

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The text is centered within the hourglass.

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Paraguay: Background and U.S. Relations

Mark P. Sullivan, Foreign Affairs, Defense, and Trade Division

May 7, 2008

Abstract. 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.

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CRS Report for Congress

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Updated May 7, 2008

Mark P. Sullivan
Specialist in Latin American Affairs
Foreign Affairs, Defense, and Trade Division

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Prepared for Members and
Committees of Congress

Paraguay: Background and U.S. Relations

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.

In Paraguay's April 20, 2008, presidential election, former Roman Catholic bishop Fernando Lugo, running on an electoral coalition known as the Patriotic Alliance for Change (APC) won with 41% of the vote. He defeated the candidate of the long-ruling Colorado Party, Blanca Ovelar, who received 31%, and former military commander Lino Oviedo, who ran as the candidate of the National Union of Ethical Citizens (UNACE). The election was historic, and will end more than 60 years of Colorado Party rule when Lugo is inaugurated on August 15, 2008. For some observers, Lugo's victory is a chance for Paraguay to further strengthen its democratic transition, breaking a link with its authoritarian past.

While victorious at the polls, President-elect Lugo will face tough challenges when he takes office in August. Most significantly, his ability to govern could be affected by his coalition's lack of a majority in Congress. Another potential difficulty for President Lugo is his ability to deal with entrenched government bureaucracy that essentially been controlled by the long-ruling Colorado Party. Most observers expect that Lugo will govern as a moderate since the electoral alliance that brought him to power is dominated by a center-right party.

U.S.-Paraguayan relations have been strong, with extensive cooperation on counterterrorism and counternarcotics efforts. After Lugo's victory, U.S. Ambassador to Paraguay James Cason congratulated Lugo and the APC on their victory and expressed a commitment to work and strengthen bilateral relations. The United States remains concerned about illegal activities in the tri-border area 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 has been a U.S. concern, especially piracy, counterfeiting, and contraband. The United States provided about \$12.5 million in aid to Paraguay in FY2007, an estimated \$11.6 million in FY2008, and an FY2009 request for \$11.8 million, including \$3.4 million for a Peace Corps program. In addition to regular foreign assistance funding, Paraguay signed a \$34.7 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

Introduction¹

Paraguay is a landlocked South American country bordering Argentina, Bolivia, and Brazil and has a population of about 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 was \$1,400 in 2006, according to the World Bank, one of the lowest in South America, while about 60% of the people live in poverty and 32% live in extreme poverty, according to the U.N. Economic Commission for Latin America and the Caribbean.²

Political Situation³

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

¹ Nelson Olhero, a Research Associate with the CRS Foreign Affairs, Defense, and Trade Division, and Mark Sullivan, Specialist in Latin American Affairs, authored the original version of this report in September 2007.

² World Bank, World Development Report 2008; U.N. Economic Commission for Latin America and the Caribbean, "Social Panorama of Latin America 2007," November 2007, p. 11.

³ 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.

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.

Figure 1. Map of Paraguay



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

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

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.

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.⁴

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

⁴ Brun, p. 576.

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 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.⁵ 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.⁶ 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 Election

Lead-up to the Election. Initially, President Duarte sought to overturn the constitutional ban on consecutive re-election so that he could run in the April 20, 2008, presidential election. The opposition strongly contested the President's move, however, and he abandoned his re-election efforts.

There were three major candidates in the presidential race: former minister of education Blanca Ovelar of the long-ruling Colorado Party; Fernando Lugo, the former Roman Catholic Bishop of an impoverished rural diocese, running on an electoral coalition known as the Patriotic Alliance for Change (APC); and former military commander Lino Oviedo, the leader of a failed 1996 coup who was released from prison in early September 2007, running as a candidate of party that he founded, the National Union of Ethical Citizens (UNACE).

President Duarte supported Ovelar in the fiercely contested Colorado Party's primary elections in December 2007 against former Vice President Luis Castiglioni, a contest that caused deep divisions within the party. After an outbreak of yellow fever in Paraguay, which highlighted the government's inability to attack endemic poverty and health issues, Ovelar's position in the race was seriously weakened, but received a boost, however, when the Colorado Party's well-oiled electoral machinery supported her candidacy and she appeared to gain the reluctant support of some who

⁵ Transparency International, *Corruptions Perceptions Index 2006*.

