

BTI 2016 | Paraguay Country Report

Status Index	1-10	6.38	# 42 of 129	
Political Transformation	1-10	6.75	# 38 of 129	➔
Economic Transformation	1-10	6.00	# 49 of 129	➔
Management Index	1-10	6.14	# 26 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. 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>.

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Key Indicators

Population	M	6.6	HDI	0.676	GDP p.c., PPP \$	8894.3
Pop. growth ¹	% p.a.	1.3	HDI rank of 187	111	Gini Index	48.3
Life expectancy	years	72.3	UN Education Index	0.587	Poverty ³	% 6.3
Urban population	%	59.4	Gender inequality ²	0.457	Aid per capita \$	20.0

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

Executive Summary

In June 2012, the Paraguayan Congress had President Lugo removed from office by impeachment. As stipulated in the constitution, Vice President Federico Franco was sworn in for the rest of the presidential term, which ended in August 2013. The Mercosur and Union of South American Nations (UNASUR) countries interpreted the impeachment as an “institutional coup” and suspended the new Paraguayan government from both organizations.

The general elections on 14 April 2013 brought the Colorado Party back to power. The elections were carried out correctly; no party was excluded or discriminated against. In August 2013, Horacio Cartes assumed the presidency and Paraguay returned to a democratic routine. The positive evaluation of the electoral process abroad and the unambiguous result cleared the way for a reintegration of the new Paraguayan government into Mercosur and UNASUR. Cartes began his presidency with a surprise when he signed a political pact (“Acuerdo por Paraguay”) with four of the five opposition parties (including the Liberal Party).

The government of President Cartes defined a comprehensive reform agenda. The main objectives of his government at the beginning included regaining fiscal stability, improving the infrastructure by engaging the private sector in public investment, more social investment and a resolute suppression of the rural insurgency of the Paraguayan People’s Army (EPP). With its National Development Plan 2014-2030, the government defined some long-term objectives for Paraguay, but also set some benchmarks for the evaluation of its performance during the rest of President Cartes’s term. The plan delineates three strategic axes for public policies: reducing poverty and social development, strengthening inclusive economic growth and improving the country’s integration with the world.

At the beginning, President Cartes was quite successful at obtaining the necessary legislative support from Congress to initiate his agenda. He received broader authority to deploy the military in the fight against the EPP. Congress approved a fiscal responsibility law, a state financial

administration law and a public-private partnership framework bill to facilitate and encourage infrastructure investments. Moreover, he introduced a new law for agribusiness to pay increased taxes. However, in 2014, the government lost steam and did not advance very much with regard to its self-declared objectives (for example the planned public-private partnership infrastructure investments). Moreover, resistance from within the government party became stronger. Social discontent led to various demonstrations (including teachers and employees in the healthcare sector) and strikes (including a general strike in March 2014). After a series of failures, there has been some success in the fight against the rural guerrillas, but not a real breakthrough. Corruption remained a central feature in state and administrative culture. Yet, in November 2013, after massive public protests, the Senate removed immunity from prosecution for a senator accused of nepotism and fraud. Another two senators were stripped of their immunity in April 2014. In October 2014, a freedom of information law was introduced, which requires public institutions to divulge previously confidential information about staff, salaries, audits, et cetera. The new law might, in the future, help in the fight against corruption.

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. 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 tripled 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. 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 new Paraguayan government from both organizations.

The general elections on 14 April 2013 brought the Colorado Party back to power. In general, the elections were carried out correctly. Horacio Cartes, a successful and rich businessman, who had joined the Colorado Party only in 2009, won the election with 45.8% of the vote.

The Colorado Party won an absolute majority of seats in the Chamber of Deputies (44 out of 80; with a gain of 15 seats). The main opposition party, PLRA, won 27 seats, and the other nine seats were spread among seven parties. The parties supporting ex-president Lugo won only three seats. While his supporters play only a minor role in the Chamber of Deputies, their position is much stronger in the Senate. Lugo was elected as senator (with the sixth highest vote), his party received five seats (out of 45) and the Avanza País won another two seats. So, at least in the Senate, the left now has stronger representation than in the former Congress. The Colorado Party fell short of an absolute majority in Senate with 19 out of 45 seats. Consequently, President Cartes has to negotiate

either with the Liberal Party (13 seats) or with the left. The positive evaluation of the electoral process abroad and the unambiguous result cleared the way for a reintegration of the new Paraguayan government into Mercosur and UNASUR. After his election victory, Cartes declared his intention to normalize relations with the neighboring countries. The presidents of Argentina, Brazil and Uruguay attended his inauguration in August 2013.

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 and in the province of Amambay around its capital Pedro Juan Caballero, 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. Paraguay is the principal producer of marijuana in South America, a significant transit country for drugs (cocaine) and is also becoming a processing location for cocaine. 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) guerrillas. The EPP has attacked military and police outposts and patrols, private security guards and ranchers, has extorted ransom following kidnappings, and has organized attacks with explosives. 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 (around 113,000 people or 1.8% of the population in 2012) 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

Question
Score

Monopoly on the
use of force

6

State identity

9

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. In a nutshell, apart from the few state conflicts based on issues of social exclusion, the nation-state is widely accepted.

Church and state are separate, according the constitution. However, as a pressure group, the Catholic Church has considerable influence on certain subjects discussed in bills introduced by Congress, such as abortion, divorce or gay marriage. The Catholic Church is also constantly voicing its concern about corruption, social inequality and poverty, as well as of the system of justice in Paraguay.

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 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, Amambay 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. Vote buying, extortions and irregularities are still practiced both in the internal elections of political parties and national elections. This type of problem may be partially solved by a recent modification of the electoral law that enforces holding internal elections for all political parties on one single day. 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 Electoral Court – to mobilize the

Free and fair elections
8

electorate. A new law provides for the automatic voter registration of citizens living in Paraguay after reaching the age of 18, and after a referendum in October 2011, the constitution was amended and citizens living abroad acquired the right to vote in general elections.

