

# BTI 2014 | Paraguay Country Report

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This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2014 — Paraguay Country Report. Gütersloh: Bertelsmann Stiftung, 2014.

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**Key Indicators**

Population	M	6.7	HDI	0.669	GDP p.c.	\$	6137.6
Pop. growth <sup>1</sup>	% p.a.	1.7	HDI rank of 187	111	Gini Index		52.4
Life expectancy	years	72.1	UN Education Index	0.643	Poverty <sup>3</sup>	%	13.2
Urban population	%	62.4	Gender inequality <sup>2</sup>	0.472	Aid per capita	\$	10.5

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

During the period under review, political and economic reform has stagnated in Paraguay. Shortcomings with regard to the quality of its democratic structures and the rule of law combine with severe flaws in the economic order and above all the welfare regime.

In 2008, Fernando Lugo, a former bishop and the candidate of a broad coalition of parties and social organizations, won the presidential election with 41% of the vote, the first time in the country's recent history that power was transferred through democratic elections.

The new president announced an ambitious reform program, which included land reform, poverty reduction and sustainable growth, the renegotiation of the Itaipú Dam Treaty with Brazil, and an anti-corruption campaign for more efficient and transparent public administration. However, his coalition did not claim a majority in Congress. Moreover, his coalition was itself very heterogeneous, and the strongest party of his coalition, the Liberal Party, was internally divided and supported only part of his reform agenda. The vice president, a member of the Liberal Party, was in constant conflict with the president and also is in a minority position within his own party. The Colorado Party was still the strongest party in Congress and was eager to return to government. The opposition was anxious to limit the government's financial lifeline for reforms by blocking, for example, long-overdue tax reforms and international credits. These challenges have combined to limit the government's ability to substantially progress with its reform agenda.

Thus, in crucial policy areas, such as land reform, Lugo had little success. However, he successfully renegotiated the Itaipú Treaty with Brazil. Moreover, his government has been partially successful in modernizing public administration (for instance, taking steps toward the professionalized recruitment of staff) and has taken initial steps in improving public health care. At the beginning of his presidency, Lugo pursued a strategy of putting pressure on the opposition and on political institutions, such as the legislature and the judiciary, by mobilizing his supporters in public demonstrations. However, such a strategy was not viable, given the Paraguayan political

landscape. Later in his presidency, Lugo entered more into give-and-take politics. While from time to time he successfully forged shifting congressional majorities, he also alienated erstwhile allies. He never managed to get the cohesive support of the Liberal Party.

The situation began to deteriorate in 2011, when Lugo supporters first tried to change the constitution to permit his re-election. Afterwards, the search for a candidate of the left-wing alliance that supported Lugo, along with maneuvers aimed at weakening potential adversaries, dominated politics. Political decisions became subordinated to the electoral strategies of the different parties. In the end, President Lugo fell victim to electoral positioning. He made the strategic mistakes of frustrating his own supporters, alienating his main ally in Congress (the Liberal Party), and meddling with the Colorado Party without getting any extra support from the main opposition party. While the impeachment procedure against the president in June 2012 complied with the constitution, the hastiness of the proceedings, the weak legal arguments brought against Lugo, and the limited time he had for preparing his defense demonstrate that the impeachment was used to get rid of him for political-electoral motives. In this case, the impeachment was used as a vote of no-confidence against the president by the congressional majority. Although the Paraguayan constitution provides for an impeachment process, Congress did not respect the basic principles of a presidential system, in which both the president and Congress have a separate electoral mandate (dual legitimacy) for a fixed term. After Lugo, no party had the power to set a new political agenda and politics became subordinated to short-term electoral strategies for the April 2013 elections. The elections, taking place after the end of the review period and widely considered as free and fair, resulted in the return to power of the Colorado Party. In August of 2013, Horacio Cartes took office as president of Paraguay.

## 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) tied together in the still-governing Colorado Party. 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), under the 1992 constitution, the 1990s were characterized by political instability and turmoil, and by the powerful role of the military. In 1996, a putsch by General Lino Oviedo, the commander-in-chief under President Wasmosy, failed. Notwithstanding, Oviedo continued to influence politics as a political strongman. On 28 March 1999, President Raúl Cubas Grau – elected in 1989 and considered to be the puppet of General Oviedo – resigned to avoid impeachment for his alleged role in the March 23 murder of Vice President Luis María Argaña. After mass protests, especially by young

Paraguayans, resulting in deaths and injuries, Cubas and Oviedo eventually left the country (for Argentina and Brazil, respectively), seeking political asylum.

After the resignation of President Cubas, 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 characterized his presidency. In April 2003, Nicanor Duarte Frutos of the Colorado Party won the presidential election and in August of that year he assumed office. President Duarte's government increased tax collection in a significant way, curbed fiscal deficits, contained inflation and started a program of structural reforms. Despite high approval rates, however, the reform push dissipated in the course of his term and politics refocused on power struggles within the Colorado Party and on President Duarte's re-election plans, thus reviving the political opposition and civil-society organizations. Fernando Lugo, bishop emeritus of San Pedro, one of the poorest departments in Paraguay, emerged as the leader of the opposition movement and was nominated as the candidate of the Patriotic Alliance for Change (*Alianza Patriótica para el Cambio*, APC). On 20 April 2008, after 61 years of Colorado Party domination, Fernando Lugo won the presidential election, but his APC failed to win a majority in Congress.

The new president defined four main objectives of his government: a reform of political institutions to improve the efficiency of the public administration and to curb corruption (especially in the judiciary); the creation of new jobs and the reduction of poverty; land reform; and the renegotiation of the Itaipú Dam Treaty with Brazil. However, most of the legal initiatives of President Lugo in the area of social politics were blocked. His coalition was internally divided, and some factions of the coalition often voted with the opposition. While the government did not advance its land reform plans, it did renegotiate the Itaipú Treaty with Brazil in July 2009. The renegotiation will triple the annual compensation payments from Brazil. During 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), and the EPP effectively pushed the government into a defensive stance with regard to domestic security.

After the Colorado Party regained electoral strength in the 2010 municipal elections, the following years were marked by strategic maneuvering both within the government and in the opposition camp with regard to the 2013 general election. President Lugo's support base was further debilitated after the eviction of landless farmers from a property occupied in the department of Canindeyú ended with a shoot-out that killed six police officers and 11 farmers. While political discontent increased, the Liberal Party initiated impeachment proceedings against President Lugo. On June 21, the Chamber of Deputies voted overwhelmingly (76-1) to proceed with the impeachment. The next day, the Senate voted to remove Lugo from office with a vote of 39 to 4. South American governments complained that Lugo had less than 24 hours to prepare his defense. Surprisingly, there was not much public protest in the streets against the impeachment. In the end, it was not the incident in Canindeyú that toppled Lugo but his crisis mismanagement. He alienated his former coalition partner, the Liberal Party, by nominating a controversial member of the

Colorado Party as interior minister. His decisions irritated his own party's rank and file while failing to attract additional support from the Colorado Party. As stipulated in the constitution, Vice President Federico Franco was sworn in for the rest of the presidential term ending in August 2013. The Mercosur and Union of South American Nations (UNASUR) countries interpreted the impeachment as an "institutional coup" and suspended the current Paraguayan government from both organizations.

