

Paraguay

Status Index (Democracy: 6.60 / Market economy: 5.11)		5.85	Management Index		4.95
HDI	0.755		Population	5.9 mn	
GDP per capita (\$, PPP)	4.684		Population growth¹	2.8 %	
Unemployment rate	N/A		Women in Parliament	9.6 %	
UN Education Index	0.86		Poverty²	16.4 %	
			Gini Index	57.8 (2002)	
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003)					

A. Executive summary

The starting conditions for the transformation toward a market-based democracy were rather negative in the case of Paraguay. Democracy was not achieved by means of legitimate struggle, but was merely the peripheral outcome of power struggles among the elite in the Stroessner regime. The result was a broad continuity among the elites in politics and bureaucracy. In economic terms, at the beginning of transition, Paraguay was characterized by a comparatively low density of regulation and a very open economy. Handicaps included low productivity, a large sector of loss-making state enterprises, a large informal sector and institutional conditions that inhibit growth. These include an inefficient, politicized state administration and a defective and corrupt judicial system. The weakening of the military as an actor with veto powers since the late 1990s can be considered an advancement on the way toward democratic transformation. However, support for democracy has waned; a high percentage of the population is open to authoritarian solutions. The political parties remain very inadequate in their functions of articulating and aggregating interests. Their electoral success is based on a close-meshed patronage network.

The government of President Luis Angel González Macchi (1999-2003) was marked by political corruption, political stalemate, recurring crisis in the banking sector, an economic recession and a growing fiscal deficit. International donors and financial organizations reduced their presence in Paraguay. In this context the new government of Nicanor Duarte Frutos, which took up office in August 2003, got a good start. Though only at moderate levels, the GDP grew in 2003 and 2004, the urban unemployment rate fell, investment grew, the inflation rate was reduced in a significant way and the budget deficit was cut down. The government started a reform of the tax administration, broadened the tax base, began a reform of the social security system and tried to curb corruption in the public administration, state enterprises and the judicial system (including the removal of six of nine

Supreme Court judges). International financial organizations and donors supported this reform drive. For the first time since 1960, Paraguay signed a stand-by-arrangement with the IMF.

It remains to be seen whether the reform process proves sustainable. The government has no majority in Congress and the ruling party is fragmented. Tax and banking reforms still have to confront vested interests. In the process of reforming the public administration and state enterprises, the government will have to act against its own power base. While the advances in the fight against poverty have been minimal, a partially violent conflict between landowners and landless peasants is unfolding in the country's rural areas.

The major political challenges in the future will be a broadening of the reform coalition, a de-politicization of public administration, the continuity of a sound fiscal policy, the fight against corruption, and a focalization of policies toward poverty reduction. One main issue will be land reform, because of the impending threat of violent clashes between landowners and a radicalized movement of landless peasants.

B. History and characteristics of transformation

The transition to democracy in Paraguay was initiated in 1989, after 35 years of dictatorship under General Stroessner. It was the result of power struggles within the political elite. Initially, the political opposition and civil society played no role in the transition process. Thus, the transition to democracy was characterized by extensive continuity among the elites in politics and the bureaucracy (public administration, military and judiciary). Stroessner had used the Colorado Party as a tool in safeguarding his rule. Party membership was a prerequisite for a career in the administration or the military.

Through the party, the country was covered with a closely linked network of control and patronage. Even after the transition to democracy, the Colorado Party remained in power. It is now the longest-governing party in Latin America, having been in power since 1947. While it is true that a process of democratization in political institutions was initiated under Presidents Rodriguez (1989–1993) and Wasmosy (1993–1998), with a new constitution in 1992, in the 1990s the military still played a troublesome role: It was highly politicized, it viewed itself as part of the Colorado Party and it openly took partisan positions. President Rodriguez, as leader of the coup against Stroessner, had formerly been Commander-in-Chief of the army; General Oviedo, the Commander-in-Chief under President Wasmosy, tried to use his position as a political springboard. On March 28, 1999, President Raúl Cubas Grau resigned to avoid impeachment. Cubas (Colorado Party) had taken office in August 1998 and was considered the puppet of General Oviedo, who because of a failed 1996 coup attempt was banned from the May 1998 presidential elections that he would have otherwise

presumably won. The president thwarted judicial arrangements to arrest Oviedo, who mobilized his adherents in the party and the army. There were open threats against the judiciary, parliament and opponents within the party.

On March 23, 1999, Vice President Luis María Argaña was murdered. Argaña had been considered Oviedo's main opponent within the ruling Colorado Party, and Oviedo was therefore thought to have been behind the assassination. After mass protests, especially by youths, resulting in deaths and injuries, Cubas and Oviedo eventually left the country (for Argentina and Brazil respectively), seeking political asylum. In spite of this, Oviedo remained a destabilizing power factor in Paraguayan politics, especially because repeated demands for extradition by the Paraguayan courts had been refused. In June 2004, he returned to Paraguay, where he was immediately placed in military custody. At the time of this writing, he is trying to overturn a 10-year sentence and to refute other charges. He still hopes for a political comeback. His political party Unión Nacional de Ciudadanos Éticos (UNACE), an off-split from the Colorado Party, is represented in parliament.

