Political economy of policymaking in Paraguay

Robert Andrew Nickson, University of Birmingham

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Chapter 13

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Andrew Nickson

Introduction

The main objective of this chapter is to analyze the public policymaking process in Paraguay, particularly with regard to the formulation and implementation of policies that affect the generation of remunerative employment. Concretely, the chapter addresses how the broad institutional (i.e., political, administrative and legal) environment influences—both negatively and positively—the potential for formulating and implementing a medium-term employment strategy for poverty reduction in Paraguay. The main policymaking focus of the employment strategy will be on the private sector. However, the potential contribution of an employment strategy for the public sector itself towards poverty reduction is also considered.

The formulation and implementation of public policies in general—and an employment strategy in this particular case—cannot be understood simply as the product of technical decisions taken by specialist advisors (individuals) or as collective decisions taken by one or several line ministries (organizations). Rather, policy results from a complex interplay between these individual and organizational pressures and pressures emanating from the wider institutional environment. It is during policy implementation that conflicts between policies and the interest of stakeholders operating in the wider institutional environment are most likely to become apparent. As a consequence of any such “lack of fit” between policies and institutions,
reforms may not achieve their intended goals and may instead have unintended—and sometimes detrimental—outcomes.

This chapter presents a brief historical introduction to the current policy setting, followed by a look at the major stakeholders that influence public policymaking, and at the contemporary policymaking process, with emphasis on the structure of the state, the political system, cohesion in policymaking and the capacity for strategic planning. It then analyzes the policymaking reform process in three areas—fiscal management, anti-corruption and civil service reform—and relates that analysis to policy in six areas crucial to the formulation of a successful employment strategy—fiscal, monetary, financial, exchange rate, small and medium enterprise (SME) including small agricultural producers, human capital formation, and labor.

The Historical Context

Despite the promulgation of a new democratic constitution in 1992 and the introduction of free elections, the legacy of the thirty-five year dictatorship of President Alfredo Stroessner (1954-89) has weighed heavily against efforts to improve governance. Under a succession of venal and inept presidencies—Andrés Rodríguez (1989-93), Juan Carlos Wasmosy (1993-98) and Luis González Macchi (1999-2003)—corruption escalated, earning Paraguay the reputation of 129th place out of 133 countries on the 2003 Corruption Perception Index of Transparency International. Powerful elite groups that had emerged during the dictatorship jostled to retain their power in the new democratic environment, often through buying congressional votes. As ill-gotten fortunes were rapidly amassed through the narcotics trade, counterfeiting, and the flagrant misuse of foreign aid inflows, the indices of inequality of income worsened—Paraguay becoming the third most unequal country in Latin America by the end of the decade, after Brazil and Guatemala (according to the World Bank). Meanwhile economic performance has been weak, especially over 1998 to 2002, when GDP per head contracted at an annual average of 1.2 percent. Once a “haven of peace and tranquility” under Stroessner, violent crime emerged from the mid-1990s as open unemployment doubled from 5.7 percent in 1998 to 10.8 percent in 2002.

Since assuming the presidency in August 2003, the Duarte Frutos government has surprised many observers by making a serious effort to address some of the fundamental governance problems of the country neglected by his predecessors. The government has correctly identified the fight against corruption as the central governance challenge of
Paraguay. This is the crucial underlying element that links together improvements in tax administration, government procurement, and the judicial system. Failure to quickly produce an economic upturn and better employment prospects remains a challenge to the administration.

The current context is one of “incipient reform.” The long 14-year delay between the start of the transition to political democracy in 1989 and the initiation of serious socio-economic structural reforms in 2003 is a striking testimony to the resilience and enduring power of vested interests that emerged during the 34 years of the Stroessner regime. The discussion here necessarily bears in mind this context of “incipient reform.”

**Stakeholder Analysis and the Drivers of Change**

The most organized and influential stakeholders operating in the institutional environment of Paraguay, which therefore influence the formulation of public policymaking in general and the development of an employment strategy in particular, are: the Colorado Party, importers, local businessmen, cattle-ranchers, soybean farmers, media conglomerates, public sector trade unions, and small farmer organizations. We focus on the attitude and likely responses of these various stakeholders to the two major advances of the state reform process to date—improved macro-economic management and anti-corruption measures. Note that there is considerable overlap in membership among the different stakeholders. For example, a leading member of the Colorado Party may at the same time be a powerful businessman. However, in one important area there is little overlap: most exporters are not importers (except of inputs for their production), and vice-versa. Needless to say, it is important to make a distinction between public pronouncements by stakeholders, which may be broadly supportive of state reform, and the actions, or lack of actions of stakeholders, which may better reflect their real interests.

**Colorado Party**—Founded in 1887, the Colorado Party—the Asociación Nacional Republicana (ANR)—is one of the oldest political parties in Latin America. Its unbroken period in power since 13 January 1947 is the longest of any political party in the world today. Its 392 seccionales (party branches) give it a genuinely national coverage extending down to the neighborhood level in Asuncion and to the sub-municipal level in rural areas. Its estimated membership in June, 2004, was 1,585,000. The party also fulfills a social welfare role (e.g., medical assistance, vocational training, student scholarships) although this has diminished somewhat over the past decade. There is intense
rivalry for membership of its 35-member ruling body, the Junta de Gobierno, and for inclusion in the party lists for elections to Congress and Departmental governments. It is generally assumed that the Colorado Party has much to lose from and will thus necessarily be hostile to reform of the state. Given a patronage system that helps to bind the party together through provision of public sector jobs, the introduction of a merit-based system for the selection, promotion and evaluation of public sector employees will have a cost, though since only a small share of Colorado Party members or voters have patronage public sector jobs it earns support in other ways as well like its “social welfare” function.

Importers. Paraguay has one of the most open economies in Latin America and the “triangular trade”—under which goods are imported legally to Paraguay (mainly from East Asia) for legal or illegal re-export (mainly to Brazil and Argentina)—has played a significant role in the domestic economy for more than four decades. Those importers involved in the legal aspects of the triangular re-export trade are represented by the Centro de Importadores, founded in 1939, and their views, particularly on import duties and exchange rate policy, regularly expressed in the media, have been broadly supportive of the state reform process because the modernization of the customs will significantly reduce their transaction costs. However, the interests of many powerful importers involved in illegal trade practices, including many members of the Centro de Importadores itself, will be negatively affected by the reforms which will tighten controls on the massive under-invoicing of legal imports that has been the norm for decades and discourage illegal re-exports to Mercosur countries, through greater cross-border collaboration.