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

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

In principle, the state maintains a monopoly on the use of force nationally. However, especially in border areas and in the northeastern region, the Chaco, the 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 institutions have failed to curb arms smuggling, drug trafficking and illegal immigration. The government of the United States sees Paraguay as a center for money laundering and suspects fundraising activities related to terrorist organizations in the sizable Muslim communities that exist in the border regions. Paraguay is a significant transit country for drugs (cocaine) and the principal producer of marijuana in South America. In the conflict between landowners and landless small farmers, both sides often act outside the law by illegally occupying land or organizing armed groups. The police have clashed violently (resulting in casualties) with peasants illegally occupying land. For some years, the EPP has led attacks in the countryside (with isolated acts in Asunción); there may be some connection between the EPP and the Revolutionary Armed Forces of Columbia (FARC) guerillas. The EPP has attacked military and police outposts, has extorted ransom following kidnappings, and has organized bomb attacks (for example against a local public prosecutor's office in September 2011). In April 2010 and in October 2011, President Lugo declared a state of exception in, respectively, five and two departments in northern Paraguay in response to the attacks. While the EPP poses no real threat to the state or government, several incidents between the police and the military, in the course of military operations in the northern departments, have revealed the ineffectiveness of state and local security forces.

All citizens enjoy civil rights protections in theory. In practice, however, indigenous groups' rights are often neglected by the government. This is partly because indigenous groups are small (109,000 individuals, or less than 2% of the population,

Question  
Score

Monopoly on the  
use of force

6

State identity

9

in 2008) and partly because they are poorly organized. Property interests of the indigenous peoples are not adequately protected and many have been displaced from ancestral lands. Mestizos, or citizens of mixed racial background, make up 95% of the population. The constitution recognizes Paraguay as a multicultural, bilingual country, with Guaraní and Spanish as the official languages. The numbers vary strongly, but between 40% and 60% of Paraguayans communicate predominantly in Guaraní and between 60% and 90% are bilingual. There is a significant population of Brazilians in the border area (the so-called Brasiguayos), with estimates of between 300,000 and 600,000 people. Many are landowners in possession of large parcels of arable land used for soybean production (about 14% of all farms with more than 1,000 hectares are owned by Brazilians; 9% by other foreigners). The loyalty of such landowners lies more with Brazil than with the Paraguayan state, and the Brazilian government defends its 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 most of the period under review, Fernando Lugo, was 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 formal requirements of a liberal democracy. However, patronage and political dependencies (particularly in the civil service and also in the Supreme Electoral Court) influence the election process, so that in the past the Colorado Party has been structurally in a favored position. Also, in past elections there have been complaints about vote-buying in some rural areas. Moreover, there have been severe irregularities in the registry of members of the Colorado Party, leading to an exaggerated member count. The major parties use so-called “political operators” – in part financed through the budget of the Supreme

Free and fair elections  
8

Electoral Court – to mobilize the electorate. From 2007 to 2011, the expenditures of the electoral courts rose by 240%. Nevertheless, in 2008, the ruling party lost power for the first time 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 (the Colorado Party and the Liberal Party) still dominate Paraguayan politics. In the April 2013 general election, parties that comprise the whole political spectrum from right to left, including a feminist party, will participate. A new law provides for the automatic voter registration of citizens living in Paraguay after reaching the age of 18. Another law that would substitute the closed-list system ("lista sábana") with an open-list system has repeatedly been rejected in Senate. The idea behind the law is to weaken the influence of party oligarchs and to reduce the possibilities of "buying" a seat in Congress. After a referendum in October 2011, the constitution was amended and citizens living abroad acquired the right to vote in general elections. This is of particular relevance since more than half a million Paraguayans live in Argentina and there are calculations that Paraguayans living abroad correspond to 23% of currently registered voters.

Democratically elected representatives have the power to govern, and the influence of veto actors, especially those in the military, has declined. The military is plainly subordinated to civilian government control.

Effective power to govern

7

However, due to its system of "weak presidentialism," in which the elected president might face an oppositional Congress, the head of state's ability to govern is effectively limited in such political configurations. Moreover, due to the mobilization power and economic influence of landowners, land reform and the taxation of agricultural exports have been repeatedly blocked before such plans could be seriously debated in Congress. The country has an extremely low rate of taxation (as a percentage of GDP), clear evidence of economic pressure groups' veto power. In addition, the reiterated postponement of the introduction of a personal income tax, along with the watering down of the personal income tax law, demonstrates the power of the economic sectors that oppose widening the formal economy. 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.

Freedom of association and assembly is guaranteed by the constitution. Social dialogue has been strengthened under the government of President Lugo, but freedom of assembly had been limited during the states of exception in several departments in 2010 and 2011.

Association / assembly rights

8

Independent political and civil-society groups are generally allowed to form. 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. Farmers and the landless are also organized, the latter in the Liga Nacional de Carperos. However, only 4% of workers are covered by collective bargaining.

Freedoms of opinion and of the press are constitutionally guaranteed and in general citizens can express their opinions freely. However, there is no legislation guaranteeing access to public information. There is a pluralistic media sector, including private and public radio and TV broadcasters. A March 2011 telecommunications law puts limits on the broadcasting power of community radio stations and prohibits them from carrying advertising. Generally, media pluralism is threatened by the consolidation of ownership and by the influence that political parties and economic interest groups exert on the media. Consolidation in the print media also results in significant self-censorship and in biased news coverage. Critical journalists are sometimes physically threatened and there have even been assassinations, especially when reporters have focused on corruption or organized crime. The relationship between President Lugo and part of the media was always quite tense. For some time, he refused to hold press conferences. Defamation and libel laws are applied quite arbitrarily and are used to intimidate journalists and media owners. Reporters have been also threatened by the EPP. Freedom House (Freedom of the Press) classifies Paraguay as partly free. It is ranked 30 (out of 35) in the Americas. Although there are no government restrictions on the Internet, only approximately 24% of the population used the Internet in 2011.

Freedom of  
expression  
6

### 3 | Rule of Law

Paraguay has enshrined the separation of powers and mutual checks and balances in its constitution. These checks and balances function particularly well when the president does not have a majority in Congress. The Supreme Court may also act independently, even though judges are selected according to political criteria and quotas; newly elected presidents have repeatedly attempted to change the composition of the Supreme Court. In comparison with the constitutional attributes of other Latin American presidents, the Paraguayan president is not strong. Congress demonstrated its strength by unseating President Lugo in the June 2012 impeachment. In this case, the impeachment was realized as a “vote of non-confidence” against the president by the congressional majority. Therefore, in a certain way, Congress did not respect the basic principles of a presidential system, where both president and legislature have a separate electoral mandate (dual legitimacy) for a fixed term.