After the resignation of President Cubas in 1999, the head of the Senate, Luis Angel González Macchi, was sworn in as the new president for the remainder of the term until August 2003. Because of his lack of democratic legitimacy (he was not popularly elected) and the fragmented nature of the ruling Colorado Party, González was in a weak position. Therefore, it is no surprise that planned economic reforms could not be implemented. Political stalemate, economic backsliding, widespread corruption and a clear deterioration of the social situation have characterized his presidency.

In April 2003, Nicanor Duarte Frutos from the Colorado Party won the presidential election with 37.1% of the votes and assumed office in August. His party is in a minority position in both chambers of Congress (37 out of 80 deputies; 16 out of 45 senators). Nevertheless, the new government marked a good start. In 2003 and 2004 there was an economic upturn, the government increased the tax collection in a significant way, it curbed fiscal deficit, contained inflation, and started a program of structural reforms. In opinion polls, President Duarte retains a high level of popular support.

C. Assessment

1. Democracy

In transforming its political order, Paraguay has made slow progress in strengthening its political institutions. There are still shortcomings at the level of political participation and representation, the quality of its democratic institutions and the rule of law. Some progress has been made in stabilizing democracy (veto

powers of the military have been neutralized), but this progress has to be consolidated further.

1.1. Stateness

In principle, the state's monopoly on the use of force has been established nationwide, but it does not come into effect everywhere, especially in border areas. Great parts of the country are sparsely populated, with no control of the borders and the airspace. In the "tri-border area" where Paraguay, Argentina and Brazil meet, around the border city of Ciudad del Este, the state's power and will have failed in the battle against smugglers and illegal drug dealers. The U.S. government still includes Paraguay in its list of major drug-transit or major illicit drug-producing countries. Concerns of security experts that the region could be converted into a refuge for international terrorists, however, have not been confirmed so far. There is a significant population of Brazilians in the border area (so called *brasiguayos*), many of them landowners in possession of great stretches of arable land, which is used for soybean production. Their loyalty is more to Brazil than to the Paraguayan state. The possession of large tracts of land by foreigners gives a special twist to the conflict over land in Paraguay.

All citizens share the same civil rights. However, in practice indigenous groups cannot assert their rights adequately. This is partly because they are few in number (90,000 or 1.8% of the population) and partly because they are a poorly organized minority. Ninety-five percent of the population is "mestizo", of mixed parentage. Constitutionally, Paraguay is a multicultural, bilingual country. Guaraní and Spanish are the official languages.

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

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

1.2. Political participation

While national elections largely satisfy requirements of a democracy, irregularities in the manner of nomination of candidates by party leaders have been repeatedly reported. Moreover, forms of patronage and political dependencies (particularly in the civil service) influence the election process, so that the Colorado Party is structurally in a favorable position.

Democratically elected representatives have the effective power to govern, and the influence of actors with veto powers, especially those in the military, has declined. The military is subordinated to civilian control but civilians do not exercise this control in a satisfactory way.

Independent political and civil society groups are generally allowed to form freely. However, there are legal and bureaucratic barriers to the possibilities of union organization due to a high minimum membership requirement. Private sector employers oppose the formation of unions. The level of unionization is around 15% of the formal labor force. During the period under review, the state sometimes reacted to union protests with extreme severity. Farmers and the landless are also organized. Their mobilization in favor of state subsidies, land allocation and land ownership is sometimes suppressed violently by the state or private actors.

Freedoms of opinion of the press are constitutionally guaranteed. There is a pluralistic media sector, including private and public radio and TV broadcasters. However, media pluralism is greatly threatened by the growing concentration of press ownership. The second biggest newspaper (Noticias) declared bankruptcy at the end of 2004, the third biggest newspaper (Ultima Hora) was bought by a TV Channel (Canal 4) in 2003. Press access to information is occasionally restricted by politicians and the administration. Critical journalists are sometimes physically threatened, especially if they report on corruption and organized crime. The independence of the press is further hampered by the extensive influence of business interests and politicians over the media. Defamation and libel laws are applied quite arbitrarily and are used to intimidate journalists and media owners.

1.3. Rule of law

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

The judiciary, especially the Supreme Court, has a relatively independent position in principle, though it cannot be considered politically neutral. Apart from professional criteria, judges are appointed according to political criteria as well. At all levels, there are problems with professionalism and a severe vulnerability to corruption and political influence in trials. After his inauguration, President Duarte initiated a clampdown on corruption in the Supreme Court, four members of the tribunal resigned voluntarily and two were removed by an impeachment proceeding. Only three judges of the Supreme Court remained in office. Party-based quotas heavily influenced the selection of new judges in the Supreme Court.

While the introduction of a new code of criminal procedure (1999) better protects the rights of the accused, deficiencies in the rule of law result from the prolonged duration of proceedings and investigative arrests.

