

CRS Report for Congress

Paraguay: Background and U.S. Relations

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Summary

The demise of the long-ruling Stroessner military dictatorship in 1989 initiated a political transition in Paraguay that has been difficult at times. Current President Nicanor Duarte Frutos has implemented some reforms that have addressed corruption and contributed to economic growth. Yet, due in large part to the country's authoritarian past, Paraguay's state institutions remain weak while corruption remains ingrained in the political culture, impeding democratic consolidation and economic development.

The April 2008 presidential elections could serve as a test of the strength of Paraguay's democracy since the ruling Colorado Party faces the possibility of losing its dominance after 60 years in power. At this juncture, the opposition is divided mainly between support for former Catholic bishop Fernando Lugo and former General Lino Oviedo, the leader of a failed 1996 coup who was released from prison in early September 2007. Lugo had been the leading opposition candidate and was considered the frontrunner for the elections but the emergence of Oviedo's candidacy has altered the political context. Both Lugo and Oviedo may still be declared ineligible to run in the elections by the Paraguayan Supreme Court. Observers believe that, in the absence of a second-round run off, a divided opposition increases the chances of the Colorado Party's candidate retaining the presidency in the 2008 elections.

U.S.-Paraguayan relations have been strong, with extensive cooperation on counterterrorism and counternarcotics efforts. U.S. authorities remain concerned about the prevalence of illegal activities in the tri — border area (TBA) with neighboring Argentina and Brazil such as money-laundering, drugs and arms trafficking and trade in counterfeit and contraband goods. The protection of intellectual property rights (IPR) has been a U.S. concern, especially piracy, counterfeiting, and contraband. The United States provided about \$13.3 million in aid to Paraguay in FY2006, an estimated \$11.7 million in FY2007, and for FY2008, the Administration has requested \$9.7 million in assistance, including \$1.3 million to support child survival and health, \$4.7 million in development assistance and nearly \$3 million for a Peace Corps program. In addition to regular foreign assistance funding, Paraguay signed a \$34.65 million Threshold Program agreement with the Millennium Challenge Corporation in May 2006, with the funds targeted specifically at programs to strengthen the rule of law and build a transparent business environment.

For additional information, see CRS Report RL33620, *Mercosur: Evolution and Implications for U.S. Trade Policy*, by J. F. Hornbeck, and CRS Report RS21049, *Latin America: Terrorism Issues*, by Mark P. Sullivan. This report will be updated as events warrant.

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Paraguay: Background and U.S. Relations

Introduction

Paraguay — a landlocked South American country bordering Argentina, Bolivia and Brazil — has a population of 6.5 million predominately concentrated in and around the capital city of Asunción. The majority of the population is of mixed Spanish and Guaraní Indian descent. Both Spanish and Guaraní are the official languages, with over 90% of the population fluent in Guaraní. Paraguay's per capita income in 2005 was \$1,280, one of the lowest in South America, and over 40% of the population live in poverty.

Political Situation¹

The current political context in Paraguay has been shaped by the country's turbulent political history. In the late 19th century, a two-party system emerged with the formation of the Colorado Party and the Liberal Party, but the Colorado Party soon became the dominant political force, ruling between 1887 and 1904. Paraguay was defeated in the War of the Triple Alliance (1864-1870) against Argentina, Brazil and Uruguay and lost 25% of its territory and over half of its population. This defeat led to an extensive period of political instability, with three civil wars in the first half of the 20th century and a war with Bolivia between 1932-1935, the Chaco War, that further weakened political institutions and hindered economic development. The Liberals ruled from 1904 until 1940, until the military assumed control with a succession of authoritarian leaders.

The Colorado Party returned to power in 1946, and has remained in power until the present day, making it the longest-ruling political party in the world. In the late 1940s, the party began to assume greater control over state institutions and the bureaucracy to the point where party membership was a prerequisite for civil service positions and promotion in the military, further perpetuating the Colorado Party's dominance.