The relatively underdeveloped local private business sector has a long history of close ties with the state, which were greatly strengthened under the Stroessner regime, especially during the construction of the Itaipú dam project. Under the “estado contratista” the growth of individual companies was quite dependent upon highly personalized and corrupt political relationships with senior figures in the Stroessner regime. The fortune of virtually every millionaire businessman in Paraguay was developed through illicit contracts with the state in two main areas—the awarding of state contracts (e.g. road construction) and the awarding of state concessions (e.g. state lottery). The personalized and uncompetitive nature of contract awarding has often been matched by highly traditional styles of management, a lack of entrepreneurial spirit and a low re-investment of profits which,

1 Importers involved in legal trade mask their involvement in the illegal trade by the use of “front” companies.
2 The only exceptions are a number of owners of retail supermarkets.
instead, were dissipated on consumption and overseas real estate investment, especially in Brazilian and Uruguayan coastal resorts. Once the major dam construction period ended in 1980, the serious deficiencies of the private sector became apparent and many companies collapsed as the economy went into a prolonged recession. But a major expression of the institutional culture is the strongly expressed view that the state should bail out the private sector at times of economic difficulty.

Local Businesses. — Historically, industrialists are represented by the Unión Industrial Paraguaya (UIP), created in 1936. A wider grouping, the Federación de la Producción, la Industria y el Comercio (FEPRINCO), established in 1949, that also includes agro-exporters and importers, has been more a powerful voice representing the views of business interests. Both organizations supported the Stroessner regime and began to distance themselves only when economic difficulties emerged from the mid-1980s on. The fact that FEPRINCO represents business groups with very different economic interests has reduced its lobbying to a limited number of common concerns such as “state profligacy” and “corruption.” A recent grouping, the Asociación de Empresarios Cristianos (ADEC), created in 1981, has a conscious concern for promoting ethical behavior and probity in business activity. The very existence of ADEC reflects the prevailing view that most leading businessmen are tainted with corruption. Pedro Fadul, the leader of Partido Patria Querida (PPQ), who came a close third in the 2003 presidential election, is a founder member of ADEC.

Their differing situations suggest different likely responses from three particular subgroups of local business. Those businesses closely involved in illicit links with the state are potential major losers from transparency and probity in the awarding of state contracts and are thus likely to subvert its implementation. Those industrialists, represented by the UIP, involved in the production of goods for the domestic market often face stiff competition from imports, whether legal imports or contraband, and are likely to welcome tighter controls by the Customs Department on both import tax evasion through under-invoicing and on contraband. Finally, those retail, wholesale and service sector businesses whose success is dependent on the overall growth in the domestic economy, and particularly the inflow of foreign direct investment, should be broadly supportive of the reform process. Consistent with the above, the UIP, representing mainly Paraguayan-owned companies producing for the domestic market, has generally been more supportive of the reforms than has FEPRINCO. But large sections of the media, reflecting pressure from powerful business interests with illicit links to the state, have taken a very hostile attitude.
Cattle-Ranchers. Cattle-ranchers have long been a powerful stakeholder group, as major beneficiaries of Paraguay’s unequal land tenure system. They are organized through the Asociación Rural del Paraguay (ARP), founded in 1938 in response to the threat of expropriation by the short-lived reformist Febrerista government. The vast majority of high-income families resident in Asuncion own an estancia (cattle ranch) so there is considerable overlap between cattle-ranchers and other stakeholders, including the Colorado Party, importers and industrialists. Cattle-ranchers are regarded as broadly hostile to the state reform process, as evidenced by statements from the Asociación Rural del Paraguay (ARP). For generations, they have become accustomed to a high rate of return on capital as a result of non-compliance with the limited rural land taxation and the non-payment of minimum wage and social benefits to their workers. The introduction of measures in the state reform such as a new land tax and personal income taxation are perceived as negative.

Soybean Farmers. — Soybean farmers emerged as a powerful stakeholder group during the 1990s. There has been a dramatic increase in the area under soybean cultivation, with Brazilian immigrant farmers consolidating their holdings by buying up land from smaller, often impoverished Paraguayan farmers. Soybean farmers are represented by the powerful Cámara Paraguaya de Exportadores de Cereales y Oleaginosas (CAPECO). Most of its members are medium-scale family farmers, often second-generation immigrants from Brazil, of European extraction. It is understood that the large transnational soybean companies that operate in Paraguay are not CAPECO members. Soybean farmers are broadly supportive of the state reform process, especially aspects relating to improved formalization of the economy, particularly with regard to land-titling, combating corruption, and improved personal security. However, they were the main backers of a successful campaign organized in late 2003 by the Coordinadora Agrícola de Paraguay (CAP) in opposition to government plans to impose VAT on unprocessed agricultural products. This campaign involved a threatened “tractorazo,” the blocking of major highways by thousands of agricultural vehicles, a show of strength that has proved successful as a bargaining ploy in the past.

Media Conglomerates. — The major channel of open opposition to the state reform process has been the media conglomerates and their various forms of diffusion. Media concentration is high in Paraguay, with seven groupings dominating the newspaper industry, television, and to a lesser extent, radio. Six of the seven groupings are controlled by families whose fortunes were made through close links with the
Stroessner regime (Nickson, 2006, Table 1) and who are among the richest individuals in Paraguay. All four major daily newspapers have been either skeptical or outright hostile to the state reform program in general, at the same time expressing the urgent need for government action to create employment. Their hostility to the reform process is generally explained in terms of the potential financial losses the owners would suffer from the introduction of personal income taxation and from less lax company taxation. Given their wide-ranging business involvement, the interests of these media owners overlap with each of the other business groups mentioned here; a main feature they have in common is their wealth, which would lead one to expect that they would speak with a common voice in opposition to taxes but somewhat less so on other issues of public policy.

Public Sector Trade Unions. Although trade union membership is very low as a proportion of the total labor force, it is high in central government ministries and state companies. The credibility of the national trade union leadership was severely dented from the mid-1990s by the revelation of widespread corruption at the highest level. Subsequently, a more militant leadership has emerged under the banner of the Central Sindical de Trabajadores del Estado (CESITEP), a broad grouping of trade unions spanning the public sector, among which membership and activism are particularly strong in the state electricity company (ANDE) and among teachers. Not surprisingly, these unions are extremely hostile to state reform, in particular reform of the civil service law and privatization of state companies. They have also led opposition to the 2004 fiscal reform law. CESITEP has organized many appeals to the Supreme Court against the civil service law on the grounds that it is unconstitutional, and has effectively halted its implementation.