At the level of political leadership, corrupt officials have been prosecuted in isolated cases—for example, former President Wasmosy—but they often take advantage of political, legal or procedural loopholes. Therefore, the vast majority of cases of political corruption are not prosecuted. While the government of President Duarte started with the purge of corrupt officials in tax recollection, customs administration, police and the courts, the Corruption Perception Index of Transparency International (2004) still ranks Paraguay (at rank 140) as the worst case in Latin America.

Civil liberties are largely secure, especially basic political rights. There are no political prisoners. Conditions in the hopelessly overcrowded prisons have repeatedly sparked criticism. However, some progress has been made with the construction of new prisons. There are repeated reports of excesses by the security forces, including torture and extralegal executions, against prisoners, those suspected of crimes and draftees. The forcible draft of minors, which is against the law, has decreased. In a few spectacular cases, human rights violations from the Stroessner era were criminally prosecuted. However, most cases have not been processed yet, even though the office of the Prosecutor General includes a special advisor for human rights who actively works to prosecute crimes under the dictatorship.

1.4. Stability of democratic institutions

Democratic institutions perform their functions, but frictions arise in the interplay between the president and Congress. This is because the ruling Colorado Party, lacking an absolute majority in both chambers, is splintered into several factions, and except for election periods, intramural competition undermines the party's coherence, thus hampering government action.

Democratic institutions are supported by the relevant actors, but in the case of the governing party or some of its factions, some doubt remains as to whether this support is a matter of principle. Hitherto there has been no transfer of power between the government and the opposition at the national level. Additionally, in Paraguay, there is a latent risk that free and fair elections might bring antidemocratic politicians into power.

1.5. Political and social integration

The Paraguayan party system is dominated by two parties, the Colorado Party and the Liberal Party. Each is more than 100 years old. They will continue to form the

axis of the country's political system for at least the medium term. From time to time splits occur within the Colorado Party or new parties emerge, but it is doubtful if they will survive with a significant electoral basis. At the end of the review period, more parties are represented in the new Congress (5 in the Chamber of Deputies, 6 in the Senate). The effective number of parties is 2.57 in the Chamber of Deputies and 4.0 in the Senate.

The Colorado Party is still the dominant party. After more than 50 years in power, the party has a closely enmeshed patronage network. Many of the 190,000 government employees owe their jobs to their party affiliation. Both traditional parties have a broad social base. Direct elections for executive offices in the party and the nomination of candidates for elective office generate possibilities for mobilization in both parties. However, the parties only sometimes work as instruments for articulating and aggregating social interests; they are more likely to serve as tools to mobilize voters for party caudillos. Hence, the internal fragmentation of the two parties among competing party leaders is also typical, though stronger in the Colorado Party.

Compared to the political parties, the system of social interest groups is weak, not very well connected and dominated by only a few interest positions. There is no link to the parties in terms of collateral organizations, although one of the umbrella labor organizations is close to the Colorado Party. The labor movement is weak and fragmented. However, contacts exist with the movement of landless peasants. Strong organizations represent the interests of rural landowners (cattle ranchers and soybean producers), like the Asociación Rural del Paraguay (ARP), Coordinadora Agrícola de Paraguay (CAP), the Asociación de Productores de Soja (APS) and the Confederación Paraguaya de Cooperativas (CPC). Landless peasants and small farmers are mainly organized in the Mesa Coordinadora Nacional de Organizaciones Campesinas (MCNOC), which represents about 40,000 families, and in the Federación Nacional Campesina (FNC).

Support for democracy is low amongst Paraguayan citizens (between 30% and 50%) and has been receding in the past few years. Compared to the rest of Latin America, a high percentage of the population is open to the idea of authoritarian solutions. A comparative study of the United Nations Development Program (UNDP) in 2002 identified more than 60% of Paraguayan citizens as non-democrats, the highest percentage in Latin America. Voter turnout is low (64% in the last presidential and parliamentary elections), only 53.5% of the population in voting age cast their vote in 2003.

Autonomous organization in civil society is uneven. It faces socioeconomic barriers and suffers from a lack of civic culture. Trust among the population is rather low. In 2004, only 6% of Paraguayans trusted their fellow citizens (Latinobarómetro); this is one of lowest percentages in Latin America. Less than 15% of the population is organized in some civic or interest organization, most participate in religious organizations. Around 200 NGOs exist in the country.

2. Market economy

During the presidency of Luis González Macchi, the transformation and modernization of the Paraguayan economic regime stagnated. Deficiencies still exist in the organization of competition, the role of state enterprises, bank supervision, and control of the informal or shadow economy, in combating corruption, property rights and strengthening the rule of law. Some progress in economic reform has been made only since the regime of President Duarte.