Separation of  
powers  
6

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 removal of all judges); he later vetoed the appointment of a new judge. Finally, in January 2011, an ad-hoc voting alliance of the National Union of Ethical Citizens (Unidad Nacional de Ciudadanos Éticos, UNACE) and the Liberal Party elected two judges (one for each party) to the Supreme Court to fill the vacancies. However, the Colorado Party still holds a majority in the Supreme Court.

Independent  
judiciary

5

On the whole, the judiciary is the subject of as well as an actor in recurring power struggles merely at the margins of the rule of law, sometimes fostered by ambiguities of the constitution itself. In April 2012, the Senate created an institutional crisis when an ad-hoc majority of Liberals, UNACE and the party Patria Querida (PQ) passed a resolution calling for the removal of seven Supreme Court judges (including the president of the court), arguing that their five-year terms had expired in 2010. Five of the seven judges are close to the Colorado Party, two are affiliated with the Liberal Party. The constitution in its general provisions on the judicial branch (section I) sets a five-year term and stipulates that judges (“magistrados judiciales” in the constitution’s wording) must be ratified two times consecutively in order to become irremovable (article 252). However, deciding on a similar case already in 2000, the Supreme Court had declared that Supreme Court judges are “ministros” and thus irremovable as they are not subject to the regulations concerning “magistrados.” Article 261 of the constitution – in its section II referring to the Supreme Court – indeed says that the “ministros” of the Supreme Court can only be removed by impeachment. In 2001, the Inter-American Commission of Human Rights (IACHR) had backed the Supreme Court’s interpretation. Another attempt to remove the seven Supreme Court justices by impeachment did not proceed after Lugo’s removal from office in June 2012, and as of the time of this writing, all the Supreme Court judges have remained in place.

Officeholders who break the law and engage in corruption are not prosecuted adequately. The resulting impunity is closely related to high levels of structural corruption, which include the judicial sector. 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 suspected cases of political corruption are not prosecuted. However, corruption charges have also been used politically, creating a significant difference between actually prosecuted cases of corruption and accusations in the mass media. One of the main objectives of the government of President Lugo was to combat

Prosecution of  
office abuse

4

corruption (especially in the judiciary) and to push for more transparency. But it has been 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 revoked by a two-thirds majority, which is hardly ever achieved, given the current political domination of the Colorado Party in Congress.

Civil liberties are largely secure, especially basic political rights. There are no political prisoners. While a new code of criminal procedure, introduced in 1999, better protects the rights of the accused, deficiencies in the rule of law result from the prolonged duration of proceedings and investigations. Conditions in the country's 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 small farmers' 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 claim that the fight against the EPP has been militarized and human rights have not been sufficiently respected. Whereas an increasing number of laws and international treaties protect the rights of indigenous people, they have not been sufficiently respected. Decisions of the Inter-American Human Rights Court in favor of indigenous communities have not always 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. In the case of President Lugo's impeachment, Congress did not respect the basic principles of a presidential system, in which both president and Congress have a separate electoral mandate (dual legitimacy) for a fixed term. In June 2012, Congress initiated a "vote of no-confidence" against President Lugo, with the Chamber of Deputies voting 77 to 1 and the Senate 38 to 4 in favor of ousting him.

Performance of democratic institutions

6

From the beginning of his term, President Lugo's party had no majority in Congress. The governing coalition was very heterogeneous and included some minor parties and the Liberal Party, which is divided in factions and was opposed to some of the president's reform proposals (for example land reform and the income tax). But the opposition was also divided between UNACE (the party of retired General Oviedo) and the Colorado Party, which is split between different factions. Thus, there were shifting coalitions in Congress and much conflict over petty politics. Frictions also exist between the central government, the departments and the municipalities, for

instance regarding the distribution of royalties from the binational dams with Brazil and with Argentina. Thus, decentralization and the principle of subsidiarity are not fully functional in Paraguay. In addition, the effect of politics on public administration is another serious flaw in the interplay of democratic institutions. According to the 2011 Latinobarómetro survey, 39% (2010: 35%; 2009: 33%; 2008: 22%) of Paraguayans were satisfied with how democracy is working in their country (the Latin American mean was also 39%). The public administration is highly politicized and is quite inefficient, which in turn hampers public-sector reforms, such as the professionalization of administration. There is not much trust in political institutions like Congress and the parties, but in this Paraguay does not 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 such as clientelist structures from the Stroessner era undermine the functioning of democratic institutions. At the beginning of his presidency, Lugo toyed with the idea of mobilizing his followers in order to put pressure on Congress and the judiciary to force constitutional reform initiated by a referendum. He only backed off when the opposition threatened to impeach him.

Since then, his adversaries in the National Congress have threatened several times to impeach him. Finally, in June 2012 another impeachment procedure was pursued and the Senate voted to remove President Lugo from office with a clear majority of 39 to 4. Though the proceedings complied with formal requirements of the constitution, the hastiness of the procedure, the weak legal arguments brought against President Lugo and the limited time he had for preparing his defense demonstrate the political-electoral motivation of this process and its lack of respect for democratic norms. However, an impeachment is always more a political than a judicial decision. Moreover, since the impeachment, the rules of the game have been respected. Vice President Franco replaced Lugo. All parties prepared for the April 2013 elections, and Lugo supporters were not persecuted or hampered in their pre-electoral activities. The EPP 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.

## 5 | Political and Social Integration

Even though Lugo's election seemed to point to a change in the Paraguayan party system, it is still dominated by two traditional parties, the Colorado Party and the Liberal Party. Each 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 instance, President Lugo would not have won the election without the support of the Liberal Party. In the 2010 municipal elections, the Colorado Party and the Liberal Party together won almost 70% of the vote and 80% of all municipal councilor seats.

Commitment to democratic institutions

7

Party system

7

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. Occasionally there have been splits within the Colorado Party or new parties have emerged, but today only UNACE has survived with a significant electoral base. The Colorado Party is still the strongest party. During 61 years in power, the party created a close-knit patronage network. 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. 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. In 2011, 61% of Paraguayans sympathized with a party (compared with a South American mean of only 42%) and 33% strongly identified with a party (source: *Latinobarómetro*). The Colorado Party claims 1.9 million members, the Liberal Party one million members and UNACE around 400,000 members. However, around 840,000 persons are affiliated with more than one party. This corresponds to 24% of the electorate. In the primaries for the April 2013 presidential elections, turnout varied from 830,000 in the case of the Colorado Party to 420,000 in the Liberal Party and 88,000 in total for both alliances on the left. Due to patronage networks, the parties function only partially 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. Lugo's base of support was only to a very limited extent articulated through the parties represented in Congress.

Compared to political parties, the system of social interest groups is weak. It is politically fragmented and dominated by only a few issues. 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 groups 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 several competing trade union federations. However, contacts exist with the movement of landless small farmers, which is also poorly organized and which lacks adequate means of democratic articulation. 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).