General Alfredo Stroessner, who was a member of the Colorado Party, staged a coup in 1954, and consolidated power in a repressive military dictatorship that lasted 35 years. The key to the Stroessner regime's longevity was an alliance among

¹ Sources for the historical information in this section include Diego Abente Brun, "Uruguay and Paraguay: An Arduous Transition," in Jan Knippers Black (ed.), *Latin America: Its Problems and Its Promise*, Cambridge MA, Westview Press, 2005; and Paul C. Sondrol, "Paraguay: Precarious Democracy" in Howard J. Wiarda and Harvey F. Kline (eds.), *Latin American Politics and Development*, Boulder Colorado, Westview Press, 2000.

the military, dominant economic groups, and the Colorado Party. The military regime was characterized by strong political repression, the personalization of authority, ultra-nationalist and anti-communist rhetoric, and widespread corruption. With democratic advances occurring in other South American countries, Stroessner ultimately was overthrown in a 1989 coup and fled to Brazil, where he lived until his death in 2006. In 2004, a Truth and Justice Commission ultimately was set up to investigate human rights abuses that occurred under the Stroessner regime.

Figure 1. Map of Paraguay



Source: Map Resources. Adapted by CRS. 9/2007

The overthrow of the Stroessner regime initiated a process of democratization, with the enactment of a new constitution in 1992 and competitive elections held for the first time in 1993. Despite the democratic transition, however, many characteristics of the country's extensive period of military rule have persevered. Although opposition parties have held a majority in Congress, the dominance of the Colorado Party has remained intact, including its control over the state apparatus. The political culture has remained a product of the country's authoritarian past with pervasive corruption and clientelism. Nascent democratic institutions have been weak and almost every post-Stroessner President has faced some legal troubles.

In 1996, Army Commander General Lino Oviedo revolted after President Juan Carlos Wasmosy ordered him to step down. Oviedo resigned, but attempted to run in the 1998 presidential elections as the Colorado Party's candidate. Oviedo's candidacy was nullified after the Supreme Court upheld his conviction and ratified a 10-year prison term for his barracks revolt. Oviedo's running mate, Raúl Cubas, was elected President in 1998 and defied the Supreme Court by freeing Oviedo from prison as one of his first acts in office. This action led to the initiation of impeachment proceedings against the President, and intensified the rivalry between Vice President Luis María Argaña and President Cubas and Oviedo. Argaña was assassinated in March 1999 and blame was placed on both Cubas and Oviedo, sparking widespread demonstrations and violence in Asunción. President Cubas was forced to resign, and both he and Oviedo fled the country. As a result, Luis González Macchi, the president of the Senate, completed the presidential term and attempted to establish a government of national unity, but constant infighting within the coalition led to a weak government that was marred by corruption and inefficiency.²

Nicanor Duarte Frutos of the Colorado Party (National Republican Association or ANR) was elected president on April 27, 2003, defeating Julio César Franco of the opposition Authentic Radical Liberal Party (PLRA, related to the original Liberal Party) as well as three other candidates in an election that observers judged to be free and fair. The Colorado Party also captured 37 seats in the 80-member Chamber of Deputies, the largest block, and 16 of 45 seats in the Senate, while the largest opposition party, the PLRA, won 21 seats in the lower house and 12 seats in the Senate. Three smaller parties won the remaining seats. During the campaign, Duarte portrayed himself as a strong leader, and he promised to implement widespread institutional reforms, prioritize the fight against corruption and establish a transparent government. As discussed below, President Duarte has enacted reforms that tackle tax evasion and corruption. Since his election, however, the President's popularity has declined because of public concerns about rising crime and unemployment. As a result, he has resorted to more populist rhetoric as a means of retaining support for the Colorado Party.

Corruption

Observers maintain that corruption remains a major impediment to the emergence of stronger democratic institutions and sustainable economic development in Paraguay. President Duarte's measures to combat corruption have included

² Brun, p. 576.

increased penalties for tax evasion and other measures to increase tax revenue, greater oversight of government spending, and a crackdown on the trade of contraband and counterfeit goods. He also removed members of the Supreme Court after corruption allegations surfaced against them. These measures were partially successful, as evident in Transparency International's 2006 corruption perceptions index in which Paraguay ranked 111 out of 163 countries.³ This ranking was an improvement from 2004 when the country was classified among the six most corrupt countries in the world and the second most corrupt in the Western Hemisphere. For the 2007 index, however, Paraguay dropped to 138 out of 180 countries.⁴ The opposition has claimed that anti-corruption efforts have not been far-reaching enough because they have not addressed the clientelism that is pervasive in Paraguayan politics or the dominance of the Colorado Party in governmental institutions.

2008 Presidential Elections

President Duarte sought to overturn the constitutional ban on consecutive re-election so that he could run in the April 2008 presidential election. The opposition strongly contested the President's move, however, and he abandoned his re-election efforts. Duarte supports former education minister Blanca Ovelar as the Colorado Party's presidential candidate. Ovelar will compete against current Vice President Luis Castiglioni for the party's nomination, and José Alderete, the interim president of the Colorado Party. A party primary is expected to be held in December 2007.

