

2009 - 2013  
March 31, 2009

**COUNTRY  
PARTNERSHIP  
STRATEGY**  
FOR THE REPUBLIC  
OF PARAGUAY



THE WORLD BANK



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OF PARAGUAY

## IBRD

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## Abbreviations and Acronyms

AAA	Analytical and Advisory Activities	IFC	International Finance Corporation
ANNP	State-Owned Port Operator/ Administración Nacional de Navegación y Puertos	IFIs	International Financial Institutions
APC	Alianza para el Cambio	IMF	International Monetary Fund
AS	Advisory Services	INCOOP	National Institute of Cooperatives
BCP	Central Bank of Paraguay	JBIC	Japan Bank of International Cooperation
BEE	Business Enabling Environment	JICA	Japan International Cooperation Agency
BOP	Balance of Payment	JSDF	Japan Social Development Fund
CAF	Andean Development Corporation / Corporación Andina de Fomento	LAC	Latin America and the Caribbean Region
CAS	Country Assistance Strategy	MIGA	Multilateral Investment Guarantee Agency
CISNI	Consejo Impulsor del Sistema Nacional de Integridad	MOF	Ministry of Finance
COPACO	Public Telecommunications Utility / Compañía Paraguaya de Comunicaciones	NGOs	Nongovernmental Organizations
CPI	Consumer Price Index	PEP	Private Enterprise Partnership/IFC
CPS	Country Partnership Strategy	PETROPAR	Paraguay Oil Company / Petróleos Paraguayos
CY	Calendar Year	QAG	Quality Assurance Group
DPL	Development Policy Loan	RAF	Resource Allocation Framework
ESW	Economic and Sector Work	SEPA	Sistema de Ejecución de Planes de Adquisiciones
FDI	Foreign Direct Investment	SIAF	Financial Management Integrated System
GDP	Gross Domestic Product	SMEs	Small and Medium Enterprises
GEF	Global Environmental Facility	SOE	State-owned Enterprise
HBS	Household Budget Survey	TA	Technical Assistance
IBRD	International Bank for Reconstruction and Development	TEKOPORA	Conditional Cash Transfers Program
IDB	Inter-American Development Bank	UPAF	Upper Parana Atlantic Forest
IDF	Institutional Development Fund	USAID	United States Agency for International Development
IFA	Integrated Fiduciary Assessment	VAT	Value Added Tax
		VoIP	Voice over the Internet Protocol
		WB	World Bank
		WHO	World Health Organization

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# [ Executive Summary ]

The victory of Fernando Lugo, a former Catholic bishop, in the presidential elections of April 20, 2008 ended 61 years of Colorado Party dominance. President Lugo heads a center-left coalition, the *Alianza Para el Cambio (APC)*, consisting of a wide array of political organizations with a broad ideological base and organizational capacity. President Lugo's victory presents an historical opportunity for Paraguay to address longstanding governance, social and economic challenges and improve the living standards of its population. Since this is the first time in recent history that there is an alternation of power in Paraguay, the APC faces important challenges in handling an administration that has responded for some 60 years to the interests of a single political tradition.

On the economic front, between the years 2004 and 2008 Paraguay experienced its strongest economic expansion since the 1970s. GDP grew by 4.3 percent in 2006, by 6.8 percent in 2007 but slowed down to 5.8 percent in 2008 due to the global economic crisis. This strong economic performance resulted in a decline in

overall poverty levels, from 46.4 percent in 2002 to 35.6 percent in 2007. Extreme poverty has also fallen from 21.7 percent to 19.4 percent during the same period, although it increased between 2006 and 2007 due to raising food prices and lack of spillovers from growth to formal employment. At the same time, Paraguay has a very unequal distribution of income and assets. For instance, in Paraguay the richest 10 percent of the population accounts for almost half of total income, while 2 percent of the agricultural establishments (about 6,400 farms) occupy almost 82 percent of the agriculturally exploited land (namely, 20 million of the 24 million hectares in agricultural use, or one-half of Paraguay's total area of 40 million hectares).

The year 2008 started off buoyantly, but the global crisis hit in October mainly through a sharp reduction in trade (commodity export orders and prices fell and there was also a sharp reduction in re-exports due to the depreciation of the Brazilian Real) and workers' remittances. The guaraní rapidly lost a quarter of its value, and trade-related economic activity slowed down (i.e., all agricultural activities

and the majority of services including re-exports). The financial sector, mostly comprising foreign-owned banks, has strengthened its capital position over the past years but, as the impact of the global economic crisis deepens, credit quality may deteriorate due to a slow down in the real sector. The outlook for 2009 and beyond is very uncertain due to the sharp fall in external demand for agricultural products, possible further declines in commodity prices, domestic uncertainty, and the impact of these developments on revenue collection. However, the authorities' Medium Term Macroeconomic Framework is appropriate, and includes fiscal measures equivalent to about 2 percent of GDP this year to buffer the economy from the global slowdown.

On the social front, the administration inherited a backlog in social services due to a combination of lack of funds and weak state institutions, which has resulted in low standards of provision of basic services. In the water and sanitation area, about 61 percent of the population has access to drinkable water (only 49 percent in rural areas), while only 8 percent of the population has access to network sanitation. On the education front, participation rates are among the lowest in Latin America (especially in secondary education where desertion rates are high). The health sector is confronted with very high maternal mortality rates, while according to World Health Organization (WHO), 39 percent of the population does not have access to health services. Addressing these needs in a sustainable manner will require not only financial resources but also strengthening state institutions that are responsible for delivering basic services.

In the longer term, Paraguay faces the challenge of diversifying its economy away from commodity exports to provide more rewarding jobs to citizens that today depend on low paying activities in the rural and informal sectors. In addition, Paraguay needs to strengthen the ability of the State to provide social and economic services by collecting additional resources in an equitable and non-distortionary manner.

The Lugo administration has developed a program for Paraguay to transition to a modern economy based

on improving governance and reducing corruption, addressing the needs of vulnerable groups and restoring growth in light of the global crisis. The elements of the Government's program are embodied in the Ministry of Finance Economic and Social Plan for 2008-2013 and in the recently announced Anti-Crisis Strategy. Three major cross-cutting and inter-related themes –*governance, poverty and growth* – emerge from the Plan, and clear measures and objectives have been identified for each of these themes. The Bank concurs with the Government's assessment of the challenges ahead and has developed the proposed Country Partnership Strategy (CPS) to support the Government's objectives in each of the cross-cutting themes with specific interventions as follows:

- **Governance.** The Bank intends to increase its assistance to Paraguay in the governance area, which is consistent with the utmost priority the authorities have assigned to this area, as well as with the recent selection of Paraguay as a pilot for the implementation of the Bank's Governance and Anticorruption (GAC) Strategy. In particular, the Bank will assist the authorities in obtaining concrete results in their anticorruption drive by supporting their adherence to the WB/ UNODC Stolen Asset Recovery Initiative (StAR). The Bank will further support efforts by the authorities to increase the effectiveness of public investments, by assisting with the development and implementation of a governance framework for all Bank projects. Very importantly, the Bank will support the Government's objective to initiate a sustainable process for building state institutions through a series of programmatic Development Policy Loans (DPL) focusing on improving accountability of public enterprises, initiating civil service reform, and strengthening the internal control system for the public administration.

- **Poverty.** In close collaboration with other donors, the Bank will support the authorities to: (i) enhance social safety nets through non lending activities that could be followed by an investment operation; (ii) develop participatory mechanisms for land reform through an investment project; (iii) improve the quality of secondary education and establishing a scholarship program for Paraguayans to receive

education abroad to improve the quality of future civil servants and leaders through lending; (iv) expand the coverage of water supply and sanitation through the recently approved Water and Sanitation Modernization Project; (v) reduce vulnerabilities for the rural poor through the Sustainable Rural Development Project; and (vi) expand community-based activities to cover the poorest 40 districts and vulnerable populations in metropolitan Asunción through an Additional Financing for the Community Development Project. In addition, the DPL programmatic series will include a component to help safeguard and improve key social programs.

• **Growth and Environment.** To help mitigate the effects of the global crisis on the economy and the poor, the Bank will provide quick disbursing funds through the proposed DPLs. In addition, the Bank will help Paraguay make better use of its valuable hydroelectric assets perhaps through an investment project to expand the power transmission grid. The IFC will seek opportunities to engage with the private sector in transport, financial services and, more broadly, in supporting small and medium enterprises including through technical assistance to reduce barriers to doing business. In addition, the Bank will support Government's efforts to better define the longer term growth and diversification agenda through analytical work and non-reimbursable TA.

The new administration and its shared vision offer an historic opportunity for the international community to engage more deeply with Paraguay and contribute to achieve the country's development goals. While carefully monitoring the underlying risks, the Bank and the IFC will aim at stepping up their involvement in Paraguay under the CPS, both with lending and non-lending activities. The overall support would be selective, i.e., focused on a few projects in areas where the World Bank has clear advantage and expertise, and where proven implementation capacity exist. The Bank will work closely with others in the international community, as it will continue to be a minor player in Paraguay.

The CPS provides for an indicative lending envelope of US\$500 million over the five year period through

FY13. This amount implies a moderate increase in Bank exposure, which is justified by the challenges the country is facing and by the strategic role the Bank has been called upon to play in helping Paraguay achieve progress in the agreed focus areas. The proposed program will be front loaded, with about forty percent of the indicative envelope devoted to programmatic development policy lending and an additional 13 percent in pre-identified investment lending. This will help protect delivery of basic services to vulnerable populations and infrastructure investment from the adverse impact of the global financial crisis. The remainder of the Bank's indicative lending program has not been pre-identified, so as to maintain flexibility during implementation given the overall country and program risks, the changing nature of Paraguay's needs, and the uncertainties surrounding the global financial crisis. There is, however, an ongoing dialogue between the Bank and the authorities concerning possible lending for financing safety nets and electricity.

The indicative envelope will be reviewed at the time of the CPS Progress Report, taking into account the level of absorption and implementation capacity, the Government's ability to maintain a sound macroeconomic framework, the progress made in the governance, poverty and growth agenda and the Bank's lending capacity at that time. The CPS Progress Report will hence provide an opportunity to carry out a comprehensive assessment of the progress achieved in CPS implementation and reassess priorities.

There are a number of implementation challenges for the Government's Program that could put the CPS implementation at risk:

• **Creating a legislative consensus on the development agenda.** Since the APC lacks a majority in Congress, the authorities will need to make a special effort to forge a consensus beyond its constituency to ensure that its economic and social agenda has legislative backing. Since in Paraguay Government implemented grants and loans have to be individually approved by Congress outside the budget process, such consensus should also encompass a political

agreement on the role of external assistance in supporting the country's development efforts. This would avoid past controversies that blocked the approval of external grants and loans, including those from the Bank.

• ***Starting a process to improve key elements of the public administration.*** Since implementation capacity in line ministries and agencies is weak, transforming policy objectives into concrete outcomes is a challenge. Planning, financial management, and monitoring and evaluation capacity across ministries and agencies needs to be strengthened in the short- to medium-term. At the same time, opportunities for civil society to oversee, sponsor, or even implement Government's activities will need to be further developed.

The Bank will carefully monitor the above mentioned risks (as well as fiduciary and program-specific risks) while monitoring the delivery of expected outcomes under each of the three cross-cutting themes identified earlier (see Results Matrix in Annex 1). The steps that the authorities expect to take with Bank's support, although small and specific, are expected to help reach a critical turning point in the country's development agenda.

# [ Introduction ]

1. The election of Fernando Lugo as President of the Republic presents Paraguay with an opportunity to tackle more effectively its long standing poverty and governance issues. Whether Paraguay will be able to take advantage of this opportunity will largely depend upon Paraguay establishing a broad consensus on development challenges and vision, and the Government's ability to implement change. The Bank's Country Partnership Strategy (CPS) has been developed with the objective of assisting the new authorities weather the global economic crisis and implement reforms that lead to tangible results in strategic development areas, with a clear priority on issues pertaining to governance, poverty alleviation and growth. The CPS also intends to assist Paraguay develop a consensus on the policy agenda to address long-standing structural challenges through programmatic analytical work and its dissemination. The proposed strategy will cover the term of President Lugo, CY 2009 to CY 2013. Recognizing that Paraguay's economy is subject to domestic and

external shocks, and that the political environment is volatile, the proposed CPS provides an indicative program while it incorporates flexibility to ensure responsiveness to the country's needs, particularly those derived from the international financial crisis.





# [ The Country Context ]

## A. POLITICAL CONTEXT

2. The victory of Fernando Lugo, a former Catholic bishop, in the presidential elections of April 20, 2008 ended 61 years of Colorado Party dominance. With a margin of 10 percentage points above the Colorado candidate, the victory gave President Lugo and his movement strong legitimacy. His reputation as an anti-corruption champion and his life-long commitment to the poor confer President Lugo a strong moral authority.

3. President Lugo heads a center-left coalition, the *Alianza Para el Cambio (APC)*, which includes one main political party (the Liberals), three minor ones, and about one dozen political movements that span a wide range of ideologies. Despite the range of political views, the coalition shares key priorities that include a deep commitment to improve governance and government institutions and to reduce corruption, to improve the livelihoods and

opportunities for the poor in a sustainable fashion, to strengthen the management of the country's vast hydroelectric resources, and to consolidate the country's democratic process. The *APC* has also adopted a pragmatic economic policy stance based on maintaining sound macroeconomic management and a balanced view of the role of the State, while safeguarding the environment. Lugo's victory, therefore, opens up an opportunity for Paraguay to start tackling its long-standing governance, corruption, and poverty issues.

4. While the economy is likely to benefit from this stance, and from reduced levels of corruption, significant economic policy reforms may be slow in materializing. This is not only because addressing the backlog of needed structural reforms is a daunting task in itself, but also because the Government faces an uphill battle in obtaining the passage of reforms in Congress, where it does not have a solid working majority.

## B. ECONOMIC DEVELOPMENTS AND OUTLOOK

### Economic Recovery (2003-2007)

5. **Over the past four years, Paraguay experienced its biggest economic expansion since the 1970s.** Paraguay went through a period of economic stagnation in the late 1990s and early 2000s, as a result of terms of trade shocks, a domestic banking crisis and the economic turbulence in the Southern Cone. Between 2003 and 2005, supported by a successful stabilization program, the macroeconomic situation turned around, with growth averaging 3.6 percent during this period. Growth momentum continued in later years, supported by a favorable external environment and continuation of sound economic policies. GDP grew by 4.3 percent in 2006 and by an exuberant 6.8 percent in 2007 (Figure 1), and was set to continue at a comparable pace in both 2008 and 2009.

6. **The resurgence of growth was driven by agriculture and the recovery in domestic demand.** Between 2003 and 2007 agricultural production grew 7 percent per year on average. Related sectors, such as beef processing (accounted for under manufacturing)

were also very dynamic, advancing 6 percent on average during the same period. While these sectors were driven mainly by the upsurge in commodity prices, productivity gains also played a role—even in the livestock sector which has traditionally been based on extensive practices. Also dynamic were assembling industries and communications, which grew on average more than 8 percent each during the period. And with free private sector entry into ports and shipments, logistics also started to catch up, although large opportunities remain for further efficiency gains. On the expenditure side, consumption growth accounted for 82 percent of total GDP growth between 2003 and 2007, with investment accounting for the rest. Investment was particularly dynamic in the latter years of the period when it expanded very sharply. On the external front, import growth fully offset export growth during this period.

7. **Prudent fiscal management from 2003 through 2007 contributed to the recovery.** The restoration of macroeconomic stability, which re-established confidence and pushed up consumption, was anchored in a tight fiscal stance. But fiscal policy also contributed to recovery in an indirect manner: tax policy reforms, coupled with improvements in tax and customs administrations, brought about an

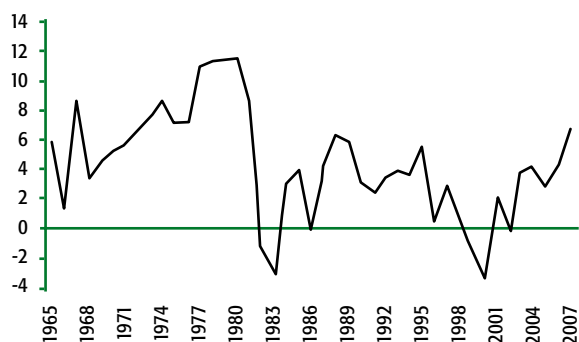
Table 1: Paraguay Key Economic Indicators, 2002-2007

	2002	2003	2004	2005	2006	2007
Real GDP growth (%)	0,0	3,8	4,1	2,9	4,3	6,8
CPI inflation (eop, % change)	14,6	9,3	2,8	9,9	12,5	6,0
Central government fiscal balance (% of GDP)	-3,2	-0,4	1,6	0,8	0,5	1,0
Current account (% of GDP)	1,8	2,3	2,1	0,2	0,8	0,2
Public debt (% of GDP) 1/	56,7	57,7	44,5	38,5	30,5	22,2
incl. Central Bank debt (% of GDP)	58,5	61,1	48,1	43,7	37,5	30,9

1/ Includes domestic and external public debt of the non-financial public sector.  
Source: Ministry of Finance and Central Bank of Paraguay. See Annex Table B6.



**Figure 1: Real GDP growth**  
(annual % change)

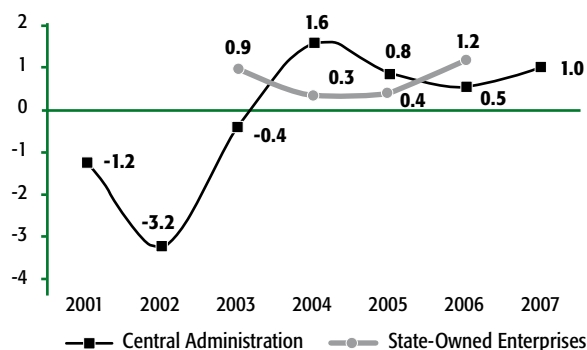


Source: Central Bank of Paraguay.

important first wave of economic formalization.<sup>1</sup> While tax revenues remain significantly below comparable middle income countries, these reforms supported a stabilization of revenues around 18 percent of GDP. Since the level of primary spending was maintained at about 16-17 percent of GDP, it was possible to achieve an average primary surplus of 2 percent of GDP. Most state-owned enterprises (SOEs) were also kept under a strict budget constraint<sup>2</sup> (Figure 2), although that was achieved primarily through cuts in investment rather than in recurrent spending. The resulting overall fiscal surplus for the consolidated government was about 1 percent of GDP for the 2004-07 period.

**8. Public debt levels are low.** Sound fiscal policies, lower interest rates, higher growth, and the strengthened guaraní all contributed to a fall in public debt. The public debt to GDP ratio, including domestic debt by both the government and the Central Bank of Paraguay (BCP), decreased rapidly from 59 percent of GDP in 2002 to around 30 percent in 2007.<sup>3</sup> The

**Figure 2: Overall fiscal balance**  
(% of GDP)



Source: Ministerio de Hacienda.

interest rate profile of central government external debt is highly favorable: 33 percent has a fixed interest rate (most of it at 3 percent or less), while the remaining two-thirds that carries variable interest rates is owed to multilateral and bilateral creditors. The Government has observed a policy of providing no explicit sovereign guarantees to state-owned enterprises since 2003. To counterbalance the effects of the global financial crisis on the economy, the Ministry of Finance plans to run small primary deficits over the next few years. With limited domestic options to issue long-term debt,<sup>4</sup> the government is likely to increase its external borrowing from multilateral and bilateral partners in the short- and medium-term.

**9. Paraguay's external position strengthened.** The current account went from a deficit of 4.1 percent in 2001 to a peak surplus of 2.3 percent in 2003, mainly on the account of stronger export performance.<sup>5</sup> Between 2003 and 2007, the surplus remained between roughly 1 and 2 percent of GDP. Paraguay did not run large

1. This is the case for instance of commerce in informatics, a key activity in Ciudad del Este (the country's second largest city and a well known center for intermediating goods from abroad mainly to the more protected market of Brazil under a legal tourist regime).

2. An exception to this is PETROPAR, the state-owned petroleum company, which has run up a significant stock of commercial debt due to subsidization of diesel fuel consumption.

3. While the government's debt has been falling rapidly in recent years, the Central Bank accumulated debt through the issuance of significant amounts of sterilization bills.

4. Domestic bonds are of short maturity (less than 3 years) and are primarily bought by domestic banks.

5. The CBY does not have a system to register re-exports through Ciudad del Este, and the country's two large hydropower (co-owned with Brazil and Argentina, respectively) are treated as foreign companies. These make the BOP (and National Accounts) statistics very unreliable in Paraguay.

current account surpluses when commodity prices increased in 2006 and 2007 because imports started to boom due to strong domestic demand and high oil prices.<sup>6</sup> The strong rise in international commodities prices that began in 2007 resulted in a surge in foreign exchange inflows, supported also by higher levels of worker's remittances, and by increased corporate social responsibilities and infrastructure spending of the two hydroelectric plants. These put pressure on the guaraní to appreciate from Gs.5,300/US\$ at the end of 2006 to below Gs.4,000/US\$ in mid-2008. Between June 2007 and June 2008, the Central Bank accumulated US\$1 billion in international reserves in an effort to moderate this appreciation.

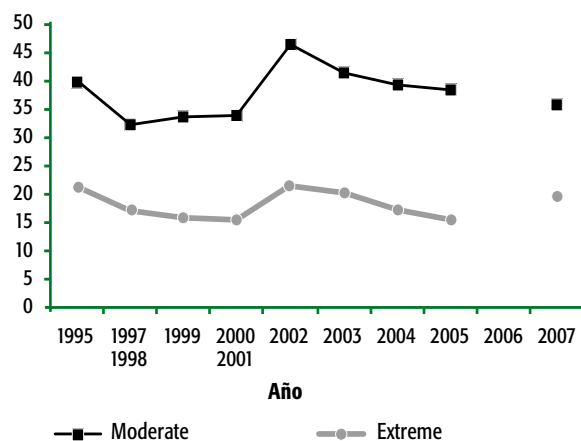
**10. Despite progress in recent years, poverty and inequality remain high relative to other Latin American countries.** Incidence of moderate poverty peaked at 46 percent in 2002, and has since then fallen to 35.6 percent. Extreme poverty has fallen from 21.7 to 19.4 percent during the same period (Figure 3). This fall suggests that the recent economic growth has been to some extent pro-poor. Despite this positive trend, poverty levels are now only back at the levels observed in the late 1990s, and extreme poverty

increased between 2005 and 2007. The increase was due to rising food prices and lack of spillovers from growth into poverty, suggesting that poverty is a structural problem that requires a concerted and holistic effort to be addressed effectively. Moreover, the nature of poverty appears to have changed: while moderate poverty used to be a primarily rural phenomenon, it has recently become more prevalent in urban areas.<sup>7</sup> Paraguay also suffers from high income inequality. At 0.55, Paraguay's Gini coefficient of income distribution is the fourth highest in Latin America (Figure 4). The richest 10 percent of the population accounts for between 42 and 47 percent of total income. Similarly, inequality in land distribution is among the highest in the world. Reducing poverty and inequality in a sustained manner thus remains an important challenge, particularly with regards to access to productive assets, possibilities to accumulate human capital, and labor market opportunities.