Interest groups  
6

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 substantially after the election of Fernando Lugo, to 53% in 2008, according to the Latinobarómetro surveys. Afterwards, support fell again for a short time, to 46% (2009), and rose again, to 54% in 2011 (2010: 49%) against the Latin American mean of 58%. Paraguayan satisfaction with how democracy is working in the country has been rising, with 39% of citizens being more or less satisfied in 2011 (2010: 35%; 2009: 33%; 2008 22%; the Latin American mean is also 39%). Compared to the rest of Latin America, a higher percentage of the population is open to the idea of an authoritarian solution. Only 52% of the Paraguayan respondents – compared to 40% in 2010 and a Latin American mean of 66% – said they would never, under any circumstances, support a military government. This is, after Guatemala, the second lowest value in Latin America. Some 57% (2010: 52%) of the Paraguayan respondents answered that there can be no democracy without political parties (with a Latin American mean of 58%), and 62% (2010: 53%) said the same about Congress (Latin American mean: 59%). In general, during the first four years of the Lugo presidency, support for democracy in Paraguay increased, and Paraguay moved closer to the Latin American mean.

Approval of  
democracy  
5

Autonomous organization in civil society is uneven. Groups face various socioeconomic barriers to organizing, and there is a general lack of civic culture. The question remains whether citizens participate in independent or clientelistic organizations. There is a 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 building roads 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 the common good. Trust among the population is still low but has risen; according to the 2011 Latinobarómetro survey, 22% of Paraguayans trusted their fellow citizens (2010: 14%), which matches the Latin American average. According to the 2012 LAPOP survey data, community participation in Paraguay is not very high, but is higher than in many other Latin American countries. Some 12% of Paraguayan respondents participated, in the last 12 months, in a demonstration or protest march (source: LAPOP 2012). This is fourth-highest value in Latin America.

Social capital  
5

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Question  
Score

Socioeconomic  
barriers  
4

Paraguay is a lower-middle-income country with gross national per capita income (PPP) of \$4,727 in 2011 (constant 2005 international dollars). It is ranked 107 out of 187 countries in the 2011 Human Development Report (with a HDI value of 0.665) and is classified as a Medium Human Development country. Paraguay improved its rank by 1 between 2006 and 2011. The HDI value of Paraguay is above the average (0.630) for countries in the medium human development group and below the average (0.731) for countries in Latin America and the Caribbean. If adjusted for inequality, Paraguay falls by 6 ranks. As per the Human Development Report 2011, the country's Gender Inequality Index ranking was 87 out of 146 countries, with a score of 0.476 (the best performer being the Netherlands at 0.174, and the worst performer Yemen at 0.853). Social exclusion is quantitatively and qualitatively extensive and structurally ingrained. The index of income inequality is high (Gini Index 0.55 for 2011). Paraguay will probably not achieve all of the Millennium Development Goals, especially with regard to the eradication of extreme poverty and hunger. From 2010 to 2012, 25.5% of the population suffered from hunger, an increase compared with the period 2007 to 2009 (16.8%; source: FAO). Nearly 50% of the working population receives a salary below the minimum wage in their principal occupation. In 2011, 32.4% of the population lived in poverty (2008: 37.9%) and 18.0% in indigent conditions (2008: 19.0%). However, in rural areas the poverty rate was 44.8% (2008: 48.8; national statistics). CEPAL (Social Panorama 2012) calculates a higher percentage of poor people for 2011 (49.6%). Inequality in land distribution increased during the last decade. Farms with fewer than 50 hectares account for 91% of all farms, but only for 6.3% of all farmland. From the opposite point of view, 8.7% of farms account for 94% of farmland. Half of the farmland redistributed through land reform from 1991 to 2008 was later resold to medium-sized and large agricultural producers. Some 53.3% of the employment in the urban sector is informal (women 61.1% for 2010). The adult literacy rate is officially 94.6%, but functional illiteracy is much higher than 5.4%.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	15955.0	20028.4	26008.0	<b>25502.1</b>
GDP growth	%	-4.0	13.1	4.3	<b>-1.2</b>
Inflation (CPI)	%	2.6	4.7	8.3	<b>3.7</b>
Unemployment	%	6.5	5.7	5.6	-
Foreign direct investment	% of GDP	1.2	2.4	1.6	-
Export growth	%	-9.3	19.7	2.8	<b>-7.0</b>
Import growth	%	-8.5	24.8	10.4	<b>-3.5</b>
Current account balance	\$ M	483.6	-65.8	288.8	<b>115.6</b>
Public debt	% of GDP	16.1	13.7	11.9	<b>11.4</b>
External debt	\$ M	4134.4	5075.6	6010.9	-
Total debt service	\$ M	442.7	457.2	455.4	-
Cash surplus or deficit	% of GDP	0.1	1.3	1.0	-
Tax revenue	% of GDP	11.6	12.0	12.1	-
Government consumption	% of GDP	10.9	10.4	10.3	<b>12.2</b>
Public expnd. on edu.	% of GDP	-	4.1	-	-
Public expnd. on health	% of GDP	3.6	3.3	3.7	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	1.1	1.1	1.2	<b>1.7</b>

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

## 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 public-transport fares. In addition, the government sets the minimum wage, which is often not adhered to. Around 10% (300,000) of the workforce is employed in the public sector (2011). The informal sector is large and includes, apart

Market-based  
competition  
4



from licit but unregistered activities, cross-border smuggling and the illegal production and sale of narcotics, pirated music, stolen automobiles and weapons. The Index of Economic Freedom (2013) ranks Paraguay at 15 of 29 countries in the Americas, and at 80 in a global ranking. According to the index, the Paraguayan economy is 61% free. The Global Competitiveness Index 2012 – 2013 ranks Paraguay 116 out of 144.

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. In the Global Competitiveness Report 2012/2013, Paraguay is ranked 121 out of 144 in effectiveness of anti-monopoly policy.

Anti-monopoly  
policy  
3

Paraguay's membership in the Southern Cone Common Market (Mercosur) has largely liberalized trade with Argentina, Uruguay and Brazil. The weighted average tariff rate is 3.7%, 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. Paraguay has repeatedly addressed these customs procedures, which it perceives to be unfair and exaggerated, within the Mercosur framework. In the World Bank 2013 Doing Business Report, Paraguay ranks at 103 out of 185, but in the specific ranking of "trading across borders" it ranks only at 155. Paraguay so far has been involved in 15 WTO trade disputes as a third party.

Liberalization of  
foreign trade  
8

According to the IMF, the legal and regulatory framework of banking supervision has improved considerably over the last years but still lacks legal provisions to fully accomplish international standards; flaws include a lack of effective supervision. Public financial institutions, such as the National Development Bank (BNF), the Development Financial Agency (AFD) and 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. Moreover, a regulatory framework for cooperatives has been implemented, and cooperatives account for a substantial part of the financial system's assets. Banks are well capitalized and profitability is high. Higher capital requirements and more stringent provisioning measures became effective in January 2012. While rising since 2010, non-performing loans represent only 2% of all loans (March 2012). The capital market is relatively open for foreign investors.

Banking system  
7

## 8 | Currency and Price Stability

Controlling inflation and a suitable foreign-exchange policy are recognized goals of government economic policy. Inflation went down from 7.2% in 2010 to 4.9% in 2011 and 3.4% in 2012 (October). There have been plans in the central bank to lower the inflation target from 5% to 3%. Paraguay has a floating exchange rate. Because of close ties to its two big neighbors in the 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 appreciated 10.6% against the U.S. dollar in 2011, helping to bring down inflation. The guaraní depreciated slightly in 2012 (2.4% until October). 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.