At this juncture, it appears that the opposition's support is divided between two potential candidates: former General Lino Oviedo, the leader of a failed 1996 coup who was released from prison in early September 2007, and Fernando Lugo, the former Roman Catholic Bishop of an impoverished rural diocese. Pedro Fadul, the head of the Dear Fatherland Party (PPQ), has also announced his candidacy for the upcoming presidential election.

Oviedo, who had returned to Paraguay in 2004 to serve his 10-year prison sentence, was granted conditional release on September 6, 2007, and indicated his desire to be a presidential candidate if court rulings permit him. There are still pending charges against Oviedo for masterminding the March 23, 1999 assassination of Vice President Luis Maria Argaña, and for the subsequent killing days later of seven protestors opposed to Oviedo.⁵ Oviedo is the founder and leader of the National Union of Ethical Citizens (UNACE), a political party which he ran from prison. In the aftermath of Oviedo's release, a poll showed Oviedo with 31.5% support compared to 27.5% for Lugo and 27.2% for the Colorado Party candidate. Some observers, including many in the opposition, believe that President Duarte orchestrated Oviedo's release in order to split the opposition for the presidential

³ Transparency International, *Corruptions Perceptions Index 2006*.

⁴ "Glimmer of Success in Paraguay's Corruption Battle," *Financial Times*, August 14, 2006; "Chile and Uruguay the Least Corrupt in Latin America," *LatinNews Daily*, September 27, 2007.

⁵ "Paraguay: Oviedo Goes to Supreme Court," *Latin American Weekly Report*, September 27, 2007.

elections and improve the Colorado Party's chances of retaining power, particularly in the absence of a second-round run-off. Oviedo is viewed as a populist and he appeals to the same rural poor constituency that has supported Lugo.

Until Oviedo's release, Lugo had been the frontrunner in the polls, and his candidacy was endorsed by several left-wing labor unions and social organizations and parties. This included the endorsement of the PLRA, the main opposition party. Lugo's political discourse emphasizes empowering the poor, agrarian reform and putting an end to endemic corruption, which he views as emanating from decades of Colorado Party dominance. Lugo has also stated that he is open to private capital and a consensus-based development model.⁶ Some of Lugo's opponents have accused him of maintaining close ties to Venezuelan President Hugo Chávez, a charge that Lugo has denied. These accusations resurfaced when Paraguayan media reported the existence of a document detailing Chávez's plans for increasing his influence in Paraguay, which included seeking out political leaders that were sympathetic to the "Bolivarian" vision for South America.⁷ A complicating factor for Lugo's candidacy is that the judiciary has not yet ruled if he is eligible to run. Paraguay's constitution prohibits members of the clergy from running for public office, and the Vatican has rejected Lugo's resignation and petition for laicization. In the aftermath of Oviedo's release, Lugo announced a new electoral coalition known as the Patriotic Alliance for Change (APC), which includes the PLRA and seven smaller parties.⁸

Due to the legal impediments related to the candidacies of Lugo and Oviedo, there exists the possibility that one or both will be declared ineligible to run in the presidential elections. Some observers believe, however, that any attempts by the Paraguayan Supreme Court to disqualify either candidate could lead to political unrest, given the significant popular support that both Lugo and Oviedo enjoy.⁹

Economic Situation

The Paraguayan economy, which remains heavily dependent upon its traditional agricultural exports of soybeans, cotton, and meat, grew by 4.3% in 2006, and is estimated to grow 4.1% in 2007.¹⁰ Paraguay lacks significant mineral and petroleum resources, but possesses vast hydroelectric resources, including the world's largest

⁶ "Paraguayan Former Bishop Aims to End 60 Year One-Party Rule", *Agence France-Presse*, September 18, 2007.

⁷ Pablo Amarilla and Patrick J. McDonnell, "Venezuela Plan for Paraguay Causes an Uproar; Paper Said to be Orders from Chávez to Deepen Ties Prompts Cries of Foreign Infiltration", *Los Angeles Times*, September 3, 2007.

⁸ "Poll Shows Oviedo Favourite in Paraguay," *LatinNews Daily*, September 17, 2007; "Elections Blown Wide Open as Oviedo Freed," *Latin American Weekly Report*, September 13, 2007; "Oviedo Release Complicates Paraguayan Political Panorama," *Latin American Regional Report: Brazil and Southern Cone*, September 2007.