2.1. Level of socioeconomic development

Paraguay is ranked 89th of 177 countries in the 2004 Human Development Report. In Latin America, only Ecuador and Bolivia have lower HDI. Social exclusion is quantitatively and qualitatively extensive and structurally ingrained. The indices of income inequality worsened in the 1990s: the richest 10% of the population now has 70 times as much disposable income as the poorest 10% (the Gini Index in 2003 is 0.504 for urban and 0.581 for rural populations, Dirección General de Estadística, Encuesta y Censos). According to 2003 national poverty statistics, which include an estimation of the value of housing and real estate, 41.4% of the population lives below the poverty line, nearly half of it (20.1%) in extreme poverty. The CEPAL data of 2001, which includes only monetary income, classifies more than 60% of the population as poor. There is also an urban-rural gradient; the proportion of the poor in rural areas is much higher than in urban areas. Of the extreme poor, 80% live in rural areas. More than 60% of the urban labor force works in the informal sector (2003; ILO). The lower GDI (0.736) compared with HDI (0.751) reveals inequalities in achievements for women.

2.2. Organization of the market and competition

Market competition operates under a weak institutional framework. Free competition and the protection of property rights are limited by endemic corruption and political influence in the administration and judiciary. There is a strong state sector in telecommunications, electric power generation, oil refineries, cement production, railways and water utilities. In addition, the government sets minimum wages. The informal sector is large and substantial and includes activities such as cross-border smuggling and the illegal production and sale of narcotics, pirated music, stolen automobiles and weapons.

The formation of monopolies and oligopolies is neither regulated nor impeded. Foreign trade has a medium level of protection. Membership in MERCOSUR has largely liberalized trade with Argentina, Uruguay and Brazil; an average duty of 12.5% applies for the rest of the world.

The banking system and capital market are poorly differentiated, with inadequate regulation and supervision. The banking sector went through crises in the 1990s and in 2002-2003. Many banks and more than 50 enterprises in the financial sector had to close down between 1995 and 2003. The bulk of deposits (more than 80%) are now in foreign banks. Banking supervision has improved, but it is still inadequate because of scarce qualified personnel and because of political influence over banking decisions. In 2003, a new deposit guarantee scheme was created to protect clients against bank insolvencies. International financial organizations demand strengthening the independence of the central bank and a public bank reform law, because public banks, such as the National Development Bank (BNF), possess a high percentage of nonperforming loans and are susceptible to corrupt practices.

2.3. Currency and price stability

Controlling inflation and an appropriate foreign exchange policy are recognized goals of economic policy, but have not been consistently pursued and do not have an adequate institutional framework. The inflation rate of 14.6% in 2002 was reduced to 2.1% in 2004. Paraguay has a floating exchange rate. Because of the close ties to its two big neighbors in MERCOSUR, the Paraguayan currency (the guaraní) depends on the economic development and the currency rates (measured against the U.S. dollar) in Argentina and Brazil. The guaraní appreciated against the U.S. dollar in 2003, which in part reflects the strength of the currencies in the neighboring countries Argentina and Brazil. While the guaraní weakened again in the last quarter of 2004, it is expected that it will remain stable immediately after the end of the review period.

There are signs of a consistent policy for stability but without sufficient institutional safeguards for the future. Thus, there is a permanent risk of policy changes in response to domestic lobby groups. The government's 2005 budget proposal was partially defeated in Congress. The budget now includes a rise in the public wage bill as well as an increase in social expenditure. Principal causes of the fiscal deficit until the review period are the high expenses for personnel in the public sector, deficits at state enterprises and above all, in public pension funds, misuse of public money due to corruption, tax evasion and a small tax base (around 10% of the GDP). There is also a problem of efficiency in tax collection, because the tax laws establish a framework of tax pressure of about 20%.

2.4. Private property

Property rights and the regulation of the acquisition of property are fundamentally well defined, but there are problems with their implementation under the rule of law, not least of all because of deficiencies in the judicial system. Land titles are often ill defined, especially in the agricultural sector. A latent and sometimes

violent conflict exists between the interests, which large agricultural corporations (some of them foreign-owned) have in consolidating and expanding their holdings on the one hand, and the demands of the landless and small farmers for agrarian reform and land redistribution on the other. Protesters often occupy land, with subsequent conflicts, which both sides often conduct outside the rule of law.

Private activities represent the backbone of the economy, but concentration of market power is tolerated by the state. In some sectors such as telecommunications, electric power generation, oil refineries, cement production and water utilities, state enterprises exercise a monopoly or subvert fair competition. Privatization programs came to a halt, because they proved to be very unpopular. However, the government plans to attract private capital for joint ventures with state enterprises.

2.5. Welfare regime

Because of the size of the challenges involved, as well as the state's limited resources and poor economic performance, the country is unable to combat poverty systematically under the actual conditions. There are rudimentary measures to avoid social risks, but they are sharply segmented in terms of territory, class and sector. The social security system extends only to those employed in the formal sector of the economy. The pension system is organized on a pay-as-you-go basis; it covered only 12.5% of the workforce in 2001. Only 21% of senior citizens (aged 60 and over) receive pension benefits. Social insurance for employees in private business is still a relatively young concept, which manages to keep its budget balanced, though it has been adversely affected by recurring banking crises. The pension fund for state employees runs into chronic deficits, and must rely on injections of cash from the government budget (nearly 2% of GDP), because it includes payments for retired military personnel, veterans of the Chaco war and their descendants. This is an ill-defined category, giving rise to the suspicion that a great number of people receive unjustified benefits. Because of the demographic structure of the population (high fertility rates and high population growth rates), there is less necessity for a general overhaul of the pay-as-you-go pension system. More important are an increase in administrative efficiency and a curbing of corrupt practices.