Anti-inflation /  
forex policy

8

Generally speaking, the government pursues a consistent policy for macrostability. However, due to the countercyclical politics of the central government (for example increasing the salaries in the public sector by 30%), there was a fiscal deficit in 2012 of -2.8% of GDP. From 2004 to 2011, the government ran budget surpluses. Despite the slight deficit in the past year, the general government debt is less than 14% of GDP, one of the lowest in the region. President Lugo named Dionisio Borda, an independent and internationally recognized expert, as his finance minister. Borda had also been finance minister in the cabinet of President Duarte (2003 – 2005), where he received most of the credit for eliminating the budget deficit. The nomination of Borda sent a strong signal that the government was committed to economic stability. He was one of two ministers who stayed in office until the abrupt end of the Lugo presidency. State revenues increased because of better tax collection and a curb on tax evasion. However, the opposition repeatedly blocked government initiatives to increase state revenues and at the same time boosted spending for electoral purposes. In October 2010, against the suggestions of the World Bank and the IMF, Congress overrode a presidential veto and postponed again (for the fourth consecutive time) the introduction of a 10% personal income tax until 2013 (the official end of Lugo's presidential term). It was, however, approved after the impeachment of President Lugo and took effect in August 2012.

Macrostability

8

In January 2013, the Paraguayan government successfully placed a \$500 million, ten-year sovereign bond in the international financial market (with a yield of only 4.625%).

## 9 | Private Property

Property rights and the regulation of the acquisition of property are generally well defined, but there are problems with their implementation under the rule of law, not least of all because of inefficiency and corruption in the judicial system. 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 and a comprehensive cadastre is not in place, adding to conflicts over land titles, and thus property rights. The World Bank (2013) ranks Paraguay 67 out of 185 in registering property. The distribution of counterfeit or pirated goods is not sufficiently penalized. In January/February 2012, a Canadian mining company (LAMPA) threatened to close its open-pit gold mine (Independencia) because the government did not sufficiently secure its property rights against independent gold diggers.

Property rights  
6

Private activities represent the backbone of the economy, but concentration of market power is tolerated by the state, for instance, in the media sector. In some sectors, such as telecommunications, electric-power generation, oil refineries, cement production and water services, state enterprises exercise a monopoly or subvert fair competition. Ports and airports are also managed by state-owned enterprises. 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. Privatization programs had 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. However, the government of President Lugo had no clearly defined strategy for how to deal with foreign direct investment, and the interim government of President Franco had no time or mandate to develop a new policy. In principle, the government of President Lugo was opening the mining sector for exploration licenses, and there were major investment projects by foreign companies (for example, CIC Resources in titanium dioxide) in the mining sector. Moreover, there were plans by RTA (Canada) to construct an aluminum plant close to Itaipú. But the project was blocked because of the discussion about the price at which the Paraguayan state should sell power to the company. The government of President Franco had a plan to push forward this project but in the end it did not advance. In October 2011, President Lugo vetoed a law approved by Congress to award concessions to upgrade and operate the three main airports of the country. The veto was motivated above all by political-electoral concerns (the law was initiated by a former minister and future

Private enterprise  
7

presidential candidate of the Liberal Party) and a threatened strike by airport workers. The next government will have to define a clear policy with regard to foreign investment in mining and energy-intensive industries. These are both sectors where Paraguay has underutilized potential.

## 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 20% of the working-age population is covered by social security. The pension system is organized on a pay-as-you-go basis, that is, it is not financed by assets that are set aside. However, due to 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. There is a lack of reliable data on the system's liabilities and assets. However, there are plans to create a superintendency of pensions. Public spending for health was between 2.1% (World Bank) and 4.5% (CEPALSTAT) of GDP in 2010. In December 2009, the administration of President Lugo introduced free medical visits and free dental treatment in public hospitals. The government paid conditional cash subsidies (in exchange for commitments regarding health and education of children) to about 83,000 poor households in 2011 (up from 15,000 at the beginning of Lugo's presidency), covering around 400,000 persons (via the Tekopora program). Life expectancy is relatively high, at an average of 72.5 years. In some rural areas, self-regulated and small-scale "social pharmacies" operate to supplement scarce public health services and to improve primary health care in remote areas.

Social safety nets  
5

Society is severely segmented, and there are few institutions with a mandate to alleviate social discrepancies. Accordingly, surveys reveal that most Paraguayans perceive an individual's social background (membership in a family or clan or contact with higher social classes) as the main source of opportunities. Social expenditures are low in comparison with 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 labor laws and other legal protections are not adequately monitored or prosecuted 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. In the Human Development Report 2011, the country's Gender Inequality Index ranking was 87 out of 146 countries. Among people with at least secondary education,

Equal opportunity  
4

the female/male ratio was 0.878. With regard to the labor force participation rate, the female-male ratio was 0.658. Only 15.6% of seats in the Chamber of Deputies and 12.5% of seats in the Senate are occupied by women. Of newly elected mayors, only 7.6 % (2010) are women (2006: 5.6%). Of 36 appeals court judges, 10 are women; one woman is a member of the Supreme Court. Apart from inequalities based on gender, a lack of equal opportunity exists mainly with respect to the indigenous population, which is more than any other group excluded from education, health services, access to public office and general opportunities in the labor market.

## 11 | Economic Performance

In 2010, the Paraguayan economy grew by 13.1% according to CEPAL (and by 14.2% according to World Bank data). This result was due to 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. In 2011, growth slowed to 4.4% (World Bank speaks of 6.9%) and, in 2012, the economy contracted by 1.8% (CEPAL data). The slowdown was the result of a severe drought and an outbreak of foot-and-mouth disease affecting the export of beef. However, it is expected that the economy will recover in 2013. Urban unemployment fell slightly from 7.0% in 2010 to 6.5% in 2011. But underemployment, not unemployment, is the main problem of the Paraguayan economy. Some 20% of the workforce is underemployed. Agriculture accounts for more than 20% 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. However, because of the countercyclical politics of the central government (for example increasing public-sector salaries by 30%), there was a fiscal deficit in 2012 of -2.8% (of GDP). The general government debt is less than 14% of GDP, one of the lowest in the region.

Inflation went down from 7.2% in 2010 to 4.9% in 2011 and 3.4% in 2012 (October). While the guaraní appreciated 10.6% against the U.S. dollar in 2011, which helped to bring down inflation, it depreciated slightly in 2012 (2.4% through October). The value of investment (gross domestic investment rose from 17.7% in 2010 to 19.3% of GDP in 2011) and trade has grown. However, basic infrastructure shortcomings, low productivity, underdeveloped technological capacities and the large share of informality are still the greatest challenges for the Paraguayan economy. There is also a lack of public investment in infrastructure (for example, electricity transmission lines). The Global Competitiveness Index (GCI) ranks Paraguay at 116 out of 144 countries (2012 – 2013), at 123 with regard to innovation and sophistication, and at 135 with regard to the quality of institutions. The tax base is quite low; top corporate taxes are 10%, the lowest corporate tax rate in the region. Tax revenue as a percentage of GDP was only 13.2% in 2011, the lowest in South America. While commercial

Output strength  
7

agriculture accounts for more than 20% of GDP, its contribution to tax revenue is very small (0.26% of GDP). The IMF also considers the financial sector under-taxed.