⁹ "Paraguay: Oviedo Release Shakes up Political Panorama," *Oxford Analytica*, September 11, 2007.

¹⁰ "Paraguay Country Report," *Economist Intelligence Unit*, September 2007.

hydroelectric generation facility, the Itaipú Dam, built and operated jointly with Brazil. Remittances from Paraguayans living abroad have significantly contributed to sustained economic growth. According to the Inter-American Development Bank, remittances totaled some \$650 million in 2006, about 9% of gross domestic product.

Paraguay experienced an economic recession for several years in the aftermath of a succession of bank failures from 1996-1998 that wiped out half of Paraguay's locally owned banks. When elected in 2003, President Duarte inherited a government that had defaulted on \$138 million in debt, primarily as a result of low tax revenue.¹¹ Under President Duarte, the economy rebounded, due in part to the implementation of reforms that include anti-corruption initiatives, which have increased revenue, strengthened institutions, and created a more favorable environment for foreign investment.

Paraguay is heavily influenced by the economic conditions of its larger neighbors, Argentina and Brazil, which are fellow members of the Common Market of the South (Mercosur).¹² As one of the smaller countries of Mercosur, Paraguay has complained that its exports face significant restrictions entering Argentina and Brazil. Paraguay's industrial sector is still largely underdeveloped, with much of the population still employed in subsistence agriculture. Economic growth tends to be limited by Paraguay's imports of manufactured goods, as well capital goods that are necessary to supply the industrial and investment requirements of the economy.¹³ This has led to a widening of the country's trade deficit, estimated at \$1.1 billion in 2006.

Paraguay's informal sector is very large, estimated at about half of the country's gross domestic product, and is estimated to employ over 40% of wage-earning workers.¹⁴ A significant part of the country's commercial sector consists of importing goods from the United States and Asia for re-export into neighboring countries. Most of these imported goods are not declared at customs, preventing the government from obtaining substantial tax revenue. Counterfeit trade and smuggling are prevalent in the country's border regions.

Relations with the United States

Paraguay and the United States have good relations, cooperating extensively on counternarcotics and counterterrorism efforts. The United States strongly supports the consolidation of Paraguay's democracy and continued economic reforms.

¹¹ Michael Thomas Derham, "Against All Odds," *LatinFinance*, March 1, 2005.

¹² Mercosur has the goal of implementing a common market among its members, but to date only a limited customs union has been achieved.

¹³ Luis Carlos Nino, "Inflation Increases Slightly as Paraguay's Trade Deficit Widens," *Global Insight Analysis*, June 4, 2007.

¹⁴ Richard Lapper and Adam Thompson, "Cash-Starved City in Paraguay Fights War on Counterfeit Goods," *Financial Times*, September 9, 2005; and "Latin America and Caribbean, A Barrier for Development," *States New Service*, May 23, 2007.

President Duarte is viewed by many observers as very pro-U.S. and became the first Paraguayan head of state to be received at the Oval Office. The United States is Paraguay's eighth largest trading partner, with trade increasing over the last four years. U.S. imports from Paraguay totaled about \$58 million in 2006 while in the same year, the value of U.S. exports to Paraguay was over \$910 million, according to Department of Commerce trade statistics.

The protection of intellectual property rights (IPR) has been a U.S. concern, especially piracy, counterfeiting, and contraband. The Duarte government has made significant efforts to improve IPR protection, but the United States Trade Representative maintains that the country continues to have problems due to its porous border and ineffective prosecutions. In 2003, U.S. and Paraguayan officials signed a Memorandum of Understanding (MOU) to strengthen legal protection and enforcement of intellectual property rights in Paraguay. This MOU was extended in 2006 through the end of 2007.