The general elections on 14 April 2013, which brought the Colorado Party back to power, were carried out correctly, and no party was excluded or discriminated against. Parties that comprise the whole political spectrum from right to left, including a feminist party, participated. Both freedom of assembly and freedom of expression were ensured. The turnout for the presidential elections was quite high by Paraguayan standards (68.2% in 2013, compared with 65.5% in 2008). Around 1,500 national and more than 500 international observers closely monitored the electoral process.

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

8

However, due to its system of “weak presidentialism” (based on the power distribution between president and Congress in the 1992 constitution) 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. For instance, to override a presidential veto Congress does not need two-thirds majority, but only an absolute majority. 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 a low rate of taxation (12-13% of GDP), clear evidence of economic pressure groups’ veto power. In addition, the reiterated postponement of the introduction of a personal income tax (until 2013), 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. 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 have largely organized around the land problem in Paraguay and they have lately demanded a more comprehensive agrarian policy for smallholders. The main organization is the

Association / assembly rights

8

Federación Nacional Campesina (FNC). The Liga Nacional de Carperos is of recent formation and without the weight of the FNC. However, in total, 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. Legislation guaranteeing access to public information was approved quite recently. In October 2014, a freedom of information law was introduced, which requires public institutions (including Congress) to divulge information (for example, related to salaries and contracts). There is a pluralistic media sector, including private and public radio and TV broadcasters. 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. There are no legal limits on media concentration. Critical journalists are sometimes physically threatened and there have even been assassinations, especially when reporters have focused on corruption or organized crime (especially in remote border areas). Reporters have also been threatened by the EPP. In 2014, three journalists were killed in attacks attributed to organized crime and corrupt local politicians.

Freedom of
expression

6

Defamation and libel laws can be used to intimidate journalists and media owners. Freedom House (Freedom of the Press) classifies Paraguay as partly free. It is ranked 29th (out of 35) in the Americas. There are no government restrictions on the Internet or access to it. Access to the Internet has increased. In 2013, according to Latinobarómetro, 66% of the population never used the Internet. About 12% of Paraguayans were connected every day, and 26% used social media platforms (Facebook).

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. While President Cartes strives to consolidate presidential powers, for example, with regard to the nomination of ministers and control over the budget, he has to adjust his policy in consideration of congressional majorities.

Separation of
powers

7

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. 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.

Independent
judiciary

5

The murder of a journalist by hitmen in October 2014 brought the corruption of judges and the infiltration of the judiciary by drug-traffickers and organized crime into the public spotlight. The president of the Council of Magistrates, who has disciplinary power over the magistrates, declared in November 2014 that 25% of the judges in Paraguay are corrupt. Under pressure from the media and the public, President Cartes and members of Congress from all parties asked for a cleanup of the judiciary and initiated impeachment procedures against four of the nine Supreme Court judges (as a result, one resigned voluntarily) and one judge of the Supreme Electoral Court (who also resigned). The cleanup of the judiciary might be a strategy to deflect the criticism from corrupt politicians. And there is high risk that future nominations to the Supreme Court will be – as in the past – subject to political bargains and quotas between the Colorado Party and the Liberal Party. Therefore, senators from the left and dissident senators from the Colorado Party and the Liberal Party request a general reform of the courts with the objective of increasing the independence of magistrates from political influence and improving the professional skills of the judiciary.

Corruption is still a central feature in state and administrative culture; many of the state’s resources are distributed based on patronage networks. The Global Competitiveness Report (2014–2015) lists corruption (19%) and inefficient government bureaucracy (16%) as the most problematic factors for doing business in Paraguay. 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 being victims of any kind of corruption in Paraguay was 21% (the Latin American mean was 19.8%). This percentage rose to 28% in 2014, while the Latin American mean did not change (19.4%). Some 78%

Prosecution of
office abuse

4

(73% in 2012) of the Paraguayan respondents said corruption was “common” or “very common” in their country.

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 judiciary and the infiltration of the political and judicial system by organized crime. 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. 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. In November 2013, it required two contradictory votes and massive public protests to remove immunity from prosecution of a senator of the Colorado Party accused of nepotism and fraud. Two other senators (one from the Liberal Party and one from the Frente Guaso) were stripped of their immunity in April 2014. At the end of 2014, one senator had been acquitted by the judiciary, while the other two proceedings were still ongoing.

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, illegal arrests and extralegal executions. Human rights defenders working to promote small farmers’ rights have been harassed and threatened. There have been irregularities in the judicial proceedings against eleven imprisoned campesinos related to the violent incidents, which led to the impeachment of Fernando Lugo. Parts of Paraguayan society see them as political prisoners. 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 always been sufficiently respected. Decisions of the Inter-American Human Rights Court in favor of indigenous communities have been executed with great delays.

Civil rights

7

4 | Stability of Democratic Institutions

Democratic institutions perform their functions, but frictions can 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. After the ouster of President Lugo as stipulated in the constitution, Vice President Franco was sworn in for the rest of the presidential term ending in August 2013. The general elections in April 2013 were carried out correctly; no party was excluded or discriminated against.

In August 2013, Horacio Cartes assumed the presidency and Paraguay returned to a democratic routine. While Cartes' party has a majority in the Chamber of Deputies and he has signed a political pact with the main opposition party, there are shifting voting coalitions in Congress and a great deal of conflict over petty politics. The Paraguayan Congress has wide-ranging authority. Governing and law-making are complicated by the fact that the governing party and the most important opposition party are both composed of competing factions. In addition, the effect of politics on public administration is another serious flaw in the interplay of democratic institutions. The public administration is highly politicized and is quite inefficient, which in turn hampers public-sector reforms, such as the professionalization of administration. Clientelistic networks that subvert political institutions are much stronger at the regional and the local levels. Finally, the judiciary is not really independent and functions as a part of a balance of power system controlling both the government and the parliament. It is highly politicized and corrupt.