Small Farmer Organizations. After suffering severe repression during the Stroessner regime, peasant organizations have mushroomed since the mid-1990s. Historically they have represented the interests of small agricultural producers, especially cotton farmers with less than 20 hectares. In recent years, they have given voice also to the growing plight of landless farm households, a key contributory factor to both rural poverty and urban crime. A land reform law was passed in 2001 after lying dormant in Congress for more than a decade but still lacked enabling legislation at time of writing, due to the opposition of politically powerful landowners. Almost all members of Congress own an estancia. Meanwhile, and in the absence of land reform, the number of invasions of large landholdings by groups of landless farmers has escalated since the mid-1990s. In more recent years, some have become
infiltrated by criminal elements intent on illegal logging. As landowners hire private security guards and special police units to protect their land, this has led to a spiraling increase in violent shoot-outs and the assassination of peasant leaders. The peasant organizations are now expressing open hostility towards Brazilian soybean farmers, accusing them of poisoning peasant communities through the uncontrolled use of pesticides and aerial crop spraying, burning their crops and calling for their expulsion from the country. Three main organizations represent small farmers—the Federación Nacional Campesina (FNC), the Mesa Co-ordinadora Nacional de Organizaciones Campesinas (MCNOC) and the Organización Nacional Campesina (ONAC). Since 1994 they have carried out an annual march through Asuncion in pursuit of their main demand for land reform. The lack of a single body representing small farmers has more to do with personal conflicts among its leadership than ideological differences. The FNC is the largest and organizationally most solid of the three and has developed a detailed negotiating stance based on the need to process agricultural products. The two main small farmer organizations, FNC and MCNOC, have been vociferous in their opposition to private sector involvement in public services and in defense of the existing institutional arrangement for provision of water supply, electricity and telecom. In June 2002 they provided the backbone of the Congreso Democrático del Pueblo (CDP), which organized a large-scale march on Asuncion that forced the government to make a volte-face on the privatization of Copaco, the state telecom company. Ironically, Paraguay has one of the lowest landline telecom coverage in Latin America and rural families suffer most from this low coverage.

Drivers for Change

The domestic “drivers for change” in Paraguay are still relatively weak, and are confined to a small group of advisors and senior administrators in the executive branch of government together with the opposition Partido Patria Querida. There remains widespread opposition to reform in (i) the middle and lower ranks of the public administration; (ii) the ruling Colorado Party, including the Junta de Gobierno and its representatives in Congress; and (iii) the main opposition parties, Partido Liberal Radical Auténtico (PLRA), the Partido País Solidario (PPS), and the Partido Encuentro Nacional (PEN). Much of the opposition to the reform program, especially by “progressive sectors” of the PLRA as well the PPS and PEN, is motivated by political opportunism rather than ideological disagreement. For historical reasons, the fact that a Colorado Party
government is spearheading the much-awaited reform program generates intense hostility and resentment, irrespective of the merits of the program itself. During the repressive Stroessner regime, with the support of the police and military, the Colorado Party meted out extremely harsh treatment to its political opponents. This bitter legacy has engendered an enduring and visceral hostility towards the Party by much of the political opposition. Ironically, this hostility is especially pronounced among urban “progressive” intellectuals—precisely the sort of “opinion formers” who, in a different political context, would be “natural allies” of the executive reform program.

While the balance between the forces for reform and those against it may appear one-sided in favor of the latter, it is worth noting that a number of the economic success stories of recent decades elsewhere in the world have involved very similar constellations of forces: a president or prime minister with considerable power and independence from the main vested interests together with a strong group of technocrats. When these actors both think and act in the broader national interest and are able to implement enough initial policy reforms to set the economy on a fast growth path, that growth itself weakens much of the opposition to reform since with a rapidly expanding pie it becomes less important to fight for specific pieces of it. Workers previously legitimately worried about losing their positions are much less so when the labor market is tight. Business groups are less averse to paying taxes when their incomes are rising quickly and they see the taxes being put to good use from their point of view.

The Public Policymaking Process

The State in Paraguay

The Paraguayan public sector is relatively small in size, suffers from a high level of politicization and endemic corruption and, not surprisingly, operates at an extremely low level of efficiency and effectiveness. The origin of each of these features can be traced back to the role played by the public sector during most of the twentieth century, features that were greatly strengthened during the Stroessner regime (1954-89). Its small size—the share of central government in GDP is around 14 percent, one of the lowest in Latin America—is hardly surprising given the minimal tax base of a weakly-industrialized

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3 Much of the following section derives from Nickson and Lambert (2002).
country. Between 1989 and 2000, however, and contrary to the overall trend in Latin America, central government employment grew by 34 percent, mainly in the areas of health and education as mandated by the 1992 Constitution (Nickson, 2006, 14).

Extreme politicization, inefficiency and corruption are a legacy of the Stroessner era, when political service was routinely rewarded with employment in the public sector, personal loyalty counted for more than performance, and the state became a repository of Colorado support. In 1998 Paraguay was rated by Transparency International as the most corrupt country in the world bar Cameroon and it continues to perform poorly in the annual Corruption Perception Index (CPI) of this organization. Trade-related contraband activities stand out as perhaps the most pervasive form of corruption. From its origins during the Stroessner period in alcohol beverages, cigarettes and electronic goods, this trade diversified in the 1990s to include stolen vehicles, armaments, as well as drug-trafficking, and associated money-laundering. The growth of state enterprises during the later years of the Stroessner period was accompanied by private appropriation of both legal and illegal benefits through rampant corruption. This legacy would have a strong impact on citizen attitudes towards privatization of these state companies in the post-Stroessner period (Borda, 1993).

The above-mentioned structural features of the public sector have combined to produce the essential distinguishing feature of Paraguayan public administration, its high degree of informality and lack of institutionalization. In practice, the precise responsibilities of most individual ministries remain undefined, leading to duplication of effort in some areas and a vacuum in others. The prevailing informality manifests itself in many ways, including the absence of filing systems and proper recordkeeping of meetings, minimal internal expenditure control mechanisms, and virtual absence of policy analysis and medium-term planning. The lack of institutionalization in the public administration is evidenced by an extremely high rotation of senior and middle-level staff; the absence of a transparent system of recruitment; promotion based solely on political and personal loyalty; and the absence of staff performance evaluation. There is an almost complete disjoint between salary levels and job classification, the former being determined largely by personal and political loyalties. These features help to explain the poor delivery of public services, both in terms of quality and coverage.

Even by Latin American standards Paraguay’s political parties are highly fragmented—raven by factions, which are not programmatic or ideological in character but which coalesce and dissolve around issues of personal and group loyalty in pursuit of rents from the capture of
Lack of Cohesion in Public Policymaking

The low level of cohesion in the formulation and implementation of public policy in Paraguay may be attributed in part to the country’s failure—unlike most other Latin American countries—to undergo a strong period of import-substituting industrialization, thereby prolonging the existence of a “weak state” model consistent with the structural features of a primary producing economy. Although the long period of authoritarian rule from 1954-89 gave the impression of greater coherence in policymaking, this was deceptive and reflected the centralization of power rather than effective processes of decision-making. When the edifice of authoritarianism crumbled in 1989, the appearance of cohesion quickly disappeared in the absence of clear norms, procedures and traditions of consultation in the formulation stage. Lack of cohesion was in fact exacerbated by a series of legislative reforms that have encouraged a highly adversarial relationship between the executive and legislative. Reacting against the “strong executive” model that characterized the Stroessner dictatorship, the democratic constitution of 1992 sought to redress the balance by granting the legislature strong powers of control over the executive.
Losing Ground in the Employment Challenge

Foremost among these reforms was the prohibition on the executive to decree either a State of Emergency or to dissolve Congress. Other structural features of the new executive-legislative relationship that have proved inimical to coherent policymaking include the limitations on the executive’s capacity to deal with cases of corruption in the executive itself; the lack of limitations on Congressional changes to, in particular increases in, the budget; the prohibition on the immediate reelection of the president, which acts as a structural impediment to the executive’s pursuing any longer run approach to policymaking and an incentive for the party to distance itself from the president near the end of his/her term; and the contradictory procedures for emergency replacement of the president and vice-president.