Society is severely segmented, and there are hardly any institutions to make up for vast social discrepancies. Programs of social assistance receive only 0.3% of the GDP. Social expenditures (as percentage of the GDP) are low in comparison to other South American countries. There are particularly marked differences in the delivery of health care. Violations of labor law and other legal protections, such as for children and health care, are not adequately monitored or sanctioned by the government. At the operating level, collective bargaining agreements are often

impossible because of opposition raised by the business class. Women have comparatively little access to higher education and public office. There is a sharp urban-rural gradient here. The GDI is 0.736 as compared to the HDI 0.751.

2.6. Economic performance

Real per capita income shrank in the 1990s, and growth of per capita GDP was negative from 2000 to 2002, with a modest recovery in 2003 and 2004. On a per capita base the economy is still stagnant. Urban unemployment has risen by over 10% since 2000. But unemployment is not the main problem of the Paraguayan economy, it is underemployment. Public debt is now about 50% of GDP. But there are some positive signs too, as the budget deficit has been reduced. The volume of investment and trade has grown. However the unfavorable trade balance can endanger the economic recovery. Low productivity and underdeveloped technological capacities are still the greatest challenges for the Paraguayan economy. In the 1980s and 1990s, productivity sank 1.8 % on an annual base. According to the World Economic Forum's growth competitiveness index, Paraguay scored 95 out of 101 in 2003 and 100 out of 104 in 2004.

2.7. Sustainability

Ecologically sustainable growth is given only sporadic attention and has a weak institutional framework. This is particularly evident concerning the ecological impact of the country's large hydroelectric plants. There is little control of deforestation in the border regions, which accelerated because of the recent soybean boom. Reducing air and water pollution is not a priority. Despite the appointment of an Environment Secretary, coordination on ecological issues in the government is lacking. Organizations of small farmers and landless peasants protest against the indiscriminate fumigation of soybean plantations and the use of herbicides, because of the environmental damage and water pollution caused by this practice.

In spite of an improving school enrollment rate during the period of review, the educational system has great deficiencies. Only rudimentary research and development facilities exist. Quantitatively, investment in education and training, as in research and development is rather low.

3. Management

3.1. Level of difficulty

The structural constraints on governance are high. At the beginning of the period under review, Paraguay showed marked recessive tendencies in the economy and

great social disparities. The country is unable to combat poverty systematically on its own. Future development is hampered by the lack of an educated labor force, an inefficient and overstuffed public administration, widespread corruption in politics and society and severe deficiencies in infrastructure. Only 5.4% of households have a personal computer, 37% own a telephone (2002). While the forces for reform in politics and society are weak, many veto points that block political and economic transformations exist.

The democratization process in Paraguay began in 1989, after a long phase of authoritarian rule, with a weak autonomous civil society, a weak political opposition, and great continuity among the elites in politics and officialdom. Politics is based on patronage networks, which subvert civil society.

Great ethnic homogeneity is certainly an advantage for the Paraguayan government. There are no religious differences that could be seen as sources of conflict. Political parties do not articulate social rifts between the poor and the rich. However, a growing class conflict between landowners and organized landless peasants in the rural areas is observed.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	3
System of government:	<i>Presidential</i>	Electoral system disproportionality:	24.4
		Latest parliamentary election:	27.04.2003
		Effective number of parties:	3.2
1. Head of State:	<i>Luis A. González Macchi</i>	Cabinet duration:	03/99-08/03
Head of government:	<i>Luis A. González Macchi</i>		
Type of government:	<i>divided government</i>	Parties in government:	1
2. Head of State:	<i>Nicanor Duarte Frutos</i>	Cabinet duration:	08/03-present
Head of government:	<i>Nicanor Duarte Frutos</i>		
Type of government:	<i>divided government</i>	Parties in government:	1
		Number of ministries:	10
		Number of ministers:	10
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties reflects the political weight of parties (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

3.2. Steering capability

The political leadership is committed to constitutional democracy and a socially responsible market economy, but it has to compromise its power base. As a clear signal of his reform impetus, President Duarte named an independent candidate,

Dionisio Borda, as Finance Minister. The minister and his collaborators receive most credit for the elimination of the budget deficit. He is well connected with international finance organizations, respected by the opposition and parts of the NGO sector. His main critics are in the governing Colorado Party. President Duarte and the Finance Minister seem to have set clear strategic aims. The first aim is to cut down the budget deficit by curbing tax evasions and reforming the public pension system. The second aim is to normalize relations with international donors and finance organizations as a condition for new credits and grants. The third aim is to reform the administration and create a broader tax base (including new progressive taxes on property and income). Finally, the fourth aim is to use new fiscal revenues to combat poverty and confront the demands of landless peasants. However, not all cabinet members have the same standing as the finance minister; most have been appointed due to their political loyalty. It has to be seen whether the strategic priorities are maintained over periods of crisis and stalemate. While critics approve the reform policy of President Duarte, they point to certain authoritarian and populist traits in his governing style. For that reason, his plans to reform the constitution to allow a consecutive re-election could become a destabilizing factor. There is a risk that President Duarte could subordinate his economic policy to maintaining his personal power.