## 12 | Sustainability

While CO<sub>2</sub> emissions are quite low (0.7 metric tons per capita), 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, which are its main energy source (in 2011, 65.6% of the energy supply and 99% of grid-connected electricity production came from renewable energy). Only 10 Paraguayan companies possess an ISO 14001 certification. The most recent strategic economic and social plan (2008 – 2013) of the Lugo government explicitly favors an integral approach combining economic, social and environmental policies. However, this approach has been implemented only to a very limited extent.

There has been little control of deforestation in border regions, which has accelerated to an alarming level 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 and because of the health risks for the people living in the affected regions. As a result of protests by commercial farmers, the government of President Lugo repealed legislation to regulate the use of agrochemicals (with regard to healthcare, food safety and environmental standards). While the Lugo administration took a cautious stand with regard to the admission and cultivation of genetically modified maize and cotton, interim President Franco lifted most of the restrictions immediately after taking office. Anti-smoking legislation had been diluted in Congress due to the pressure of the tobacco lobby.

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, levels of functional illiteracy are much higher than 5.4%, especially in rural areas. There are large inequalities between urban and rural areas with respect to enrollment rates and, above all, concerning tertiary education. Despite rising school enrollment rates (net primary enrollment rate 2010: 83.6%; secondary enrollment rate, 61.1%; CEPALSTAT), the educational system still has significant qualitative deficiencies. These are related to proper staffing; however, 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.

Environmental  
policy  
4

Education policy /  
R&D  
5

Quantitatively, investment in education and training, as in research and development, is rather low. While public expenditures on education reached 4.1% of GDP (2010), research and development expenditures were as low as 0.1% of GDP (2008). There were 74.8 researchers in R&D per one million people (2008). The Global Innovation Index ranked Paraguay 84 out of 141 countries in 2012 (2011: 74 out of 125).

## 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. Paraguay's main exports are agricultural products. Therefore, the economy suffers in the case of climatic adversities such as droughts (which happened in 2008/2009 and 2011/2012). The country is unable to combat poverty systematically on its own. Future development must contend with persistent and considerable social inequality; the lack of an educated labor force (relatively low levels of human capital); labor market inefficiencies; an inefficient and overstaffed public administration; a weak business climate; widespread corruption in politics, in society and in the private economic sector; and deficiencies in infrastructure. While the forces for reform in politics and society seemed to be strengthened by the electoral victory of President Lugo, his presidency demonstrated that there still exist many veto points where necessary political and economic reforms can be blocked. The main constraints were a system in which the president has limited powers, and President Lugo's inability to rely on a stable majority in either body of the legislature. This dominance of the traditional parties in both chambers is closely related to widespread clientelist structures that persist from the Stroessner regime. 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 highly politicized public administration, which also lacks professionalism.

Structural  
constraints

7

The democratization process in Paraguay, begun in 1989 after a long phase of authoritarian rule, unfolded amid 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

Civil society  
traditions

6



organization. There is a network of small civil society organizations that could be used for mobilization processes in times of crisis. However, on an everyday basis, the connection between small, limited organizations and wider social movements is poorly developed. Interpersonal trust is very low in Paraguay, a symptom of low levels of social capital. However, civil society groups formed the core of the political movement and alliance that brought President Lugo to power and supported his government. Moreover, there has been a strong human rights movement in 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). Thus, the picture is very mixed in Paraguay: There is only little social capital, which is, however, combined with intense but locally restricted forms of cooperation and the national human rights movement.

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. Nevertheless, a growing class conflict between landowners and organized landless small farmers 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 most violent clash ended in June 2012 in the department of Canindeyú with a shoot-out and six police officers and 11 small farmers killed. The event triggered the impeachment of President Lugo. The EPP, while active and with some support 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

5

## II. Management Performance

### 14 | Steering Capability

The government of President Lugo was 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 as finance minister an independent, Dionisio Borda, an expert who is well connected with international finance organizations and respected by the opposition and parts of the NGO sector. The government claimed to pursue long-term aims. It presented a five-year (2008 – 2013) economic and social strategic plan for sustainable growth with social justice goals.

Question  
Score

Prioritization

7

At the beginning of his administration, President Lugo set four priorities: public-sector reform, poverty reduction, land reform, and the renegotiation of the Itaipú Dam Treaty with Brazil. The government created a new institution for land reform (Coordinadora Ejecutiva para la Reforma Agraria, CEPRA), but the organization did not have enough funds for a cadastral survey, the result of insufficient political support in Congress and the veto power of the industrial agrarian sector. Other reform efforts, such as the professionalization of public administration, advanced but were also held back by a politicized staff and loyalty to Colorado Party networks. The government successfully renegotiated with Brazil a three-fold increase in the royalty payments from the Itaipú Dam. The agreement was finally approved by the Brazilian Senate in April 2011. However, the government was less successful in planning for an efficient use of the new revenues. It did not get a majority in Congress for its project to create a special social-economic development fund. The government also was not successful in negotiating with the Argentine government to sell surplus energy from hydroelectric power plants through the Argentine power grid to Uruguay.

The government of President Lugo defined a comprehensive reform agenda, but reform politics were hampered by the president's fragile power base, including conflicts within the alliance that supported Lugo in the presidential election. Congress decides the budget and the president had no congressional majority. He could only veto congressional decisions. Ministers often tried to negotiate separately the budget for their portfolio in Congress. However, some observers also blamed political inexperience for his limited success in negotiating with the legislative chambers. Dinoniso Borda, the finance minister, resumed the tax reform project that he started under the Duarte presidency. However, the introduction of a personal income tax was blocked in 2011 by an oppositional majority in Congress for the fourth consecutive year. It was only approved after the President Lugo's removal from office and took effect in August 2012. However, tax revenues rose by 15.8% in 2011 because of better tax collection. While the government started a program for rural development, with regard to poverty reduction and land reform, the results have been very modest. The government was able to renegotiate the Itaipú Treaty with Brazil in 2009. 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. While in principle the government of President Lugo was in favor of foreign direct investment, for example in mining and energy-intensive industries, it did not develop a clearly defined strategy and policy for how to deal with foreign investors. There were plans by RTA (Canada) to construct an aluminum plant close to Itaipú. But the project was blocked because of the discussion about the price at which the Paraguayan state should sell power to the company. The last two years of the Lugo presidency were also marked by conflicts over the economic policy between finance minister Borda and the secretary-general

Implementation  
6

of the presidential office, Miguel Angel López Perito, who was seen as a potential candidate in the 2013 presidential elections.