Several features of the current electoral legislation also act as a hindrance to effective and coherent policymaking, namely the simple majority system for electing the president, who can thus be elected with less than 50 percent of the votes; the closed party list system, which decreases both the representativeness and accountability of the political system; the absence of limitations on private financing of political parties, which permits large donations by wealthy individuals in exchange for promises to protect their interests or for places on the party list, thus more generally turning the country into a plutocracy; and the lack of transparency in regard to declaration of assets by politicians in spite of repeated efforts to introduce relevant legislation, whose failure in the face of resistance from politicians tends to confirm the widely held view that politicians seek office with the prime intention of obtaining financial benefits through illegal rent-seeking activities. Intense factionalism has co-existed with a culture of strong support by members of parliament to colleagues accused of corruption and misbehavior, even in the face of overwhelming evidence.

State Capacity for Strategic Planning

For the first time in recent history, a government of Paraguay has had a serious project for reform of the state and, thanks to this, the wider issue of the formulation of a strategy for national development and for employment generation has also been under consideration. With the exception of the highly regarded National Statistical Office (Dirección General de Estadística, Encuestas y Censos—DGEEC) (Nickson, 2006, 23), the organizational framework for formulating these strategies will
have to be constructed virtually from zero. In the past there was no strategic thinking within government at all.  

The lack of strategic direction in policymaking is mainly the result of the legacy of a predatory state. In the absence of overall strategic thinking at Cabinet level, each ministry “does its own thing” and views its relationship with other ministries as basically antagonistic. There is minimal cross-ministerial coordination with each ministry jealously guarding its autonomy and operating as a separate fiefdom. Except under donor pressure, there is a lack of a “culture of evaluation” of the impact of government expenditure with reporting systems based almost exclusively on input data rather than output and outcome data. Because of these institutional features, there is a virtual absence of policy analysis and medium-term strategic planning, both of which are crucial to the success of an employment strategy. Instead, the prevailing improvisation means that decision-making is “re-active” rather than “pro-active,” in the form of a series of “knee-jerk” responses to outside events, taken within a strategic vacuum.

The negative impact of these features of the institutional environment is felt, for example, as the government makes the first efforts to coordinate public investment and expenditure targeted at poverty reduction. The public institutions responsible in each case are the planning ministry, Secretaría Técnica de Planificación (STP) and the social action ministry, Secretaría de Acción Social (SAS). Although both report directly to the presidential office, in practice they have had great difficulty in introducing a strategic approach through coordinated actions of the individual line ministries. Resistance from vested interests in the key ministries of agriculture, education and health has so far undermined efforts by the SAS to coordinate a multi-sectoral approach to tackling poverty.

The Public Policy Reform Process

We now examine the progress of reforms made by the present government during its first year in office in three areas of public

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4 Though many good studies were prepared on a wide range of policy issues, their recommendations were hardly ever implemented because of the absence of such a strategic vision within government. The most significant example of this was the complete failure, despite detailed studies carried out by UNIDO, to develop a strategy for energy-intensive industrialisation in the 1980s as the two major binational hydroelectric projects, Itaipú and Yacyretá, came on stream.
policy—overall fiscal management, tackling of corruption and public administration reform. Advance has far been greater in the first two of these than in the last.

**Fiscal Management**

The incoming administration had to correct a massive fiscal imbalance inherited from its ineffectual predecessor, that of President González Macchi. By early 2003 this had led to weeks long arrears in the monthly payment of teachers and other public sector workers. The incoming finance minister, Dionisio Borda, began a major campaign to stamp out collusion between corrupt tax inspectors and taxpayers through the rotation and “freezing” of officials known to be corrupt. In a surprise move, he closed down a 250-person special unit for investigation of the country’s largest 5,000 company taxpayers. Within months, tax receipts from this sector had increased substantially because of the reduction in corruption. This and other measures led to a dramatic increase in overall fiscal revenue—by January-March 2004 tax receipts were averaging 37 percent higher in real terms than twelve months before.

At the end of 2003 the government faced the prospect of a major debt default as the first repayments became due on a US$ 400 million “jumbo” loan from Taiwan that the former president, González Macchi, had negotiated in 1999, the proceeds from which had been largely squandered. In November 2003 the government signed an IMF stand-by agreement that provided emergency bridging finance from the World Bank and the Inter-American Development Bank that enabled it to meet these heavy debt service payments. As part of this IMF agreement, the government committed itself to a major fiscal reform package. Despite the outright hostility of the PLRA, the opposition-controlled Congress finally passed the new legislation in June 2004 thanks to support from Patria Querida. The law introduced personal income taxation for high earners for the first time in Paraguay, as well as a land tax on all rural holdings above 300 hectares. In a country with a highly unequal distribution of income and rural land, these are very important advances that will gradually reduce the current over-dependence on regressive indirect taxation (VAT and import tax). According to the finance ministry, in 2005 alone the law will increase

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5 Subsequent additions to the loan brought the total to close to US$500 million.
Paraguay’s meager tax effort by 1.5 percentage points from 9.7 percent to 11.2 percent of GDP.

**Tackling Corruption**

Its various efforts to reduce corruption are an integral part of the state reform process. These include a serious effort to end Paraguay’s role as a regional center for contraband, a role that has led to growing tensions with its partners in MERCOSUR. In October 2003 Durante Frutos removed the interior minister Roberto González, following accusations of his involvement in a scandal surrounding contraband CDs. Though a decrease in exchange-rate competitiveness and stricter control by Brazilian customs both of “tourist” purchases in the Paraguayan border city of Ciudad del Este and of illegal imports have considerably reduced the re-export and contraband trade since the mid-1990s, Paraguay remains a major conduit for counterfeit and pirated goods from East Asia and this has led to growing pressure from the United States over infringements of intellectual property rights. The presence of organized crime, arms smuggling and even international Islamic militant groups, has led to calls for increased surveillance of the area around Ciudad del Este.