In June 2012, an 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 have not been persecuted or hampered in their pre-electoral activities.

The general elections on 14 April 2013, which brought the Colorado Party back to power, were carried out correctly. Both freedom of assembly and freedom of expression were ensured. The turnout for the presidential elections was quite high by

Performance of
democratic
institutions

6

Commitment to
democratic
institutions

8

Paraguayan standards. Ex-President Lugo was elected to the Senate and he was not hindered from exercising his mandate.

The EPP poses no risk to Paraguayan democracy; the same is true for the reactions of the government and the security forces with regard to this threat.

5 | Political and Social Integration

Even though Lugo's election in 2008 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, which is the major opposition party. Each has been operational for more than 100 years. The Colorado Party won the presidential election in 2013 and is still the strongest party. During more than 60 years in power, the party has created a close-knit patronage network.

Party system

7

The effective number of parties was 2.57 in the Chamber of Deputies after the 2003 election, and increased to 3.42 in 2008 but dropped to 2.39 in 2013. In the Senate, the number of effective parties is higher, but decreased from 4.0 in 2003, 3.89 in 2008, to 3.53 in 2013. 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, according to Latinobarómetro. The Colorado Party claims 1.9 million members, and the Liberal Party one million 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. At the end of 2014, there were three Colorado factions and two factions of the Liberal Party in the Chamber of Deputies.

While the left has now seven out of 45 seats in the Senate and former President Lugo is one of the senators, it is still in a minority position. Moreover, the left is divided. It has to be seen whether it can consolidate its position as a major actor in national politics, which can give voice to demands articulated by civil society organizations. Anyway, in the foreseeable future, the only option for the left to take over the government again is in a coalition with the Liberal Party.

In the 2013 Latinobarómetro survey, only 6% of Paraguayans interviewed classified themselves on the left (0-3) on a left-right scale; 31% were on the right (7-10) and 44% in the center (4-6); the average position was 5.9 (Latin America 5.3). Thus, the Paraguayan electorate is basically a center-right electorate, which is reflected in the dominance of the Colorado Party and the Liberal Party.

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.

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).

Peasants in Paraguay have a long tradition of struggle around land and other rural issues. Peasant organizations existed in the 1960s under the name of Ligas Agrarias Campesinas, and were heavily repressed by the dictatorship which aimed to destroy them. Peasants were able to reorganize in the 1990s and today they remain the main and most important social movement in Paraguay. They are organized in the Federación Nacional Campesina, which, however, often lacks adequate means for articulating and promoting its demands within political institutions. This is related to the fact that the traditional political parties still have very profound roots in the countryside in Paraguay and they are able to water down campesinos' demands and behavior on election days.

Voter turnout in presidential and congressional elections rose slightly, from 64% (2003) to 65.5% (2008) to 68.2% (2013). 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 later stabilized around 50% (2010: 49%; 2011: 54%; 2013: 50%) against the Latin American mean of 56% in 2013. Paraguayan satisfaction with how democracy is working in the country had been rising during the Lugo presidency, with 39% of citizens being more or less satisfied in 2011 (2010: 35%; 2009: 33%; 2008 22%) but then dropped to 25% in 2013 (Latin American mean: 39%). Compared to the rest of Latin America, a higher percentage of the population is open to the idea of an

Interest groups

6

Approval of
democracy

5

authoritarian solution. In 2013, 32% (Latin American mean: 16%) of Paraguayan respondents agreed that under some circumstances, an authoritarian government can be preferable to a democratic one. Some 39% of the Paraguayan respondents answered that there can be a democracy without political parties (with a Latin American mean of 31%), and 34% said the same about Congress (Latin American mean: 27%). 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. After the removal of Lugo, support did not decrease, but there is still a high percentage of Paraguayans with authoritarian attitudes. The 2014 LAPOP survey estimates the percentage of the population with stable democracy attitudes in Paraguay at 15.4%, which places Paraguay at 19th out of 25 countries in the Americas (including Canada and the United States).

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 2014 LAPOP survey data, community participation in Paraguay is not very high (around 12%), but is higher than in most of the other Latin American countries. Compared to other Latin American countries, a relatively high percentage of the respondents in Paraguay (Latinobarómetro 2013) articulate a willingness to protest for higher wages and better working conditions and for improvement in healthcare and education.

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 \$5,290 in 2012. It is ranked 111th out of 187 countries in the 2014 Human Development Report (with a HDI value of 0.676) and is classified as a medium human development country. The HDI value (data relate to 2013) of Paraguay is above the average (0.614) for countries in the medium human development group and below the average (0.740) for countries in Latin America and the Caribbean. If adjusted for inequality, Paraguay falls by five ranks (with a IHDI of 0.513). As per the Human Development Report for 2014, the country's Gender Inequality Index ranking was 88th out of 149 countries, with a score of 0.457 (Latin America and the Caribbean 0.416). Social exclusion is quantitatively and qualitatively extensive and structurally ingrained. The index of income inequality is high, but the Gini Index was reduced between 2011 (0.52) and 2013 (0.48) (World Bank). 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 usually used for subsistence production. At the same time, 8.7% of farms account for 94% of farmland. The poverty rate as percentage of the population fell from 35.1% (2009) to 23.8% in 2013 (2010: 34.7%; 2011: 32.4%; 2012: 26.8%) and extreme poverty was reduced from 19.4% (2010) to 10.1% (2013) (World Bank). The incidence of poverty in rural areas is three times as high as in urban areas. Sixty-eight percent of the families in extreme poverty live in rural areas. CEPAL data, while giving higher figures, also corroborate a poverty reduction from 49.6% of the population in 2011 to 40.7 % in 2013.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	8734.7	20047.5	28896.7	30984.7
GDP growth	%	2.1	13.1	14.2	4.4
Inflation (CPI)	%	6.8	4.7	2.7	5.0
Unemployment	%	5.8	5.7	5.2	-