### Macroeconomic outlook and the effects of the global crisis

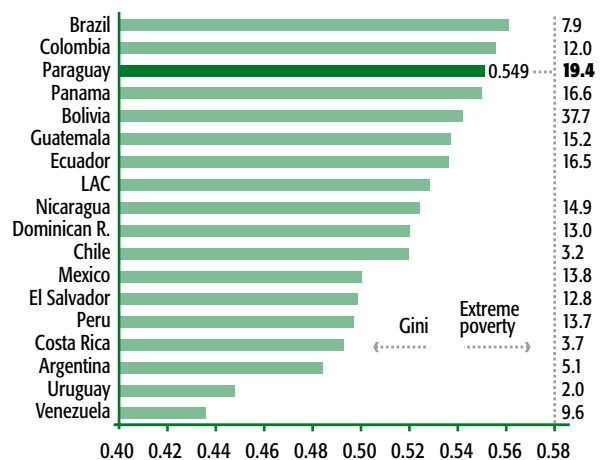
**11. The year 2008 started off buoyantly, but the global crisis hit in October.** This was mainly through

**Figure 3: Poverty Incidence**



Source: Staff calculations based on household survey data.

**Figure 4: Inequality and extreme poverty**



Source: Staff calculations based on household survey data.

6. The economy is depends fully on oil imports, but has abundant hydroelectric production capacity.

7. This trend will need to be confirmed once the revised methodology for calculating poverty is in place. The World Bank is providing technical assistance to update the methodology.

a sharp reduction in trade (commodity export orders and prices fell and there was also a sharp reduction in re-exports due to the depreciation of the Brazilian Real) and workers' remittances. The guaraní rapidly lost a quarter of its value, and trade-related economic activity slowed down (i.e., all agricultural activities and the majority of services including re-exports). The financial sector, mostly comprising foreign-owned banks, has strengthened its capital position over the past years but, as the impact of the global economic crisis deepens, credit quality may deteriorate due to a slow down in the real sector. GDP growth which advanced at rates higher than 7 percent mid-year, closed the year at 5.8 percent due to the global crisis.

**12. The administration's medium-term macroeconomic policy framework is appropriate.**

The administration is committed to continue implementing prudent macroeconomic policies, and is focusing on fiscal sustainability, improved competitiveness and equitable growth – as laid out in the Government's Strategic Economic and Social Plan for 2008-13 presented in September 2008. A key objective of the Plan is to create fiscal space, particularly on the revenue side, to allocate more resources to priority social and investment programs, especially those aimed at reducing poverty. In order to achieve this, the Government is committed to maintaining inflation within single digits, gradually increasing tax collections through better administration and the introduction of new taxes, and improving the efficiency of public spending. The plan also envisages important reforms to SOEs that would help address the contingent liabilities that these companies represent.<sup>8</sup>

**13. At the same time, the less favorable external environment presents an important challenge.**

As a small open economy with limited access to international financial markets, Paraguay will be affected by the ongoing financial crisis primarily on the real side. Falling commodities prices and a decline in global demand for Paraguay's exports represent the main transmission channels and will especially affect the agriculture sector, a key driver of growth. Prices for soy beans, one of Paraguay's main exports, have already fallen 42 percent since their peak in July 2008, and there are indications that demand for meat in some of Paraguay's main export markets has begun to decline. As a result, Paraguay's current account fell into deficit (estimated around 2.2 percent of GDP) in 2008 for the first time since 2001. The economy will also be affected by the fall in remittances and foreign direct investment, although the impact is expected to be less pronounced than in the case of trade.<sup>9</sup>

**14. The effects of the financial crisis on Paraguay's currency have already become apparent.**

Mirroring the devaluation of the Brazilian real as investors fled to safety, the guaraní depreciated sharply in recent months. In October the Central Bank reversed intervention policy course and began to sell international reserves in order to contain the slide in the guaraní (Figure 5). While this intervention led to a loss of US\$460 million in international reserves, at US\$2.8 billion (or 3.7 months of imports) the Central Bank's foreign exchange cushion remains comfortable and well above historical levels.

**15. The deterioration in the real sector presents a significant risk for the financial sector.**

Since the last banking crisis in the early 2000s, the level of financial intermediation has improved, and the banking sector is generally considered to be sound, with an average capital adequacy ratio well above the regulatory floor of 10 percent.<sup>10</sup> Dollarization remains high but is on a declining trend: 39 percent of bank credits to the

8. Due to the lack of audited information and the fact that many liabilities are in the form of short-term commercial credits, these contingent liabilities cannot currently be reliably quantified.

9. In 2007, remittances (as recorded in the balance of payments) reached US\$200 million (approximately 2% of GDP), while foreign direct investment amounted to approximately US\$240 million.

10. Even though the regulatory floor is above the Basel minimum of 8 percent of risk-weighted assets, it should be noted that Paraguay does not fully observe international capital adequacy standards. As a consequence, the ratio presented here tends to exaggerate the capital cushion of banks.

private sector are now denominated in US dollars, down from 47 percent in 2005. But credit grew fast between mid-2007 and end-2008, raising some concerns over the quality of banks' credit portfolio. The expected economic slowdown will be more acute in agriculture (which accounts for 26 percent of outstanding bank credit) and the services sector. This may lead to an increase in non-performing loans, which currently account for 1 percent of banks' loan portfolio. Preliminary estimates suggest that banks could withstand a moderate to significant deterioration in their loan portfolio. To deal with higher credit risk, commercial banks are already reducing and becoming more cautious in their lending, which may restrict liquidity.

**16. The outlook for the non-banking financial sector is uncertain.** Cooperatives account for 30 percent of total loans in the system and for 16 percent of total deposits, and they are interlinked with the banking system through loans and deposits. Unlike banks, financial cooperatives fall under the supervision of the National Institute of Cooperatives (INCOOP), whose supervision capacity is still weak. In addition, the regulations applied to cooperatives are weaker than those applied to the banking sector. Information about the sector is scarce, outdated and of uncertain reliability, making it difficult to adequately assess potential risks.

**17. In light of the evident deceleration of the economy, the Government has announced its intention to implement an economic revitalization plan for 2009.**<sup>11</sup> The plan consists of a set of monetary and fiscal policies: (i) injection of liquidity into the financial system; (ii) fiscal expansion to safeguard priority social and investment spending programs; (iii) provision of financing to the productive sectors of the economy through a second-tier state-owned development agency *Agencia Financiera para el Desarrollo* (AFD); and (iv) mobilization of financing to ensure adequate resources for the plan, including approximately US\$300 million in fast-disbursing IFI loans and lines of credit to the AFD. The fiscal

measures are equivalent to about 2 percent of GDP and are targeted to buffer the economy from the global slowdown. The CPS will contribute to this plan through the existing portfolio and the series of development policy loans.

### Medium-term outlook

**18. Under a baseline scenario, economic growth will fall from an estimated 5.8 percent in 2008 to -0.5 percent in 2009, in line with lower global and regional economic growth forecasts.** On the supply side, the growth reduction will come primarily from a fall in agricultural production, caused by the decrease in soy and other agricultural commodity prices as well as reduced yields due to the ongoing severe drought. Activity in other sectors, especially livestock production and re-exports of manufactured goods is also projected to slow down significantly. On the demand side, there will be a significant slowdown in private consumption and investment. In the medium term, as global growth recovers, Paraguay is expected to converge towards a long-term growth rate of 4.5 percent (Table 2). Key assumptions for this baseline scenario are (i) the successful implementation of the Government's priority spending programs in 2009 and the maintenance of higher levels of public investment; (ii) the recovery in global economic growth beginning in 2010; and (iii) a gradual recovery in commodity prices.

**19. The authorities foresee running a counter-cyclical fiscal policy to counteract the effects of the crisis.** In the short term, tax collections will decrease as a result of lower imports. Revenue from VAT on imports, import duties, and excises (representing 55 percent of total tax revenues) will fall, as will corporate income tax revenue from export and import related activities. Expenditures in 2009 are expected to increase from the very low levels observed in 2008, due to moderate public sector salary increases, an expansion of social safety net programs and, most importantly, a significant increase in capital spending. Even though the public sector's ability to execute non-

11. The plan is formally called *Plan de Reactivación Económica*.

wage spending, particularly investments, remains low, there is a backlog of infrastructure programs initiated in 2008 that is expected to be implemented within the coming months. Overall, the base case scenario foresees a primary deficit of 1 percent of GDP for 2009 and an overall deficit close to 2 percent of GDP, which will gradually improve as tax revenue recovers. Although Paraguay's fiscal position provides some headroom for countercyclical fiscal policy, the country will need to rely on an estimated US\$300 million financial package of support from its international development partners, including the World Bank, the Inter-American Development Bank (IDB), the Andean Development Corporation (CAF) and the Japan International Cooperation Agency (JICA), to ensure sufficient resources, especially if tax revenues are affected more strongly than currently expected. The authorities have not requested support from the IMF, but have agreed to bi-annual Article IV missions.

**20. Paraguay's debt burden and debt servicing indicators are manageable under reasonable assumptions.** Under the baseline scenario, public debt levels will remain sustainable. Public debt<sup>12</sup> would increase from 19.3 percent of GDP in 2008 to 22.9 percent in 2010, and would then gradually fall to 19.1 percent by 2013. Under an alternative scenario in which the primary deficit expected

for 2009 is maintained throughout the projection period, debt levels would be higher at 22.5 percent in 2013. Sensitivity analyses suggest that the main vulnerabilities of Paraguay's debt position stem from low growth and a depreciation in the exchange rate, as a large share of public debt is denominated in foreign currency. Contingent liabilities – such as a major recapitalization of banks, financial cooperatives or SOEs – also pose important risks. If the economy grew on average 1.6 percentage points less than under the baseline scenario throughout the projection period, debt levels would reach 23.4 percent by 2013. A contingent liability shock or a 30 percent real depreciation over the baseline would have a much greater impact on debt levels, pushing them up to 29 percent by the end of the projection period.<sup>13</sup>

**21. There are important downside risks to the baseline scenario.** An even more pronounced fall in commodity prices and a stronger reduction in Paraguay's agricultural production resulting from the ongoing drought and/or a credit squeeze would have important effects on growth. Thus, a stress-test was performed on the base case with the following assumptions: (i) commodity prices for soy fall by an additional 10 percentage points in 2009 compared to the baseline scenario and continue depressed in 2010; (ii) production of soy, wheat, corn and meat falls an

**Table 2: Medium term macroeconomic outlook (baseline)**

	2008	2009	2010	2011	2012	2013
Real GDP growth (%)	5,8	-0,5	1,5	3,0	4,5	4,5
CPI inflation (eop, % change)	7,5	6,7	6,3	6,0	6,0	6,0
Central government fiscal balance (% of GDP)	2,8	-1,6	-1,7	-1,2	-0,7	-0,3
Current account (% of GDP)	-2,2	-3,1	-2,9	-2,6	-2,8	-2,9
Public debt (% of GDP) 1/	19,3	21,8	22,9	21,0	20,7	19,1

1/ Non-financial public sector, excl. Central Bank. Source: Government and staff projections based on RMSM-X model

12. Excluding BCP debt.

13. Details of this DSA are included in Annex 6 of the DPL document.



**Table 3: Alternative macroeconomic scenario**

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Real GDP growth (%)	-2,0	0,5	2,5	3,0	4,5
CPI inflation (eop, % change)	6,5	6,2	6,0	6,0	6,0
Central government fiscal balance (% of GDP)	-2,2	-1,6	-1,4	-0,9	-0,4
Current account (% of GDP)	-5,0	-4,9	-4,4	-3,2	-2,7

Source: Staff projections based on RMSM-X model

additional 10 percentage points; (iii) remittances from Paraguayan workers abroad fall by 50 percent. Under this scenario, the economy would shrink by 2 percent and the current account deficit would increase to 5 percent of GDP in 2009 and 2010 (Table 3).<sup>14</sup> The exchange rate depreciation would be even more pronounced than under the baseline scenario. This simulation suggests that Paraguay's vulnerability to external factors is very high.

### C. STRUCTURAL CHALLENGES

22. Paraguay faces a number of important long-term developmental challenges which the new administration will have to address in order to transform Paraguay into a transparent, equitable and dynamic economy. These challenges broadly relate to three areas – governance, poverty, and growth and environment.

#### Governance

23. The public sector exhibits significant weaknesses in the formulation and implementation of public policies as well as in the delivery of public services. Underlying these findings is the fact that Paraguay's institutions have suffered from limited political

competition, poor checks and balances among state powers and limited accountability and transparency in the public administration (Annex 2 provides a broader description of governance). The recent presidential elections are a clear indication that a healthier and more competitive political process is starting to get underway, with the expectation of improved public debate and social consensus building. There are also increasing efforts in the public administration to offset the systemic practices of patronage and corruption. The initial steps towards the development of a professional civil service is an important goal in this process.

24. Paraguay faces very serious challenges in the area of corruption control. According to a recent assessment,<sup>15</sup> the perception of corruption is high in all governmental institutions, including state-owned enterprises and the two binational enterprises. According to this report, a high degree of corruption is associated with campaign finance, and public contracts or concessions, although large scale corruption also thrives in contraband and other illicit activities. Corruption also affects multiple aspects of daily life. These findings corroborate the outcome of an earlier survey conducted by a public/private Council established to promote integrity in 2005 (the "*Consejo Impulsor del Sistema Nacional de Integridad–CISNI*").

14. The impact on the current account is dampened somewhat because imports will fall in response to lower domestic demand.

15. Evaluación de la Corrupción – Paraguay; Mimeo by Benjamin Crosby and Laurence Beck from Management Systems International, July 2008.

## Poverty

25. In spite of recent improvements in poverty and income inequality rates since 2002, both welfare measures remain high relative to the rest of Latin America (see para. 10). In addition, current official data shows no progress in poverty reduction when seen over the last decade. Part of income inequality originates through inequalities in access to basic opportunities among children. It is therefore useful to focus social and economic policies on the need to increase opportunities for all. A World Bank study on the equality of opportunities in access to basic services among children in Latin America shows that, although Paraguay is close to having universal access to electricity, it still has a long road ahead in education and water and sanitation. The study suggests Paraguay needs to focus on increasing coverage rates and, in particular, on paying close attention to the coverage rates of disadvantaged groups.

26. **Social Exclusion.** Indeed, Paraguay faces tremendous challenges in terms of social exclusion that condition many of the high expectations that the new Government faces as it enters office. In the rural areas, as noted above, Paraguay has the highest concentration of land ownership in the world. While significant investments in capital and land improvements are being made by some of the large stakeholders, nonagricultural rural jobs are scarce. Thus, about 24 percent of the rural population lives in extreme poverty, and a total of 35 percent lives below the poverty line overall. Indigenous people (about 87,000 people nationwide or about 1.7 percent of the national population) face particular challenges: in the 412 indigenous communities registered nationwide, only 55 percent of residents have secure land access (either titled or with title in process). Only 26 percent of these communities have their own health centers or posts. In addition, the habitat occupied by many indigenous communities has undergone deforestation in recent year and consequent environmental degradation, and in many cases cannot provide the communities with adequate sustenance. As a consequence of these problems,

many peasants and indigenous people have migrated to cities and settled in marginal zones.

27. As the rural poor move to urban areas, they face a shortage of minimum-standard housing, public services and employment opportunities. In the Asunción Metropolitan area alone, some 150,000 people live in 78 informal settlements. Demographically, Paraguay is a young country with 2/3 of the national population below 30 years of age and some 36% below 15. One in three Paraguayans between age 7 and 17 works, often in an ill-defined and insecure environment. According to the 2001 Integrated Household Survey, some 38,000 minors between the ages of 5 and 17 worked as domestic servants in private homes. Only 3 in 10 poor children between the ages of 5 and 9 have a national identity card, a circumstance that limits access to public benefits and programs.

28. **Social Protection.** Paraguay features limited risk coverage through participation in the formal labor market. In addition, despite a decrease in formal unemployment, underemployment and informality are on the rise. International experience has proven that well targeted conditional cash transfers are an effective means of combating extreme poverty. The most important effort Paraguay has made in this direction is through the conditional cash transfers program (TEKOPORA) which was initially introduced in the poorest areas of the country. However, program coverage has so far been limited, due to the large number of public social programs under implementation which are competing for limited management and financial resources. In the short-term, therefore, Paraguay needs to focus on prioritizing social programs, with a view at concentrating its resources on the most effective ones. Moreover, with the projected deceleration of the economy, a well targeted set of social programs will be needed in order to protect the most vulnerable.

29. **Health.** The new Government faces urgent challenges in the health sector, including high infant and maternal mortality rates, and poor quality and limited access to health services. Provision of public health is inadequate and has suffered persistent deterioration

over the last ten years. Paraguay has also been exposed to epidemics that affect the population, such as outbreaks of malaria, dengue, and yellow fever. The deterioration in health outcomes has occurred despite an increase in Government spending for health by US\$18 per capita in 2007. The low impact of increased public spending is attributable to fragmentation in the provision of public health care between the Ministry of Health and the pension and health fund – with a vibrant but often unregulated network of private providers filling in numerous gaps. Despite these overlaps, according to the WHO, almost 40 percent of the population does not have access to health services. Overall, public spending focuses substantially on inputs, particularly human resources, where incentives and tasks are not always well defined. Finally, the sector is affected by a significant degree of politicization.

**30. Education.** In the last decade, Paraguay's education system has made considerable strides, including an improvement in system coverage at all levels, increases in the average educational level of the population, and improvements in the sector's internal efficiency. In addition, public expenditure on education (around 4 percent of GDP) is one of the highest in the region. Despite these achievements, participation rates in Paraguay are among the lowest in the region, especially in secondary education where desertion rates are high. Therefore, Paraguay needs to carefully evaluate the results of educational reforms and prepare a program for the near future, which is the focus of current efforts by both the Bank and other donors. The medium-term agenda includes, inter alia, an expansion in the coverage of middle level education (grades 7-9), improvements in equity in access to the third cycle of elementary education and middle level education, as well as improvements in system efficiency and in educational quality in view of increasing coverage.

**31. Public Pensions.** With only 0.6 percent of workers in the lowest income quintile participating in the system, Paraguay is the country in Latin America with the lowest coverage and the most inequitable access to pensions. Therefore, in the medium-term, there is an urgent need for Government to gradually improve

the pension system, with the objectives of making the system more uniform and equitable, and of increasing its coverage.

## Growth and Environment

**32.** Paraguay's long run growth performance has been disappointing. GDP per capita grew by 1½ percent on average since 1960, but over the past 25 years, GDP per capita declined by a yearly average of ½ percent. The recent growth acceleration between 2004 and 2008, the largest expansion since the 1970s, was welcomed, but sustaining it will be a challenge due to a number of weaknesses in the economic structure. While private investments have contributed to the development of new products and opened new markets over the past few years (e.g., beef exports to Israel and Russia, sesame exports to Japan, stevia exports to the region, and organic sugar to Europe), the export base is still narrow and highly dependent on commodities. The investment in private ports and a public-private association for animal health has eased some of the logistics and certification barriers faced by products such as soy bean and beef. As noted above, Paraguay has improved education coverage, particularly at the primary level. However, Paraguay's economic potential is still constrained by weak human and physical capital, as well as the economic and financial volatility the country has experienced (see Annex 4 on Growth Prospects).

**33. Agriculture.** Beyond the macro trends described above, agriculture in Paraguay is a story of three sectors – a highly productive, mechanized agricultural sector focused on exports (concentrated on soybeans and beef which together represent about 90 percent of registered exports) which exists alongside large extensions still under-utilized and a large number of poorly educated smallholders with little access to effective agricultural extension services, land and capital. Within small landholders, some are so poor and deprived of land, human capital and basic services that they are unlikely to survive without significant social assistance. Others, however, have had better access to basic services—particularly education—and are slowly forming a small but successful middle class



in rural areas, devoting time to both agricultural and service activities. Among small landholders, the youth has for the most part migrated to Asuncion or to Argentina, Spain or the United States.

**34. Transport, Communication and Water.** There are a number of infrastructure bottlenecks that limit social inclusion of the poor and the country's competitiveness as an exporter. The paved network, although accounting for less than 10 percent of the overall road network, connects major trade centers within the country and with Mercosur. The challenge ahead is to deploy an appropriate program of routine maintenance to avoid losing this key investment. The rural roads network comprises very few all-weather roads, providing rural communities with limited access to markets and basic social services. In river-based transportation, the key issue is the lack of dredging and signaling, which imposes excessive logistic costs. This is currently an unfunded mandate for the public entity that administers the country's state ports, *Administración Nacional de Navegación y Puertos* (ANNR), which is also responsible for regulating private ports. The ANNR and the Ministry of Public Works are exploring ways to address this issue, including the possibility of unbundling the functions of ports and waterways regulator from those of operating the country's ports. In addition, the private sector (key river users such as private ports, barges operators, and load owners) have expressed willingness to create a public-private partnership that would be responsible for river maintenance and signaling. In telecommunications, despite a significant liberalization of the cellular network, fixed lines and fiber optic cable were until recently under the monopoly of *Compañía Paraguaya de Comunicaciones* (COPACO), the country's state-owned enterprise. This monopolistic situation is responsible for the very limited penetration of broadband internet and lack of affordable and good quality long-distance dialing. The new administration has shown a strong commitment to address this issue and, in March 2009, issued a resolution (with World Bank technical support) that opened access to fiber optic. However, the liberalization of Voice over Internet Protocol (VoIP), over which COPACO still enjoys a monopoly, is still

pending. In the water supply and sanitation sector, with only 61 percent of the population connected to piped water supply networks (and only 49 percent in rural areas), service coverage in Paraguay remains low even in comparison with other lower middle income countries. Only 8 percent of the national population has access to piped sanitation.

**35. Business Climate.** Paraguay's overall ranking in the Doing Business indicator dropped from 108 in 2008 to 115 in 2009, which is below the average for LAC and for lower middle income countries. The downward change reflects lower rankings in four areas: starting a business, registering property, getting credit and trading across borders. While Paraguay continues to fare comparatively well in the first three areas, the deterioration in the latter area puts the country in the lowest quartile. Improvements in ranking were achieved in two areas: closing a business and enforcing contracts, although Paraguay continues to lag behind comparator countries in both of these areas. Paraguay's poorest performance is in employing workers, trading across borders, and closing a business. The country also needs to consolidate its 2007 gains in the opening a business indicator, by modernizing the handling of relevant transactions by the city of Asunción and other major cities.