The government is committed to democracy and a market economy. It largely achieved its reform goals for the first period of review by balancing the budget, avoiding a debt default, getting fresh money, reforming the pension system for public employees and creating new taxes. In December 2003, Congress approved a reform of the public employees' pension system: The law increases the contribution rate from 14 to 16% and the retirement age to 62. It eliminates bonus payments for the 13th month. The government expects that the reform will generate savings of around 0.3% of the GDP in 2004, but the reform has only a limited impact on the deficits of the pension plans for retired police and army officers. Finance minister Borda purged the tax administration of offending officials to combat tax evasion. In the first 10 months of 2004, the collection of tax receipts was 36.8% higher than in the same period in 2003. In February 2004, the government issued a decree imposing an export tax on soybeans, and in July 2004, the Congress passed a new fiscal law (*Ley de Adecuación Fiscal*). The opposition Party *Patria Querida* supported this law. The new law reduced the profit tax from 30 to 10%, but eliminated all exemptions and widened the tax base of many other taxes, especially the value-added tax. It introduced for the first time an income tax for high-income earners, which is not in application at the time of this writing. In October 2004, the government submitted to Congress a bill with the aim to introduce a tax on large rural landholdings. Tax collections shall be used for poverty-reduction programs. With the declared objective to combat corruption in the judicial sector, the government and Congress pushed through the retirement or impeachment of six of nine Supreme Court ministers. However, quotas based on party affiliation tainted the renewal of the Supreme Court, and new corruption scandals erupted in the courts during 2004.

The political leadership responds to mistakes and failed policies with changes; learning processes take place more frequently than in former times. However, the authoritarian and populist traits in the governing style of President Duarte set a limit to his willingness to change policies.

3.3. Resource efficiency

The government uses only some of the state's available resources efficiently, but is committed to increase the efficiency. The state bureaucracy is still oversized, civil servants being almost invulnerable to dismissal. Recruitment of administrative personnel still puts a heavy emphasis on political loyalty. Nevertheless, the state budget seems to be balanced. Tax evasion has been curbed and fiscal revenue has increased in significant way. The administration promotes the external auditing of public enterprises; it changed the management of several state enterprises and institutions responsible for social security. A new procurement law reduces the scope of corruption in the public sector.

The government tries to coordinate conflicting objectives and interests but with only limited success. There are significant intra-governmental friction, redundancies and lacunae. A conflict of interest exists between the finance minister and the governing party. While the finance minister likes to reduce the costs of the public administration, the governing party is interested to buy support in future elections. As a result, the parliament raised the wage bill in the 2005 budget proposal of the government. Another conflict refers to the financing of land purchases for redistribution. In October 2004, the finance minister threatened to resign over the use of government funds to gratify protestors outside of the normal procurement procedures.

The government seeks to provide more integrity mechanisms. Some mechanisms ensuring integrity are effective, while others do not work. Corruption is still a central feature of state and administrative culture; many of the resources of the state are distributed based on patronage networks. However, the government has provided positive signals with the purging of the tax administration, the national police, the directors of state enterprises, customs and the social security institution, more transparency in government procurements, and the impeachment of corrupt judges. After only two months in office, President Duarte forced the Interior Minister, his personal friend, to resign on the grounds of his involvement in a case of smuggling of compact discs. However, the same person was immediately appointed to a well-paid job as counselor of the Yacyretá hydroelectric plant. In March 2004, he returned to the cabinet as defense minister.

3.4. Consensus-building

The main political actors agree on establishing a market-based democracy. Nevertheless, there are problems with implementation, because there are many veto points in the political system, and economic reforms harm vested interests of the political elite. The government has to negotiate its way through this, looking for support from the different opposition parties. Politics has been marked more by dissent than by consensus. In June 2004, the favorite of President Duarte for the Lower Chamber lost against another candidate from the ruling Colorado Party, who was supported by the opposition. There is a lack of consensus-building mechanisms, for example between business owners and unions or between politicians and actors from civil society.

Reformers can successfully neutralize or at least co-opt anti-democratic veto actors. The military is under control, and former General Oviedo is serving his prison term.

Although the political leadership is trying to prevent the escalation of political rifts into conflicts, it cannot reduce existing divisions. Conflict over farmland is growing. Landless peasants are invading large landholdings. Evictions are violent with victims on both sides. The risk of a further escalation of conflicts between landowners and occupants is high. The landless are organized in a broad movement and represented by different organizations. However, the conflict over land is not articulated along party lines. The government tried to mitigate the conflict and started talks with the movement of landless peasants. At the same time, it tried to pacify agro-exporters and large landholders, using police forces and military to expel farm occupants.

Though the government has attempted to promote the population's sense of solidarity, President Duarte seems to prefer a populist top-down approach to social problems.