Economic indicators		2005	2010	2013	2014
Foreign direct investment	% of GDP	0.1	1.7	1.2	-
Export growth	%	11.5	19.9	18.4	0.9
Import growth	%	8.1	24.8	6.8	2.8
Current account balance	\$ M	-67.5	-57.3	620.6	-
Public debt	% of GDP	28.0	15.6	16.8	19.0
External debt	\$ M	5411.7	12652.0	13429.8	-
Total debt service	\$ M	476.6	457.3	1865.6	-
Cash surplus or deficit	% of GDP	0.9	1.9	-	-
Tax revenue	% of GDP	10.2	12.1	-	-
Government consumption	% of GDP	9.3	10.4	12.1	12.0
Public expnd. on education	% of GDP	-	3.8	-	-
Public expnd. on health	% of GDP	2.2	3.1	3.5	-
R&D expenditure	% of GDP	0.07	-	-	-
Military expenditure	% of GDP	0.9	1.1	1.4	1.5

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

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. The informal sector is large, and economic activity is characterized by many small and very small enterprises.

There is a strong state presence in telecommunications (though this is challenged by private cellular telephones companies, as most Paraguayans use cellular phones rather than land lines), electricity production, gas and oil refineries (albeit with increasing competition), cement production, and water industries. The government controls the price of fuel and public-transport fares. In addition, the government sets the minimum wage, which however is often not adhered to. Around 10% (more than 300,000 employees) of the workforce is employed in the public sector, which increased by 32% (almost 70,000 jobs) between 2007 and 2014. There are no formal

Market-based
competition
4

restrictions on capital investments and capital movements, but, according to the Heritage Foundation, domestic companies are favored in government procurement bids.

The informal sector is large and includes, apart from licit but unregistered activities, cross-border smuggling and the illegal production and sale of narcotics, pirated music, stolen automobiles and weapons. Some 50.9% of employment in the urban sector is informal (men 46.6%; women 56.0% for 2013). The Index of Economic Freedom (2014) ranks Paraguay 15th out of 29 countries in the Americas, and 78th in a global ranking. According to the index, the Paraguayan economy is 62% free. The Global Competitiveness Index for 2014 – 2015 ranks Paraguay 120th out of 144, and 133rd with regard to institutions. The most problematic factors for doing business are corruption, inefficient government bureaucracy, an inadequately educated workforce and inadequate infrastructure.

The formation of monopolies is generally prohibited by Article 107 of the national constitution. An antitrust law, the Law on the Defense of Competition, was introduced in June 2013. It aims at targeting anticompetitive agreements, abuse of dominant position and predatory pricing. But in practice, monopolies are rarely split up. Monopolies exist in many areas, such as telecommunications (Corporación Paraguaya de Comunicaciones, holding the monopoly on fixed-line voice services, including local telephony, international long distance telephony, and VoIP) and electricity (Administración Nacional de Electricidad, ANDE). The Global Competitiveness Report for 2014-2015 ranks Paraguay 128th out of 144 concerning the effectiveness of anti-monopoly policy.

Anti-monopoly
policy
3

With total exports and imports at almost 95% of GDP in 2013, foreign trade is among the highest in the region, though exports are highly concentrated on a few products (soy, grains, and meat) and most go to Brazil. 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 4.3%, 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 2015 Doing Business Report, Paraguay ranks 92nd out of 189 countries, but in the specific ranking of "trading across borders" it ranks only at 150th. Paraguay so far has been involved in 16 WTO trade disputes, but only as a third party.

Liberalization of
foreign trade
8

After several banking crises in the 1990s and early 2000s, the legal and regulatory framework of banking supervision has improved considerably over the last years and become more risk-based, increasingly meeting international standards. Public financial institutions, such as the National Development Bank (BNF), the Development Financial Agency (AFD) and the central bank (BCP) have been strengthened. The Superintendence of Banks (SIB) within the BCP is responsible for the supervision of the financial sector. 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, and a new anti-money laundering plan was launched in June 2013. Moreover, a regulatory framework for cooperatives has been implemented, and cooperatives account for a substantial part (20%) of the financial system's assets. As of 2013, the system consisted of 16 banks (seven foreign and nine domestic, including the state-owned development bank).

However, the non-banking financial sector – especially exchange houses – still operates in a weak regulatory environment with limited supervision. Banks are well capitalized and profitability is high. Higher capital requirements and more stringent provisioning measures became effective in January 2012. Credit reached about 36% of GDP in 2013. On average, deposits constitute about 85% of total liabilities. The credit to deposit ratio (around 0.8) has remained significantly below the 1.5 benchmark ratio for potential banking crisis. While rising since 2010, non-performing loans represent only 2.4% of all loans (June 2013). The bank capital to assets ratio was 10.0 in 2013 and 10.3 in 2012. The capital market is relatively open for foreign investors. The dollarization ratio is at 40% for both loans and deposits.

8 | Currency and Price Stability

Controlling inflation and a suitable foreign-exchange policy are recognized goals of government economic policy. Inflation is under control (2012: 4.0%; 2013: 3.7%; October 2014: 3.4%) and within the range established by the central bank in 2011 (5% +/-2%). 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 depreciated -2.9% against the U.S. dollar in 2013, and -0.6% until October 2014. 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.