**36. Electricity.** While Paraguay is blessed with abundant hydropower generation capacity, key weaknesses in transmission and distribution hamper the development of productive activities in both rural and urban areas, as well as the prospects for formal exports. While electricity coverage reaches 93.8 percent of all households (just below the LAC average of 94.6 percent), average per capita consumption per year was only 853 kWh, far lower than in Chile or in Brazil. Moreover, system losses are very high and well above the 13.5 percent weighted average for the LAC region. The authorities are currently discussing with Brazil possible ways of making the bilateral treaty on the Itaipú dam more flexible, thereby allowing Paraguay to better utilize this important asset.

**37. Environment.** Paraguay has lost at least 80 percent of its forests over the last 50 years and

losses of 500 ha/day occurred between 1966 and 1991. Of the remaining 2 million ha in the Upper Parana Atlantic Forest (UPAF, i.e. forests east of the Paraguay River), only an estimated 800,000 are still considered productive. This is due to destructive logging practices that have degraded the forests, and a result of deforestation that has fragmented much of the UPAF into unmanageably small remnant patches. While deforestation appears to have slowed recently in the east—due both to resource depletion and some success with a “Zero Deforestation” law—it is estimated to have increased in the Arid Chaco, which is home to 78 percent of Paraguay’s remaining native forests. With the right incentives and institutions, however, Paraguay could exploit its comparative advantage in forestry, as rates of return for key varieties in Paraguay appear to be higher than in other countries in the Southern Cone. To this end Paraguay started to promote forest conservation and payments for ecological services. The country has also started to reform its Forest Management Services by granting the institution greater autonomy.

# [ The Government's Economic and Social Program ]

38. The new Government's vision is based on the need to improve governance and reduce corruption, address the needs of vulnerable groups, and restore growth in light of the effects of the international financial crisis. The elements of a program to achieve these goals were outlined in various presidential addresses and are now embodied in the Ministry of Finance Economic and Social Plan for 2008-2013<sup>16</sup>. The Plan is part of a broader Government's Program that the new administration is preparing and updating on the basis of submissions by the individual Ministries, and has been adjusted in light of the global economic crisis (see para. 17).

39. The main features of the program can be subsumed into three major cross-cutting themes below.

» **Governance:** *Strengthening state institutions to improve policy making, public service provision, and the rule of law.* Given past political interference

in the public sector, the emphasis is on beginning a process to modernize the public administration through civil service reform and to increase the efficiency and governance of state-owned enterprises (where alternatives ranging from appointing capable managers and re-launching investment programs, to recapitalization and private public partnerships are being considered).

» **Poverty:** *Improving investments in the social sectors and focusing public spending on the extreme poor.* While the emphasis will be on employment generation and poverty mitigation, a comprehensive agrarian reform and a reorganization of the cadastre will also be launched. While the specifics of this reform has not been developed, which has created uncertainty among investors, the authorities are addressing the long standing issue of lack of opportunities to access land by the rural poor.

16. See <http://www.hacienda.gov.py/web-hacienda/index.php?c=218>

» **Growth and Environment:** *Fostering growth with a focus on employment generation and on improving income distribution, without destabilizing the country's macroeconomic framework or the environment.* In light of the global financial crisis, the emphasis is on continuing sustainable macroeconomic policies and maintaining stability in the financial sector, while investing in basic public infrastructure, education and in improving the business climate to increase productivity and competitiveness. Also important for the administration is to better use the potential of the two hydro power plants that the country co-owns with Brazil and Argentina, respectively.

**40. Assessment.** The new Government has established an agenda to initiate a transition to a transparent, equitable and dynamic economy that will benefit from the support of the international community. The Bank agrees that substantial progress in the three cross-cutting themes and in the sub-areas identified in the Economic and Social Plan, is needed for Paraguay to reach a turning point in its development agenda. The CPS will therefore focus on assisting the authorities achieve progress in selected aspects of the three cross-cutting themes underpinning future Bank and IFC support. However, the Bank is a relatively small donor in Paraguay and, as such, it will be highly selective in its interventions with the expectation that these will be complementary to the efforts undertaken with the assistance of other international donors.

# Lessons from Previous Engagement-The FY03-07 CAS

41. Starting in 2003, the Bank initiated a process of reengagement with Paraguay after a long period of inactivity. The Bank responded quickly and positively to the professional management demonstrated by the new administration upon its coming to office in April 2003 by preparing a new CAS for FY03-07 (subsequently extended to FY08). The program included an Economic Recovery Loan for US\$30M to help address the financial crisis and meet significant budgetary shortfalls at the time. The CAS also envisaged engagement in new sectors such as health, roads, pensions and social protection, and provided support in preparing a strong package of financial sector reforms.

42. Implementation of the CAS faced significant difficulties and fell short of the expected outcomes. Only US\$146.5 million in loans were approved for the extended CAS period FY04-08 out of the base case envelope of US\$325 million. Only five loans

reached effectiveness and two additional projects were approved but are still not effective<sup>17</sup>. With the benefit of hindsight, implementation of the CAS program would have been stronger if the Bank had better taken into account various factors including:

- The complexity of governance issues in Paraguay, particularly as they pertain to the relationship between the executive and the legislature. The constitutional requirement that Congress approves each loan individually after Board approval led to substantial delays in the effectiveness of projects, and ultimately to the cancellations of the Maternal Child Basic Health Insurance Project, as well as the Strengthening of the Ministry of Finance Technical Assistance loan and the Financial Sector Technical Assistance loan.
- The limited capacity of the public administration to plan, execute and monitor public investment

17. The Sustainable Rural Development Project for US\$37 million and the Water and Sanitation Modernization Project for US\$63 million

operations. The establishment of quality project teams constitutes a serious challenge that affects project implementation, particularly at the initial stages. There is, overall, a low level of professional capacity in the public sector and it has taken a prolonged Bank involvement in sectors such as rural water supply and education to build strong counterpart teams. In some cases, less intricate project design would have reduced the difficulties encountered in building implementation capacity.

- Limited Bank presence on the ground has implied a lack of continuity in policy dialogue, and an inability to provide timely preparation or implementation support. To address this problem, project management was in some cases outsourced to external agencies, which was clearly unsustainable. The field office is being gradually strengthened to ensure there is sufficient local professional capacity to respond to implementation challenges.

43. The success of the AAA program was also lower than expected. A 2007 QAG assessment found the AAA program moderately satisfactory overall, and highly satisfactory in terms of its strategic relevance, coherence and integration. However, the program was rated only moderately satisfactory in terms of its likely impact, local participation, consultation and dissemination. Nonetheless, some AAA products were deemed useful by the Government (e.g., the FY08 Integrated Fiduciary Assessment, the FY08 Education Sector Study, and the FY08 and FY03 Policy Notes) and others added long lasting value to the development agenda in Paraguay as, for example, the FY07 Land Tax study, which is being used by the Lugo administration as a key input into its own tax policy reform program. Since the QAG panel report was issued, the Bank has increased its emphasis on client participation to improve ownership and has enhanced collaboration with other donors.

44. Many lessons can be drawn from the experience of the 2003 CAS, including the need to invest in building broad project ownership during the preparation stage, and that of leveraging technical assistance with grant

funding to the extent possible. In conclusion, the 2003 CAS served as a tool for the Bank to maintain a seat at the policy table and had a limited but still significant development impact. The shortfall in the delivery of the lending program limited the degree of partnership and risk-sharing arrangements that lending instruments would have provided. Despite Bank's efforts to re-engage under the 2003 CAS, the Bank's presence in Paraguay remains limited. The outcomes and recommendations of the CAS Completion Report which carefully reviewed the 2003-2008 program (see Annex 5) formed part of the dialogue with Government and informed the design of this CPS.

# [ The Country Partnership Strategy ]

## A. STRATEGIC CONTEXT

45. This CPS proposes an increased engagement of the Bank as Paraguay initiates a new phase in its efforts to surmount significant and entrenched development challenges. The process ahead will most probably be difficult and there are no guarantees of success. However, the new Administration's key strategic priorities constitute a solid basis for the Bank to focus its support. In the near term, there is also strong coincidence in the approach proposed by the authorities to mitigate the effects of the global financial crisis, which will also be an important focus of our partnership. The Bank's proposed strategy also seeks to further strengthen the efforts undertaken by civil society to transform Paraguay into a more democratic, equitable and prosperous society. In this context, and in order to ensure an effective response to the emerging needs arising from changing domestic and external conditions, the Bank proposes to focus on the following strategic initiatives:

- Supporting ongoing efforts to introduce changes in the country's governance structure around a

series of Programmatic Development Policy Loans (DPLs) which will also provide the backbone of Bank's financial assistance over the coming years. While the focus of the DPLs will be on the new administration's state modernization agenda, it is expected that the DPLs will underpin the governance reform efforts of the Lugo Administration. Parallel knowledge assistance on broader governance issues will be addressed in the context of the GAC initiative discussed below. The first operation in the programmatic DPLs series is being presented to the Board together with this CPS.

- Supporting the poverty alleviation efforts, mostly through the Bank's continued engagement in investment lending and knowledge assistance in the human development and social infrastructure areas. The Bank's past involvement in the education, rural development, safety nets and water and sanitation sectors will provide the basis for an expanded and more effective dialogue with the Lugo Administration on poverty alleviation



and increased social equity. A new area for Bank involvement will be enhancing land access through participatory mechanisms, where the Bank can provide relevant international experience and which is a top priority in the Government's reform program. As part of the poverty alleviation agenda, a Water and Sanitation Sector Modernization Project was approved recently, building upon a long tradition of Bank's successful involvement in the sector.

- Supporting the Government's sustainable growth agenda with direct IFC assistance to private enterprises in the areas of trade financing and transport, as well as increased private sector involvement in the infrastructure sector. In addition, the Bank will seek to provide assistance to the new administration in some infrastructure investments, particularly in the areas of transport and electricity that are deemed to have significant potential for enhancing growth.

46. The proposed program, while clearly delineated, has some built-in flexibility to allow the Government to make adjustments as the economic, political, and social environment evolves. Therefore, only the initial two years of the CPS indicative program will be identified, with the outer years left open in order to accommodate future needs (see Box 1 below for key program parameters).

47. The CPS was prepared on the basis of extensive consultations with the Government, the international community and civil society. This broad consultative process helped shape the CPS and informed its design (see Annex 6). In addition, during implementation of the CPS, a special effort will be made to strengthen donor coordination for all activities, moving from coordination to joint activities and missions and even to seeking formal co-financing for our projects.

### Program Objectives and Instruments

48. The Bank Group's program will seek to make a selective contribution towards helping the Government meet its broad objectives of improving **governance**,

**reducing poverty and sustaining growth**—both in the short and medium term. Specific targets identified by the authorities in these areas (and the sub targets associated with Bank's assistance) are included in the program matrix. Details on the Bank Group's indicative program by area of Government action are provided in Table 4 below.

### Governance

49. The Lugo administration is placing governance at the forefront of its reform agenda. In particular, President Lugo's program emphasizes the need to break with past practices that enabled corruption and to establish a new standard of governance for the country based on improved democratic dialogue, increased accountability, transparency and integrity. Within this overall context, and in line with Paraguay's recent decision to become a pilot for the implementation of the Bank's GAC strategy, the Bank intends to significantly increase its governance assistance to Paraguay (See Box 2). The GAC provides a broad framework for the various initiatives through which the Bank will provide its governance assistance to the country. The main expected outcome of Bank support in this field will be that the current administration will mark the turning point of a credible process through which Paraguay will attain adequate governance standards and institutional development.

- **Lending.** A series of three Programmatic Development Policy Loans (DPLs), with a tentative envelope of US\$ 200 million, will support fiscal management and public sector reforms, including improved accountability of public enterprises, civil service reform and the overhaul of the internal control system for the public administration. Technical Assistance for supporting the authorities' reform efforts is being provided by several bilateral donors including the EU, USAID and Japan. In addition, the DPLs will provide timely budget support to ensure that critical social spending is not affected. This program will contribute to the Government plan's overall objective of achieving sustainable and more equitable growth by providing direct support to three of its areas





## Box 1: Key Parameters of the Country Partnership Strategy

- An average indicative Bank lending program of about \$100 million per year up to a total of \$500 million is projected for the five year period FY09-FY13. The CPS, however, does not propose a detailed lending program beyond FY10, with the identified program being about US\$265 million, or 53 percent of the entire envelope.
- There is a clear recognition of the significant risks involved in the implementation of the proposed strategy. The political environment, the country's implementation capacity and uncertain external conditions constitute significant factors that could end up adversely affecting the viability of the proposed assistance scenario. Thus, it is proposed that intensive monitoring and flexibility be considered critical elements of CPS implementation. The Bank will engage the authorities periodically in order to assess progress and will be prepared to change the proposed partnership terms if adverse conditions would make the proposed strategy impracticable.
- Up to 40 percent of the CPS envelope (i.e. \$200 million) will be in the form of Programmatic Development Policy Loans (DPLs) in the governance area. The indicative program also includes about US\$65 million in identified investment lending in the three thematic areas (see Table 4 below).
- Non-lending support will also be provided in the form of AAA, grants and fee for services, when appropriate, in support of government priorities and the lending program.
- The indicative envelope of \$500 million over the FY09-FY13 period would increase Bank exposure in US dollar terms, but still leaving the Bank a relatively minor creditor. The indicative envelope would be revised at the time of the CPS Progress Report in the third year of implementation, subject to the level of absorption, implementation capacity and Government's ability to maintain a sound macroeconomic framework, as well as the Bank's lending capacity at that time.
- At the proposed lending levels, and under the macro-framework presented in Annex Table B6, total IBRD debt is expected to remain below 3 percent of GDP and converge to 14 percent of total public debt over the medium term. Debt service to the World Bank is expected to represent less than 2 percent of total fiscal revenues.
- The Bank plans to collaborate closely with IFC, particularly in sectors that could enhance growth or offer new opportunities to increase value added, such as finances, infrastructure, SME development, agribusiness and trade.



**Table 4: Strategic Areas of Government Action and World Bank Group Support**

	<b>1. Governance</b>	<b>2. Poverty Reduction</b>	<b>3. Sustainable Growth and Environment</b>
1. Identified Lending:		<ul style="list-style-type: none"> <li>• DPL I (FY09, \$100m)</li> <li>• DPL II (FY10, \$50m)</li> <li>• DPL III (FY12, \$50m)</li> </ul>	<ul style="list-style-type: none"> <li>• IFC Barge Project (FY09)</li> <li>• IFC Trade Lines (FY09)</li> <li>• Electricity (FY10, \$tbd)</li> </ul>
		<ul style="list-style-type: none"> <li>• Land Access (FY10, \$35M)</li> <li>• Education (FY10, \$30M)</li> <li>• Safety Nets operation (FY11, tbd)</li> </ul>	
Grants (underway/new), Fee for Services (FFS) Cost Sharing (CS)	<ul style="list-style-type: none"> <li>• DFID Gov (FY08, \$0.2M)</li> <li>• Payments –FFS (FY08,\$0.3M)</li> <li>• StAR program (FY09)</li> <li>• IFC Business Enabling Environment (CS) (FY09)</li> <li>• GAC support (to be mobilized)</li> <li>• IDF for Congress (FY10, \$0.4M)</li> <li>• TFSCB Statistics (FY09, \$0.1M)</li> <li>• TFSCB Statistics (FY10, \$0.4M)</li> </ul>	<ul style="list-style-type: none"> <li>• JSDF Indigenous Land (FY08,\$1.7m)</li> <li>• JSDF Indigenous Communities. (FY08, \$1.6m)</li> </ul>	<ul style="list-style-type: none"> <li>• Environmental. Services. (FY08,0.2M)</li> <li>• IFC Business Enabling Environment (CS) (FY09)</li> <li>• GEF for Biodiversity. (FY10, \$4.5M)</li> </ul>
ESW and NLTA	<ul style="list-style-type: none"> <li>• Quick Response Note (tbd)</li> <li>• Programmatic. Public Sector. NLTA (FY10)</li> </ul>	<ul style="list-style-type: none"> <li>• Quick Response Note (Civil society FY10)</li> <li>• Programmatic Poverty NLTA (FY10)</li> <li>• Programmatic. Safety. Net &amp; Labor (FY10)</li> <li>• Health Service Delivery (FY10)</li> </ul>	<ul style="list-style-type: none"> <li>• Quick Response Note (tbd)</li> <li>• IFC Airports (FY09)</li> <li>• Financial Sector NLTA (FY10)</li> <li>• Programmatic Growth NLTA (FY10)</li> <li>• State of the Environment. ESW (FY10)</li> <li>• Municipal service ESW (FY10)</li> <li>• IFC Business Enabling Environment (FY10)</li> </ul>
	<ul style="list-style-type: none"> <li>• Participatory Policy Notes (FY12)</li> </ul>		

Source: Annex Tables B3 and B4

of focus: macroeconomic policy, state-owned enterprises and state modernization. The DPL series is also designed to assist the Government in its efforts to contribute to the anti-crisis plan from January 2009.

• **Non-Lending.** The Bank’s program will contribute to furthering the governance agenda through the various GAC initiatives (See Box 2)

• **Other.** Equally important would be to support the Government’s effectiveness agenda in the area of service delivery, by incorporating a governance component into Bank-financed investment operations --building on the successful experience of the Roads Maintenance Project, which includes a Governance Action Plan which supports the supply side of governance and encourages social participation, control and accountability.

- **IFC.** The IFC aims to ease the microfinance environment via improved regulation and a potential expansion in advisory services. In early FY09, the Business Enabling Environment (BEE) of LAC's Advisory Services (AS) Facility visited Paraguay and presented to the Government and to the private sector experiences in other countries on simplifying processes for attaining construction and operating licenses. This was well received and the BEE team is prepared to work on this topics should the authorities request it. IFC is willing to place an investment officer in the World Bank's office if their program in Paraguay warrants it.

## Poverty

50. The Government's broad and ambitious objective of **reducing poverty** entails, inter alia, a reduction in poverty levels through employment creation, an improvement in social indicators, a decrease in inequality through increased access to public services and land, and a reduction in the incidence of child labor. Within these broad objectives, it is expected that Bank support will contribute to improving living conditions for the rural poor through improving access to and the effectiveness of social programs in education, water and sanitation, safety nets and access to land (see Annex 5 for country's indicators with respect to MDGs).

- **Lending.** In the immediate term, and to mitigate the impact of the global financial crisis on the vulnerable population, the DPL series is expected to provide the resources needed by the Government to maintain the social programs already included in the 2009 budget. In addition, the proposed additional financing to the Community Development Project will continue past support to local communities, and the recently approved Water and Sanitation Modernization Project will support an expansion in coverage of water supply and sanitation services. In the medium-term, the Bank program is expected to assist the authorities in designing and implementing a market based land reform through a proposed Land Access and Administration operation. In addition, a

Secondary Education project is included in the first two years of the indicative program under the CPS. It is expected that this project will contribute to improve educational coverage and outcomes, particularly in the rural areas, and help the authorities establish a scholarship program to develop a future cadre of Government officials. The Bank and the authorities are also discussing possible Bank engagement in expanding safety nets through non-lending activities that could be followed by an investment operation.

- **Non-lending.** In terms of AAA, the Bank will continue an active engagement with the authorities in the poverty area. The successful poverty assessment non-lending TA, which helped to improve poverty measurements and also carried out, jointly with local researchers, an analysis of poverty issues, will be continued. This will be supported by a programmatic dialogue on safety nets, and on the coverage of vulnerable populations through the country's formal health and pension systems. In addition, the Bank will continue to mobilize grant funding, including from the Japan Social Development Fund, to address the needs of vulnerable groups (two JSDF grants supporting indigenous groups are currently ongoing).

## Sustainable Growth and Environment

51. The authorities' key objective is to foster sustainable growth with a focus on employment generation and managing better the country's hydroelectric potential, while safeguarding macroeconomic stability and the environment. The Bank and IFC will support this objective through programs for the short- and medium-term. In the short-term, the focus will be on safeguarding macroeconomic stability and, in particular, on helping mitigate the effects of the global financial crisis on economic activity, employment and poor households by providing quick disbursing funds as part of the proposed programmatic DPLs. The IFC's immediate focus will be on facilitating financial intermediation and helping the authorities improve the investment climate. The Bank and IFC will also





## Box 2: GAC in Paraguay

The Paraguay GAC strategic objective is to establish the Bank as an advisor of choice for the Government of President Lugo in its mission to develop a viable governance path towards increased social equity, economic growth and stronger democratic institutions. The Bank recognizes there are important development partners that have been playing a proactive and substantive role in supporting governance related activities in Paraguay and the Bank will work in close coordination with them. Building on previous areas of involvement, the GAC Pilot seeks to engage the government in a multi-pronged GAC agenda dealing with:

- Broad governance issues where the Bank can play a facilitating role in placing governance as a priority in the overall public policy agenda. In this area the Bank supported an International Conference on Governance and Development convened by President Lugo in August 2008 with the objective of presenting to the domestic political community relevant international experience in the handling of governance challenges. The Government has made two additional requests for assistance in: (i) facilitating the return of stolen assets through the StAR initiative; and (ii) improving the domestic investigative and sanctioning capacity to handle corruption. Both these activities respond to specific government needs and enjoy strong ownership by the new administration. The Bank envisages to take a leading role in both initiatives, while ensuring close coordination with other donors in the respective fields.
- Country fiduciary agenda derived mostly from our recent Integrated Fiduciary Assessment (IFA). The IFA has provided the analytical basis for a reform agenda aimed at improving transparency and accountability in key government functions, i.e., public investment planning and implementation, civil service reform, state enterprise oversight and improved internal and external control mechanisms. This proposed agenda will be supported by a series of programmatic DPLs over the next years, together with a strong effort to coordinate the reform agenda with other development partners providing technical assistance support in these areas.
- An investment portfolio agenda consisting in the mainstreaming of all Bank funded operations within the regular state structure (thus, doing away with PIUs and the outsourcing of project implementation to international agencies) and in increasing reliance on country systems in key fiduciary areas. This agenda faces significant governance challenges, as it has implied phasing out ring fencing arrangements which were customary in Bank operations and tackling the civil service, organizational and fiduciary challenges derived from the increased reliance in country systems. In line with this agenda, the Government has recently issued new civil service rules to attract qualified personnel in the handling of internationally funded investment projects.
- A sector and project specific agenda. Starting with the path-breaking Road Maintenance Project, new operations are expected to develop explicit governance frameworks to deal with governance challenges in the respective sector. GAC-related incremental preparation budgets have enabled the conduct of governance related analytical work in the education, rural and water and sewerage sectors. It is expected that new operations in these fields will have a much stronger governance content. One specific challenge for the rural sector is the development of detailed frameworks to introduce increased transparency and accountability in community driven projects, users' associations and the broader communities.