The political leadership frequently ignores civil society actors and formulates its policy autonomously. However, it takes into account and accommodates the interests of civil society organizations, when these organizations can put pressure on the government, or when they form part of the power base of the government party. Hence, the interest organizations of teachers could negotiate some modifications in the public pensions reform bill. Under pressure, President Duarte and Vice-President Luis Castiglioni started a dialogue with movement of landless peasants and created a rural crisis cabinet. On September 24, 2004, the government reached an agreement with the umbrella organization of the peasants, the Frente Nacional por la Soberanía y la Vida, to distribute immediately 13,000 hectares of land. Simultaneously the government tried to accommodate the interests of soybean producers and cattle-ranchers, organized in the Coordinadora

Agrícola del Paraguay (CAP). Police forces and military acted against land invasions and roadblocks. By the end of 2004, there were no advancements in land distribution, nor were any special funds earmarked for this program.

The political leadership recognizes the need to deal with acts of injustice and human rights violations during the Stroessner dictatorship, but the process of reconciliation is slow. At this time of this writing, only a few victims of the dictatorship have been comprehensively indemnified, and the compensations are quite low. As a response to pressures from civil society, a commission of truth and justice was created by law, which commenced work in the second half of 2004.

3.5. International cooperation

The new government of President Duarte works with bilateral and predominantly with multilateral international donors and financial organization, including the IMF, the IADB and the World Bank, with the aim of integrating international assistance into the domestic agenda of reforms. During the former regimes, projects for technical collaboration had a very limited impact.

The government of President Duarte tries to act as a credible and reliable partner, and it receives more external support than the government of the former president Luis Gonzalez Macchi. In December 2003, the IMF granted the Paraguayan government a 15-month \$73 million standby arrangement to avert a default on the external debt, to support the reform program, stabilize the economy and to advance structural reforms. It was the first IMF program for Paraguay since 1960. The government cleared its arrears with World Bank as a condition for the agreement with IMF, and it received new loans from World Bank and the IADB totaling \$45 million in 2004. However, major international actors still express doubts on the sustainability of reforms because of the weak power base of the government. The public sector is considered as inefficient to carry out reform projects.

Paraguay is a member of MERCOSUR, along with Argentina, Brazil and Uruguay. The population generally supports belonging to this common market (Asuncion is the headquarters of the MERCOSUR Court of Arbitration), even if some voices loudly advocate the country's own path during periods of political or economic crisis. The Paraguayan economy is closely tied to those of the neighboring states, so that economic crises in Argentina and Brazil have direct consequences in Paraguay. Membership in MERCOSUR has helped stabilize Paraguayan democracy in the sense that these two big neighbors have intervened diplomatically in active ways during periods of political crisis (e.g. threatened coups in 1996, 1999 and 2000). Through MERCOSUR, Paraguay is also involved in negotiations on a free-trade agreement with the European Union. Together with the MERCOSUR countries, it is conducting parallel negotiations on easing trade with the United States, within the FTAA process. In November 2004, the

Paraguayan government signed an energy co-operation agreement with Venezuela, whereby the government of President Chavez will supply petroleum on preferential financial terms. In October 2004, president Duarte visited Germany and Italy in order to expand trade and cooperation.

4. Trend of development

4.1. Democratic development

Stateness, political participation and the rule of law maintained their levels prior to the period under review. While the Paraguayan borders are still porous for illegal activities, the so-called lawless area in the triple border around Ciudad del Este seems to be under the control of domestic and foreign intelligence services. Voter turnout and political participation are low. The scope of corruption, deficiencies in justice and shortcomings of party structures have changed very little or not at all. According to Transparency International's Corruption Perception Index of 2002, Paraguay was placed 98th among 102 countries studied; in 2004, it was 140th out of 146 countries, and ranked the worst of all South American countries. Some reforms have been implemented in the judicial system, which included the expulsion of corrupt judges.

Table: Support for democracy (in %)

	2000	2002	2003	2004
Satisfaction with how democracy is working (percentage of "satisfied" or "very satisfied" responses)	12	7	9	13
"Democracy is preferable to any other form of government"	48	41	40	39
"Under some circumstances, an authoritarian government is preferable to a democratic one"	39	38	44	39

Source: Latinobarómetro 2000–2004 (<http://www.latinobarometro.org>)

The Colorado Party remains fragmented, and its ability to act as the bearer of governmental responsibility is restricted. The opposition parties offer no clear alternative programs and place short-term power interests above political reforms and a strengthening of democracy. The parties' deficiencies in articulating and aggregating interests have led social actors to try to impose their interests directly, through political protest. While the population's skepticism about democracy is still very high, satisfaction with the working of democracy has risen a little bit after the induction of President Duarte, but it is still on a very low level.

Democracy has become more consolidated in some aspects. The position of the military as an independent powerbroker in the political process has been further weakened and the risk of a takeover by the armed forces has sharply declined. The presidential and parliamentary elections of 2003 met democratic standards, and the transfer of power was peaceful. The presidency regained democratic legitimacy and political support by the citizens. The return of General Oviedo has had no destabilization effect. He serves his prison sentence and his political influence is on the decline.