Banking system

7

Anti-inflation /
forex policy

9

Generally speaking, the government pursues a consistent policy for macrostability, resulting in strong economic fundamentals (low debt, sizeable official reserves, and small fiscal and external imbalances). From 2004 to 2011, the government ran budget surpluses. 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 1.8% of GDP and of 2.0% in 2013. A deficit of 1.8% was expected for 2014. The 2013 Fiscal Responsibility Law establishes a limit of -1.5% of GDP starting in 2015. However, in December 2014, Congress approved an amended budget, which might raise the fiscal deficit in 2015 to more than 3%. Despite the deficit in the past years, the central government debt is less than 13% of GDP (2013), one of the lowest in the region.

Macrostability
8

State revenues increased because of a broader tax basis. After Congress had postponed for several years the introduction of a 10% personal income tax, which had been established by law, it finally went into force in August 2012. Moreover, new taxes (VAT and income) for the agricultural sector were approved in 2013. As a result, during 2014 (up till September), the state's income from taxes was 18.4% higher than in 2013. Tax revenues are estimated at 12-13% of GDP in 2014 and 2015.

In January 2013, the Paraguayan government successfully issued a \$500 million, ten-year sovereign bond in the international financial market (with a yield of only 4.625%). Another thirty-year bond for \$1 billion (with a yield of 6.1%) was issued in August 2014. By this means, the external debt increased from 8.7% to nearly 12% of GDP in 2014, but is still quite low.

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 (2014) ranks Paraguay 60th out of 192 countries in registering property.

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. In principle, the government of President Lugo was opening the mining sector for exploration licenses, and there were major investment projects by foreign companies 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. The Cartes government still has 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. Since 2008, foreign direct investment (FDI) has hovered around 1.4 % of GDP. Foreign investment in Paraguay profits not only from low taxes, but also from beneficial regulations in terms of profit remittances.

Private enterprise
7

10 | Welfare Regime

Social expenditures as a proportion of GDP have greatly increased in the last 15 years, but are still low in comparison with other South American countries (17.8% of GDP in 2012). There are rudimentary measures to moderate social inequities, but efforts are sharply segmented in terms of territory, class and sector. Social protection is one of the lowest in Latin America. The social security system extends only to those employed in the formal sector of the economy. As of 2012, only 27% of the working-age population is covered by health care and only 19% is covered by social security (pensions). 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.

Social safety nets
5

There are particularly marked differences in the delivery of health care. Public spending for health was 10.3 % of GDP in 2012 (CEPALSTAT). Only 24% of the

population has health insurance coverage. During the administration of President Lugo, access to public health services improved. In December 2009, the administration of President Lugo introduced free medical visits and free dental treatment in public hospitals.

The government of President Lugo 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). The government of President Cartes declared that the number of families covered by the program rose to 100,000 in 2014. This figure has been questioned by NGOs. Life expectancy is relatively high, at an average of 73 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.

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, clan or contact with higher social classes) as the main source of opportunities. 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. As per the Human Development Report for 2014, the country's gender inequality index ranking was 88th out of 149 countries, with a score of 0.457 (Latin America and the Caribbean 0.416). With regard to labor force participation rate, the female rate was 55.4% (male 84.6%). Only 17 % of seats in the Chamber of Deputies and 20 % of seats in the Senate are occupied by women. Twenty-seven percent of ministers are women (3 of 11). Of the mayors elected in 2010, only 7.6 % are women (2006: 5.6%) and only one of the 17 governors of departments is a woman. 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.

Equal opportunity
5

11 | Economic Performance

In 2012, the Paraguayan economy contracted by 1.2% (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, in 2013, the Paraguayan economy recovered and grew by 14.2%, according to CEPAL, and 4.4% in 2014, according to the World Bank. The forecasts for the next years are similar. The extremely positive results in 2013 were due to rising demand and high prices for agricultural exports (especially soybeans) and an exceptionally good harvest. Urban unemployment fell slightly from 6.1% in 2012 to 5.9% in 2013. 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 the primary sector. The agricultural sector is highly volatile due to weather conditions and fluctuations in commodity prices and external demand. 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 1.8% of GDP and of 2.0% in 2013. A deficit of 1.8% was expected for 2014. The general government debt is less than 13% of GDP (2013), one of the lowest in the region.

Inflation went down from 4.0% in 2012 to 3.7% in 2013 and 3.5% in 2014 (October). The guaraní depreciated -2.9% against the U.S. dollar in 2013, and -0.6% until October 2014. The value of investment (gross domestic investment is expected to grow from around 16% of GDP in 2013 to 18% in 2016) 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 need of public and private investment in infrastructure (for example, electricity transmission lines; paved roads), one of the main objectives of President Cartes' government. FDI has only been around 1.4% of GDP since 2008.

The Global Competitiveness Index (GCI) ranks Paraguay 120th out of 144 countries (2014 – 2015), 132nd with regard to innovation and sophistication, and at 133rd with regard to the quality of institutions. The tax base is quite low and regressive (due to the high dependency on indirect taxes); 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 agriculture accounts for more than 20% of GDP, its contribution to tax revenue is small.

Output strength
8

12 | Sustainability

While CO₂ emissions are quite low (0.8 metric tons per capita in 2010), 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 number of certificates issued (per billion PPP\$ GDP) was 0.3 in 2012.

Environmental
policy
4

There has been little control of deforestation in border regions, which has accelerated because of the recent boom in soybean production. Reducing air and water pollution has not been a priority. Organizations of small farmers and landless peasants as well as indigenous groups occasionally protest against the indiscriminate fumigation of soybean plantations and the use of herbicides, because of the environmental damage and water pollution caused by such practices and because of the health risks for the people living in the affected regions. 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 National Development Plan 2030 (Plan Nacional de Desarrollo Paraguay 2030) approved in 2014 includes transversal lines related to environmental sustainability. The real impact of this programmatic component has yet to be seen.

The literacy rate is quite high at 93.9%, while the rate between men and women is somewhat unequal (male literacy rate, 92.9%; female rate, 94.8%). However, levels of functional illiteracy are much higher than 6.1%, 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 2011: 81.9%; secondary enrollment rate, 62.6%; 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.