In implementing the GAC, the Bank will seek to mobilize trust funds and other resources which would allow the country to make progress in the various areas and initiatives.



launch programs for the medium-term aiming at either supporting interventions that unambiguously enhance growth prospects, or facilitating the internal dialogue on how best to promote sustainable growth (See Annex 6 on Growth Prospects). Specific interventions would include:

- **Lending.** The Bank is considering to co-finance the medium-term program to improve the electricity grid, jointly with other potential financiers (such as the European Investment Bank and, potentially, private sector sources). In addition, there is ongoing dialogue on other possible infrastructure interventions (e.g., rural roads, public ports and airports, and key waterways) but no specific project has been identified so far. These initiatives will build on the ongoing Road Maintenance Project which, among others, supports private sector participation in road maintenance and will aim at increasing access to markets in the rural areas of San Pedro and Caguazu (the country's two poorest departments).

- **Non-Lending.** The Bank will launch a programmatic dialogue on growth related issues in Paraguay, which will consist of an exchange of experiences between countries in a similar situation, and will lead to the preparation of short analytical reports on specific issues, such as the effects of contraband trade on the economy and the potential for diversification of the agro-industry and export businesses away from soy and beef products. Other donors are expected to be involved in this type of analysis, which will look at the big picture, but also focus on sustainable rural development and on the development of small cities. Given Paraguay's financial sector vulnerability to a potential economic downturn, the Bank will support the Government's efforts to monitor these vulnerabilities, and take action to strengthen supervision when required, through a non-lending TA.

- **Other.** The Government has expressed interest in a country environmental assessment which would prioritize interventions in a range of environmental areas (such as deforestation, water contamination,

indoor/outdoor air pollution). The Bank will further support the environmental agenda through a Global Environmental Facility (GEF) program, including a US\$20m (US\$4.5m GEF grant) program to conserve biodiversity in the Atlantic Forest of Eastern Paraguay. Looking forward, Paraguay has yet to commit a significant portion of its Resource Allocation Framework (RAF) for biodiversity and climate change under GEF-IV. The Bank will look for opportunities to develop GEF projects, particularly in areas that maximize synergies with Bank lending. The Bank further supports Paraguay's participation in the Forest Carbon Partnership Facility (FCPF) and will seek to mobilize support for this initiative from a bilateral donor.

- **IFC.** IFC is renewing its engagement with Paraguay. So far this fiscal year, IFC has committed an additional trade line with a third local bank, and is pursuing additional operations with financial institutions focused on SMEs, microfinance and agribusiness and with a strong presence outside the capital city in order to maximize reach. As part of the strategy to improve transport services and trade in Paraguay, IFC has also committed and disbursed this fiscal year a US \$60 million loan to the largest barge operator on the Parana-Paraguay river system. Further, IFC is considering projects in the agribusiness sector, as well as in the cellular telecommunications sector. Given the need to improve infrastructure in Paraguay, IFC and the Bank will coordinate closely to identify projects that could be supported by the World Bank Group. On the Advisory side, IFC's pipeline consists of two projects: one with a local microfinance institution, helping it to expand its services and in turn access to finance, and another one to simplify local regulation in Asuncion to ease the cost of doing business for entrepreneurs.

## Program Monitoring

52. Beginning in mid-FY10, yearly CPS review missions (or program discussions during the Annual Meetings) will review with the authorities progress made in the implementation of the CPS and the proposed lending

operations, as well as analytical work and non-lending activities for the ensuing years, in order to ensure their continued relevance and jointly agree on the need for changes to the indicative program. The program will take into account the Government's needs, its absorption and implementation capacity, as well as integrity and the projects' perceived impact.

53. The flexible nature of the CPS creates a need for clear guidelines as to when and where – and how intensively– the Bank should be engaged in Paraguay. Because of Paraguay's financial circumstances following the global financial crisis and its development agenda, all future engagement will be demand-driven. However, the Bank will also ensure that its work in Paraguay serves the institution's broader goals and meets institutional standards. For this purpose, management will regularly monitor both the pace of reforms and the overall macroeconomic environment to ensure that Bank resources are properly utilized. The Bank will also ensure that governance safeguards are in place prior to utilizing Bank resources. This will require regular monitoring of Paraguay's reform efforts, particularly in the various aspects that contribute to improving transparency and governance. Indicators for governance, social needs and millennium development challenges, and growth will be regularly monitored and benchmarked against other countries through non-lending work and in collaboration with other multilateral agencies and bilateral donors.

54. In addition to monitoring performance indicators, implementation of Bank projects will also be closely monitored through bi-annual portfolio reviews, despite the fact that the portfolio is currently very small. In addition, the design of projects classified as "risky" will include self-regulating triggers which would delay or suspend preparation in case of failure to carry out reforms that are fundamental to the project's success.

55. The success of the CPS will be measured in terms of Paraguay's ability to take tangible steps towards

addressing the challenges faced under the three areas of focus (see paras. 49, 50 and 51) and that the extent to which the Bank Group contributed to these results. As the program is demand driven, the continued interest by the Government in obtaining increased assistance from the Bank would be an indication that the Bank is being responsive to the country's assistance needs. Finally, the Government's ability to mobilize effectively the Bank's financial and technical resources will be the key driver to the successful implementation of the CPS.

## B. PORTFOLIO

56. The Bank's portfolio in Paraguay is small, consisting of two projects under implementation (the Road Maintenance Project for US\$74 million approved in FY07, and the Secondary Education Project for US\$24 million approved in FY 2004), and three projects awaiting effectiveness pending Parliamentary approval (the US\$37.5 million Sustainable Agricultural and Rural Development Project approved in FY08, the US\$9 million additional financing for Community Development Project, also approved in FY08, and the Water and Sanitation Sector Modernization Project)<sup>18</sup>. Overall, the portfolio is considered satisfactory, as indicated by the satisfactory rating of the two projects under implementation and the two projects which have recently closed (the initial phase of the Community Development project and the Fourth Rural Water Supply Project). However, the two project awaiting effectiveness for over six months have been downgraded to unsatisfactory status given delays in their approval by Parliament.

57. From the beginning of 2006, the Government and the Bank made a strong effort to improve portfolio performance in a context of high fiduciary risk. Particular focus was placed on institutional aspects of operations, ensuring not only fiduciary compliance but also capacity building. A systematic financial management and procurement assessment of the portfolio is

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18. This project was almost unanimously approved by the upper chamber of Congress on March 26, 2009, but awaits approval by the lower chamber.

carried out on a regular basis. In addition, the SEPA (*Sistema de Ejecución de Planes de Adquisiciones*) is expected to be introduced as the portfolio grows in size to ensure greater transparency in the procurement process. The system has been presented to the Government and is currently being implemented by the Road Maintenance Project. It will be subsequently implemented by the Sustainable Agriculture and Rural Development Project and the additional financing for the Community Development Project as soon as they become effective. The expectation looking forward is to continue deepening this effort in particular in the design of new operations.

58. However, the main challenge to portfolio performance continues to be posed by extensive delays in obtaining Congressional approval of new projects, as in Paraguay all externally funded loans and grants require Congressional approval on a case by case basis outside of the budget process. The Executive is committed to increase the flow of information to Parliament on donor funded projects and the Bank will support these efforts by ensuring that information on planned Bank funded projects is readily and widely available. However, since major improvements are needed in the institutional processes whereby the Executive and the Legislative branches approve external assistance, which are also at times politicized, this issue will continue to pose serious consequences for the predictability and level of development assistance.

59. Progress in portfolio management was accompanied by positive steps towards strengthening financial management. The 2006 budget law prohibited the use of outsourcing in the implementation of new projects. This will initiate a strong effort to strengthen state structures for the management of investment projects. In addition, an important tax and customs reform was initiated in 2004, and technical improvements to the budget process were implemented in the areas of financial planning, cash management, and budget accounting. With the support of the IDB and the United States Agency for International Development (USAID), the Comptroller General of the Republic has been strengthened, which has contributed to some

improvement in the external audit function. Despite these efforts, external audit still exhibits considerable weaknesses, including the limited effectiveness of follow-up on audit recommendations. The Government is also initiating reforms of the internal audit function (*Auditoria General del Poder Ejecutivo*, AGPE); nonetheless, AGPE's current institutional capacity is still not sufficiently developed to allow it to carry out its duties effectively. In procurement, modern legislation has been recently adopted. This, together with the creation of the General Directorate for Public Procurement and the development of a public procurement system, has strengthened transparency.

60. Despite these accomplishments and the commitment of the new Government to improve public financial management and the accountability and control environment, substantial challenges remain for both the authorities and the donor community. In the areas of financial management and control, the initiatives undertaken are too recent to show significant results and need to be monitored. More efforts are required to strengthen control agencies. The Bank will continue its dialogue with the authorities during the CPS period in order to identify opportunities to assist the Government in planning and implementing reforms for improving public financial management and accountability. This will be carried out by expanding non-project fiduciary work and by identifying opportunities for providing support through grant funding.

61. **IFC.** During the last CAS period, IFC committed and fully disbursed US \$15 million to finance the expansion of a cellular telecommunication company. In FY08, IFC extended two trade lines of US \$5 million each to two local financial institutions with the goal of strengthening the financial sector while expanding access to finance for exporters.

### C. IBRD FINANCIAL PRODUCTS AND SERVICES

62. IBRD offers a full array of financing and risk management products, which could provide flexibility

to Paraguay in managing its debt, including the ability to change the financial characteristics of existing and future loans as to better manage financial risks relating to currency, interest rate, roll over and commodity price volatility. Within this context, Paraguay may want to consider engaging staff of the World Bank's Treasury to become fully aware of the flexibility, depth and breadth of IBRD's full menu of banking products and services, including IBRD's technical assistance in designing and implementing a broad strategy for public debt management aimed at reducing both market risks and overall costs of funding.

63. IBRD recently introduced a new pricing and maturity structure that makes IBRD loans very competitive for Paraguay. This pricing structure currently stands for USD borrowings at approximately LIBOR + 78 bps for loans with a fixed spread and LIBOR + 1 bps for loans with variable spread, inclusive of a 25 bps front-end fee. In addition, the new pricing structure has become more transparent and predictable, with the elimination of the commitment fee and yearly waivers, while retaining the existing flexibility to manage currency, interest rate, roll over and commodity price risks. Furthermore, maturity of IBRD loans was recently extended, allowing for maturities of up to 30 years. This combination of pricing and extended maturities should be very attractive to the Government of Paraguay as it pursues its own developmental agenda throughout the new CPS period.

#### **D. DEVELOPMENT PARTNERS**

64. A large number of international organization and bilateral donors are active in Paraguay. Paraguay, however, lacks a formal aid coordination mechanism and, up to recently, donor coordination has taken place largely on an ad hoc basis. Since the appointment of President Lugo, the Government has made concerted efforts to take the lead in coordinating donor support, and the donor community now meets regularly, jointly with Government counterparts, to identify a common strategy in support of the new administration. Efforts notwithstanding, Paraguay's

weak financial and institutional capacity provides the ground for a donor-driven set of investment programs. Through the proposed CPS, the Bank will support the Government's efforts to assume the leading role in reviewing investment programs and particularly in deciding which projects to include in the indicative program for the latter part of the CPS period.

65. In the past, the Bank has maintained an active dialogue with other international organization, including the IADB, and key bilateral donors, including the United States and Japan. In addition, the Bank has been in close consultations with the IMF team, which carries out bi-annual Article IV consultations after the country successfully completed three successive arrangements, and has maintained close ties with the IFC, particularly as it plans to step up its involvement in Paraguay over the coming years. The Bank has also coordinated with other relevant donors at the sectoral level and at the level of individual projects. For example, the Bank has engaged very closely with key partners in the policy areas covered by the DPL, including tax system, public sector financial control, expenditure management and human resources management. Table 5 below provides details on key donors' assistance programs and Bank collaborative efforts. For details on principal areas of assistance by donor, see Annex 7.

#### **E. EXPECTED RESULTS OF THE CPS**

66. Indicative outcomes and results indicators are presented in the annexed CPS Results Matrix. Expected CPS outcomes as indicated in the Matrix will be further refined as the needed information becomes available, and are therefore subject to change. These changes will be reflected in the CPS Progress Report which will be prepared at the end of the third year of CPS implementation. The CPS Progress Report will take stock of program implementation at mid-term and the revised indicators will reflect the status of program implementation at that stage. A Client Survey will also be carried out at the time of preparation of the CPS Progress Report.



**Table 5 : Main Development Partners by Area of Focus**

	<b>Key Areas of Focus</b>	<b>Ongoing and/or Planned Support</b>	<b>Collaboration with the Bank</b>
Inter-American Development Bank (current loans and grants portfolio)	<ul style="list-style-type: none"> <li>• Governance</li> <li>• Poverty and inclusion</li> <li>• Growth and Competitiveness</li> </ul>	<ul style="list-style-type: none"> <li>• 93 programs (24 sovereign-guaranteed loans, 6 non sovereign guaranteed loans, 40 technical cooperation grants, 17 FOMIN operations, and 6 small productive grants) totaling US\$716M in commitments, of which US\$474M undisbursed.</li> <li>• The 2009 program amounts to US\$366,6M. It includes a PBL to improve the public administration (US\$50M), a road project (US\$65,6M), a rural sanitation project (US\$48M) and a liquidity facility for growth sustainability (US\$200M). Technical cooperation and FOMIN is programmed to be between US\$9M and \$10M.</li> </ul>	<ul style="list-style-type: none"> <li>• Progress in harmonizing fiduciary arrangements</li> <li>• Consultations and joint meetings with counterparts on the Education Project and DPL programs</li> <li>• Joint ESW/Integrated Fiduciary Assessment</li> </ul>
Japan International Cooperation Agency and Japanese Bank for International Cooperation	<p>- JICA priority areas include:</p> <ul style="list-style-type: none"> <li>• Poverty Reduction, including human development and income improvement for small farmers</li> <li>• Economic Competitiveness for Growth</li> <li>• Improve of the Public Administration and Good Governance</li> <li>• MERCOSUR</li> <li>• Conservation of the Environment and sustainable development</li> </ul> <p>- JICA (recently merged with JBIC) is also providing support through investment projects..</p>	<p>-Over the 2002-2006 period annual support from JICA has been in the range of JAP¥1.6-2.1 billion (or about US\$15.6-21.1million), which has also been maintained for more recent years. Specific support included Technical Cooperation Projects to help:</p> <ul style="list-style-type: none"> <li>• Poverty. Medical Education, Mental Health, Small Cooperatives in the Southeastern Paraguay.</li> <li>• Growth. Agricultural Technology Center, Quality and Productivity Center, and Improvement of Social Infrastructure.</li> <li>• Governance. Strengthening of the Civil Service and, starting last FY, Local Government Capacity Building.</li> <li>• MERCOSUR. Regional Cooperation on Animal Health, Impact of Tariff Unification on Paraguay, Tourism.</li> <li>• Environment. Starting last FY, Decentralization in Environment Management, Solid Waste Management.</li> </ul> <p>Support also includes studies on Integrated Rural Development for Small Farmers; and Civil Society Initiatives, including productive activities for low income women.</p> <p>-JBIC's most recent project supports the construction of the Iguazu hydropower station (JAP¥21.4 billion or US\$215 Million)</p> <p>-JBIC also supported a feasibility study for export corridors in the Western and Eastern areas of Paraguay (completed, loan request in process) and a feasibility study for water supply in the metropolitan area of Ciudad del Este (March 2009)</p>	<ul style="list-style-type: none"> <li>• Consultations on civil service reform and agriculture</li> <li>• Joint outputs for previous pension/safety nets work (including joint missions)</li> <li>• Possibly formal or informal co-financing arrangement for DPL</li> </ul>

**Table 5 : Main Development Partners by Area of Focus (cont.)**

	<b>Key Areas of Focus</b>	<b>Ongoing and/or Planned Support</b>	<b>Collaboration with the Bank</b>
European Union	<p>- In December 2007 Paraguay and the EU signed a MoU on cooperation for 2007-13 for €117 million in grants supporting two sectors: education and economic integration. It builds on ongoing support for the Government's poverty reduction strategy. - The EU has two programs of Technical Assistance under implementation on growth and governance</p> <p>- Furthermore, the EU supports a number of social sector initiatives implemented through civil society, amounting to about € 7M.</p> <p>- Paraguay also benefits from TA and cooperation from the EU-MERCOSUR, and EU-LAC programs</p>	<p>- Pre-2007 support:</p> <ul style="list-style-type: none"> <li>• Poverty Reduction via general budget support(€28M committed €14M disbursed, 7 to be disbursed in 2009)</li> </ul> <p>- Support on the Dec 2007 MOU:</p> <ul style="list-style-type: none"> <li>• Education. Sectoral budget support (first financing agreement of 54M € pending signature). Prevision of a first €10M disbursement in 2009</li> <li>• Integration. Project approach. first financing agreement of € 6M pending signature.</li> </ul> <p>- TA:</p> <ul style="list-style-type: none"> <li>• Governance: State Reform (€6M)</li> <li>• Growth: Competitiveness (€13M)</li> </ul> <p>- Civil Society: 25 contracts in 2009 in areas such as:</p> <ul style="list-style-type: none"> <li>• Agro-Ecological Production</li> <li>• Strengthening of Peasant and Indigenous Communities (support for the legalization of land distributions)</li> <li>• Fight Against Poverty, Education and Literacy (Teaching for Adults)</li> <li>• Civil Society Participation and Human rights.</li> </ul>	<ul style="list-style-type: none"> <li>• Joint ESW for the Integrated Fiduciary Assessment</li> <li>• Joint Mission/ Meetings on Education program</li> <li>• Continuous team consultation to ensure synergies</li> </ul>
USA/USAID	<p>The US program focuses on economic growth and social justice, while fighting corruption, narcotics and other forms of illegality that undermine national development</p>	<ul style="list-style-type: none"> <li>• 1st Threshold Program under the Millennium Challenge Account focused on fighting corruption, financial management, judiciary system, customs, and formalization (\$34.6M completed in 2008)</li> <li>• 2nd Threshold Program approved, focusing on anti-corruption in law enforcement, customs, healthcare and judicial sectors (\$30.3M)</li> <li>• Debt for Nature Swap (\$7.4M)</li> <li>• Democracy and civil society Programs</li> <li>• Peace Corps program</li> <li>• Support for competitiveness and formalization through Paraguay Vende and other initiatives</li> <li>• OPIC/Citibank have a program supporting SMEs (\$95M).</li> </ul>	<ul style="list-style-type: none"> <li>• Continuous team consultation to ensure synergies</li> <li>• Close coordination on DPL and Integrated Fiduciary Assessment</li> </ul>

# [ Risks ]

67. Notwithstanding Paraguay's economic expansion and strong performance over the past four years, a number of important risks must be acknowledged. Some of these are external risks, others are country related risks, and we will only address those risks that could affect the delivery of the program under the CPS.

68. *Political and Governance Risks.* The minority hold of the APC coalition in the Legislative and its limited government experience may negatively impact on the Government's ability to formulate and implement its development agenda.

69. This may have two operational consequences for the Bank's program and, more generally, for all programs of external assistance. First, the preparation of new projects might take longer than expected while consensus is being reached among Government and stakeholders. While in some sectors, such as education, a well defined sectoral strategy is already in place, other projects are more likely to suffer preparation delays, such as land redistribution. The Bank will seek

to carry out non-lending activities in areas of strategic priority for the authorities to help clarify options and unify views. In addition, project preparation should set as a critical priority the development of consensus and ownership of specific investment initiatives. Second, there is also a risk that even if there is consensus on a sector strategy, a highly fragmented Congress may fail to approve new investments (with Bank's or other donors' support) once these have been prepared. To mitigate such risk, the Bank will continue to increase the knowledge available to the various stakeholders. A Communication and Governance grant will be implemented to help strengthen the communication skills of both the Government and the executing agencies. Despite these efforts, this risk is assessed as **high**, since the current institutional environment is conducive to suboptimal decision making in this area.

70. *Social Risks.* Despite high economic growth and advances in employment, the social situation is fragile, given the high levels of exclusion in the country. The lack of housing and social services, as

67. Notwithstanding Paraguay's economic expansion and strong performance over the past four years, a number of important risks must be acknowledged. Some of these are external risks, others are country related risks, and we will only address those risks that could affect the delivery of the program under the CPS.

68. *Political and Governance Risks.* The minority hold of the APC coalition in the Legislative and its limited government experience may negatively impact on the Government's ability to formulate and implement its development agenda.

69. This may have two operational consequences for the Bank's program and, more generally, for all programs of external assistance. First, the preparation of new projects might take longer than expected while consensus is being reached among Government and stakeholders. While in some sectors, such as education, a well defined sectoral strategy is already in place, other projects are more likely to suffer preparation delays, such as land redistribution. The Bank will seek to carry out non-lending activities in areas of strategic priority for the authorities to help clarify options and unify views. In addition, project preparation should set as a critical priority the development of consensus and ownership of specific investment initiatives. Second, there is also a risk that even if there is consensus on a sector strategy, a highly fragmented Congress may fail to approve new investments (with Bank's or other donors' support) once these have been prepared. To mitigate such risk, the Bank will continue to increase the knowledge available to the various stakeholders. A Communication and Governance grant will be implemented to help strengthen the communication skills of both the Government and the executing agencies. Despite these efforts, this risk is assessed as **high**, since the current institutional environment is conducive to suboptimal decision making in this area.

70. *Social Risks.* Despite high economic growth and advances in employment, the social situation is fragile, given the high levels of exclusion in the

country. The lack of housing and social services, as well as the recent increases in food prices, are fueling tensions in the urban areas. In regions, use of land in highly mechanized soybean production has fueled tension with poor small-scale farmers and landless peasants. The political transition has generated high expectations, particularly among the poor, that urgent social needs will be met and the new Government is expected to implement social emergency measures. There is therefore a social risk associated with the authorities not being able to deliver on their program as quickly as the public expects, or in a manner that meets expectations. This could engender social discontent leading to lack of support for the Government. Despite the fact that much of the Bank's and other partners' programs are geared to help improve social conditions in the short and medium-term, the social risk is assessed as **high**.

71. *Fiduciary Risk.* The ineffectiveness of the control system, together with the inefficiency of the budget process and the lack of fiscal transparency, are the main challenges Paraguay faces in procurement and financial management. These shortcomings, coupled with Paraguay's underlying political and institutional weaknesses, are particularly harmful to the smooth implementation of donor funded operations. As public sector investment depends crucially on IFIs and bilateral donors' lending and grants, continued weakness of the fiduciary environment would seriously undermine the implementation of the Government's program. The Bank will ensure close supervision of the program under implementation over the CPS period. The new administration's strong commitment towards improving the integrity environment and the actions that it plans to undertake in the near future –including those under the Programmatic DPL–should lead towards a gradual improvement of fiduciary conditions in the country. In the meanwhile, the fiduciary risk is assessed as **high**.

72. *External Shocks and Natural Disasters.* Paraguay is highly vulnerable to further deceleration of the world economy, and additional setbacks in international prices and demand for the country's export products.