4.2. Market economy development

While the HDI value increased from 0.738 to 0.751 between 1995 and 2000, the country's level of human development has not changed since 2000. HDI values have increased less than the worldwide as well as the Latin American average. The per capita income has shrunk and poverty tended to increase since 1997. The CEPAL indicates that the Paraguayan economy would have to grow by more than 4% per annum until 2010 to recover the GDP per capita of 1995.

The institutional framework for working toward a market economy has improved in some segments such as finances and taxes, but not comprehensively. Most of the state administration is still inefficient, corruption runs high, and the justice system is deficient.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004a
Growth of GDP in %	-3.3	2.0	-1.6	3.8	2.8
Growth of GDP p.c.	-5.7	-0.6	-4.0	1.3	0.3
Export growth in %	-14.2	-0.7	0.1	17.5	13.3
Import growth in %	-6.0	-1.7	13.5	15.3	26.4
Inflation in % (CPI)	8.6	8.4	14.6	9.3	2.1b
Investment in % of GDP	18.3	16.8	16.0	16.5	20.3
Tax Revenue in % of GDP	n.d.	9.6	10.1	n.d.	n.d.
Urban Unemployment in %	10.0	10.8	14.7	11.2	10.0
Budget deficit in % of GDP	-4.3	-1.1	-3.0	-0.4	0.7
Current account balance in billion \$	-192	-275	73	146	-223

a) Provisional figures; b) November 2004 (variation 12 months)

Source: CEPAL, *Balance Preliminar de las Economías de América Latina y el Caribe 2004*, Santiago de Chile 2004; CEPAL, *Balance Preliminar de las Economías de América Latina y el Caribe 2003*, Santiago de Chile 2003; World Bank, *World Development Indicators*.

Overall, economic development has essentially stagnated during the period, both quantitatively and qualitatively. The economy is recovering from the worst recession of the past 20 years; GDP has grown by 3.8 and 2.8 in 2003-2004.

However, on a per capita base the growth has been very modest. Tax revenues as percentage of GDP are very low.

D. Strategic perspective

The Paraguayan presidential democracy is characterized by a strong Parliament with a bicameral structure and a fragmented party system. The consequence is that many issues in the political decision-making process are vulnerable to vetoes. Comprehensive political and economic reforms must therefore draw on broad coalitions. At the same time, Paraguay's democracy suffers from the presence of a hegemonic party that was already in power during the dictatorship, which still contains authoritarian residues. A successful modernization of the state and the economy would undermine the power base of the governing Colorado party. The party landscape – including a divided opposition and internal party factionalism — will change little in the near future and will hinder the formation of stable majorities. In addition, the still heavy sediment of authoritarianism in political culture, combined with the country's unresolved social problems, can foster authoritarian tendencies in politics.

What are the main problems in the future? It will be difficult for the government to consolidate fiscal stability, because there are many unsatisfied demands. In the end, the way out for the government will depend on the capabilities of the president to control his own party and to establish a working relationship with parts of the opposition. President Duarte still receives much support from the citizens. However, this support will evaporate if there are no clear and permanent results in the fight against poverty and corruption. The greatest challenge for the government constitutes the conflict over land, which can quite easily get out of control. There is no easy way to reconcile the conflicting interests of landless peasant and large agro exporters, many of whom are foreigners, in particular Brazilians.

To accomplish its social agenda, the government needs medium to high economic growth rates. However, economically, Paraguay is dependent on the world economy and the demand for its most important (agricultural) export products, as well as on developments in the neighboring MERCOSUR countries. Any leeway for independent action is rather limited.

There are many challenges ahead for President Duarte until the end of his term in 2008. Real politics will maintain a course between the following two extremes:

- President Duarte is capable of continuing his reform course. He unites the factions of the governing party behind his leadership and he establishes a stable pattern of cooperation with parts of the opposition. Constitutional reform enabling a re-election is perceived as a stabilizing factor in politics. The government moves forward with a reform of the public administration

and state enterprises. Corruption in the public administration and the judicial system are reduced. While the government sustains a sound fiscal policy, it also gets extra funds to confront poverty and to start a policy of land distribution. There are still conflicts in the countryside, but these are diminishing in volume and violence. The external economic context is positive; the Paraguayan GDP grows moderately.

- Political infighting in the governing party increases, because caudillos in the different factions seek to consolidate their power base. The opposition majority in Congress practices a politic of confrontation, blocking government initiatives. In this context the debate over a constitutional reform is an aggravating factor. The president succumbs to populist temptations; fiscal discipline is loosened. Economic reforms come to a halt. Violent clashes in the rural areas intensify. The government takes repressive measures; and human rights violations increase. Because the economy stagnates, poverty indices stay high.

External actors should support the Paraguayan government with its tax and fiscal reforms. This is the only way to create more resources for an active social, labor market and educational policy. Special importance should be given to the reform of the public administration: Paraguay needs a more efficient and less politicized administration. External actors should support the Paraguayan government to develop programs for poverty alleviation. In addition, they should help the government to find a sustainable and fair solution to the land conflict.