Education policy /
R&D
5

Research and development facilities are rudimentary. Think tanks in Paraguay have taken up the slack for the lack of research activities in universities. However, there are only few think tanks and research institutions devoted to long-term research. Most locally conducted research still happens as part of short-term consultancies funded by international donors. Quantitatively, investment in education and training, as in research and development, is rather low. Recently, the National Council of Science

and Technology (CONACYT) received a significant amount of funding to support research in diverse knowledge areas. Nearly 150 research proposals were approved for funding in 2014. The beneficiaries are universities, think tanks and NGOs.

In terms of tertiary education, Paraguay has experienced a boom of private universities (as in other Latin American countries). However, those universities do not make any difference when compared to state universities in terms of quality of education, and sometimes they perform very badly. They are basically profit-oriented institutions and not concerned with raising the educational standards.

While public expenditures on education reached 4.8% of GDP (2011), R&D expenditures were as low as 0.05% of GDP (2011). There were 195 researchers in R&D per one million people (2011). The Global Innovation Index ranked Paraguay 89th out of 143 countries in 2014 (2012: 84th out of 141).

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 (only 9% of roads are paved, of which 25% are severely deteriorated) 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) or flooding. 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. Public-sector reforms are 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. 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 26 organizations (and five 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.

Civil society
traditions

6

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
4

II. Management Performance

14 | Steering Capability

The government of President Cartes is committed to constitutional democracy and a market economy. The main objectives of his government, however, have been concentrated on economic transformation. This included reform of the public sector, regaining fiscal stability, a stronger role for private enterprise in the economy, improving the infrastructure by engaging the private sector in public investment, more social investment and a resolute suppression of the rural insurgency of the EPP. Initially, the government was able to effectively prioritize and organize its strategic objectives and policy measures. Cartes started his presidency with a surprise when he signed a political pact (“Acuerdo por Paraguay”) with four of Paraguay's five opposition parties (including the Liberal Party) to engage in cooperation (including joint legislative initiatives and sharing congressional leadership positions). During the first months in office, President Cartes was quite successful. He received broader authority to deploy the military in the fight against the Paraguayan People's Army (EPP). He managed to convince a congressional majority to approve a fiscal responsibility law, which introduced a fiscal deficit ceiling of 1.5% of GDP and limited current expenditure increases to a maximum of 4% above the annual inflation rate. Against the resistance of the powerful commercial farmers (and their interest groups), Cartes passed a law that will compel agribusiness to make higher tax contributions. Moreover, against strong opposition and protests in the streets, he steered a public-private partnership framework bill through Congress to facilitate and

Question
Score

Prioritization
7

encourage infrastructure investments. And the government initiated actions to control small-scale contraband on the borders with Argentina and Brazil. Furthermore, Congress approved a state financial administration law to improve the government's cash management.

In addition, in 2014, the government approved the National Development Plan 2030 (Plan Nacional de Desarrollo Paraguay 2030). The plan delineates three strategic axes for public policies between now and 2030: reducing poverty and increasing social development, strengthening inclusive economic growth and improving the country's integration with the world. The strategic axes incorporate four transversal lines: equal opportunity; efficient and transparent public management; territorial organization and development; and environmental sustainability.

As the National Development Plan indicates, it remains to be seen whether the executive can realize its goals and monitor these policies. The plan is also intended to serve as a reference point for monitoring and evaluation of public policies. However, until now, Paraguayan politicians and policymakers have been unused to following long-term plans and they seldom have maintained policies initiated by previous administrations. In addition, the lack of qualified technical personnel in many ministries has impaired the planning, evaluation (including social and environmental risks), execution and monitoring of projects.

The government of President Cartes defined a comprehensive reform agenda. At the beginning, Cartes was quite successful at getting the necessary legislative support from Congress to initiate his agenda. He received broader authority to deploy the military in the fight against the Paraguayan People's Army (EPP). Congress approved a fiscal responsibility law, a state financial administration law and a public-private partnership framework bill to facilitate and encourage infrastructure investments. Moreover, taxation on the agricultural sector was substantially increased (basically by requiring agribusiness to pay corporate income tax).

However, subsequently, in 2014, the government failed to advance its policies. For the execution of major joint public-private partnership infrastructure projects, the government must improve public investment management, planning and regulatory capacity. The tax authorities are not sufficiently prepared to absorb an increase in taxpayers. As a result, tax collection remains relatively low (at about 51% of its potential). With regard to the goal of fiscal stability, in December 2014, Congress approved an amended budget, which revealed a risk that the fiscal deficit in 2015 might rise to more than 3%.

While the government of President Cartes started an offensive against the EPP and became more discretionary in deploying the military, it was not very successful. There have been few advances and the EPP is still actively killing security personnel. In general, drug trafficking and organized crime still undermine public security.

Implementation
6

The government demonstrates a general ability to engage in policy learning, but its flexibility is limited. An important step has been the signing of the political pact (“Acuerdo por Paraguay”) with four of the five opposition parties (including the Liberal Party) at the beginning of Cartes’ term, signaling the need for a more cooperative policy-making if long-term goals and the continuity of policies are to be upheld. Over the last 10 years, think tanks, research institutions and advocacy organizations have had a certain amount of influence on policy decision-making. Opinion-makers from these institutions are listened to by policymakers. International cooperation, for instance, with the IMF and Inter-American Development Bank (IDB) has a long tradition in Paraguay, has served as a supporter of continuous reform efforts from one government to another and, to a certain extent, has also facilitated learning from past experiences by observation and knowledge exchange. One example has been the World Bank’s Public Sector Development Policy Loan Project, which – according to the World Bank’s evaluation in 2014 – was maintained, despite political turbulence, and showed at least “moderately satisfactory” results.