The Lugo administration lacked a majority in Congress and its reform agenda confronted many obstacles. The government was expected to change things rather than perpetuate the status quo, including the former government routines. However, out of necessity, he had to 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 was the first time since the transition to democracy that a government had not been run by the Colorado Party, its executive officeholders had limited experience (with the exception of the finance minister, Dionisio Borda). Moreover, independent research institutions, think tanks and institutionalized knowledge exchange between such institutions and the government are almost nonexistent in Paraguay and could not be established within a short time and limited budgets. Consequently, institutionalized policy learning confronted many obstacles. However, the Lugo government was the first to establish dialogue with social movements, which was a first step toward gaining experience and expertise on selected topics. International cooperation, which has a long tradition in Paraguay, has served as a supporter of continuous reform efforts from one government to another and in a certain way also facilitated learning from past experiences.

Policy learning

7

## 15 | Resource Efficiency

The government of President Lugo was committed to increasing efficiency. In September 2008, the finance minister created a technical unit for public modernization, and the state secretary for the public sector, Lilian Soto, intended to modernize the recruitment system. However, the state bureaucracy is still oversized, and civil servants are almost impossible to dismiss. That is, rather than the threat of politically motivated public-sector dismissals, the main problem is the difficulty of those dismissals. Recruitment of administrative personnel still puts a heavy emphasis on political loyalty (especially at the municipal level), leading to deficient staffing, despite the high number of employed. However, the recruitment system was subject to reform, and recruitment based on merit has expanded. Still, there are several challenges with respect to the modernization of the public sector, such as intra-administrative coordination to implement new steering processes. In February 2011, the president dismissed the head of the land reform institute (INDERT) and the director of the state-owned cement company (INC) because of mismanagement. One year later, in May 2012, the president again dismissed the head of INDERT because of corruption charges against the organization with regard to the acquisition of land

Efficient use of assets

5

for redistribution. The state budget was, with the exception of 2012, balanced. Tax evasion has been curbed, smuggling has been reduced and fiscal revenue increased significantly. However, there is only little effective taxation of the agricultural sector. The combat against the guerrilla group EPP is hampered by institutional rivalries between the police and the armed forces and professional deficiencies of the security forces.

The government of President Lugo tried to coordinate conflicting objectives and interests, although it was difficult. The Patriotic Alliance for Change (Alianza Patriótica para el Cambio, APC) was a very heterogeneous coalition that supported a center-left presidential candidate, while the major party of the Alliance, the Liberal Party, was a center-right party. Moreover, the Liberal Party is split in different factions, and the faction of Vice President Franco was in the minority most of the time. In addition, the heterogeneous alliance had no majority in Congress and had to negotiate with a strong but also divided opposition. Often, the different ministries negotiated separately, seeking advantage for their portfolios. However, the fragmentation both of the opposition and of the government has led to a cobbled implementation of policy priorities rather than to genuine policy chaos. In the last two years of the Lugo presidency, there were recurrent clashes over the course of economic policy between the minister of finance, Dionisio Borda, and the secretary of the presidential office, Miguel Angel López Perito.

In addition to the heterogeneous coalition and the divided opposition, the underlying basic interests of different groups conflict (for instance with respect to agrarian reform) to an extent that the government has had little chance to reach a balance of these interests and thus a coherent policy.

Corruption is still a central feature in state and administrative culture; many of the state's resources are distributed based on patronage networks. As part of the 2010 Latinobarómetro survey, some 16% of respondents said that they or relatives had heard of acts of corruption in the last 12 months. In the 2012 LAPOP survey, the percentage reporting any corruption victimization in Paraguay was 21% (the Latin American mean was 19.5%). Some 73% (Latin America: 70.4%) of the Paraguayan respondents said corruption was "common" or "very common" in their country. Some mechanisms ensuring integrity are effective, while others simply do not work. A positive example is the reformed public procurement system, which already, in 2003, produced a credible shift in public-sector procurement procedures. Also, credible efforts have been undertaken to modernize the public sector's recruitment system toward a meritocratic system. However, some central institutions, such as the national audit office, lack sufficient funds and independence to properly fulfill its tasks. Also, 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 help stem illicit money

Policy  
coordination  
6

Anti-corruption  
policy  
5

flows. Overall, the government of President Lugo provided positive signals and was committed to more transparency, integrity and efficiency in public administration. However, the Lugo administration was not exempt from corruption and mismanagement (as in, for example, the case of the organization in charge of land reform). In February 2011, Foreign Minister Lacognata had to resign because he received two salaries (as minister and as member of the binational Itaipú council). Moreover, congressional deputies still claim the right to appoint supporters to public institutions. President Franco was accused of nepotism because relatives got jobs in the public administration. In one of his first acts, he appointed his sister-in-law to the lucrative job of director of the binational hydroelectric Itaipú Company.

## 16 | Consensus-Building

Officially, 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 that would result in strengthened democracy and market economy threaten the vested interests of the political elite. Formal democratic institutions are subverted by informal and clientelistic practices. In the administration of President Lugo, there was no broad consensus on the direction and the tempo of political and economic reforms. The government party had 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, did 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. With regard to the market economy, the formalization of the economy through the personal income tax has been blocked for years by veto players. Moreover, high levels of market concentration and economic inequality indicate a considerable way to go to establish an inclusive market economy.

Consensus on goals

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The military respects the democratic legitimacy of the government and is not an independent political actor. However, the government of President Lugo maintained a continuous distrust of the armed forces. Shortly after assuming the presidency, Lugo replaced 33 high-ranking officials with the objective of modernizing the armed forces. From time to time, there have been rumors of civilian-military coup plots. Yet there was no apparent danger of an open subversion by the military of the democratic order. However, there was a risk that social conflicts could get out of control and put 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. In the end, a violent clash between landless farmers and the police created the pretext to impeach a reform-minded president. Anti-democratic actors are not openly visible, but the historically grown systems of clientelism and patronage are

Anti-democratic actors

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essentially anti-democratic and are largely associated with the traditional political parties: 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.

Although the political leadership tried to prevent the escalation of political cleavages into conflicts, it could not mend existing divisions. Political cleavages do not split primarily along ethnic, class, regional or religious lines. One major political cleavage relates to the traditional parties (ANR and PLRA) on the one hand, and progressive parties on the other. Another division relates to the indigenous population, which is, however, very small in number and not sufficiently organized to forcefully articulate this division. A third major cleavage, conflict over available farmland, has been growing since the Duarte presidency. The landless are organized into a broad movement and represented by different organizations. At the end of its term, the Duarte government essentially left the land problem to its successor. Land reform was a central topic of Lugo's presidential campaign. But there was only weak congressional support to put land reform into effect. The Lugo government attempted to mediate between the landless movement and the powerful group of landowners. This approach was difficult, since large landowners and soy producers are important and influential economic actors. Moreover, Brazilian landowners in Paraguay receive the strong support of their government in Brazil. The Lugo government 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, there were not enough available revenues or managing capacities, not to mention political support, even for watered-down land reform. While social conflicts in the countryside diminished from 212 in 2008 to 174 in 2009 and 65 in 2010, they increased again to 68 in the first half of 2011, and they became more violent in 2012 – culminating in the shoot-out in Curuguaty. The opposition accused President Lugo of supporting land invasions.