A sustained drop in growth could also affect the credit quality of the domestic financial system, and may particularly affect financial cooperatives. In addition, although not likely in the short to medium term, supply shocks related to higher international oil prices could become a drag on the economy. Lastly, Paraguay's economic activity is highly prone to natural disasters such as fires, droughts and floods. The Bank will help address the risks through flexibility in its program, thereby allowing resources to be redirected quickly towards areas of need during the CPS implementation period.<sup>19</sup> Also, in the past, the Bank has made available to the authorities of the treasury services it offers to help the country navigate external shocks. A future area of engagement may consist, precisely, in a more active use of those services. Continued prudent economic management will be critical to reduce the likelihood and impact of such shocks. The risk associated with external shocks and natural disasters is assessed as **high**.

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19. Other donors are actively helping Paraguay develop its natural disaster response capacity.





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# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals <sup>20</sup>	Issues and Obstacles <sup>21</sup>	CPS Outcomes <sup>22</sup>	Milestones <sup>23</sup>	Bank Group Program (and Partners) <sup>24</sup>
<b>I. Governance and Anticorruption: Strengthening state institutions to improve policy making, public service provision, and rule of law for investments and households.</b> (Note: Translated from the Government's Economic and Social Strategy 2008-2013)				
<b><i>i. Fighting corruption and increasing transparency</i></b>				
Breaking up with the practices that enabled corruption opportunities in the past	<ul style="list-style-type: none"> <li>• Widespread acceptance of corruption (including mini-payments) among public officials and the population</li> <li>• Weak public administration (low incentives, and burdensome processes) provides the grounds for corruption to thrive</li> <li>• Lack of transparency in key activities increase the perception of corruption (e.g., the handling of social spending in Paraguay by the ITAIPU hydropower plant)</li> </ul>	<ul style="list-style-type: none"> <li>• Number of high profile corruption cases successfully brought to (domestic or international) justice Baseline: 0 (2008) Target: 5 (2014)</li> <li>• Number of ministries or agencies formally adopting good governance practices Baseline: 1 (2006) Target: 3 (2013)</li> </ul>	<ul style="list-style-type: none"> <li>• Subscription to the WB/ UNODC Stolen Assets Recovery Program;</li> <li>• Preparation of a plan for coordinating anticorruption action by the various agencies;</li> <li>• Agreement on governance framework for roads (done) and water sectors;</li> <li>• Implementation progress in all the above mentioned areas</li> </ul>	<p><b>WB</b></p> <ul style="list-style-type: none"> <li>-Possible GAC TF</li> <li>-StAR initiative</li> <li>-Road Project (FY05),</li> <li>- Water Project (FY09)</li> </ul> <p><b>Partners:</b></p> <ul style="list-style-type: none"> <li>- USAID, IADB, JICA</li> </ul>

20. Longer-term or higher-order development objectives identified by the country. Usually not achievable in the CAS period nor solely addressed by the CAS program. Only those to which CAS outcomes will contribute are included.

21. Critical issues and obstacles to achieving country development goals, providing the logical link to CAS outcomes.

22. Country results deemed achievable in the CAS period and which the Bank expects to influence through its interventions. Indicators of each outcome are included, with baselines and targets.

23. Progress markers of CAS implementation; outputs, actions, or outcomes expected to be realized during CAS implementation.

24. Ongoing and planned lending, grants, and guarantees; analytical and advisory activities. Includes IBRD, IDA, IFC, and MIGA. Partners included if cofinancing or other support of same CAS outcome.

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<b>ii. Modernization of the Public Administration to improve service delivery .</b> (Note: Translated from the Government's Economic and Social Strategy 2008-2013)				
<i>a. Strengthening Financial Public Control</i>	<ul style="list-style-type: none"> <li>• Ineffective internal control procedures and environment; limited internal audit capacities</li> </ul>	<ul style="list-style-type: none"> <li>• Increase effectiveness of internal control and internal audit function               <ul style="list-style-type: none"> <li>– PEFA Indicators for Internal Control and Internal Audit (PI-20 and PI-21) have been upgraded</li> </ul> </li> <li>Baseline: D+ (IFA 2008)</li> <li>Target: C (2013)</li> </ul>	<ul style="list-style-type: none"> <li>• The Government has issued two decrees to upgrade the Office of the Executive's Internal Auditor (AGPE) to ministerial level; and to strengthen the authority and independence of AGPE in order to establish a the standard internal control model (MECIP) and determine criteria for selection of internal auditors throughout the central administration.</li> <li>• 50 percent of ministries and secretariats have established internal control committees, internal control norms, and trained staff to implement the MECIP; and their respective internal audit units (AIs) have the number of employees and competitive hiring processes required by AGPE.</li> </ul>	<p><b>WB</b></p> <ul style="list-style-type: none"> <li>- Programmatic DPL</li> <li>- Public Sector AAA</li> </ul> <p><b>Partners</b></p> <ul style="list-style-type: none"> <li>- JICA</li> <li>- US/USAID</li> <li>- IDB</li> <li>- EU</li> </ul>
<i>b. Gradually Professionalize Civil Service</i>	<ul style="list-style-type: none"> <li>• Weak state institutions, particularly the civil service due to lack of meritocratic recruitment, lack of simple and clear remuneration policies, and lack of controls over Human Resource Management policies.</li> </ul>	<ul style="list-style-type: none"> <li>• Personnel recruitment and promotions are based on merit and professional skills.               <ul style="list-style-type: none"> <li>– Percent of officials recruited competitively and supervised by Civil Service Secretariat (SFP).</li> </ul> </li> <li>Baseline: 0, only some consultants (2007)</li> <li>Target: 30% of all hires (2013)</li> <li>– Percent of civil servants promotions supervised by SFP.</li> <li>Baseline: 0 (2007)</li> <li>Target: 30% of all hires (2013)</li> </ul>	<ul style="list-style-type: none"> <li>• Government introduces competitive and transparent processes for recruitment and promotion of civil servants, and the Civil Service Secretariat is overseeing those processes.</li> <li>• Amendments to the Civil Service Law to strengthen public servants' professionalism and to redefine the scope of public administration, as well as the rights, obligations, and procedures associated to recruitment, promotion and removal of public servants</li> </ul>	<p><b>WB</b></p> <ul style="list-style-type: none"> <li>- Programmatic DPL</li> <li>- Public Sector AAA</li> </ul> <p><b>Partners</b></p> <ul style="list-style-type: none"> <li>- JICA, USAID, IADB, CAF</li> </ul>

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<b>ii. Modernization of the Public Administration to improve service delivery.</b> (Note: Translated from the Government's Economic and Social Strategy 2008-2013)				
<p><i>c. Restore Government Oversight on State-owned enterprises (SOEs)</i></p> <p><i>Note: Government program on SOEs is more ambitious and aims at "efficient State-owned enterprises (SOEs) to improve welfare and competitiveness"</i></p>	<ul style="list-style-type: none"> <li>• Ineffective provision of public services by SOEs due to:</li> <li>- Discretionary management practices; lack of transparent financial management. Mis-governance arising in part from the ineffective organization of the state ownership function, and</li> <li>- Low levels of investments, often below depreciation levels, by SOEs due to lack of management capabilities and financial resources</li> </ul>	<ul style="list-style-type: none"> <li>– Finances and operations of SOEs are transparent and subject to greater scrutiny by Government and civil society</li> <li>• Improve public service delivery for Water and Electricity by increasing the share of capital expenditure over total expenditure for ESSAP from 8.5% (2008 baseline) to 20%, and for ANDE from 10.6% (2008 baseline) to 20%. Baseline: 8.5% ESSAP (2008) 10.6% ANDE (2008)</li> </ul>	<ul style="list-style-type: none"> <li>• Government has issued a decree to establish a Council for SOEs (CEP) ensuring (i) public sector oversight on SOEs, and (ii) the definition of a Government policy for SOEs' reform.</li> <li>• A Holding Agency of SOEs is legally established to replace CEP. It has the authority to: (i) elaborate SOE corporate governance, including the criteria for appointment and removal of high rank personnel; (ii) redesign management evaluation mechanisms; (iii) design a system of investment planning, and (iv) evaluate the financial situation of each SOE.+</li> <li>• The Holding Agency ensures that, beginning in 2010, all SOEs are subject to annual external audits by international audit firms, which are required to be prepared according to CEP/Holding standards, and published.</li> <li>• The Ministry of Finance establishes clear rules with respect to transfers and payments between SOEs and the Central Administration.</li> <li>• Projects in support of investments by ESSAP become effective (i.e., are approved by congress)</li> <li>• ANDE satisfactorily implements ongoing investment program and develops (jointly with financiers) a transmission investment program</li> <li>• Appropriate fiduciary management of public investments by ESSAP and ANDE</li> </ul>	<p><b>WB</b></p> <ul style="list-style-type: none"> <li>- Programmatic DPL</li> <li>- Public Sector AAA</li> </ul> <p><b>Partners</b></p> <ul style="list-style-type: none"> <li>- JICA, IADB</li> </ul> <p><b>WB</b></p> <ul style="list-style-type: none"> <li>- Water Project (FY09)</li> <li>- Electricity Transmission (FY10)</li> </ul> <p><b>Partners:</b></p> <ul style="list-style-type: none"> <li>- IADB, JICA, EIB, MERCOSUR, SPAIN</li> </ul>

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<b>II. Poverty: Improving investments in the social sectors (health and education) and focusing public spending on fighting extreme poverty.</b> (Note: Translated from the Government's Economic and Social Strategy 2008-2013)				
<b><i>i. Employment generation and fighting poverty (especially in light of the effects of the global financial crisis on Paraguay)</i></b>				
<p>Extreme and overall poverty is kept at 2007 levels despite the expected economic slowdown</p> <p>Source: DEEG</p> <p>Baseline: 20% &amp; 36% (2007)</p> <p>Target: 20% &amp; 36% (2012)</p> <p>Note 1: Government program is more ambitious than the Bank in terms of poverty targets as it was produced prior to the crisis.</p> <p>Note 2: Poverty measurement methodology is expected to be revised for the 2008 indicators)</p>	<ul style="list-style-type: none"> <li>• Large number of public social programs under implementation, which compete for limited human resources and infrastructure.</li> </ul>	<ul style="list-style-type: none"> <li>• Focus the limited country capacity and financial resources on a few programs:               <ul style="list-style-type: none"> <li>– Increase the number of beneficiaries (households) for the conditional cash transfer program—Tekopora, PRO-PAIS II, and Ñopotivo</li> <li>Baseline: 18,700 (2008)</li> <li>Target: 75,000 (2012)</li> </ul> </li> <li>– Retool institutional capacity to address other important poverty concerns, particularly those arising from the crisis, via decentralized mechanisms, such as community driven projects</li> <li>– Provide opportunities for community groups or micro-enterprises to participate in maintenance agreements for rural roads</li> </ul>	<ul style="list-style-type: none"> <li>• Gradually increase beneficiaries of the conditional cash transfer programs as follows: (1) 25,000 beneficiaries by 2009, (2) 50,000 beneficiaries by 2011, (3) 75,000 beneficiaries by 2012</li> <li>• In parallel improve targeting methods, and the supply of health, education, and nutrition that might be required for the program</li> <li>• Launch a dialogue on the options that Paraguay has to counteract the effects that the Global financial crisis might have on poorest households (including, if appropriate, partnership with private sector in support of active labor market policies, vocational education, etc.)</li> <li>• Effectiveness of the additional finance for community development</li> <li>• Process of Strengthening the Secretariat for Social Action (SAS in Spanish) begins</li> </ul>	<p><b>WB:</b></p> <ul style="list-style-type: none"> <li>- Programmatic dialogue on social policy</li> <li>- Programmatic poverty assessment</li> <li>- Possible safety nets operation</li> <li>- Additional Finance for a Community Development Project (FY08)</li> <li>- JSDF for community development of indigenous communities</li> <li>- Road Maintenance project (FY06)</li> </ul> <p><b>Partners:</b></p> <p>EU, IADB, GTZ, ILO, UNFPA, UNDP, Mexico, Brazil, Chile, and other bilaterals</p>

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<i>ii. Integrated Agrarian Reform, and reactivation of small-scale (household) agriculture</i>				
<ul style="list-style-type: none"> <li>• Implement a comprehensive agrarian reform with intermediation by the state and participation of key relevant sectors: small-scaled (household) agriculture and agricultural enterprises</li> <li>• Strengthening small/ scale agriculture as suppliers of food, to ensure national food security and achieve growth with equity and with insertion into markets</li> <li>• Promote participation of the peasant sectors through strengthening communities, and taking into account gender and equity.</li> <li>• Promote cultural, social and territorial stability for indigenous populations</li> </ul>	<ul style="list-style-type: none"> <li>• Weak consensus on how best to address the landless problem, and weak implementation capacity for this agenda (including land access and agricultural support services)</li> </ul>	<ul style="list-style-type: none"> <li>– Launch participative approach to increase land access for vulnerable groups (e.g., low income or young farmers, indigenous), and provide appropriate support services to them</li> <li>• Number of communities benefitting from project-sponsored land access opportunities and proper support service arrangements Baseline 0 (2008) Intermediate 10 (2011) Target 50 (2013)</li> <li>• Increased number of indigenous communities with formal title Baseline 0 (2008) Target 30 (2012)</li> <li>• Launch program to provide integrated support to the rural poor in San Pedro and Caaguazu Baseline 0 (2008) Target 100 of which 5 indigenous communities (2013)</li> </ul>	<ul style="list-style-type: none"> <li>• Consensus on options to enhance land access reached. 2009</li> <li>• Participative options designed to complement traditional practices. 2010</li> <li>• Communities' application and screening process advances. 2011</li> <li>• Participative land-access support to communities starts to be implemented 2012</li> <li>• Sustainable rural development project declared effective (2009)</li> <li>• Implementation arrangements deployed</li> <li>• Community applications, screening</li> </ul>	<p><b>WB</b></p> <ul style="list-style-type: none"> <li>- Sustainable Rural Development Project (FY08)</li> <li>- Land Access and Administration project (FY10)</li> <li>- Programmatic municipal development dialogue.</li> <li>- JSDF for titling land to indigenous communities</li> </ul> <p><b>Partners</b></p> <p>FAO, GTZ, IFAD, IADB, IICA, Japan</p>



# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
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### iii. Increase enrollment rates and quality of secondary education

• Managerial problems at all levels of the education sector (Ministry, Departments, schools), deficient supply of service at the delivery level (lack of schools, lack of maintenance, lack of key educational inputs), high dropping out rates and low transition rates between lower and upper secondary education, and low student achievement (quality)

• Increase in enrollment rates at the pre-school, lower secondary, and upper secondary together with increases in quality of secondary education  
Baseline (2005, gross enroll. rates)  
- Pre-schooling, 89%  
- Lower secondary, 80%  
- Upper secondary, 52%  
Target (2012, g.e.r)

	2009	2011	2012
Pre-schooling	92	96	99
Lower Secondary	90	95	99
Intermediate	60	64	66

• Continue support for the conditional cash transfer associated with upper secondary school attendance  
• Continue efforts to improve secondary education curriculum and increase teacher's skills through initial training and in-service training  
• Expand the achievements test for secondary students (SNEPE - *Sistema Nacional de Evaluación del Proceso Educativo*) and participation of the country in international students assessments (TIMSS and/or PIRLS)

**WB**  
- Secondary education project  
- Programmatic Social Protection dialogue  
**Partners:**  
- EU's education modernization program  
- IADB Primary Education Strengthening Program

### iv. Increase access to water and sewerage services for the entire population, including indigenous populations

Population with access to sewerage  
Baseline: 8% (2007)  
Target: 20% (2013)

Population with access to drinkable water  
Baseline: 61% (2007)  
Target: 71% (2013)

• Lack of a sound strategy for the sector, although the framework for incentives to providers so as to ensure system efficiency and sustainability is advanced.

• Lack of a strategic institutional framework for the sector at the national level, and lack of identification of concrete actions to improve the efficiency of providers. Finally, lack of an investment framework for the sector for the short, medium and longer-term.

• Increase coverage of water and sanitation system in rural and urban areas and in particular increasing the number of additional families (over 2007):  
- using sanitation systems in the Asunción metropolitan area: Target of 15,000 new families by 2013  
- Using water supply systems in rural and indigenous areas: Target of 5,000 new families by 2013  
- Using basic sanitation in rural areas: Target of 4000 new families by 2013).

• Framework for managing the sector agreed (rural and urban)  
• Investment program for water and sewerage approved  
• Increased level of public investment in the sector materialized

**WB:**  
Water Modernization Project  
**Partners:**  
- Mercosur structural funds  
- Japan  
- EU  
- IDB  
- Spain

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<b>III. Growth with equity: Fostering growth with a focus on employment generation and on improving income distribution, without destabilizing the country's macroeconomic framework, and in an environmentally friendly manner.</b> (Note: Translated from the Government's Economic and Social Strategy 2008-2013)				
<b><i>i. Appropriately responding to the global financial crisis, while safeguarding macroeconomic and financial stability</i></b>				
	<ul style="list-style-type: none"> <li>• Strong external volatility coming from a sharp reduction in trade (the fall in commodity prices and export demand) and worker's remittances.</li> <li>• Low overall tax revenues and reliance on trade related taxes (VAT on imports, duties, and excises) makes it difficult to smooth out fluctuations w/ sustainable fiscal deficits (although debt to GDP is low).</li> <li>• Expenditure in personnel accounts for about half of total spending. Since it is protected the country tends to cut social and infrastructure spending during crisis. Low capacity to formulate, implement and monitor capital and social spending. Chronic budget under-execution.</li> <li>• Progress in supervising banks and microcredit institutions has been made since the financial crisis of the 1998-2003 period, but fast growing and weakly supervise cooperatives could pose a systemic risk to financial stability.</li> </ul>	<ul style="list-style-type: none"> <li>• Adoption of a countercyclical fiscal policy to mitigate the impact of the crisis on the most vulnerable population, but maintaining a sustainable fiscal stance in terms of public debt to GDP:               <ul style="list-style-type: none"> <li>- The overall fiscal balance to move from surplus to deficit, but to avoid sharp increases in the debt to GDP ratio the average deficit be around 1% of GDP (2009-2011)</li> <li>- Increased tax-to-GDP ratio Baseline: 11.9% (avg 2004-08) Target: 13.0% (2013)</li> </ul> </li> <li>• Utilizing the fiscal headroom to increase targeting of public spending, away from wages and other recurrent spending and towards capital and social protection items:               <ul style="list-style-type: none"> <li>- Increase public investment/ GDP ratio Baseline: 1.8% in 2008 Target: 3.5% in 2013</li> <li>- Increase coverage for the conditional cash transfer program Baseline: 2008: 18,000 Target: 100,000 in 2013</li> </ul> </li> <li>• Financial sector supervision framework strengthened</li> </ul>	<ul style="list-style-type: none"> <li>• Adoption by congress of the emergency, anti-crisis, package of \$300M which is co-financed by IDB, CAF, Japan and the World Bank.</li> <li>• Gradually (as political economy permits) expand the base of tax payers by, for instance eliminating VAT deductions from the profit tax paid by agricultural enterprises (the IMAGRO), improving administration for the 114 largest firms and designating as VAT withholding agents, increasing excises.</li> <li>• Adoption by the Executive of financial programs (which control non-protected such as social programs and public investments) that are consistent with social and infrastructure priorities (for 2009 and beyond)</li> <li>• Efficient institutional and operational mechanisms for public entities responsible for social policy implementation are introduced.</li> <li>• Progress in introducing international supervision standards for cooperatives</li> <li>• Given the lack of predictability of how the economic slow down will affect the financial sector, the CBPY undertakes systemic risk analysis of potential scenarios and contingency measures for each of them</li> </ul>	<p><b>WB</b></p> <ul style="list-style-type: none"> <li>- DPLs</li> <li>- Programmatic public sector reports</li> <li>- Programmatic growth notes</li> <li>- Macroeconomic and financial sector monitoring</li> </ul> <p><b>Partners</b></p> <p>IMF, US Treasury, IDB, JICA, CAF</p>

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<p><i>ii. Moving towards a more sustainable pattern of growth, based in greater diversification of products and external markets; supporting investments in infrastructure and human capital, and improvements in the investment and business climate, that will unambiguously move the country in that direction in the short to medium term</i></p>				
<p>a. Infrastructure:</p> <ul style="list-style-type: none"> <li>- Electricity: Start the process to improve the country's transmission capabilities</li> <li>- Airports: Increase air traffic potential and reduce its cost</li> <li>- Roads: increase efficiency of public spending on roads, by focusing resources on maintenance of main network and basic rural roads Percent of road spending devoted to routine road maintenance Source: MOPC Baseline: 10 MUSD (2006) Target: 35 MUSD (2013)</li> <li>- River navigation: reduce the time and cost of transporting merchandize through the Parana/Paraguay river system</li> <li>- Telecommunications: significantly improve quality and cost of the country's internet network for voice and data</li> </ul>	<ul style="list-style-type: none"> <li>• Country unable to optimize the electricity it generates (half of that generated in ITAIPU and YACYRETA) for lack of transmission capacity</li> <li>• Underutilized air navigation assets for lack of investments (e.g., radars) and a frame-work to secure partnerships with the private sector</li> <li>• Lack of basic systems to implement regular maintenance programs of the road network</li> <li>• Lack of strategic planning and link with budget resources</li> <li>• Weak institutional framework for regulating river traffic, maintaining the navigability of the river, and operating the state's ports</li> <li>• COPACO, the SOEs has a monopoly on fiber optic and has precluded the use of VoIP</li> </ul>	<ul style="list-style-type: none"> <li>• Investment program to interconnect generation facilities with domestic and potential foreign users launched.</li> <li>• Exploration of ways in which the air traffic potential is maximized, including possibly through private sector participation</li> <li>• Improve the quality of road infrastructure though the increase of km of road under systematic road maintenance</li> <li>Baseline 25% of paved road network under routine maintenance in 2007 Target 50% by 2013</li> <li>• Achieve a 10 meter operational depth and 24 hour navigation all year round in waters of Paraguayan and shared jurisdiction in the Paraguay and Parana rivers</li> <li>• Number of internet users per 1000 people increased Baseline: &lt; 4.1 (2006) Target: 7 (2013)</li> </ul>	<ul style="list-style-type: none"> <li>• Carry out feasibility studies including environmental and social assessments</li> <li>• Initiate the construction of the first tranche of a major new transmission line.</li> <li>• Adoption by Parliament of the simple airport concession framework submitted by the Ministry of Public Works in 2008</li> <li>• Detailed analysis of options</li> <li>• First maintenance contracts awarded to the private sector. 2009</li> <li>• All maintenance contracts for the paved road network awarded. 2011</li> <li>• Toll network optimized. 2012</li> <li>• Develop an strategy for the institutional framework of river navigation (and the role of the ANNR, the state's port authority, in this framework) 2009</li> <li>• Develop public-private sector schemes for financing and operating river maintenance 2010</li> <li>• Enact decree on internet liberalization (free provision of fiber optic)</li> </ul>	<p><b>WB</b></p> <ul style="list-style-type: none"> <li>- Road maintenance project</li> <li>- Electricity transmission project</li> <li>- Possible additional infrastructure project</li> <li>- Programmatic AAA on small cities/rural development</li> <li>IFC</li> <li>- Dialogue on Airports.</li> <li>- Investment in logistic company for river transportation</li> </ul> <p><b>Partners:</b> Korea, IADB, JAPAN, CAF, Chile, EU</p>