**Public Procurement**—Corruption through over-invoicing of supplier contracts to the public sector has been endemic in Paraguay, acting as the “cement” that binds parts of the private sector with those political forces engaging in illegal rent-seeking activities, facilitated by a complete lack of transparency or monitoring. The names of the companies awarded major contracts by the state have varied very little over the past thirty years. Reform began in mid-2003 with the establishment of an Office for Public Procurement, Dirección General de Contrataciones Públicas (DGCP), within the Ministry of Finance, following the promulgation of a new law (Law 2051 of July 2003). All 301 state institutions (including central, departmental and municipal bodies) are now required to present an annual procurement plan to the DGCP and no purchases will be allowed that fall outside such plans. The DGCP publishes the details of all suppliers’ contracts within these annual plans—from tendering, through to bidding and adjudication—on its website. The DGCP estimates that the measures introduced so far will produce a 30 percent savings in the annual US$800 million government procurement bill though such savings may not all come quickly.
Combating Endemic Company Tax Evasion – The legal department of the finance ministry, Abogacía del Estado, with a staff of 63, is responsible for monitoring company tax returns and for taking legal action against those companies suspected of tax evasion or in arrears with their taxes. Its work necessarily focuses on the 360 largest companies, which together account for the great bulk of total company tax revenues. The 17 lawyers employed by the Abogacía are paid an incentive, honorario, for their work in the form of 10 percent of the tax debts reclaimed through court actions. In the past, it has been widely suspected that many acted in collusion with private companies, condoning tax evasion in exchange for bribes. The reform process began in mid-2003 with a more equal distribution of the court actions, certificados, which had previously been granted only to a few favored lawyers. The lawyers were also given new computer equipment and clear objectives for their work. In August 2004 the Abogacía became the first public sector body in Paraguay to successfully introduce an internationally recognized quality assurance program when it was awarded an ISO 9001/2000 accreditation. The benefits in terms of tax arrears collected rose from Gs 1,642 million in 2002/03 to Gs 13,143 million in 2003/04, an increase of Gs 11,501 million (US$1.98 million). The extra administrative cost of accreditation is estimated at a very modest US$ 95,000, giving a net benefit of US$1.97 million.

The Customs Office – The custom office has for decades been regarded as one of the most corrupt branches of the public sector and a major conduit for siphoning of state revenue to powerful factions within the Colorado Party. The benefits from rent-seeking were so considerable that until very recently it has been a widely accepted practice for aspirants to work in the customs without pay for periods of more than a year. Once appointed, and with the advantage of “work experience” they soon recouped their loss of earnings through illicit activities. The key source of corrupt earnings derives from (i) gross under-invoicing of legal imports, thereby reducing the tax liabilities of importers; and (ii) enabling prohibited goods such as counterfeit CDs to enter the country. The reform of the prevailing institutional arrangement began in 2003 when a national customs body, the Dirección Nacional de Aduanas (DNA), was established. This was followed by the introduction of a new customs code in January 2005 (Law 2422). It is hoped that the increased professionalization, by granting managerial autonomy and a merit-based recruitment system, bring an end to the politicization of the DNA. The customs reform will bring major economic benefits in the form of higher tax revenues and a reduction in transaction costs for importers.
Civil Service Reform

The absence of professionalism in the public administration is a major cause of the low productivity of public expenditure, though two frequently-heard explanations for low professionalism—overstaffing and low educational levels—are not in fact very important in the Paraguayan case. Gross overstaffing is no longer prevalent in central government ministries or in state companies with “ghost workers,” though the continuing practice of the six-hour working day suggests the potential for productivity gains. Formal educational levels are surprisingly high in the public administration (Nickson, 2006, 30). The main reason for low productivity lies elsewhere, in the fact that post-holders continue to see public sector employment more as an income-producing prize rather than as a job with important obligations attached. Although both staff numbers and salaries increased considerably during the 1990s, this was not accompanied by reforms in staff recruitment and promotion. Only two ministries (education and finance) and one state agency (the National Statistical Office) show signs of administrative modernization.

In December 2000 the Senate finally approved a new civil service reform law, Law 1626, after having rejected its partial veto by the executive. The principal features of the new law are: a transparent system for selection and promotion of civil servants; the creation of a Public Service Commission; a six-month trial period, with job tenure granted only after a two-year minimum; dismissal within 30 days for staff who fail their personal evaluation twice; a maximum age of 45 for those applying for special contract posts; accelerated retirement provision for public administrators with 15 years or more of service; compulsory retirement at age 65; and an increase in the working day from six to eight hours. This final provision has the potential for considerable fiscal saving by putting an end to the widespread practice of overtime payments. But the implementation of this new law was quickly suspended after public sector trade unions made over 700 appeals to the Supreme Court against the law on the grounds that 40 of its articles were unconstitutional, including the introduction of the eight-hour day, the merit-based system for the selection and promotion of public administrators, the two-year minimum service before job security is granted, and the compulsory retirement at 65. The interests of the judiciary are now a major obstacle to the implementation of Law 1626. It is believed that the reluctance of the Supreme Court to reject the appeals against the law from public sector trade unions is because the judiciary wishes to ensure that the law does not apply to its own staff.
In short, there is thus far little evidence of significantly improved performance in the bulk of the public administration system and it is unlikely that improvements could be made fast enough to have a major impact on the quality of the public administration over the next five years.

The Political Economy of Key Areas of Policy Reform

This section examines the constraints on adequate performance posed by the institutional environment in six specific areas that are deemed crucial to good employment outcomes—fiscal policy; monetary policy and the financial system; exchange rate policy; support to small and medium enterprises, including agricultural producers; housing construction; and human capital formation. In each of these areas there are severe political and/or administrative impediments to good performance and the resulting positive contribution to employment creation. The switch from “improvised” to “strategic” policy formulation within the state apparatus will clearly not happen overnight. It will require a major attitudinal change, not only among politicians but also among the senior ranks of the public administration. Policymaking in area of employment policy requires “joined-up government,” i.e., inter-ministerial collaboration and coordination.

Fiscal Policy

A start has been made to improve Paraguay’s fiscal policy management, move towards a more progressive tax and expenditure pattern and provide the country with the capacity to undertake a level of investment needed for satisfactory growth with benefits shared throughout the population. The current fiscal reform program contains two crucial elements designed to counter the structural rigidities caused by the extreme level of inequality—the personal income tax and a tax on large landholdings. However, the impact of both taxes will be delayed by (i) the need to introduce new administrative mechanisms for tax collection; and (ii) the extensive opportunities for reducing tax liability by deductible costs. Irrespective of the “progressive” nature of the tax reform, any “pro-poor” impact also requires that the extra revenue be put to good use, something which cannot be taken for granted given Paraguay’s fiscal history. Maintaining support for the fiscal reform will thus depend crucially on visible signs that the increased public expenditure is being channeled in a “pro-poor”
direction. A pro-poor employment-oriented approach to public expenditure will call for the increased expenditure to be directed to the bedrock social sectors, such as education and health. One priority area in this regard involves improved overall coordination and control of foreign aid inflows and the associated counterpart funding.