U.S. Aid

The United States provided about \$13.3 million in aid to Paraguay in FY2006 and an estimated \$11.7 million in FY2007. For FY2008, the Administration has requested \$9.7 million in assistance, including \$1.3 million to support child survival and health, \$4.7 million in development assistance and nearly \$3 million for a Peace Corps program. Development assistance includes support for projects that promote export diversification and private investment, as well as projects that aim to combat corruption and strengthen institutions. In past years, Paraguay had faced restrictions in terms of receiving Economic Support Funds (ESF) and International Military Education and Training (IMET) assistance because the Paraguayan government has not signed a bilateral immunity (Article 98) agreement that would give U.S. soldiers immunity from International Criminal Court prosecution. In the fall of 2006, however, President Bush waived the Article 98 restrictions for IMET and ESF for Paraguay.¹⁵

In addition to regular foreign assistance funding, Paraguay signed a \$34.65 million Threshold Program agreement with the Millennium Challenge Corporation in May 2006, with the funds targeted specifically at programs to strengthen the rule of law and build a transparent business environment. Paraguay also signed an agreement with the United States in 2006 under the Tropical Forest Conservation Act that provides Paraguay with \$7.4 million in debt relief in exchange for the Paraguayan government's commitment to conserve and restore tropical forests in the southeastern region.

Counternarcotics Cooperation

Paraguay is a major transit country for illegal drugs destined primarily for neighboring South American states and Europe. The Chaco region in the northwestern part of the country is a major transshipment point of illegal drugs, along

¹⁵ For background, see CRS Report RL33337, *Article 98 Agreements and Sanctions on U.S. Foreign Aid to Latin America*, by Clare M. Ribando.

with the tri-border area (TBA) with neighboring Argentina and Brazil. A 1987 U.S.-Paraguay bilateral counternarcotics agreement was extended in 2006. U.S. counternarcotics efforts in Paraguay have focused on providing training, equipment and technical assistance in order to strengthen the capacity of the country's National Anti-Drug Secretariat (SENAD), along with initiatives to help combat money laundering and corruption. The United States is assisting in the completion of a helicopter pad and support facilities that would increase SENAD's capacity to disrupt trafficking networks. According to the State Department's March 2007 *International Narcotics Control Strategy Report*, SENAD arrested several major Brazilian drug traffickers and in 2006, carried out drug seizures that inflicted an estimated financial loss of \$39 million to narcotics traffickers.

TBA and Terrorism

The United States is particularly concerned about illicit activities in the TBA, where money laundering, drug trafficking, arms smuggling, and trade in counterfeit and contraband goods are prevalent. Such activities thrive in the tri-border region due to porous borders, a lack of surveillance, weak law enforcement and pervasive corruption by local officials, especially in the Paraguayan border city of Ciudad del Este. The United States has worked closely with the governments of the TBA countries on counterterrorism issues through the "3+1" regional cooperation mechanism, which serves as a forum for discussions, and the United States has provided anti-terrorism and anti-money-laundering support to Paraguay.

U.S. Immigration and Customs Enforcement (ICE) sent a team of specialists to the tri-border region to investigate trade-based money laundering in 2006, and has assisted the Paraguayan government in developing a Trade Transparency Unit that will examine discrepancies in trade data in order to determine cases of customs fraud, trade-based money laundering or the financing of terrorism.¹⁶ U.S. treasury officials have held workshops in the region to encourage more banking sector involvement in efforts against money laundering while the U.S. embassy's legal adviser in Asunción held training courses for local investigators and prosecutors in charge of combating possible terrorism links.¹⁷

For a number of years, the United States has had concerns that the radical Lebanon-based Hezbollah and the Sunni Muslim Palestinian group Hamas have used the TBA for raising funds among its sizable Muslim communities by participating in illicit activities and soliciting donations. Nevertheless, according to the State Department's annual terrorism report for 2006 (issued in April 2007), there is no corroborated information that these or other Islamic extremist groups have an operational presence in the TBA.

The State Department's terrorism report states that Paraguay did not exercise effective immigration or customs control on its borders, and that although Paraguay

¹⁶ U.S. Department of State, *International Narcotics Control Strategy Reports: Volume II Money Laundering and Financial Crimes*, March 2007.

¹⁷ Monte Reel, "South American Terror Pipeline?; U.S. is Helping to Crack Down on Money Laundering in a Region Where Three Nations Meet", *Houston Chronicle*, August 6, 2006.

is generally cooperative on counterterrorism efforts, its judicial system remains severely hampered by a lack of strong anti-money-laundering and counterterrorism legislation. In May 2007, Paraguay's Chamber of Deputies approved a bill that would incorporate a clause on terrorism in the country's penal code, making terrorist association and the financing of terrorist activity punishable crimes. In August 2007, however, Paraguay's Senate delayed the bill because of concerns that its definition of a terrorist act could lead to legitimate social protests being labeled criminal acts.

Figure 2. Tri-border Area of Argentina, Brazil, and Paraguay



Source: Map Resources. Adapted by CRS. 9/2007