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<i>iii. Sources of Growth and Overall Competitiveness</i>				
<p>Lack of consensus on country's economic and social direction and on exploiting all potential sources of growth</p> <p>Creating qualified new jobs by increasing in-country value added and/or diversifying foreign partners</p>	<ul style="list-style-type: none"> <li>Domestic tension due to the expansion of modern agricultural production and cattle ranching, which is often blamed by local actors for rural-urban migration, and deforestation.</li> <li>Private investment faces many issues including an erratic legal and judiciary framework and inconsistent application of the rule of law. There is also a lack of qualified labor, and in there is a significant amount of red-tape for almost every transaction. Financing might be also an issue for small and medium enterprises.</li> </ul>	<ul style="list-style-type: none"> <li>Dialogue on sources of growth (including the potential role of the modernization of agricultural enterprises) launched.</li> <li>Enterprise investments are fostered through gradual but consistent improvements in the business climate</li> </ul> <p>Baseline: 17% of GDP (2007) Target: 18% of GDP (2013)</p>	<ul style="list-style-type: none"> <li>Participatory diagnostic prepared on major constraints to sustainable growth</li> <li>Continuation of the cluster work of the Ministry of Industry and Commerce, which essentially is a public/private mechanism of dialogue to resolve business obstacles faced by key industries</li> <li>Start a program to simplify the opening of a business and the issuance of construction licenses in Asunción.</li> <li>Continue programs to promote public/private dialogue towards resolving business obstacles</li> <li>Continue programs to support private sector development through the second-tier bank (AFD), and foster greater IFC (and IDB's private arm) presence in Paraguay</li> </ul>	<p><b>WB group:</b></p> <ul style="list-style-type: none"> <li>WB's Programmatic Growth Notes</li> <li>WB's secondary education project</li> <li>IFC's ongoing financial sector operations</li> <li>IFC's ongoing operations in logistics</li> <li>IFC's possible support to selected agribusinesses</li> <li>IFC BEE program</li> </ul> <p><b>Partners:</b> US, IADB, JAPAN, EU, UNDP</p>

# Annex 1

## Paraguay Country Partnership Strategy Results Matrix

Country Development Goals	Issues and Obstacles	CPS Outcomes	Milestones	Bank Group Program (and Partners)
<i>iv. Safeguarding the environment</i>				
<p>Preventing further deforestation in the Upper Parana Atlantic forest, while introducing good environmental practices by small farmers in Caaguazu and San Pedro.</p> <p>Promoting forest conservation and payment for ecological services (PES).</p> <p>Participating in the international carbon market.</p> <p>Setting of environmental priorities.</p>	<ul style="list-style-type: none"> <li>• Destructive logging practices that have degraded the forests, and with this the habitat of many species. The zero deforestation law has slowed down the trends, but cash-strapped farmers still cut trees illegally.</li> <li>• Lack of enabling environment to promote carbon finance operations.</li> </ul>	<ul style="list-style-type: none"> <li>• No of groups exposed to conservation practices in the Upper Parana Atlantic Forest, Caaguazú and San Pedro Baseline: 0 (2007) Target: 15 (2013)</li> <li>• Ecological services identified and valued, from farmers' land selected in pilot areas</li> <li>• Decrease in unsustainable forest management practices and slow down of the expansion of the agricultural frontier as a result of the implementation of PES in pilot areas.</li> <li>• Strengthening of the national capacity at both institutional and technical level in order to enable the development of Clean Development Mechanism (CDM) projects and other mitigation activities</li> <li>• At least one carbon finance (CF) operation in a key sector.</li> <li>- An analytical tool to determine environmental priorities.</li> </ul>	<ul style="list-style-type: none"> <li>• Agreement with OAS and IDEA to promote payment for ecosystem services and sustainable agriculture.</li> <li>• Extension of the Carbon Finance Assist Country Work Program</li> <li>• Study of mitigation potential in the country to participate in the Carbon Partnership Facility (CPF).</li> </ul>	<ul style="list-style-type: none"> <li>- GEF: Paraguay Biodiversity</li> <li>- IBRD: Sustainable Rural Development (PRODERS, in portfolio)</li> <li>- Carbon Partnership Facility</li> <li>- Carbon Finance</li> <li>- WBI Carbon Finance Assist</li> <li>- WBI Development Market Place</li> <li>- AAA: Cost of Environmental Degradation and State of the Environment</li> </ul>

# Annex 2

## CAS Completion Report

Date of CAS: November 26, 2003: Report No. 27341-PA  
Period covered by the CAS Completion Report: FY04-FY08  
CAS Completion Report completed by: Frank Earwaker, Consultant, September 2008

### Summary

This document evaluates the achievement of CAS objectives in Paraguay together with the respective contributions of the Government and the Bank.

The 2003 CAS was prepared at a time when Paraguay was emerging from a long period of economic decline and deepening poverty. After President Nicador Duarte Frutos was elected in April 2003 he espoused a far-reaching agenda of structural and policy reforms aimed at correcting fiscal imbalances, fostering growth and reducing poverty. At the same time, he sought to restore confidence in Government and encourage greater civic participation.

The Bank responded positively and promptly by preparing a CAS based upon discussions with the new administration. Following upon a long period of low Bank activity in Paraguay and little lending, the CAS was structured in terms of re-engagement. It proposed a strong program of lending and AAA for the CAS period FY04-07. It was later on decided not to extend the CAS period to FY08 through a Progress Report, but rather to wait for the new administration to take office in order to synchronize the CSP period with the electoral cycle and design a new CSP which more adequately reflected the new administration's priorities.

The operational re-engagement of the Bank under the FY04-07 CAS began with an Economic Recovery SAL (ERL) that was presented to the Board in December 2003 along with the CAS. The ERL successfully provided financial support for the Government's short- and medium-term action program in the areas of fiscal stabilization, deficit reduction, taxation, public administration, financial sector reform, pension reform and the fight against corruption. Results in terms of renewed economic growth and poverty reduction exceeded the targets of the CAS.

The CAS envisaged substantial additional adjustment lending in the financial sector but that had to be scaled back because the financial sector reform agenda did not move forward on as broad a front as expected. At the same time, differences emerged between the executive and the legislature which made it difficult for the Government to get Congressional approval for external loans as required by the national constitution. As a result, some Bank loans were withdrawn or cancelled before loan signing/effectiveness. Of the 13 lending operations envisaged in the base-case CAS scenario only four were approved and became effective.

It is now clear that the CAS overestimated the prospects for Bank lending under a new administration and actual lending fell far short of the CAS program. Nevertheless, the Bank was able to re-engage effectively with Paraguay. Even when projects were dropped, withdrawn or cancelled the Bank was able to achieve positive results in helping the reform agenda move forward with other instruments such as grant financing and analytic work. Project preparation work also contributed directly to progress with the Government's reform agenda, particularly in areas such as financial management and budgeting.

The program of AAA envisaged in the 2003 CAS was effectively delivered. An assessment of AAA in Paraguay by a QAG panel concluded that the program was highly satisfactory in terms of its strategic relevance to the issues confronting Paraguay. In many cases analytic work was undertaken in cooperation with other international agencies including the IMF, the IDB and the European Union. It has served to advance and enhance the policy dialogue with the Government. As a result, the Bank and Paraguay are now well placed to move ahead further with a broad-based policy dialogue backed by selective lending operations strategically targeted at areas where the Bank can contribute most effectively to foster growth and reduce poverty.

# Annex 2

## CAS Completion Report

### I. INTRODUCTION

1. The FY04-07 Country Assistance Strategy for Paraguay was written at a time when the outlook for Paraguay appeared brighter than it had for many years past. The country was emerging from a long period of economic stagnation during which time income per capita (according to the World Bank Atlas methodology) had fallen from US\$1,810 in 1998 to US\$1,170 in 2002 and 46 percent of the population had fallen below the poverty line. Poor economic performance had been exacerbated by declining world prices for soybean and cotton exports and by financial turmoil in neighboring countries, including a devaluation of the Brazilian currency in 1999 and an economic collapse of Argentina in December 2001.

2. With the election of President Nicador Duarte Frutos in April 2003, a window of opportunity was opened for reforms that could arrest and reverse the economic decline of Paraguay. The new administration espoused a structural reform agenda that focused on five key areas: (i) correcting fiscal imbalances; (ii) restoring confidence in government; (iii) fostering economic growth with social equity; (iv) reducing poverty; and (v) encouraging greater civic participation in government. The Government moved quickly to build a coalition of support for its reform agenda and also sought the support of the international financial community. The Bank responded promptly by preparing Policy Notes that served as a basis for discussions with the Government

on critical policy issues.<sup>25</sup> Following those discussions the Bank also prepared a CAS that was presented to the Board together with an Economic Recovery SAL in December 2003 – only four months after the new administration took office. In parallel to those efforts, the Government reached an agreement with the IMF on a 15 month stand-by arrangement. Other international and bilateral financial institutions, including the IDB, were also forthcoming in extending support.

### II. PARAGUAY'S NATIONAL DEVELOPMENT GOALS

3. The Government clearly explained its development strategy in a letter of development policy dated November 19, 2003 and delivered to the Bank in the context of an Economic Recovery SAL. Additional and more detailed information on economic and financial policies were contained in a Letter of Intent dated December 5, 2003 and delivered to the IMF in the context of a 15 month stand-by agreement.

4. In its letter of development policy the Government candidly acknowledged that many years of economic stagnation had exacerbated poverty and insecurity in Paraguay. It also acknowledged serious shortcomings in the ability of the Government itself to provide basic infrastructure and social services. The situation called for a radical change in the country's development model and, in articulating the vision, objectives and strategic guidelines for a medium-term program

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25. "Policy Options for the New Administration" Report No. 25894-PA; June 6, 2003



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## CAS Completion Report

of action, the Government identified four strategic objectives.

5. The first strategic objective was to restore confidence in the State and its representatives. To that end, the Government undertook to modernize the public administration, make it more efficient, more transparent and less prone to corruption. In particular, state institutions were to operate within a clearly defined rules-based framework and their performance would be assessed on the basis of results.

6. A second strategic objective was to foster an active participation of the citizenry in building democratic institutions. In that context, the Government would seek to involve civic society in the processes of policy formulation and program implementation. The country's "social capital" would be enhanced by strengthening the institutional framework of citizen cooperation.

7. A third strategic objective was to revitalize economic growth and employment by investing in physical and human capital within the context of a sound macroeconomic framework. The need to strengthen financial sector institutions and restore sound management to fiscal and monetary policy was clearly understood. In particular, there was an urgent need to regain control of the public finances and place them on a basis that would be sustainable in the long-term.

8. The fourth strategic objective was to fight poverty, corruption and insecurity. Programs of basic health care, and education were to be strengthened and

extended to sections of the population that were underserved. Likewise, basic infrastructure services including low-income housing were to be provided to lower-income communities.

### III. THE BANK'S PROGRAM OF SUPPORT

9. The program proposed in the CAS was broadly supportive of the Government's program while recognizing that progress would depend critically upon the effectiveness with which the authorities pursued structural and policy reform. Since there had been a long period of low Bank activity in Paraguay and little lending, the CAS was structured in terms of re-engagement. The proposed strategy took into account a long-history of political difficulties and institutional weaknesses that had obstructed reform efforts in the past. In a situation which was recognized to be "high risk / high reward" the CAS incorporated clear performance criteria according to which lending would be tied to the administration's progress in matters of economic management and reform. A base case lending scenario was proposed subject to compliance with key triggers in public administration, fiscal and financial sector reforms and portfolio implementation. If the triggers were not met, lending was to revert to a core program of investments in support of the millennium development goals. The CAS also included a high case scenario although it was acknowledged that Paraguay was unlikely to meet the criteria for the high case until the latter years of the CAS period at best. Within those constraints, the proposed program of Bank assistance was based on four pillars.

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## CAS Completion Report

10. The first pillar was to support key structural reforms needed to stabilize the public finances and strengthen the financial sector. An Economic Recovery SAL was presented to the Board at the same time as the CAS and it provided financial support commensurate with an ambitious program of reforms that the new administration had submitted to Congress for approval. The intention was that a stable structure of public finances and a strengthened banking system would bolster the confidence of private investors and thereby lay the foundation for sustained economic recovery. Analytic work was also envisaged to advance the Bank's dialogue on key economic reforms.

11. A second pillar of Bank support was to assist the Government in its effort to improve governance and the transparency of public administration. It was envisaged that support would be provided through a series of technical assistance loans and grants. In that context, a loan to transform the Ministry of Finance into a "ministry of excellence" by professionalizing the civil service staff, upgrading internal procedures and controls and by reorienting its institutional goals towards service to the public, was viewed as a flagship project to be followed by similar initiatives in other ministries and at other levels of government including municipalities which would then be better prepared to accept responsibility for decentralized public services. It was envisaged that the operations program would be supported and complemented by analytic work including a land tax study and an institutional and governance review.

12. A third pillar of the CAS was to support sustainable growth by helping to improve the business

environment and thereby foster private sector development. At the same time, special attention was to be given to increasing production and productivity in rural areas where the majority of the poor live. A wide range of initiatives was envisaged, including investments in rural roads and in water supply and sanitation. Agricultural extension and natural resource management were to be upgraded and support would be provided for sustainable forestry management with a view to developing Paraguay's huge potential for forestry products.

13. The fourth pillar for Bank support focused on the Government's program for social inclusion – closely linked to poverty reduction and rural-based growth. Support was to be provided for systemic social sector reforms to better target the rural poor including outreach to the indigenous population. A program of lending and AAA was proposed in such areas as education reform, maternal and child health insurance, social protection and pension reform.

### IV. CAS OUTCOMES

14. The 2003 CAS was results based. Explicit country performance indicators were specified in a CAS Program Matrix, which is included at the end of this completion report as Attachment 1 along with actual outcomes. No clear distinction was made in the CAS between overall country indicators and indicators specific to the CAS itself.

15. Actual outcomes for the country performance indicators were mixed. In broad terms the outcomes

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## CAS Completion Report

for fiscal and financial stabilization were generally good, as were the outcomes with respect to sustainable growth. By way of contrast, outcomes in the areas of governance and social inclusion fell far short of the targets in many cases.

16. It is clear in retrospect that the CAS was overly optimistic with respect to the structural and policy reforms that could be successfully implemented by a new administration. Notwithstanding the bold reform agenda that was articulated by President Nicador Duarte Frutos when he first took office, the administration underestimated the challenges in delivering such an ambitious program, particularly those related to governance and institutional competence. Not only did outcomes fall short of targets but progress was slower than envisaged in many areas.

17. It is also clear in retrospect that the CAS overestimated the prospects and possibilities for new lending in areas where the Bank had previously only a limited presence. The CAS proposed a base-case lending program of thirteen operations but only four of them were approved and became effective. In many cases the shortfall was directly related to the inability of Government to obtain legislative approval for projects that were well prepared and ready for implementation. In other cases, the high priority given to reforms such as those in the financial sector and social security diminished as time passed.

18. However, when due allowance is made for the initially ambitious targets, steady and significant headway was made in the overall country relationship with Paraguay. The country dialogue has flourished both at the

macro level and at the sector level, underpinned by a high-quality program of analytic and advisory work. Overall project implementation has been good and in some sectors, such as transport and water supply, the Bank has helped with the introduction of innovative development strategies. Even when projects were withdrawn or cancelled, the Bank was able to contribute to moving the reform agenda forward by mobilizing other instruments such as grant financing. During the CAS period the Bank deepened its engagement in Paraguay and became a strong partner. The Bank's recent broader involvement in issues of governance and the adoption of Paraguay as a pilot country for the GAC initiative is further evidence of a deeper and broader country relationship.

### Pillar 1: Fiscal and Financial Stabilization

#### Overview

19. This pillar of the CAS was clearly perceived as an urgent priority driven by the difficult economic circumstances confronting the Government when it took office in August, 2003. Country outcomes were good as evidenced by a consistently strong economic performance throughout the CAS period. The indicative indicators that were targeted in the CAS were largely achieved as shown in Attachment 1. CAS outcomes were good overall. Although a flagship Economic Recovery SAL was outstandingly successful, a follow-up Financial Sector Adjustment Loan had to be reduced in scope and content because the pace of reform was slower than anticipated. Analytic work undertaken by the Bank was strategically relevant and of high quality.

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## CAS Completion Report

### Macroeconomic Performance

20. **By most indicators Paraguay has performed better than anticipated during the 2004-07 CAS period.** It can be seen from Table 1 below that real GDP growth has averaged 4.4 percent compared with only 3 percent projected in the CAS. The driving forces behind that growth have been threefold. First, macroeconomic management was generally sound. Second, the strong performance of neighboring countries, particularly Argentina and Brazil, had a ripple effect. Third, Paraguay has benefited from strong commodity prices with exports growing at close to 35 percent a year in nominal dollar terms. However, by the same token, Paraguay is now even more vulnerable to external shocks because imports have also grown at a rapid pace that may be unsustainable if the external economic environment were to deteriorate. Another crisis in neighboring countries or a roll-back in commodity prices would have serious repercussions for Paraguay.

21. Macroeconomic management was generally sound during the CAS period. The IMF affirmed that performance under the 2003 stand-by arrangement was satisfactory and largely achieved the objectives of restoring stability and starting a reform process to create conditions for sustained growth and poverty reduction. Another stand-by arrangement was requested by the Government on a precautionary basis and it was approved in May, 2006. In the context of a fifth review of the arrangement in December 2007, IMF staff stated that "All quantitative performance criteria established for end-September 2006 under the IMF-supported program were met,

and the expectation is that quantitative targets for end-December 2007 will also be observed." It is particularly noteworthy that the relative size of public sector debt has declined much more rapidly than was anticipated in the CAS. It now stands at a manageable 20 percent of GDP.

### The Bank program of support

22. **In parallel to the CAS, the Bank prepared an Economic Recovery Structural Adjustment Loan (ERL) in the amount of US\$30 million to support the Government's reform program.** The CAS and the ERL were presented to the Board together in December 2003, just four months after the new administration took office. By providing financial support for the Government's short- and medium-term action program in the areas of fiscal stabilization and deficit reduction, taxation, public administration, financial sector reform, pension reform and the fight against corruption, the ERL contributed directly to fiscal and financial stabilization as well as other objectives identified in all four pillars of the CAS.

23. The ERL was structured as a single tranche operation to help Paraguay more effectively finance the large financing gap that was revealed in 2003. A set of policy actions was identified as a condition for Board presentation and a second set of benchmark indicators was identified to assess the continuity of progress in the reform program after the formal closing date of the loan. It was anticipated that follow-up loans, such as a planned Financial Sector Adjustment Loan, would provide a vehicle for monitoring and ensuring continuity of the Government's reform program.

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## CAS Completion Report

Table 1: Projected macroeconomic indicators and actual outcomes

	CAS November 26th 2003				Latest estimates			
	2004	2005	2006	2007	2004	2005	2006	2007
<b>Real Sector</b>								
Real GDP growth (%)	2,3	2,8	3,2	3,5	4,1	2,9	4,3	6,8
CPI Inflation (%)	7,0	6,0	5,0	4,0	2,8	9,9	12,5	6,0
Gross Domestic Investment (% GDP)	19,0	20,0	20,0	20,5	16,8	17,5	17,5	18,9
Exports (% growth)	-4,4	5,1	5,0	3,2	31,9	17,1	31,5	56,5
Imports (% growth)	3,3	5,2	5,9	3,5	26,9	22,8	31,7	39,6
<b>Central Government Finances (% GDP)</b>								
Revenues	16,5	17,2	17,5	17,5	18,4	18,3	18,4	17,9
Expenditures	17,6	17,5	17,6	17,5	16,8	17,5	17,8	17,0
Of which interest payments	2,4	2,4	2,5	2,4	1,1	1,2	1,0	0,8
<b>Primary Balance</b>	<b>1,3</b>	<b>2,1</b>	<b>2,4</b>	<b>2,3</b>	<b>2,7</b>	<b>2,0</b>	<b>1,5</b>	<b>1,8</b>
Overall Balance	-1,1	-0,3	-0,1	-0,1	1,6	0,8	0,5	1,0
<b>Public Sector Debt (% GDP)</b>	<b>47,3</b>	<b>46,4</b>	<b>43,1</b>	<b>39,8</b>	<b>34,4</b>	<b>29,4</b>	<b>24,3</b>	<b>19,9</b>
<b>Balance of Payments</b>								
Current Account (% GDP)	1,0	1,3	0,6	0,0	2,0	0,5	-1,7	5,1

24. An implementation completion report for this operation found the achievement of project objectives to be satisfactory or highly satisfactory. By providing early support to the administration's economic and institutional reform agenda, the ERL helped the Government avoid a severe financial crisis, meet its short-term debt obligations and gain time to restore a fiscal balance.

25. Fulfillment of the fiscal stabilization objective in particular was highly satisfactory. An overall fiscal deficit amounting to 3.1 percent of GDP in 2002 was turned around to a surplus in 2004 that exceeded the target established by the IMF Stand-By arrangement. The improvement was the result of a strong increase in public revenues together with tight control over public spending.

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## CAS Completion Report

26. Tax policy objectives were also met satisfactorily. During 2004 tax revenues increased by 36 percent (or 2 percent of GDP) over the previous year as a result of efforts to reduce evasion and corruption, and increase efficiency. The approval of a Tax Reform Law in July 2004 was an important breakthrough which introduced new revenue instruments, broadened the value-added tax and extended the coverage of the company income tax to agriculture and ranching.

27. Progress in putting the public sector pension system on a sound financial footing was also satisfactory. In December 2003 Congress enacted measures to reduce the financial deficit of the system and introduce greater consistency between pension plans. Specific changes included raising the contribution rate from 14 to 16 percent and raising the mandatory retirement age to a uniform 62 years across the board.

28. Financial sector objectives were also met satisfactorily. The enactment of a Deposit Guarantee and Bankruptcy Law would make it easier to resolve another banking crisis if one were to arise in the future. The public sector's contingent liabilities were thereby effectively reduced.

29. Finally, there was satisfactory progress in meeting the program objectives with respect to a more efficient and less corrupt public administration. A new Customs Code was adopted in 2004 to modernize procedures and curtail corruption. Public procurement practices were improved and information on public procurement was posted on the internet. A census of public sector employees was undertaken to help rationalize the management of human resources.

30. Collectively, these achievements constituted a propitious beginning for the new administration and vindicated Bank support through the ERL.