President Lugo began his political career in the civil society movement “Tekojoja.” He was more open to civil society participation in politics, and reforms have been accompanied by numerous participatory forums. Moreover, because he lacked a strong partisan power base, he needed the support of civil society organizations to implement his political agenda and to put pressure on a political opposition that was not willing to cooperate on any substantial reform issue. 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. Apart from some demonstrations during the first days of his impeachment, civil society mobilization in his favor was more limited than expected. In the end, the traditional political class freely decided the fate of this elected president.

Cleavage /  
conflict  
management

6

Civil society  
participation

6

The political leadership recognizes the need to deal with acts of injustice and human rights violations perpetrated during the Stroessner dictatorship, but the process of reconciliation has been slow. Only a few victims of the dictatorship have been comprehensively indemnified, and 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 pressure from civil society, a Commission of Truth and Justice was created and it started its work in the second half of 2004. On 28 August 2008, the commission presented its final, 1,000-page report, which 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. The Lugo government supported the creation of a network of memorials in former repression and torture centers. Lugo also signed a decree to create a team to investigate the fate of disappeared and extrajudicially executed people.

Reconciliation  
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It remains to be seen what happens with reconciliation efforts under a renewed Colorado government.

## 17 | International Cooperation

As mentioned before, the Lugo government had clear aims of political and economic development, which included curbing corruption, public-sector reform, poverty reduction and land reform. Moreover, there is a long tradition in Paraguay of international cooperation, even under the dictatorship of General Stroessner.

Effective use of  
support  
7

After a short period of internal reflection on reform priorities, the Lugo administration 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 international assistance to the domestic reform agenda. The World Bank approved a five-year country strategy in 2009, which has an envelope of \$500 million. In 2011, Paraguay received \$100 million for a project to strengthen the energy sector. In 2010, a new country strategy for 2009 to 2014 was approved by the IDB board with an envelope of \$1 billion. The strategy was aligned with a government program (Programa Estratégico Económico y Social, PEES) that put special emphasis on social programs for poverty alleviation, infrastructure and institutional capacity in the public sector. As part of its confrontation with the Lugo government, Congress blocked loans from international financial organizations (including loans earmarked for the modernization and strengthening of the tax administration). Apart from financial cooperation, Paraguay cooperates above all with development cooperation 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. Public-sector reform was developed (from 2006 to 2012) in cooperation with USAID under the program “Threshold I + II” to combat corruption and strengthen the rule of law.

The Lugo government mostly acted as a credible and reliable partner. The lack of a majority in Congress gave the president little leeway in establishing new foreign policy initiatives. So the chances of a more leftist foreign policy, for instance, to forge closer links with Venezuela, were quite limited. However, he maintained good relations with former President Hugo Chávez, and he visited Cuba. Despite President Lugo’s sympathy toward leftist governments in Latin America, he maintained good relations both with other Latin American countries as well as with the United States and Europe. The U.S. government and Paraguay collaborated extensively on anti-narcotics and anti-smuggling policies. At the same time, Paraguay diversified its international partners. Its relations with Russia were upgraded, and 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. The relationship between Paraguay and its Latin American neighbors deteriorated after the impeachment of President Lugo. The participation of the Paraguayan government was suspended in the meetings of UNASUR and Mercosur, but not in the Organization of American States (OAS). The United States and Europe did not impose sanctions on the Paraguayan government. Nevertheless, the Paraguayan president could not participate in the Ibero-American Summit in November 2012 and the EU-CELAC summit in January 2013. Within Mercosur, Paraguay blocked the inclusion of Venezuela as a full member, which was, however, rather because of the Paraguayan Congress than the president. The short period of Paraguay’s suspended Mercosur membership was used by the remaining members to vote in favor of Venezuela’s accession. In January 2013, the Paraguayan government successfully placed a \$500 million, ten-year sovereign bond in the international financial market (with a yield of only 4.625%).

In 2011, the Paraguayan Congress ratified the founding treaty (2008) of the new South American regional organization UNASUR (Union of South American Nations). Paraguay is also a founding 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 economic crises in Argentina and Brazil have direct consequences in Paraguay. The population generally supported inclusion in this common market, even if some voices loudly advocated that 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

Credibility

7

Regional  
cooperation

7



in Mercosur have not been sufficiently taken into account. Having 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. The relationship with the other Mercosur countries was already strained before Lugo's impeachment. For reasons related to domestic politics, the Paraguayan Senate blocked the ratification of the protocol for the entry of Venezuela into Mercosur that was signed in 2006, and had been ratified by all other member countries. The Paraguayan Senate also did not ratify the Montevideo Protocol (also called Ushuaia II Protocol), signed in December 2011 and related to the defense of democracy in the Mercosur. Moreover, the signing of the protocol was one of accusations against President Lugo during the impeachment.

In the past, the membership in Mercosur had helped to 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). However, the reaction by the Mercosur countries to Lugo's impeachment was more problematic, at least from the perspective of the protection of democracy in Paraguay. Though it is debatable whether the impeachment represented a breakdown of the constitutional order, Mercosur and UNASUR took this position and suspended the Paraguayan government from all meetings of the organizations. However, the OAS did not suspend the Paraguayan government. Moreover, in a procedure that was controversial from a legal perspective, the other Mercosur members took advantage of the suspension of the Paraguayan government to ratify the entrance of Venezuela in the Mercosur. As part of its protest, the Paraguayan government renounced approved funds from the Mercosur Structural Development Fund (FOCEM).

## 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 vetoes, 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 held power for 61 years and returned to government in August 2013. A successful modernization of the state and the economy would undermine part of the power base of most of the major parties.

The new president Horacio Cartes – elected in April 2013 – is confronted with various major challenges. He has to overcome the growing polarization of the political system and to find some kind of reconciliation with the supporters of ousted President Lugo. The de-escalation will also depend on which role Lugo, who has been elected to the Senate, will choose to play. Cartes has to confront the lingering land conflict, where no consensual solution is in sight. There will be no congressional majority for comprehensive land reform. Another pressing challenge is the continuation of the state apparatus' modernization by, for instance, increasing the independence of the judiciary and by improving the efficiency of the public administration (and curbing corruption). Moreover, efforts for poverty alleviation need to be improved, and creating and implementing a strategy to deal with the country's ecological wrong turn is a pressing issue as well. However, given the political landscape and the related vested interests of powerful actors, the chances for major reforms of the political system and the economy are quite limited. Moreover, President Cartes has to reintegrate Paraguay in UNASUR and Mercosur. Having a clear democratic mandate from the recent elections, the re-insertion will not be very difficult. However, it will be a challenge to find a face-saving formula for Paraguay to accept and ratify the admission of Venezuela to the Mercosur.

Thus, all in all, major challenges lie ahead for the new government, and the chances that fundamental steps will be taken to deepen democracy and develop an inclusive market economy seem quite low. As the return of the Colorados into government signals a relapse into political stagnation, it will depend on more progressive domestic political forces as well as on international development cooperation to create pressure and incentives to pursue necessary next steps in Paraguay's transition.