Monetary Policy and the Financial System

Central Bank monetary policy has since the early 1990s been orthodox, wedded almost exclusively to a “low inflation” target, which may have been achieved at the cost of extending the economic recession. The commercial banking system is widely criticized for its failure to contribute to economic recovery and job creation through its very cautious policy towards expanding its loan portfolio and through the extremely high spreads between the high interest rates charged to borrowers and the very low rates paid to savers. Despite a steady increase in the level of deposits since 2002 and a commitment to the incoming government to end their freeze on new loans and inject a Gs 600,000 million in new lending to the private sector, commercial bank credit was lower in mid-2004 than in late 2001 (Nickson, 2006, 35). The banks had opted instead to put their large pool of surplus funds either in zero interest current account deposits at the central bank or in zero-risk central bank treasury bills (Letras de Regulación Monetaria—LRMs). The government has seen this behavior as unjustified in the light of improved governance, the lower inflation rate and greater fiscal prudence and as justifying the complaint by the private sector that, without cheaper credit, economic recovery and employment creation cannot be sustained. The increased holdings of LRMs occurred in spite of a deliberate shift in monetary policy designed to reduce their attractiveness and so encourage commercial banks to lower their lending rates; the average annualized LRM rate fell from 19.7 percent in 2002 to around 9.5 percent by April 2004.

The extremely conservative stance of the commercial banks reflects their high risk perception caused by the continuing high level of bad debts in the banking system (22 percent in March 2004); the “regional” perspective taken by the foreign-owned banks that now dominate the Paraguayan banking system—following the 2002 economic crisis in Argentina, many foreign banks imposed “across-the-board” restrictions on credit growth to the Southern Cone; the currently much reduced rate of inflation, which helps to bolster the real rate of return on LRMs, despite the fall in their nominal rates; the tax-free nature of interest
earnings on LRM; and the profile of bank deposits themselves, 80 percent of which still consist of demand deposits (end-May 2004).

**High Interest Rates on Loans.** The high cost of bank intermediation—the spread between commercial bank lending and borrowing rates—has been blamed for the low rate of domestic investment and thereby for hampering employment creation. Despite the marked improvement in macro-economic management, spreads actually increased from an annual average of 38.2 percentage points in 2002 to 39.7 percentage points in 2003. At mid-2003 average bank loan rates in local currency (at 45 percent) were still seven times higher than average deposit rates (6.3 percent). By February 2004 the weighted average bank loan rate was 40.4 percent in local currency and 9.0 percent in U.S. dollars.

Following widespread public criticism of these high bank loan rates, which is seen as a major factor holding back re-activation of the economy, from October 2003 measures were gradually introduced in order to reduce the cost of lending. At first the central bank initiated a dialogue with banks and finance companies designed to get them to reduce interest rates through “moral suasion.” In December 2003 Congress sanctioned a law that would limit interest rates on bank loans. From March 1, 2004 commercial banks were no longer allowed to charge interest rates above 66.72 percent on one-year loans. Banks charging higher rates are open to prosecution by the Banking Superintendency, Superintendencia de Bancos, on the grounds of speculation.

In another move aimed at encouraging an increase in commercial bank lending, in May 2004 the central bank revised reserve requirements for bank deposits in local currency. The measure encouraged a switch from demand deposits to time deposits by offering zero reserve requirements on deposits of more than 541 days. The revision also unified the previous differential reserve requirements rates applied to banks, savings and loan companies, and finance companies. The standard rate for demand deposits was set at 15 percent.

According to the Centro Paraguayo para la Promoción de la Libertad Económica y de la Justicia Social (CEPPO), an economic think-tank, the main reason for the high cost of money is the lack of competition in the financial sector. Recent data from the Banking Superintendency show that five banks alone account for over 65 percent of total bank deposits. Furthermore, commercial banks actively discriminate against small depositors, through the requirement for a minimum initial deposit as a condition for opening a new account. In

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6 See the discussion in Chapter 12.
August 2004 the association of financial institutions, Asociación de Empresas Financieras del Paraguay (ADELFI), pressed the government to allow them to offer current bank accounts, something that is prohibited by the present banking law (Law 861/96). Many ADELFI members are keen to operate in rural areas not reached by the current banking network. Such a move, by increasing competition in the financial sector, would help to reduce average loan rates.

**Bank Deposit Guarantee Scheme** – Public policies have been introduced to address the weaknesses of the financial system that were revealed by the banking crises. As a precondition for the IMF stand-by agreement in December 2003, the Senate approved a US$50 million bank deposit guarantee scheme. The measure replaces the previous system of government guarantee with a system financed by the commercial banks themselves. This will represent a significant saving to the public sector in the event of future bank failures.

**Pump-Priming Role of the Instituto de Previsión Social.** – One proposal for overcoming the “structural impediment” to loan expansion caused by the high share of demand deposits in total commercial bank deposits is to transfer the extensive term deposits of the state social security system, Instituto de Previsión Social (IPS), to the commercial banks. By altering the composition of their total deposit profile, it is argued that this measure would encourage them to engage more in long-term lending. The commercial banks have welcomed this proposal.

**The Banco Nacional de Fomento (BNF)** – The BNF, the only remaining state-owned bank in Paraguay and the weakest institution in the banking system, has been on the verge of collapse for many years because a combination of corruption in its loan portfolio and feather-bedding for its staff. In March 2003 the government was forced to inject Gs 40,000 million to prevent its collapse, after its agricultural loan portfolio fell into the red. The bulk of the BNF loan portfolio has gone to a few powerful private companies. Attempts to reform the BNF have been heavily promoted by the IMF and World Bank. They have both advocated its closure and replacement by a new agricultural bank after the merger of its small credit department with the state bank for small farmers, the Crédito Agrícola de Habilitación. The new bank would then make loans to small farmers, with an individual loan ceiling of US$15,000 for producers with a maximum of 40 hectares, rising to US$50,000 for co-operatives. These efforts have met with strong resistance from a powerful combination of stakeholders—construction companies and passenger transport operators who have long benefited from highly subsidized loans, often written-off altogether, and BNF
staff belonging to the Colorado Party who have benefited from the prevailing corruption and exaggerated employment benefits. These stakeholders exert a strong influence in Congress. Excessive trade union demands that laid-off workers be compensated at a rate of six months salary for every year of service, at a cost of US$15 million, have also placed in doubt the plans for restructuring the BNF. Given the key potential role of smaller farms in an employment strategy, the presence of a bank with the mandate and capacity to lend to this group is a key need in an overall employment strategy and the thus-far successful blocking of its creation a serious setback.

**Exchange Rate Policy**

There is considerable evidence that those economies that have pursued a conscious policy of currency undervaluation have achieved faster and more sustained economic growth during the period 1975-2000 (Messa et al., 2000). This period saw no conscious policy of undervaluation of the domestic currency in Paraguay. On the contrary, during the period 1991-98 a significant real appreciation took place, reflecting the overriding concern of the Central Bank to bring down the inflation rate and the desire to reduce the (local currency) cost of heavy debt repayments, following the successful renegotiation of the foreign debt in the early 1990s. More generally, the exchange rate has never been managed from a “developmentalist” perspective but has instead tended to favor the interest of importers over exporters because of the power of elite groups linked to the legal and illegal re-export trade. One possible explanation of Paraguay’s slow growth over the last couple of decades may thus be found in its exchange rate policy.