31. **The CAS envisaged additional follow-up support for financial sector adjustment with a financial sector adjustment loan (FSAL).** A Program Document proposing a two-tranche FSAL in the amount of US\$60 million was distributed to the Board of Executive Directors in August 2004 but it was subsequently withdrawn to allow the Government further time to submit a new banking law to Congress and thereby satisfy a condition of Board approval. A draft banking law, satisfactory to the Bank, was eventually submitted to Congress in December 2004. However, Board presentation of the FSAL was also conditioned upon other financial sector reforms which did not proceed as smoothly as anticipated. To better manage perceived risks to the program posed by uncertain progress with the reform agenda, the Bank and the Government agreed to a strategy of risk mitigation whereby Bank support for Paraguay's financial sector reforms would be restructured on a programmatic basis. Under this approach, a sequence of three single-tranche programmatic financial sector loans was envisaged. They were to be presented to the Board in line with measurable progress in the reform program. Bank support was to be back-loaded to reflect the perceived increased risk.

32. The first of this sequence, a programmatic financial sector adjustment loan (PFSAL I) in an amount of US\$15 million, was approved in April 2005. It provided up-front support for prior reforms. The Government encountered a long delay in securing



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Congressional approval for the loan and the deadline for effectiveness had to be extended beyond the customary 18 month Bank policy deadline. The delay in Congress did not necessarily reflect a lack of Congressional support for financial sector reform. Other Bank loans were similarly blocked at the time as well as loans from other international and bilateral financial organizations. The situation was reflective of a wider political confrontation that resulted in a stalemate between the executive and the legislature. As a result, some other Bank loans had to be cancelled. In parallel to PFSAL I, a Financial Sector Strengthening Technical Assistance Loan was designed to assist Paraguay with the modernization of its financial system by strengthening the Superintendence of Banks, streamlining the settlement of payments and monitoring the progress of other financial reforms. However, the loan was withdrawn after the Central Bank decided that it did not wish to finance technical assistance with loan funds.

33. Notwithstanding these difficulties, the implementation completion report for PFSAL I indicated that the Government has remained in compliance with the reforms supported by the loan and there have also been advances in other areas that were to be supported by subsequent Bank loans.<sup>26</sup> However, overall progress was insufficient to justify moving forward with additional Bank support for the program although the Bank continued its policy dialogue with the Government and stood ready to provide an effective response to new financial sector initiatives.

34. Among the achievements of PFSAL I which still remain in effect, the following merit particular mention. The Central Bank established specific criteria to identify troubled financial institutions so that measures may be taken to improve their financial condition. Financial institutions were prohibited from pledging their assets as security for deposits held by persons in the same institution. The Government reached an agreement with commercial banks to renegotiate public bonds. The Central Bank established norms concerning asset classification, loan loss reserves, accrued interest payments and refinancing operations as they apply to bank lending. The Central Bank also approved a strategic plan to improve banking supervision. A draft banking law was submitted to Congress in 2004 although it has not yet been enacted. Amendments to simplify the draft law are currently being considered. A draft law to combat money-laundering was also submitted to Congress in 2004 although it took until December 2007 for Congress to approve a new penal code for money laundering. Under Paraguayan law, the implementation of the new penal code will be delayed for one year to allow for the training of judges and prosecutors.

35. The Bank closely coordinated the design of PFSAL I and the broader underlying program with both the IMF and the IDB. At the time of loan approval, the IMF had had in place a stand-by program which included structural benchmarks for financial sector reform. The IMF continued to monitor financial sector developments under a follow-up stand-by arrangement which the Government entered on a precautionary

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26. "Implementation Completion and Results Report" Report No: ICR0000525; June 28, 2007



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basis. The IDB has focused, in particular, on assisting Paraguay with the consolidation of state owned banks and with developing a regulatory framework for the cooperatives sector.

**36. The operational program in support of fiscal and financial stabilization was accompanied by analytic work in key areas.** A review of the Paraguay country AAA was undertaken by a QAG panel which found that, in terms of its strategic relevance, the program was highly satisfactory. This finding was particularly applicable to the analytic work in the areas of fiscal and financial stabilization.

37. In 2005 a Financial Sector Assessment was undertaken at the request of the Government and in the context of the joint IMF-World Bank Financial Sector Assessment Program (FSAP).<sup>27</sup> The Assessment noted that the recovery of the economy provided a window of opportunity to address key financial vulnerabilities that would otherwise pose an obstacle to future growth. It advocated a more comprehensive effort to financial sector reform that would contribute to building trust in the financial system. It made specific recommendations for strengthening the prudential regulation of the fast-growing credit cooperatives sector, drastically restructuring the BNF (a publicly owned bank), overhauling insolvency procedures, regulating pension funds and upgrading the payments system. Those issues continue to figure prominently in the policy and reform dialogue between the Government, the IMF, the IDB and the Bank.

38. A public expenditure review was also undertaken in 2006.<sup>28</sup> It advocated revenue raising measures to provide additional resources for needed investments in basic infrastructure and social services which are presently insufficient for economic growth. At the same time it underscored the importance of controlling the growth of current expenditures, especially with respect to public sector wages. It noted that public employment, in addition to consuming an overly large proportion of public spending is structured according to patronage rather than discharging the functions of the state. It also advocated strengthening the presently weak budget process to better prioritize investments and facilitate the effective delivery of public services. The effectiveness of the review was enhanced by a concise executive summary which clearly identified the principal recommendations for policy makers.

39. Of particular significance was an Integrated Fiduciary Assessment (IFA) undertaken by the Bank with support from the IDB and the European Union.<sup>29</sup> The Assessment was the first of its kind in Paraguay and it incorporated the indicators-based methodologies of PEFA and of OECD-DAC which provided crucial insights into the efficiency and credibility of the budget and procurement processes. In the absence of lending, the IFA has become a key instrument for a continuing policy dialogue with the Ministry of Finance. Seminars were held with the Ministry to review the results of the IFA and non-lending technical assistance was mobilized to help the Ministry design an action plan. The collaborative

27. "Financial Sector Assessment Paraguay" FSAP Report No. 36218; May 2006.

28. "Paraguay Public Expenditure Review" Report No. 32797-PY; May 31, 2006.

29. "Paraguay Integrated Fiduciary Assessment" April 2008.

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manner in which the IFA was undertaken enabled the Government to take ownership of the process and of the product. That, in turn, made it a more effective instrument for improved fiscal management.

40. Other analytic work that clearly had a bearing on fiscal and financial stabilization as well as other pillars of the CAS included (i) a study of Real Property Taxation which constitutes a major, but as yet underutilized, source of revenue for sub-national government and (ii) a Country Financial Accountability Assessment (CFAA). Both tasks contributed effectively to the country dialogue. Technical assistance to the Ministry of Finance for improved governance and transparency (reviewed under Pillar 2 below) also contributed to better fiscal management.

### Pillar 2: Governance and Transparency in Government

#### Overview

41. The CAS was strongly supportive of the Government in its desire to restore confidence in state institutions by improving governance and transparency in the public administration. However, country outcomes were mixed and generally fell short of the targeted indicative indicators (see Attachment I). Paraguay improved its relative ranking in the Corruption Index of Transparency International but did not rise from the fifth to the fourth quintile as targeted. The Bank program of assistance likewise fell short of the CAS objectives but nevertheless helped the authorities improve governance and transparency in a number of key areas.

#### The Bank program of support

42. **The most prominent instrument of Bank support for improved governance and transparency was a project for the modernization of the Ministry of Finance.** The scope of the proposed project was ambitious and the goal was to transform the Ministry into a “ministry of excellence” by streamlining its internal procedures, professionalizing the staff and strengthening a tradition of service towards the public. It was envisaged that improved management practices within the Ministry of Finance would be linked to similar improvements in line ministries such as Education which was also aiming to improve management practices with Bank assistance from an ongoing Education Reform Loan. Hence, the modernization of the Ministry of Finance was envisaged as a stepping stone to parallel changes in other ministries and eventually to other levels of the public administration including municipalities.

43. The modernization loan was approved by the Board on April 5, 2005 in an amount of US\$7.5 million. There was a considerable delay before the loan was signed because the Government first waited for Congress to approve a financial sector adjustment loan to which the modernization loan was linked. Once the loan was sent to Congress, it became clear that prospects for timely Congressional approval were remote and the Bank decided to cancel the loan in March 2007.

44. In part, the lack of Congressional approval for the modernization loan reflected differences between the executive and the legislature that resulted in a

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stalemate. However, there was also widespread resistance to the idea that Government should borrow externally to finance technical assistance especially when grant funding is available from many bilateral donors for that purpose. In addition, the ambitious scope of the project may have provoked resistance from a conservative and cautious bureaucracy.

45. Yet the cancellation of this loan did not presage an end to modernization and reform in the Ministry of Finance. The modernization agenda continued to move forward in a number of areas, albeit at a more moderate pace, and the Bank continued to play a role with resources from trust funds in some cases. An IDF grant remained active until 2007 and it financed a number of initiatives that had been identified and targeted in the course of loan preparation. In part it financed analytic work aimed at enhancing the broader framework of fiscal management such as public sector deficit financing, an analysis of social expenditures within the budget and the adoption of multi-year budgeting. Other initiatives financed by the IDF grant were more administrative and organizational. They included the development of guidelines for public hearings on contracting; a seminar on procurement; the design of security systems for an electronic data base; a workshop on monitoring and evaluation and the purchase of hardware and software for that purpose; equipment, training and technical assistance for the Transparency Office of the Ministry and; the design of a data base for the management of human resources. Supervision revealed that all those initiatives were effective in helping the Ministry of Finance improve its operational efficiency.

46. **The Bank also provided support for improved management efficiency in the Ministry of Education.** One of the primary objectives of the Education Reform APL that was approved in June 2003 was to assist Paraguay improve the management and efficiency of the education system by “creating additional capacity for sector analysis, planning, monitoring and evaluation, and improving management and development of human resources”.<sup>30</sup> The project successfully pursued that objective during the CAS period. By June 2008, the revised closing date, a model for the selection and contracting of personnel had been designed, approved and implemented nationwide. Certification and accreditation policies had also been designed and approved and will start to be implemented in 2008. The entire administrative planning and budgetary systems have been re-engineered and, in December 2008, the new system will be introduced to the Ministry of Education and to the Department of Asuncion on a pilot basis. It is anticipated that the improved planning and budgetary systems will increase efficiency and contribute to greater transparency and the better management of human resources.

47. **The CAS also envisaged a deeper extension of governance and public sector reform to improve fiscal management at the municipal level.** However, a municipal finance project proposed in the base case program was not prepared. In part, that was because the project would focus on a better application of the real property tax which is the main (but greatly underutilized) source of municipal revenue. Until a

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30. Project Appraisal Document; Report No:25630; page 3.

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study of the real property tax was undertaken, the analytic underpinning of the project could not be put in place.

48. A real property tax study was finalized towards the end of the CAS period.<sup>31</sup> It concluded that the current yield of the tax is far below international norms. To increase the yield without incurring the expense and long gestation period of creating a full national cadastre, it proposed a revision of the property tax law based on the principle of self-assessment of property values that has worked well in many other countries. A self-assessment system could quickly develop a market value tax base that would greatly improve the revenues of local government while, at the same time, create incentives for the more effective and efficient use of rural land resources. The study provides valuable source material that could constitute a strong analytic base for addressing governance issues at the local level in Paraguay going forward.

49. **The World Bank Institute has also been active in Paraguay ever since 2000 when the Government invited the WBI to give orientation and training to representatives of civil society on how other countries have approached the issue of corruption.** With WBI support, a Government-sponsored Anti-Corruption Commission (later renamed the National Integrity Commission) developed a plan to combat corruption in the three areas of customs, procurement and the judiciary. The Commission presented its plan to the donor community and the IDB responded with support for additional work on

procurement and on customs. The Bank focused on the judiciary and, in that context, mobilized an IDF grant to support Paraguay's legal and judicial reform. The grant focused on assisting the Supreme Court in three areas as follows: (i) strengthening the judicial function; (ii) improving the administrative framework of the judiciary; and (iii) strengthening the public registries and judicial statistics. The grant effectively complemented technical assistance provided by the IDB, UNDP and USAID and successfully achieved its strategic objective of strengthening the capacity of the Supreme Court and the Council of Magistrates to perform their functions.

50. **IDF grants were also mobilized in support of Paraguay's civil service reform and to assist the National Congress streamline its internal procedures and gain ready access to legislative information.** With respect to civil service reform, grant funds were successfully employed to strengthen the National Secretariat for Public Administration (NSPA) by helping to develop an action plan for training key personnel and for upgrading personnel data. As a result, in 2004, the NSPA designed and carried out a national census of public employees to provide up-to-date and reliable information for the management of human resources. Support for the modernization of Paraguay's Congress began in 2005 and continued beyond the end of the CAS period. It includes support for (i) improving the channels of communication by updating the Congressional website, (ii) adopting best practices from internationally recognized legislative bodies including the establishment of a

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31. "Paraguay Real Property Tax" (in two volumes); Report No. 37456-PA; May 16, 2007

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congressional research center, (iii) accessing the Global Legal Information Network (GLIN) system and (iv) increasing transparency and efficiency through an electronic document management system, modernizing the Library of Congress and establishing a workflow management system to manage and monitor legislative initiatives.

### Pillar 3: Sustainable Growth

#### Overview

51. Growth is a multi-sector endeavor and the program envisaged by the CAS for this pillar was correspondingly multi-faceted. It included support for the development of infrastructure; investment in agriculture and forestry; and support for private sector development. Progress was made in all of these areas but at a slower pace than had been envisaged in the CAS. Nevertheless, country outcomes were generally good with respect to indicative targets as documented in Attachment I. CAS outcomes varied greatly from sector to sector. In sectors where the Bank had a long-standing presence progress was generally satisfactory. However, the CAS was not able to move forward in new areas such as private sector development and municipal development.

#### Agriculture and Forestry

52. **A sustainable rural investment project was programmed for FY05 but was postponed to allow for the completion of an ongoing Natural**

**Resources Management Project (PARN) and a thorough evaluation of its outcome.** Although that project dated from the mid-nineties, the loan was not closed until 2006. Hence, a significant part of project implementation took place during the period of the 2003-07 CAS. Notwithstanding implementation problems which had resulted in delays and necessitated major restructuring after a mid-term review, the project achieved most of its objectives satisfactorily. As a result of the project, the implementation completion report concluded that improved natural resource management and more sustainable approaches to agriculture are now an accepted paradigm in Paraguay while participatory decision-making and working with smallholder farmers and indigenous peoples is more commonplace.<sup>32</sup> The infrastructure development component of the project was also rated satisfactory and some 400 km of local roads were rehabilitated. However, the institutional development component of the project was rated unsatisfactory due principally to an overly ambitious attempt to decentralize while, at the same time, coordinating many agencies and attempting to strengthen weak institutions.

53. The successor project that had been anticipated for FY05 was prepared as a Sustainable Agriculture and Rural Development Project (SARD) in 2006-07 and a loan for US\$37.5 million received Board approval in January 2008. The project drew upon the lessons learned from PARN and also from the experience gained from an ongoing Community Development Project (PRODECO). Whereas the 2003 CAS had envisaged that the micro-catchment

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32. Implementation Completion Report No. 38266; December 28, 2006



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model for agricultural extension and natural resource management would be expanded nation-wide, the project area was delimited more manageably to 39 municipalities in the two poorest departments of the Eastern Region of Paraguay. Other lessons incorporated into the successor project included an effective and transparent process of participatory and decentralized planning and decision making; flexibility to accommodate the culturally-defined decision making mechanisms of different ethnic groups; and strong support from technical agencies to the beneficiaries. The PARN further effectively included indigenous people as project beneficiaries. This is a positive lesson from experience and indigenous communities will continue to be actively included as beneficiaries under PRODERS.

54. The implementation difficulties encountered with PARN and the delay in preparing a successor project serve to underscore the need for careful project design and preparation even at the cost of extending the time-horizon. A Forestry Development Project, initially programmed for FY06 was put on hold pending a clearer definition of the Government's position *vis-à-vis* the regulatory framework for sustainable forestry management including transport regulation, pricing and royalties, plantations and reforestation. The project has now been cancelled. Meanwhile, GEF resources have been mobilized to support a Maracayú Nature Park Reserve project and more GEF finance is proposed for supporting biodiversity in areas that will overlap the SARD project.

55. Analytic work in support of lending for agriculture and forestry included the study of Real Property

Taxation already cited above. That study cites evidence pointing to a considerable underutilization of land and it suggests that the absence of significant tax revenues from rural land enables underutilized land to be held without cost. A conclusion of the study is that a well structured reform of land taxation could well enhance the efficiency of land use in rural areas. It also suggests that, in view of the widespread deforestation that has occurred in the past, a new land tax exemption for natural forests managed in a sustainable manner could be an effective instrument to encourage environmental conservation.

### Infrastructure

56. **A loan in the amount of US\$74 million for a Road Maintenance Project was approved in August 2006 as envisaged in the CAS.** In many ways the project marked a new beginning for the Bank in the road sector of Paraguay, notwithstanding a history of previous loans for highways in the eighties and nineties. Whereas earlier projects had focused on building new roads, the 2006 project is concerned with road maintenance. The development objective of the project is to establish a sustainable road management strategy that ensures the upgrading and maintenance of the road network making optimal use of scarce resources. That involves developing the institutional capacity of the Ministry of Public Works, arresting the deterioration of the priority road network and improving access for the poorest rural communities. With Bank assistance, Paraguay has been able to fundamentally reshape its approach to prioritizing road maintenance.

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57. As with many other Bank loans, it took longer than anticipated to obtain the approval of Congress but the loan became effective in January 2008. Notwithstanding the delay, the Ministry of Public Works has moved forward with a number of project activities including the preparation of a Road Strategy, the establishment of a Road Planning Directorate and the adoption of an action plan to improve procurement and financial management. In addition, bidding has begun for the design of a Road Plan, a budget monitoring system and a new toll system. Several elements of an Improved Governance Framework have been put in place and the overall progress of the project is judged to be satisfactory by Bank supervision staff.

58. **The Bank has had a long association with Paraguay in water supply and sanitation. A fourth rural water supply and sanitation project dating from 1997 was still under implementation during the first part of the CAS period.** The project was innovative in that: (i) it developed a sustainable model for service delivery through local private participation via minimum subsidy concessions; (ii) it increased access to water supply and sanitation for indigenous populations; (iii) it introduced low-cost piped sewerage for small towns; and (iv) it provided for technical assistance to local Water User Boards through a second-tier system of water user associations. Most importantly, in October 2004, the Government adopted a uniform national policy for financing water and sewerage investment in rural areas based on financial policies developed by the Fourth Rural Water and Sanitation Project. In addition, innovative schemes for private sector investment have

been introduced. Altogether this is an extraordinary achievement that few other LAC countries have been able to attain. A Water Sector Modernization project that was planned for the last year of the CAS period is actively being prepared and is anticipated for FY09.

59. However, other planned projects have not materialized. A Technical Assistance Loan for Private Sector Development was not pursued because the authorities do not favor financing technical assistance by borrowing from abroad. A Municipal Services and Infrastructure Project was also not pursued, in part because it was linked to a reform of the Real Property Tax that would increase municipal revenues and provide additional resources for local roads, water supply, sanitation and solid waste management. The Bank finalized a study of the Real Property Tax in 2007 but it may take time for the authorities to consider its recommendations and take action.

60. The Bank also undertook a study of the Investment Climate in Paraguay for submission to the new administration that takes office in 2008. The study was based on information from a 2006 survey of 613 private registered firms operating in Paraguay, of which 25 percent were located in the capital, Asuncion. Hence, the data related exclusively to the formal sector of the economy. Many firms cited unfair competition from the informal sector as an obstacle to business because informal businesses did not have to comply with the same standards as the corporate sector. The study constitutes a valuable source of information to help the Government identify and relieve perceived bottlenecks that constrain private sector development.



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### Pillar 4: Social Inclusion

#### Overview

61. The CAS envisaged a broad program of Bank support for the Government's Poverty Reduction Strategy, particularly as it affected education, health, social protection and community development. Country outcomes with respect to indicative targets for these sectors were mixed as evidenced in Attachment I. Likewise, CAS outcomes varied greatly from sector to sector. There was good progress in meeting objectives in education and community development, but outcomes with respect to health and social security fell short of the CAS objectives.

#### The Bank Program of Support

62. **An Adaptable Program Loan in the amount of US\$24 million for an Education Reform Program was approved in July 2003 and was implemented during the CAS period.** The development objectives of the program were to improve the management and efficiency of the system and to improve education outcomes and equity of opportunity in secondary education. Improvements in management and efficacy were successfully achieved as indicated in the section above on governance. Substantial progress was also made with respect to expanding access to secondary education and improving the quality of education. The net enrollment for secondary schools increased from a base of 33 percent in 2001 to 40 percent by end-2007

which constitutes a substantial improvement albeit short of the 44 percent end-of-project target. Also by end-2007, the complete redesign of alternative secondary education programs was well under way based on results from a first round of field testing. The final redesigned modules are expected to be completed by mid-2008. A program of scholarships for low-income students has been introduced and the end-project target of 4,500 scholarships was already reached by 2006. Overall project implementation has been successful in reaching its development goals.

63. The Bank also successfully completed an evaluation of secondary education as envisaged in the CAS.<sup>33</sup> The work was done in close collaboration with the Ministry of Education and with other stakeholders including the IDB. The collaborative nature of the work enhances its value as a tool for education management and planning in Paraguay. It will also serve to underpin a second phase of the adjustable program lending which is being prepared for FY09.

64. **The CAS also envisaged a strong program of Bank support for the health sector in Paraguay.** Analytic work on the health sector was effectively delivered in 2006.<sup>34</sup> Several conclusions from the report fed directly into a Maternal-Child Basic Health Insurance project for which a loan of US\$22 million was approved by the Board in April 2005. However, when the Government submitted the loan to Congress it was rejected. The reasons for the rejection are threefold. First, it reflected a stand-off between the executive

33. "Educación Media en el Paraguay" Report No. 42665-PY; February 7, 2008.

34. "Health Service Delivery in Paraguay" Report No. 33416-PY; January 25, 2006.

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and the legislature that affected many other projects as noted elsewhere. Second, the structure of health care finance is a contentious issue in Paraguay. Third, there were perceptions that a previous Bank loan for a Maternal Health and Child Development Project had failed to achieve the expected results. Indeed, the implementation completion report for that earlier project rated the outcome as unsatisfactory and the sector report on health service delivery concluded that the project fell significantly short of its service delivery goals. That shortfall is reflected in the low utilization of installed capacity in health facilities which is less than 50 percent in Paraguay.

65. Nevertheless, the effort that went into preparing the Maternal-Child Basic Health Insurance Project has been fruitful in assisting the Government move forward with a number of initiatives that were conceived as part of the project. The Ministry of Health now deploys mobile medical teams to deliver medical services to less accessible areas. A health insurance manual that was written as part of project preparation is now in use to establish a health service delivery network.