⁶ "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.

had supported Luis Castiglioni in the primary. Ovelar received strong support from the Progressive Colorado Movement, and she maintained that her election as the first woman president would be a radical step for Paraguay that would bring real change to the country.⁷ Ovelar made combating corruption a central campaign theme, and vowed to create an independent judiciary.⁸

Lino Oviedo, who returned to Paraguay in 2004 to serve his 10-year prison sentence, was granted conditional release in September 2007, and indicated his desire to be a presidential candidate if court rulings permitted him. In a controversial November 2007 ruling, the Supreme Court absolved Oviedo of plotting a coup to oust then-President Juan Carlos Wasmosy in 1996, and also annulled any other pending charges against him by the military tribunal that was set up by Wasmosy. Some observers believed that Oviedo's release from prison, followed by these subsequent court decisions, were part of a pact between President Duarte and Oviedo to split the opposition vote in the elections and improve the Colorado Party's chances of retaining power. Oviedo is the founder and leader of UNACE, a political party that he ran from prison. In the presidential campaign, he was viewed as a populist and appealed to the same rural poor constituency that has supported Lugo.

From February through the election in April 2008, most polls showed Fernando Lugo as the frontrunner, although support for his candidacy decreased gradually. He was endorsed by several left-wing labor unions and social organizations and parties, and most significantly by the conservative Authentic Radical Liberal Party (PLRA), Paraguay's main opposition party. In the aftermath of Oviedo's release, Lugo announced the new APC electoral coalition, which included the PLRA and seven smaller parties.⁹ PLRA member Federico Franco became Lugo's vice-presidential running mate.

In the campaign, Lugo's political discourse emphasized empowering the poor, agrarian reform, health reform, and putting an end to endemic corruption, which he views as emanating from decades of Colorado Party dominance. Lugo also stated that he was open to private capital and a consensus-based development model.¹⁰ As a cornerstone of his candidacy, he also pushed for renegotiating the Itaipú and Yacyretá hydroelectric dam treaties with Brazil and Argentina and wants to raise the price of Paraguay's hydro-energy supplies to these countries. Some of Lugo's opponents accused him of maintaining close ties to Venezuelan President Hugo Chávez, a charge that Lugo has denied. These accusations resurfaced in 2007 when

⁷ Joel Fyke, "Elections in Paraguay: Change in the Air," Washington Office on Latin America, April 17, 2008.

⁸ "Paraguay Elections: Candidates Promise Change as Election Looms," *Latin American Brazil & Southern Cone Report*, April 2008.

⁹ "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.

¹⁰ "Paraguayan Former Bishop Aims to End 60 Year One-Party Rule", *Agence France-Presse*, September 18, 2007.

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.¹¹

Just before the election, it appeared that a high turnout could favor Lugo, although only a few percentage points separated the three major candidates. A poll from April 13, which assumed a turnout of 65%, showed Lugo with 34.5% support, followed by Ovelar with 28.9% and Oviedo with 28.5%. In contrast, a far lower voter turnout was thought to likely favor Ovelar over Lugo, with Oviedo once again in third place.¹² In the lead up to election day, some concerns about potential electoral fraud were voiced by the opposition. They maintained that there the electoral registry had not been comprehensively updated in years, and that the electoral tribunal was dominated by the ruling Colorados. Lugo was reported to have said on April 17 that only electoral fraud could defeat him in the election.¹³

Lugo's Victory. Despite concerns about potential fraud, Paraguay held successful free and fair elections on April 20, 2008, in which Fernando Lugo won with 41% of the vote followed by Blanca Ovelar with 31% and Lino Oviedo with 22%. International observation teams from the Organization of American States (OAS) and the U.S.-based International Foundation for Electoral Systems (IFES) praised the successful conduct of the elections. Both groups characterized the election as historic, with the OAS maintaining that "in spite of differences, political parties and movements achieved a fundamental consensus on the rules of the game, which as in the rest of Latin America, constitutes the essential minimum for the construction of democracy."¹⁴

The election indeed was historic, and will end more than 60 years of Colorado Party rule when Lugo is inaugurated on August 15, 2008. Paraguay's Electoral Tribunal was lauded for the quick announcement of the results, and President Duarte was praised for promising a peaceful transfer of power. (Duarte subsequently announced that he would step down as President in June, two months early, in order to assume a Senate seat that he won in the election; he will be succeeded by Vice President Francisco Oviedo.) As part of his platform, Lugo, formerly known in Paraguay as the "bishop of the poor," pledged to fight corruption, to distribute resources and lands more equitably, to reduce poverty, and to negotiate the terms of hydro energy agreements with Brazil and Argentina.¹⁵

¹¹ 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.

¹² "Ovelar Gains on Lugo in Paraguay," *LatinNews Daily*, April 14, 2008.

¹³ "Paraguay Goes to the Polls," *LatinNews Daily*, April 18, 2008.