The logic of a more competitive exchange rate is that it would act as an incentive to the production and diversification of exports and to domestic production of import-substituting goods and in the process would lead to a higher level of resource utilization and provide an added incentive for firms to invest and engage in technological upgrading. A main developmentalist argument for a competitive exchange rate is that it would encourage the emergence and growth of new non-traditional exporters, both agricultural (see Chapter 3) and non-agricultural (see Chapter 11) with the latter promoting diversification and a move away from the dependence on primary product exports to higher value-added items. There is also a prima fascia case that there are considerable growth opportunities in the

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7 For further details see Chapter 8.
domestic production of import-substituting goods for the domestic market, including food processing and unprocessed food items, especially vegetables, fruit, etc. Because non-traditional exports are still a small fraction of the total the political clout of their producers is, correspondingly, very small. Importers, on the other hand, are a powerful stakeholder group with a strong influence on public policymaking, and are expected to oppose any consistent currency undervaluation strategy. It might be presumed that industrialists producing for the domestic market would welcome such a policy, but their support will be somewhat muted because of the surprisingly high import content of much domestic manufacturing (e.g., for domestic drug production over 90 percent) and of domestic household food consumption in urban areas. Industrialists and others fear that a competitive exchange rate policy could not be easily sustained because of its impact on the inflation rate (through the rise in prices of some basic consumption goods) and hence the pressure on wage costs in the formal sector.

Support to Small and Medium Agricultural Producers

There is general agreement that the SMEs will create the bulk of net new jobs over the medium-term in Paraguay (see Chapter 6). Small agriculture and related agro-industrial processing is where employment gains could probably most easily be made. Distribution of land to small farmers, improved access to credit, infrastructure investments and diffusion of technologies are all important general elements of public policy. Some face severe political and/or public policy impediments, others less so.

The highest payoff in terms of employment and output would probably come from better access to land by those who have too little, through some form of agrarian reform. It may in fact be a prerequisite for success on the employment front and a condition to prevent rising violence and unrest. But it confronts the vested interests of the largeholder groups, powerfully represented in Congress and in the political process more generally. The government will need to move swiftly to carry out a major land reform program in order to defuse the politically explosive anti-Brazilian xenophobia that is now gaining hold in rural areas. But this will require facing down strong opposition from the Coordinadora Agrícola del Paraguay (CAP), an emerging alliance of cattle-ranchers and Brazilian soybean producers. Any such land reform program should incorporate three key aspects if it is to be successful: (i) the strict enforcement of a lengthy prohibition (20 years...
has been suggested) on the resale of all land grants; (ii) a radical improvement in the quality of the state agricultural extension service, which currently covers only 15 percent of small farmers; and (iii) the targeting of the agricultural loan portfolio of the reformed BNF exclusively on small farmers. A really well-executed reform requires administrative capacity but, though difficult, this condition would probably be easier to meet than the political one.

The second most important element of small farm policy is to improve access to better technologies, through both research and development and diffusion. The system has failed the small farmer badly over the years. On the research front the country does have a decent number of available researchers—especially at the Facultad de Ciencias Agrarias (FCA) of the Universidad Nacional de Asunción (UNA)—but research funding was been cut drastically during the 1990s and in any case too little research appears to have directed to the needs of the small farmers, a typical problem in many developing countries and one which requires some professional leadership to overcome. The other priority need is fiscal; as soon as it can be shown that the research is duly oriented to small agriculture, the flow of funds should be greatly increased. The same goes for the extension service. A strong support system for small farmers is thus impeded both by Paraguay’s very low tax burden and by a less than effective use of some of the resources at the state’s command, partly because of its pattern of clientelism. An important issue here and in other areas is what, if anything, the government can do directly and what it would be best to hand over to publicly funded private agencies, NGOs, semi-public agencies, and so on.

Given the prevailing institutional environment, the diffusion of agricultural research through the national extension service, Servicio de Extensión Agrícola y Ganadera (SEAG), has been limited. In an attempt to address this weakness and in virtually the only example to date of tercerización by the Paraguayan public sector, in 1997 the Ministry of Agriculture contracted out SEAG. Under an initiative supported by the Inter-American Development Bank, some privately-owned Unidades Técnicas de Intervención (UTI) were awarded contracts by the state, leading to a sudden jump in the demand for trained agronomists and the absorption by the UTIs of 150 recent graduates from the Facultad de Ciencias Agrarias. A 2004 study of the impact of the institutional reform is broadly positive, highlighting the greater geographical coverage of extension services. However, the wider institutional environment remains hostile. Even though UTI staff are better qualified and more highly motivated than their counterparts under the previous in-house arrangement, their capacity to deliver
services is still highly constrained, as in the past, by extreme shortages of fuel and material inputs. Still this experiment can provide useful lessons on how to raise the productivity of this crucial group of professionals.

On the credit front, there are two main ways to improve smallholder access. One is to strengthen the main credit institution in the Paraguayan interior, the local cooperatives, by supporting the existing ones and providing incentives for new ones (Nickson, 2006, 43). Since no major stakeholder stands to lose from such an initiative, and since most of the energy for their development comes from the cooperatives themselves, provision of such support should be feasible and high priority. The second route, noted above, involves a bank for small farmers, perhaps along the lines suggested by the IFIs. Here, as also noted, there are serious impediments both from BNF employees and from the current (relatively well-off) beneficiaries of cheap credit from that institution. Breaking this logjam will also be very important if smaller farmers are to flourish in Paraguay again.

A possible obstacle to the creation of a well-functioning credit system for smaller farmers is the legacy of free provision of cotton seed and pesticides, beginning with the Wasmosy government (1993-98), which sought in this manner to “buy” peasant support and so dampen calls for land reform. Gradually, a culture of “demands” emerged whereby such free distributions are now widely perceived in rural areas as redistributive measures justified by the society’s extreme inequality. As the government seeks to introduce a more formalized and effective system of credit to small farmers, this prevailing attitude of “non-payment” among borrowers will be a difficult legacy to eradicate in the short-term. Given that it originated as a form of resentment against the abject failure of the formal extension programs, a radical improvement in that field will be necessary in order to change this attitude (see Chapter 3). Small cotton farmer resistance to paying is complemented by the interest of the Colorado Party, particularly strong within the Ministry of Agriculture, which has used the cotton subsidy as a tool of patronage in order to retain political support. The 100,000 cotton farmers and their families are located in some of the poorest rural areas that were traditionally under strong Colorado Party control (e.g. San Pedro, Misiones) but where party links have been loosened in recent years in response to growing social discontent. In addition, supplier contracts for the provision of cottonseed have been a major source of rent-seeking by officials in the Ministry of Agriculture. Whatever the merits of free provision of inputs—and there is no doubting the importance of getting these inputs into the hands of small farmers—it will be essential that clear rules of the game be established as to what (if anything) is provided free, what is subsidized and what
bears market prices. Only then can a serious credit system be established. Other countries provide interesting precedents on how to handle this tricky issue.