Policy learning

7

15 | Resource Efficiency

At the beginning of his government, President Cartes was committed to increasing efficiency. He nominated a technocratic cabinet and tried to select office holders on the basis of merit. But soon, he had to back off because of resistance within his own party and the need to placate the opposition. For example, the brother of the president of Colorado Party was appointed director of the lucrative binational Paraguayan-Argentinean hydro-company Yacyreta. However, the first cabinet reshuffle in January 2015 reinforced its technocratic orientation.

Efficient use of assets

6

Cartes believes that the state functions like a company and he has stated this publicly. He has been criticized for not governing through his cabinet. Instead, he has designated managers from his own companies as personal counselors and created an inner circle of political advisors.

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. And there is still a lack of qualified technical personnel in many ministries. This impairs the planning, evaluation (including social and environmental risks), execution and monitoring of projects – including joint ventures for private-public investment in infrastructure and regulatory capacity.

The state budget was balanced until 2011. The deficit was around 2.0% between 2012 and 2014, and the objective is to reduce the deficit to a maximum of 1.5%. Tax evasion has been curbed, smuggling has been reduced and fiscal revenue increased significantly. However, there is still only low and limited 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.

Effective and coherent policy coordination is hindered by bureaucratic inefficiencies and, despite attempts to reform public administration, by the lack of qualified technical personnel in many ministries. Based on a political pact (“Acuerdo por Paraguay”) made at the beginning of Cartes’ presidency, the political opposition received congressional leadership positions and is included in the political decision-making process. While thereby providing for a broad support for Cartes’ reform policies during his first year in office, this hampered progress during the second year when contradictions among some of the government’s goals became more evident. The most significant example is the contradiction between low taxes, which on the one hand, are presented as a comparative advantage in Paraguay. On the other hand, plans are afoot to raise taxes to achieve the objective of increasing state incomes as a condition for higher social spending. In addition, deficits pertaining to inter-institutional coordination hamper the execution of the government’s reform program.

Policy
coordination
6

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 reforms have been undertaken to modernize the public sector 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.

Anti-corruption
policy
5

While, in September 2012, Congress approved a new law on the regulation of political financing, the EU Electoral Observation Mission for the 2013 general elections complained about the absence of regulations and effective mechanisms to enforce them in regard to campaign limits, transparency, audit and funding. There are no limits on the amount a donor can contribute to a candidate. Anonymous contributions are not forbidden and donations in kind are not regulated. The balance of income and expenditures (including electoral expenses) are neither audited nor made public. No penalty has ever been imposed.

After protests from civil society and the media, as well as a court decision to disclose the salaries of public officials, a freedom of information law was introduced in October 2014, which requires public institutions to divulge previously confidential information about staff, salaries, audits, et cetera. The new law might, in the future,

help in the fight against corruption. Yet, congressional deputies still claim the right to appoint supporters to public institutions. Interim President Franco (2012-2013) 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.

The president of the council of magistrates declared in November 2014 that 25% of the judges in Paraguay are corrupt. Under pressure from the media and the public, President Cartes and members of Congress from all parties asked for a clean-up of the judiciary and initiated impeachment procedures against four of the nine Supreme Court judges (as a result, one resigned voluntarily) and one judge of the Supreme Electoral Court (who also resigned).

16 | Consensus-Building

The main political actors agree on establishing a market-based democracy. Nevertheless, there are problems with implementation because there are many veto points in the political system, and economic reforms 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. 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.

The military respects the democratic legitimacy of the government and is not an independent political actor. There is a risk that social conflicts could get out of control and put political institutions under pressure. A violent clash between landless farmers and the police created the pretext to impeach reform-minded President Lugo in 2012. Anti-democratic actors are not openly visible, but the historically grown systems of clientelism and patronage are essentially anti-democratic and are largely associated with the traditional political parties: 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.

Consensus on goals

7

Anti-democratic actors

7

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 for the last decade. On the one hand, the landless are organized into a broad movement and represented by different organizations. On the other hand, 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). This approach is also in some measure employed by President Cartes with the Sembrando Oportunidades Program, which supports small-scale farmers with technical, financial and managerial assistance so as to improve their access to markets and value chains.

Cleavage /
conflict
management
7

In contrast to the period when Lugo was in power, civil society participation is not very pronounced. 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. After his ouster, civil society lost influence. Political parties and their clientelistic networks are still quite strong in Paraguay, which limits the space for civil society actors. However, the Cartes government at least engaged in a consultation process to prepare its National Development Plan 2030, in which – according to Cartes’ first government report in 2014 – diverse sectors of Paraguayan society participated, including civil society, the private sector, scientists, as well as subnational governments.

Civil society
participation
5

The political leadership recognized 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. 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.

Reconciliation
8

In June 2014, President Cartes signed a law ordering the expropriation of 14,400 hectares of rural lands that the Sawhoyamaya indigenous community has been trying to reclaim for more than 20 years. The indigenous community was displaced from their land illegally during the Stroessner dictatorship in the 1980s. Later in the year, the Supreme Court rejected claims made by the owners that the expropriation was unconstitutional. With the expropriation and the subsequent restitution process, the Paraguayan government complied with two rulings of the Inter-American Court of Human Rights, from 2006 and 2009, respectively. Other cases decided by the Inter-American Court related to restitution claims by indigenous communities in Paraguay are still not settled.

17 | International Cooperation

As mentioned before, the Cartes government has affirmed its resolve to undertake political and economic reforms, which include curbing corruption, public-sector reform, poverty reduction and increasing international competitiveness. Moreover, there is a long tradition in Paraguay of international cooperation. The Cartes administration works closely 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 IMF gives in general a positive evaluation of Paraguayan development and outlooks. The new partnership strategy of the World Bank with Paraguay for the 2015-2018 period envisions financial commitments of around \$1 billion. The World Bank will support the National Development Plan, whose main objectives include eradicating poverty, strengthening economic growth and improving the country's integration with the world through improved competitiveness.