¹⁴ OAS, "El Secretario General de la OEA Felicita Masiva y Tranquila Participación de Paraguayos en Las Elecciones Generales," April 21, 2008; IFES, "IFES Congratulates Paraguayans on Historic and Genuine Democratic Elections," Press Release, April 21, 2008.

¹⁵ Jack Chang, "Paraguay's New Leader Refuses to be Labeled," *Miami Herald*, April 22, 2008.

While triumphant at the polls, President-elect Lugo will face tough challenges when he takes office in August. Most significantly, his ability to govern effectively could be affected by his coalition's lack of a majority in Paraguay's Congress. At this juncture, it is unclear what the final party makeup will be, but no party or bloc has a majority in either house of Congress, so that Lugo's Patriotic Alliance for Change (APC) will have to work with other parties in order to approve legislation. Oviedo's UNACE party could play a pivotal role in the Congress by aligning with either the APC or the Colorados. Lugo will also have to contend with satisfying competing interests within the APC coalition; the conservative PLRA, the party of Vice-President elect Federico Franco, holds the largest bloc of APC seats in Congress. A split within the Colorado Party, between those who supported Ovelar and those who supported Castiglioni, could bode well for Lugo's ability to secure a working coalition in Congress.

Preliminary results indicate that in the 45-member Senate, the Colorados (National Republican Association or ANR) will have 15 seats; Lugo's APC coalition will have 17 seats, including the largest bloc of 15 seats for the PLRA and 2 for smaller parties in the coalition – the Party for a Country of Solidarity (PPS) and the Movement for Popular Equality (MPT or Tekojoja); Lino Oviedo's UNACE party will have 10 seats; and the Dear Fatherland Party (PPQ) will have 3 seats. In the 80-member Chamber of Deputies, the Colorados reportedly will have 31 seats; Lugo's APC coalition will have 31 seats, including the PLRA with 30 seats and the Democratic Progressive Party (PDP) with 1 seat; UNACE will have 14; and the PPQ will have 4 seats.¹⁶

Another potential difficulty for President Lugo is his ability to deal with entrenched government bureaucracy that essentially has been controlled by the long-ruling Colorado Party. Some observers have suggested that the party could use its control of the bureaucracy to weaken the President and to keep him from fulfilling his campaign promises.¹⁷ Other observers, however, stress that Lugo's victory is a chance to further strengthen Paraguay's democratic transition and break its link with the authoritarian past of the Stroessner dictatorship.¹⁸

Most analysts expect that Lugo will govern as a moderate. The largest party in Lugo's electoral coalition, the PLRA, is a well-established conservative party. Lugo has described his political views as somewhere between those of Presidents Chávez (Venezuela) and Morales (Bolivia) and the more moderate stances of Presidents Lula (Brazil) and Bachelet (Chile).¹⁹ While Venezuela's Hugo Chávez and other leftist

¹⁶ "Paraguayan Congressional Results Announced," *LatinNews Daily*, May 6, 2008; "Lugo's First Big Challenge is to Build a Congressional Powerbase in Paraguay," *Latin American Weekly Report*, May 1, 2008.

¹⁷ Andres Oppenheimer, "Top Paraguay Threat: Nation May Crumble," *Miami Herald*, April 24, 2008

¹⁸ Alexei Barrionuevo, "An Outsider's Victory Allows Jubilant Paraguayans to Look Past Dictatorship," *New York Times*, April 22, 2008.

¹⁹ Patrick J. McDonnell and Paul Richter, "Paraguay Moves a Bit to the Left," *Los Angeles* (continued...)

leaders in the region such as Nicaragua's Daniel Ortega and Ecuador's Rafael Correa welcomed Lugo's victory, most observers contend that Lugo will have to govern more moderately than these leaders since the electoral alliance that brought him to power is dominated by a center-right party.²⁰ Lugo himself has said that "I am not of the left, nor of the right. I'm in the middle, a candidate sought by many."²¹

In terms of foreign policy, Lugo, in a post-election interview, asserted that he wants to maintain good relations with all countries, including the United States and Venezuela.²² During the electoral campaign, Lugo refrained from criticizing the United States, and also was careful not to criticize or praise Venezuelan President Hugo Chávez. After the elections, U.S. Ambassador to Paraguay James Cason congratulated Lugo and the APC on their victory and expressed a commitment to work and strengthen bilateral relations. The U.S. Embassy in Asunción also maintained that Paraguay could be accredited with \$500 million to support health, education, and infrastructure as part of the Millennium Challenge Account.²³ Also in the aftermath of Lugo's victory, Brazilian President Lula da Silva maintained that he might be willing to negotiate a new price for the electricity that Paraguay exports to Brazil from Itaipú hydro-electric plant. Lugo had made the renegotiation of the terms of the Itaipú treaty with Brazil a cornerstone of his campaign. Most Paraguayans believe that Brazil pays far too little for the electricity.²⁴

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 6.4% in 2007, fueled by soybean production.²⁵ Paraguay lacks significant mineral and petroleum resources, but possesses vast hydroelectric resources, including the world's largest 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 \$700 million in 2007.