Investment in improved infrastructure is another obviously high priority component of small farm support policy, where the meeting of reasonable objectives is hampered by the combination of scarcity of public funds for investment and ineffective use of those funds.

**Low-Cost Housing and Public Works**

In general terms the prevailing links between the state and private contractors that give rise to illicit rent-seeking activities have the effect of reducing rather than increasing the labor-intensity of public works programs. A clear example is “social housing.” It is now generally accepted that the most cost-effective manner for providing low-cost housing in urban areas of lower middle income countries is through state support for “self-help” initiatives. Under this institutional arrangement, known as “sites and services,” the state provides the basic inputs—land with titling, water and electricity, plus subsidized materials—while the future residents supply the labor. This gives both flexibility in the design and speed of construction to individual households, and also reduces the unit cost of each house and maximizes labor input as well as skills diffusion. However, despite countless seminars and workshops to promote the sites and services model that is the norm in much of Latin America, the state low-cost housing body, Consejo Nacional de Vivienda (CONAVI) still operates solely through private sector contractors who build complete houses. These projects are usually funded from foreign donors, especially Japan and Taiwan. There have been numerous scandals over poor and incomplete construction as well as massive overcharging by contractors. In addition, the repayment terms for the new residents have been so favorable as to become virtual grants, making it impossible for these initiatives to be self-sustaining.

**Human Capital Formation**

There is general agreement that the overall payoff to the expenditures undertaken within the Paraguayan educational system is low compared with other Latin American countries, due to a combination of low productivity in the overall economy, low efficiency of the education system itself, and weak linkages between training in the education
system and the needs of the labor market. The low efficiency of the education system reflects both poor allocation of public resources within the sector between primary, secondary and tertiary education and low productive efficiency of teaching staff, associated with the very low number of contact hours per year and poor staff motivation, especially in rural areas. The “patronage politics” of the teaching profession still represent a major institutional constraint against improvement on each of these fronts. A complex network of patron-client relationships linked in varying degree with support mechanisms for the Colorado Party exist between teaching staff—especially school directors—and supervisory staff of the Ministry of Education. This network plays a role in maintaining large regional imbalances in teacher/student ratios through the “inflation” of enrolment numbers in order to justify teacher posts.

Generally speaking, schools located in poorer rural areas of recent colonization have suffered most from this imbalance. As a result, there are many unpaid primary school teachers in these regions at the same time that many schools elsewhere have “real” ratios well below the statutory minimum of fifteen students per staff member. Similarly, the patronage politics of the education establishment represent an enduring institutional constraint on efforts to raise the productive efficiency of the educational system. The appointment and promotion of teaching staff is still strongly influenced by non-professional considerations. At the school level, this has the effect of downplaying the importance of professional behavior of teaching staff, with the predictable negative impact on pedagogy.

Meanwhile, the lack of fit between the formal education system and the skill needs of the economy is pronounced. A 1995 World Bank survey of 243 companies concluded that that lack of trained personnel was the principal obstacle to growth (Sapelli and Janson, 1997). Respondents attributed this problem to deficiencies in the education system, particularly secondary education. A team from Harvard has been instrumental in promoting a major education reform since the mid-1990s and some progress has been made.

A state vocational training body, the Servicio Nacional de Promoción Profesional (SNPP), a dependency of the Ministerio de Justicia y Trabajo (MJT), was established in 1971 precisely to “fill the skills gap” in terms of specific capacities not developed through the education system. It has extensive resources from the proceeds of an obligatory contribution of 1 percent of gross salaries, as well as extensive donor funding, particularly from JICA in recent years. This has enabled it to establish a national network of ten branches. But the impact of SNPP has been very low because of endemic corruption.

For more details, see Chapter 9 and Schiefelbein (2005).
Losing Ground in the Employment Challenge

Plans were drawn up in 1999 under an IDB project to reform the SNPP through two major NPM (New Public Management) initiatives: (i) the introduction of a tripartite approach involving the state, employers and trade unions in the definition of its work priorities; and (ii) efforts to open up the training contracts of SNPP to a transparent bidding process from outside suppliers. The program also sought to reduce gross overstaffing in SNPP through a US$6 million voluntary early retirement program. The implementation of this program has been criticized on the grounds that those opting for retirement tended to be the most experienced and effective trainers, leaving the SNPP with a serious shortage of skilled personnel. The contracting-out of training services to the private sector was enabled by a new national training system, Sistema Nacional de Capacitación, introduced in 2000. This has been criticized on the grounds that it has reduced the “integral” nature of training. In addition to its “normal” training activities (e.g., electricians, plumbers, carpenters, refrigeration and computers), since October 2003 the SNPP has started a new program of “in situ” intensive and comprehensive 30-day training targeted at small rural communities in 70 districts.

Conclusions

This analysis highlights three major considerations from the institutional context that will necessarily influence the manner in which an employment strategy is formulated and implemented. The strategy is taking place in a country characterized by:

- **One of the most unequal distributions of income, wealth and landholding in the world.** The attitudes of extreme powerful stakeholders to the shaping of an employment strategy will therefore be particularly important and probably also extreme.
- **Virtually no tradition of strategic planning and public policymaking.** The level of inter-ministerial coordination, so crucial to success in the design and implementation of a coherent strategy, is extremely underdeveloped.
- **A public administration with a very low level of institutionalization.** The lack of cohesion and the culture of improvisation pose a major obstacle to effective implementation of an employment strategy. Confronting such a daunting challenge, no country can expect to succeed on all fronts quickly, so the sequencing of steps becomes very important. The optimal order in which to attack the problems should be based on the combination of urgency on the one hand, and on political and administrative feasibility on the other. As discussed above, fiscal policy management has already been significantly improved and...
various types of corruption somewhat curtailed, though in both areas it is important that there be no backsliding after gains are made. These are necessary prerequisite steps for government to be in a position to implement a coherent employment cum growth strategy. The strategy itself will, as noted, rely mainly on the small farm and SME sectors. Policies must be dramatically improved in both areas. Some appropriate steps are straightforward (e.g., support for development of labor-intensive agricultural export products) while others are more complicated (e.g., improvements in the educational system). Some require only the termination of a badly conceived and politically based policy, e.g., switching from full construction to site and service in the area of low cost housing.

While the short-term focus of an employment generation strategy will of necessity be on small farming and SMEs, in order to create the basis for sustainable development over the long-term the government may want to consider encouraging the use of its enormous hydroelectric resources in order to industrialize the country. Such development, however, is inherently capital intensive and creates few jobs, so it must be accompanied by other policies which do generate remunerative employment. Paraguay’s great current challenge relates to the failure of two of its three major primary exports to create significant levels of employment and its very high inequality cum weak demand for labor results substantially from that. The country would need to demonstrate its ability to resolve the current problem before taking on additional capital-intensive export industries.

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