The IDB country strategy for Paraguay (2014-2018) also supports the objectives of the National Development Plan and considers a sovereign-guaranteed lending scenario with a tentative goal of \$1 billion in loans, provided significant progress can be achieved in terms of execution. Priority is given to transportation and connectivity, water and sanitation, energy, productive development, the financial sector and public management.

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.

Effective use of
support
8

However, after a first year of more or less successful reforms, the government's impetus lost steam, and a clear roadmap specifying steps to reach its ambitious goals became less visible. The National Development Plan 2030 released in 2014 provides for a more detailed map, but given the more adverse political scenario, it remains unclear if this will remain a mere blueprint or will indeed guide a consistent use of support. The latter is all the more questionable given the country's pervasive corruption and clientelism.

Democracy is not perceived as at risk in Paraguay by the international community, at least after the return to free and widely fair elections in 2013. Overall, the Cartes government mostly acts as a credible and reliable partner. The U.S. government and Paraguay collaborated extensively on anti-narcotics and anti-smuggling policies. At the same time, Paraguay diversified its international partners. The relationship between Paraguay and its Latin American neighbors had 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). However, the unambiguous result of the Paraguayan elections in 2013 cleared the way for a reintegration of the Paraguayan government into Mercosur and UNASUR. At President Cartes' request, in December 2013, the Paraguayan Senate retroactively approved Venezuela's admission as full member to Mercosur, facilitating in this way Paraguay's collaboration in the institutions of Mercosur. Despite significant flaws, Paraguay's economic transformation is generally viewed with optimism, as is reflected in credit ratings and foreign investments. In January 2013, the Paraguayan government successfully placed a \$500 million, ten-year sovereign bond in the international financial market. Another thirty-year bond for \$1 billion was initiated in August 2014.

Credibility
9

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. Together with Uruguay, the Paraguayan government from time to time has taken a critical stance vis-à-vis Brazil and Argentina, because interests of the smaller member states in Mercosur have not been sufficiently taken into account. President Lugo, however, was able to renegotiate the Itaipú Dam Treaty with Brazil. In contrast, the negotiations with Argentina over the distribution of the accumulated debts for the Yacyretá hydroelectric dam and renegotiation of the treaty are still ongoing (January 2015). Argentina uses 95% of the produced electric power, Paraguay only 5%.

Regional
cooperation
8

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. 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).

The positive evaluation of the 2013 electoral process abroad and the unambiguous result cleared the way for a reintegration of the new Paraguayan government into Mercosur and UNASUR. After his electoral victory, President Elect Cartes declared his intention to normalize relations with neighboring countries. The presidents of Argentina, Brazil and Uruguay attended his inauguration in August 2013. Initially, the Paraguayan government tried to impose conditions for Paraguay's reintegration in the Mercosur meetings. In the end, President Cartes did not get any concessions, but it took nearly a year to organize the next regular Mercosur heads of state summit in Caracas (July 2014) with Paraguayan participation. Previously, in December 2013, the Paraguayan Senate (with a 29-10 vote) at the president's request had retroactively approved Venezuela's adhesion as full member of Mercosur.

Since 2013, Paraguay has also observer status in the Pacific Alliance and would like to join the group. This is not possible because the Mercosur membership impedes the country from independently signing trade agreements with third parties. In June 2014, Paraguay hosted the 44th General Assembly of the OAS.

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 was shaped by more than 60 years of the Colorado Party's dominance, which recently returned to government in August of 2013. A successful modernization of the state and the economy would undermine part of the power base not only of the Colorado Party, but also of the Liberal Party.

President Cartes is a political newcomer. He joined the Colorado Party only in 2009. As a result, he has no strong foundation within party, which is traditionally divided into different factions. While the Colorados have a majority in the Chamber of Deputies, this does not mean that the party will always vote unanimously for the president's proposals. Moreover, for the realization of his reform agenda, the president needs support from other parties as well. Hence, the president took the correct steps at the beginning of his government when he signed a political pact with four of the five opposition parties, including the Liberal Party. This gave him more room to maneuver and greater independence with regard to his own party. While in the first months of his presidency, Cartes met with success in his legislative initiatives, in 2014 his government lost steam and did not advance much with regard to its objectives (the planned PPP infrastructure investments). On the one hand, the resistance from within his party became stronger. On the other hand, social discontent led to various demonstrations and strikes. However, the government was quite successful in launching the National Development Plan in 2014, which received support from international lenders such as the World Bank and the Inter-American Development Bank. Now the government has set benchmarks to measure the results of its policies.

A major future challenge is reform of the state apparatus, so that planned reforms can be efficiently executed and monitored. Infrastructure deficits must be confronted to make the economy more competitive. The government has to demonstrate that private-public partnership projects are viable. While poverty has been reduced, the number of poor people is still high and may rise again in times of economic crisis. Especially in the countryside, the potential for conflict, including violent conflict, remains high. After being reintegrated into the institutions of UNASUR and Mercosur, the government must define its position with regard to the current processes of regional integration and cooperation.

Once his term advances, governing will become more complicated for President Cartes because both the opposition parties (now part of the governing pact) and possible candidates within his own party will position themselves with a view to the upcoming presidential election in 2018. The municipal elections in November 2015 are a first test as to whether the political pact between the government and the opposition can be upheld and whether the government can sustain its reform course (including fiscal stability) in election time. The country's economic prospects are

contingent on the development of the agricultural sector, which depends on the demand for (and price of) Paraguayan products, and which can be influenced by adverse weather conditions. Finally, one of the major challenges ahead is to confront corruption and organized crime's infiltration of politics or risk the disintegration of state structures in parts of the country.