¹⁹ (...continued)

Times, April 22, 2008.

²⁰ Jack Chang, "Paraguay's New Leader Refuses to be Labeled," *Miami Herald*, April 22, 2008.

²¹ Bill Cormier, "Paraguayan Ex-Bishop Aims for President," *Associated Press Newswires*, April 18, 2008.

²² "Paraguay: President-elect Lugo Plans to Maintain Relations 'With All Countries,'" Open Source Center (Asunción Channel 13 Televisión) May 2, 2008.

²³ U.S. Embassy, Asunción, Paraguay, "U.S. Embassy Offers President-elect Fernando Lugo its Strong Support for a Successful Administration," April 25, 2008; and "U.S. Embassy Congratulates the Paraguayan People on Their Participation in the 2008 General Elections," April 21, 2008.

²⁴ "Brazil-Paraguay: Lula Signals with Itaipú," *Latin American Weekly Report*, May 1, 2008.

²⁵ "Paraguay Country Report," Economist Intelligence Unit, April 2008.

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.²⁶ 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).²⁷ 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.²⁸

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.²⁹ 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. 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. As noted above, after the April 2008 election, U.S. Ambassador to Paraguay James Cason congratulated Lugo and the APC on their victory and expressed a commitment to work and strengthen bilateral relations. U.S. imports from Paraguay totaled about \$60 million in 2007 while in the same year, the value of U.S. exports to Paraguay was over \$1.2 billion,

²⁶ Michael Thomas Derham, "Against All Odds," *LatinFinance*, March 1, 2005.

²⁷ Mercosur has the goal of implementing a common market among its members, but to date only a limited customs union has been achieved.

²⁸ Luis Carlos Nino, "Inflation Increases Slightly as Paraguay's Trade Deficit Widens," *Global Insight Analysis*, June 4, 2007.

²⁹ 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.

according to Department of Commerce trade statistics. Machinery and electrical machinery account for the lion's share of U.S. exports to Paraguay.

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. In December 2007, the MOU was revised and extended through 2009.

U.S. Aid

The United States provided about \$12.5 million in aid to Paraguay in FY2007 and an estimated \$11.6 million in FY2008. For FY2009, the Administration has requested \$11.8 million in assistance, with \$2.7 million to support Child Survival and Health, \$5.1 million in Development Assistance, \$350,000 in International Military Education and Training (IMET), \$300,000 in International Narcotics Control and Law Enforcement assistance, and \$3.4 million for the continuation of a Peace Corps program in the country, with an estimated 183 volunteers. In past years, Paraguay had faced restrictions in terms of receiving Economic Support Funds (ESF) and 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.³⁰

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 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

³⁰ For background, see CRS Report RL33337, *Article 98 Agreements and Sanctions on U.S. Foreign Aid to Latin America*, by Clare M. Ribando.

laundering and corruption. The United States assisted in the completion of a helicopter pad and support facilities in order to increase SENAD's capacity to disrupt trafficking networks. According to the State Department's March 2008 *International Narcotics Control Strategy Report*, SENAD made record seizures in marijuana and cocaine, disrupted transnational criminal networks in cooperation with international law enforcement agencies, and arrested several high-profile drug 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.³¹ 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.³²

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 2007 (issued April 30, 2008), there is no corroborated information that these or other Islamic extremist groups have an operational presence in the TBA.

The State Department's 2007 terrorism report stated although Paraguay was generally cooperative on counterterrorism efforts, its judicial system remained severely hampered by a lack of strong anti-money-laundering and counterterrorism legislation. In December 2007, Paraguay's Congress approved anti-money laundering legislation as part of an overall on the country's penal code, which will improve the government's ability to obstruct and prosecute money laundering and terrorist financing, especially in Ciudad del Este. However, according to the

³¹ U.S. Department of State, *International Narcotics Control Strategy Reports: Volume II Money Laundering and Financial Crimes*, March 2007.

³² 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.

terrorism report, counterterrorism legislation that has been introduced, but not yet approved, will be critical to keep Paraguay current with its international obligations.

The terrorism report also maintained that Paraguay did not exercise effective immigration or customs control on its borders, and efforts to address illicit activity in the TBA were uneven because of a lack of resources, and corruption within customs, police, and the judiciary. The government's Secretariat for the Prevention of Money Laundering reportedly improved its progress during the second half of 2007.

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



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