anti-smuggling policies. The United States provided an estimated \$26 million to Paraguay in 2009 (including \$10 million for health and economic growth assistance). The aid request by the Obama administration for fiscal year 2010 was \$13.9 million (including \$5.8 million development assistance and \$2.1 million to support global health and child survival). At the same time Paraguay has diversified its international partners. Its relations with Russia were upgraded; Russia is now the principal market for Paraguayan meat exports. In 2009 Russia converted its consulate in Asunción into an embassy, and in 2010 for the first time a Paraguayan foreign minister made an official visit to Moscow.

Credibility

8

Paraguay is a member of the Southern Cone Common Market (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 the Paraguayan democracy, in the sense that its two neighbors have intervened diplomatically in active ways during periods of political crisis (e.g., the threat of coups in 1996, 1999 and 2000). The population generally supports inclusion in this common market, even if some voices loudly advocate the country take its own path during periods of political or economic crisis. Together with Uruguay, the Paraguayan government from time to time has taken a critical stance vis-à-vis Brazil and Argentina, because interests of the smaller member states in Mercosur have not been sufficiently taken into account. Being a much smaller economy than Brazil or Argentina, Paraguay has no real power to actively frame the agenda for cooperation with its neighbors. President Lugo however was able to renegotiate the Itaipú dam treaty with Brazil. But the Brazilian Congress did not ratify the treaty during 2009 or 2010. The Paraguayan Senate blocked the ratification of the

Regional cooperation

8

protocol for the entry of Venezuela into Mercosur that was signed in 2006, and has also been ratified by all other member countries.

## Strategic Outlook

Paraguay's presidential democracy is characterized by a strong, bicameral Congress and a fragmented party system. Consequently, many issues in political decision-making are vulnerable to veto and comprehensive political and economic reforms must draw on broad coalitions. Paraguay's democracy still suffers from the long-time dominance of the Colorado Party, which had been in power for 61 years. A successful modernization of the state and the economy would undermine the power base of this still-influential party, which also continues to be the strongest party in the National Congress. However, even with the second major party, the Liberal Party, President Lugo holds no majority in the National Congress. The Liberal Party is fragmented and does not fully support his reform agenda, with the topic of a land reform especially highly contested. The party of retired General Lino Oviedo, National Union of Ethical Citizens (UNACE) is in a pivotal position in the legislature, as it and the Colorado Party hold a majority in both houses of Congress. Thus President Lugo's chances of becoming a great reformer are quite modest. Furthermore, without a congressional majority and with a vice president from the Liberal Party, the possibility that opposition forces would want to see a premature end of his presidency is potentially likely.

However it is clear that the Colorado Party has no interest in seeing a Liberal Party member like the vice president step into the president's seat if Lugo is removed. The Colorado Party has since recovered from its defeat in the 2008 presidential elections and closed ranks to win the November 2010 municipal elections. The party has a good chance to win the next presidential elections in 2013, if the party can agree on a consensus candidate. Concerning the government's parties, there is no such consensus candidate on the political radar, nor is there the possibility for them to repeat their experience of 2008 in assembling a broad coalition against the Colorado Party. So it stands to reason that the Colorado Party will focus its energies on the next presidential election. Only in exceptional circumstances is it expected that the Colorado Party will seek to unseat President Lugo before the end of his term. But at the same time, the party has no interest in supporting his reform agenda. On the contrary, the Colorado Party has and will continue to try to curb the budgetary room for maneuver of the government in social reforms. There is a high risk that Lugo supporters will become disenchanted with the lack of real progress in the reform agenda. Social conflict in the countryside could become more radicalized and violent, putting strain on the governing coalition. 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 Southern Cone Common Market (Mercosur) countries. Any leeway for independent action is limited. There remains the possibility that the Brazilian Congress will ratify the renegotiated Itaipú treaty, which would create extra funds for the government's reform agenda. But part of the extra money will go to the municipalities where the Colorado Party holds a strong position. In order to gain some credibility with the electorate as an effective reformist president, Lugo will have to prioritize his activities on visible changes. While it will be almost

impossible to advance land reform due to the political forces in Congress, improving the efficiency of public administration, curbing corruption and expanding the social safety net in a perceptible way could be important steps to convince Paraguayans of viable alternatives to the patronage system of the past decades.