**66. Social protection was another area identified in the CAS for Bank support.** Analytic work on social protection policies, including the pension system, was delivered in 2004 as envisaged in the CAS.<sup>35</sup> The study sought to articulate a strategic vision for social protection policies that would embrace programs devoted to the alleviation of poverty and those that seek to provide economic security to the

elderly. It also reviewed issues relating to the financial management of social protection policies. The study was well received and many of the findings were incorporated into a National Strategy to Fight Poverty that was adopted by the Government in 2006 and later into a Strategic Plan for Reform of the Pensions system that was adopted by the Ministry of Finance in 2007.

67. The CAS also envisaged that the Bank would finance a Social Protection Technical Assistance Project. Preparatory work was begun but, by end-2005, it became clear that the authorities were disinclined to finance technical assistance by borrowing externally and project preparation was suspended. Nevertheless, the Bank's preparatory work effectively assisted the Government redesign the social security system as documented in a paper delivered to the Government in June 2006 and entitled "*Paraguay: Resultados de la Asistencia Técnica del Banco Mundial 2004-2005 al Sector de Seguridad Social*". In addition, the Bank, in cooperation with the IDB, assisted the Government in designing a conditional cash transfer program (TEKOPORA) as well as the operational framework of a Fund for Social Equity that was established in 2005.

**68. In 2002, just prior to the CAS, the Bank had approved a loan of US\$9 million for a Pilot Community Development Project (PRODECO) and the project was implemented during the CAS period.** PRODECO has proven to be one of the most successful social sector initiatives for addressing the development potential of the very poor in

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35. "Paraguay: Defining a Strategy for Social Protection Policy" Report No. 27352-PA; May 24, 2004

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Paraguay. The project sought to test a decentralized, bottom-up development approach as a means of enhancing incomes and increasing the quality of life of poor rural and marginalized urban communities in three Departments in the south of the country. The project provides grant finance for small-scale demand-driven initiatives prepared and submitted by beneficiary groups. Eligible initiatives include income generating projects such as artisan workshops as well as community development projects that would complement productive investments. An important component of PRODECO has been to strengthen the capabilities of local communities to design, implement and monitor income-generating and community development initiatives.

69. Supervision ratings have been consistently satisfactory both for the development objective of the project and for implementation progress. By end-2006 it had already surpassed the quantitative beneficiary targets defined at project appraisal. Some 500 sub-projects had been approved benefiting more than 5,100 families and almost 30,000 persons. Those figures compare with an original target of 3,700 families and 18,500 persons. Nearly 30 percent of the sub-projects benefit vulnerable and socially marginalized groups (including indigenous peoples, women and youths). That figure exceeds the original target by a factor of 75 percent.

70. A mid-term evaluation of the project and other monitoring data reveal that the project has been able to decentralize decision making to the local level. Reviews of the quality of supervision show that the project has effectively contributed to a culture

of results, transparency and social participation, although a recent ex-post review of procurement has also highlighted the need to strengthen the oversight of community-procured TA services. PRODECO is recognized as a key contributor to the country's poverty reduction strategy in the three departments where it operated. On that basis the Board approved additional funding of US\$9 million in March 2008 so that the program may be extended to a further five departments.

## V. OVERALL BANK PERFORMANCE

### The Lending Program

71. The CAS was structured in terms of the Bank re-engaging with Paraguay after a long period of little lending. A base case program of thirteen loans was envisaged for a total of US\$325 million. In the event, only seven loans were approved during the FY04-07 CAS period and in FY08, but three of them were either withdrawn or cancelled prior to loan effectiveness. Of the remaining six projects proposed in the CAS, three were dropped. Another three were postponed and are likely to be approved in the following CAS period. Total lending in the FY04-08 period amounted to only US\$146.5 million – less than half of the base-case scenario notwithstanding the fact that the triggers for base-case lending were substantially met (see Attachment 4).

72. In retrospect it would appear that the base-case lending program proposed in the CAS was overly-ambitious given the country situation at the time. The

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administration of President Nicador Duarte Frutos began its term of office in 2003 with far-reaching plans for reform and it was right for the Bank to respond positively. In order for the reform program to be effectively implemented with financing from the Bank, however, the executive branch would need to work in close cooperation with the legislature and this proved to be a stumbling block. Since Congress, in accordance with the constitution, must approve all external borrowing, the Bank program was particularly vulnerable to the deadlock that quickly emerged.

73. Even if Congress had been supportive the successful implementation of an active lending program would have been a challenging task after a long period in which the Bank had only a minimal operational presence in Paraguay. The Bank underestimated the support it would need to provide in order that Paraguay may reactivate and execute a lending program on the scale envisaged. The resident mission in Asunción was not strengthened commensurately with its expanded responsibilities and it had to rely on back-up support from the Buenos Aires office. In some cases project supervision had to be outsourced to the UNDP. Those shortcomings are only recently being addressed.

74. Yet it would be a mistake to infer that the shortfall in actual lending signified a failure of the Bank to reengage effectively with Paraguay. Even when projects were dropped, withdrawn or cancelled the Bank was able to achieve positive results in helping the reform agenda move forward with other instruments such as grant financing and analytic work. Project preparation work also contributed directly

to progress with the Government's reform agenda, particularly in areas such as financial management and budgeting. In addition, the program of AAA was very successful as indicated in the corresponding section below.

### **Portfolio Quality**

75. Over the 2003-08 period the total active portfolio of projects under implementation in Paraguay averaged only five projects. Because the active portfolio is so small, performance problems that may be encountered with just one or two projects appear to have a large effect on the total portfolio in percentage terms. It can be seen from Table 2 below that the percentage of projects classified as problem projects or projects at risk has varied greatly from year to year from zero to 100 percent. Hence, the analysis of aggregated portfolio data is not particularly illuminating in the case of Paraguay.

76. Nevertheless, operational experience over the past several years points to a number of special circumstances in Paraguay that frequently impact the performance of projects financed by the Bank and by other external donors. The fact that Congress is constitutionally required to approve each and every external loan can result in a long interval between loan approval by the Board and loan effectiveness. Bank policy requires loans to become effective within 18 months of Board approval. In exceptional circumstances the Regional Vice President may approve an extension of the effectiveness deadline. The deadline for many loans to Paraguay had to be extended beyond 18 months.

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77. Experience shows that Paraguay has institutional weaknesses and governance constraints which adversely affect the pace of project implementation. As a result, closing dates frequently have to be extended beyond the time envisaged at appraisal. That, in turn, means that follow-up projects are pushed back until later in the CAS period and may be deferred beyond the CAS period altogether. The Secondary Education and Community Development projects are cases in point. A longer-than-expected implementation period may sometimes be necessary in order for the development objectives to be attained and fully secured. That may, however, also increase supervision costs.

### AAA

78. The program of AAA envisaged in the 2003 CAS was delivered in full with the sole exception of a Poverty Update that was postponed until FY09 (see Attachment 3). In addition to the CAS program, other major analytic work was also undertaken. Reference has already been made to an Integrated Fiduciary Assessment which has become the single most important vehicle for advancing the Bank's policy dialogue with the Ministry of Finance. The Bank also prepared Policy Notes for the incoming administration of 2008. The Policy Notes review policy options

**Table 2: Paraguay --Selected Indicators\* of Bank Portfolio Performance and Management (Data as of May 27, 2008)**

Indicator	Fiscal Year					
	2003	2004	2005	2006	2007	2008
<b>Portfolio Assessment</b>						
Number of Projects Under Implementation <sup>a</sup>	5	4	7	6	4	4
Average Implementation Period (years) <sup>b</sup>	6.3	5.1	3.6	3.2	2.9	3.3
Percent of Problem Projects by Number <sup>a, c</sup>	20.0	25.0	0.0	33.3	50.0	0.0
Percent of Problem Projects by Amount <sup>a, c</sup>	20.7	19.5	0.0	19.1	74.4	0.0
Percent of Projects at Risk by Number <sup>a, d</sup>	60.0	100.0	14.3	50.0	75.0	50.0
Percent of Projects at Risk by Amount <sup>a, d</sup>	52.9	100.0	15.9	39.6	93.0	63.8
Disbursement Ratio (%) <sup>e</sup>	15.2	19.6	27.8	26.5	23.7	8.5
<b>Portfolio Management</b>						
CPPR during the year (yes/no)	yes	yes	yes	yes	yes	yes
Supervision Resources (total US\$)	539	718	536	617	590	319
Average Supervision (US\$/project)	107.8	179.5	76.6	102.8	147.5	79.8

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Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED/IEG by Number	34	8
Proj Eval by OED/IEG by Amount (US\$ millions)	768.0	241.0
% of OED/IEG Projects Rated U or HU by Number	39.4	42.9
% of OED/IEG Projects Rated U or HU by Amount	41.5	24.7

a. As shown in the Annual Report on Portfolio Performance (except for current FY).

b. Average age of projects in the Bank's country portfolio.

c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).

d. As defined under the Portfolio Improvement Program.

e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

\* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Sources: SAP and Business Warehouse

in many sectors, including sectors where the Bank already has an operational presence or where it may develop an operational presence in the future.

79. An assessment of the Paraguay program of AAA was undertaken by a QAG panel which concluded that the program was highly satisfactory in terms of its strategic relevance to the issues confronting Paraguay. The AAA was also rated highly satisfactory in terms of the coherence and the integrated nature of the program. The internal quality of the work was also found to be fully satisfactory.

80. However, local participation, consultation and dissemination were identified as areas in which the AAA program fell short of its otherwise high standards. The QAG report made it clear that the moderately unsatisfactory rating for these aspects of

the program reflected, to a large extent, the reluctance of the authorities to engage proactively with other stakeholders. Nevertheless, and irrespective of the cause, unsatisfactory participation, consultation and dissemination is a shortcoming that can seriously detract from the overall effectiveness of the AAA program. Accordingly, the Bank has taken steps to strengthen this aspect of AAA in Paraguay.

81. Since the QAG panel made its assessment, the Bank has undertaken additional analytic work with a heightened emphasis on client participation, consultation and dissemination. In that respect, the Integrated Fiduciary Assessment (IFA) already referred to in paragraph 35 above was of particular importance. From its very inception the IFA could count upon the support and participation of senior staff from the Ministry of Finance including the Vice



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Minister of Administration and Finance and the Director of Budget. Workshops were held to agree upon a calendar of activities and upon the areas of responsibility for the Government and for the Bank-IDB team respectively. A follow-up action plan to the IFA has also been agreed on a participatory basis. In the absence of lending, the IFA has become a key instrument for pursuing a dialogue with the Ministry of Finance on policy and structural reforms.

### Program Costs

82. The cost of AAA in Paraguay is in line with other comparator countries in Latin America and elsewhere although the spread between them is not very great. Paraguay also compares favorably with respect to

supervision costs. In terms of project preparation, however, Paraguay appears to be relatively high cost and its unfavorable ranking is made more significant by the relatively high spread between comparator countries. This may reflect preparatory work done on projects that are dropped from the program before Board presentation. On the other hand, preparatory work done on projects that do not move forward is not necessarily lost. It may very well contribute directly and indirectly to the achievement of the overall objectives of the CAS.

### Collaboration with other donors

83. The Government does not have an established framework for coordinating donor assistance.

Table 3: Comparative Costs of Bank Program (FY07-08, U\$S Thousand)

Country	Average Supervision Cost per Project	Supervision Cost Ranking	Average Preparation Cost per Project	Preparation Cost Ranking	Average Cost AAA Report	AAA Cost Ranking
Paraguay	79	6	391	2	132	7
Argentina	85	4	239	5	155	1
Bolivia	87	3	370	3	133	6
Chile	78	7	166	8	135	5
Dominican Republic	71	8	216	6	117*	8
Moldova	83	5	319	4	145	2
Peru	101	1	443	1	141	4
Tunisia	99	2	184	7	144	3

\* Only one AAA during FY07-08. Costs reflect FY07 actuals plus FY08 estimates.  
Source: Business Warehouse as of May 20, 2008



# Annex 2

## CAS Completion Report

Nevertheless, the Bank endeavors to coordinate its operational and analytic work with other donors on an *ad hoc* basis as appropriate. In some cases there are Bank-wide agreements with other agencies for working together on AAA of common interest. Reference has already been made to an Integrated Fiduciary Assessment (IFA) which was undertaken within the framework of the Public Expenditure and Financial Accountability program (PEFA). The fact that PEFA is an international partnership between the World Bank, the European Community, the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the IMF and the Strategic Partnership with Africa undoubtedly engaged the interest of the Paraguayan authorities and motivated them to cooperate proactively in the IFA. Other analytic work done jointly with other donors include a 2006 Financial Sector Assessment based on the joint IMF-World Bank FSAP and a Country Financial Accountability Assessment (CFAA) prepared jointly with the IDB.

84. Where warranted, the Bank has also cooperated on occasions with other agencies in specific project work. A Community Development Project has defined a common strategy with two complementary grants from the Japan Social Development Fund (JSDF) targeted at indigenous areas in Eastern Paraguay. Similarly, a Sustainable Agriculture and Rural Development Project has also coordinated with the JSDF and with other donors that are active in rural development including KfW, IFAD and the IDB. There is liaison with the IDB in many projects financed by the Bank.

## VI. LESSONS LEARNED

85. The Bank has effectively re-engaged with Paraguay and re-engagement has produced positive results in assisting Paraguay make progress with its reform agenda.

- Lesson: The Bank should continue with a policy of engagement in Paraguay.

86. The effective delivery of the Bank's assistance program is affected by the uncertainties that prevail in terms of Government policy priorities and legislative prospects. It is also subject to higher transaction costs because of institutional weaknesses and a fragile fiduciary environment.

- Lesson: The Bank should seek to expand its operational program in Paraguay gradually to mitigate potential risks.

87. The successful implementation of an expanded lending program would require strong support from the Bank.

- Lesson: Staff and budget resources devoted to the Paraguay program, including the resident mission in Asunción need to be strengthened in order to manage the risks posed by a fragile institutional, fiduciary and governance environment.

88. Issues of governance in Paraguay are complex, particularly as they concern the relationship between the executive, the legislature, the judiciary and civil society. Experience shows that the CAS program may

# Annex 2

## CAS Completion Report

encounter difficulties as a result of these complexities if they are not fully understood or resolved.

- Lesson: The Bank should consult widely with multiple stakeholders, including civil society to ensure that there is a broad consensus with the objectives of the CAS and the instruments for attaining those objectives.

89. Experience in Paraguay shows that CAS objectives can be successfully attained with a variety of instruments including lending, technical assistance, the use of grant finance and AAA. If one of these approaches (such as lending) encounters obstacles, other instruments can be mobilized to advance the CAS objectives.

- Lesson: The Bank should adopt a flexible approach in designing and implementing the country assistance strategy to Paraguay. It should be selective in matching instruments to changing policy priorities and political circumstances.

90. Technical assistance can play an important role in enabling Paraguay to move forwards with a program of structural and policy reform. However, experience shows that there is resistance to financing technical assistance with external loans.

- Lesson: The Bank should seek to finance technical assistance by mobilizing grant funds wherever possible.

91. In a small country such as Paraguay, a sustained commitment in sectors such as transport and water

supply has allowed the Bank good access to key decision makers and has thereby enhanced the effectiveness of economic and sector work.

- Lesson: The Bank should continue to expand and sustain an active operational presence in key sectors.

92. Experience shows that there are significant risks associated with implementing a CAS program in Paraguay.

- Lesson: The CAS should be designed to mitigate risk by undertaking fiduciary assessments and by employing instruments such as programmatic adjustment lending or adaptable program lending that can facilitate risk management where the sector policy framework is incomplete.

# Attachment 1

## Paraguay: CAS Program Matrix (FY04-FY07)

Indicative Outcomes and Results Indicators for CAS Period	Actual outcomes
<b>1. Fiscal and Financial Stabilization</b>	
<ul style="list-style-type: none"> <li>• Issuance of new series Treasury bills to refinance domestic debt by mid-2004.</li> <li>• Increase in tax revenues by 1.5 percent of GDP by end-2005.</li> <li>• Reduction in deficit of govt. pension system by 0.5 percent of GDP by 2006.</li> <li>• <b>Initiation of bank deposit guarantee system financed by commercial banks by 2005.</b></li> <li>• <b>Gradual increase in commercial bank capital to Basel standards by 2007.</b></li> <li>• <b>Consolidation and restructuring of public banks completed by 2006.</b></li> </ul>	<ul style="list-style-type: none"> <li>• New Treasury bills issued in 2006 and 2007.</li> <li>• Tax revenues increased by 1.8% GDP between 2002 and 2005.</li> <li>• <i>Caja Fiscal</i> deficit increased from 1% of GDP in 2002 to 1.2% in 2006 (in 2007 it fell to 0.3%).</li> <li>• Deposit Guarantee Fund established in December 2003. As of 2007, the Fund had collected US\$23 million in insurance premiums. Government bonds to back up the fund were issued in 2007.</li> <li>• Capitalization of banks averages 13%, with official capital requirements at 10%, in line with Basel standards.</li> <li>• A new second-tier bank (AFD) was established in 2005, and the first-tier public bank BNF has been restructured (thereby reducing public financial institutions from seven to two focused ones).</li> </ul>
<b>2. Governance and Transparency in Government</b>	
<ul style="list-style-type: none"> <li>• Improvement in rating of Transparency International Corruption Index from fifth to fourth quintile by 2007.</li> <li>• Improved MOF performance in service delivery by end-2005, as evidenced by declining trend in number of complaints received by soon-to-be established office of Customer Service.</li> <li>• Majority of public procurement contracts advertised and awarded via e-Procurement website by end-2005.</li> <li>• Improved budget efficiency via continuation of recently introduced results-oriented budget process.</li> <li>• Incorporation of decentralized entities in SIAF accounting system by end-2004.</li> <li>• Introduction of meritocratic system for hiring and promotion of civil servants by 2007.</li> <li>• Approval of rules for selection and evaluation of judges by 2005.</li> </ul>	<ul style="list-style-type: none"> <li>• Paraguay has risen within the fifth quintile and, by 2007, had moved closer to the fourth quintile.</li> <li>• Offices dealing with customer complaints have been established within Hacienda. Data on the number of complaints is not available.</li> <li>• Procurement contract are posted on internet but awards are handled manually.</li> <li>• Results-oriented budgeting is no longer practiced but budget efficiency is nevertheless gradually improving.</li> <li>• Not achieved</li> <li>• Not achieved</li> <li>• Not achieved</li> </ul>

# Attachment 1

## Paraguay: CAS Program Matrix (FY04-FY07)

Indicative Outcomes and Results Indicators for CAS Period	Actual outcomes
<b>3. Sustainable Growth</b>	
<ul style="list-style-type: none"><li>• Full functioning of Single Window for Exporters by end-2004.</li><li>• Scaling-up of micro-catchment model for agricultural extension and natural resource management to national level by 2007.</li><li>• Completion of market analysis to identify a competitive niche for forestry exports by 2005.</li><li>• Reformed regulatory framework for reforestation and forestry management in place by end-2006.</li><li>• Doubling of funding for road maintenance by 2006 budget.</li><li>• Increase percentage of roads in good condition from 40 percent to 50 percent by 2007.</li><li>• Reduction in time to register new businesses by 2007.</li><li>• Improved access to urban and rural water, from 70 and 30 percent at present to 80 percent and 50 percent by 2007.</li></ul>	<ul style="list-style-type: none"><li>• Successfully implemented in 2006</li><li>• Not achieved. The model will be extended to a further two Departments under the Bank-supported PRODERS project that was approved in January 2008.</li><li>• Not achieved.</li><li>• Forestry Law enacted in April 2008 defines institutional framework for sector.</li><li>• Funding for road maintenance has averaged US\$8 million in recent years.</li><li>• An estimated 14% of roads were in good condition by 2007.</li><li>• Achieved: The time required to register a new business decreased from 74 days in 2004 to 35 days in 2007.</li><li>• Largely achieved: In 2007 access was 80% in urban areas and 45% in rural areas.</li></ul>
<b>4. Social Inclusion</b>	
<ul style="list-style-type: none"><li>• Reduction in extreme poverty rate from 16 percent to 14 percent by 2007.</li><li>• Reduction in secondary education drop-out rate from 11 percent to 9 percent by 2007.</li><li>• Increase in secondary school enrolment rate from 33 percent to 42 percent by 2007, with narrowing urban-rural divide.</li><li>• Introduction of a basic maternal-child health insurance by 2006, with focus in rural areas.</li><li>• Decrease in infant and maternal-mortality rates by 10 percent by 2007. (Note: differences in actual databases preclude certainly re absolute levels).</li><li>• The establishment of a coherent social assistance system that effectively reaches the poorest by end-2006</li><li>• Financial separation of health and old age pension insurance within social security system (IPS) by 2006.</li></ul>	<ul style="list-style-type: none"><li>• Not achieved: Extreme poverty increased to 19% in 2007</li><li>• Secondary education dropout rate was 8.7% in 2005. 2007 data not available.</li><li>• Overall net secondary school enrollment rate was 39% in 2006. (56% in urban areas and 20% in rural areas).</li><li>• Not achieved. Bank loan rejected by Congress.</li><li>• From 2000 to 2005, infant mortality decreased by 13% and maternal mortality decreased by 12%.</li><li>• TEKOPORA program of conditional cash transferred introduced in 2005. 17,000 households covered by end-2007 (11.3% of poorest population).</li><li>• Not achieved.</li></ul>

# Attachment 2

## Comparison of programmed and actual lending FY04-08

Product envisaged in 2003 CAS	US\$ (million)	Status of Delivery as of May 2008	US\$ (million)
Economic Recovery SAL		Economic Recovery SAL FY04	30.0
Financial SAL		Programmatic Financial SAL FY04	15.0
Financial TAL		Withdrawn unsigned	
Ministry of Excellence TA		Cancelled for lack of timely approval by Congress	
Health II		Cancelled after being rejected by Congress	
Social Protection TA		Dropped	
Rural Investment		Sustainable Agriculture and Rural Development Project (PRODERS) FY08	37.5
Forestry		Now planned for FY09	
Road Maintenance		Road Maintenance FY07	74.0
Municipal Finance		Dropped	
Private Sector Development TA		Dropped	
Education Reform II		Now planned for FY09	
Water Sector Modernization		Under preparation for FY09	
	325.0		146.5

# Attachment 3

## Comparison of programmed and actual AAA 2003-08

Product envisaged in 2003 CAS (base case)	Status of delivery as of May 2008
CFAA	Done: Report No. 30084-PY; August 26, 2004
Social Protection Policy	Done: "Defining a Strategy for Social Protection Policy" Report No. 27352-PA; May 2004
Health Strategy	Done: "Health Service Delivery in Paraguay" Report No. 33416-PY; January 25, 2006
Institutional & Governance Review	Done: Report No: 31763-PY; June 2005
PER	Done: Report No. 32797-PY; May 31, 2006
Investment Climate	Done: Policy Note No. 4; 2008
Land Taxation	Done: "Paraguay Real Property Tax" 2 volumes Report No. 37456-PA; May 16, 2007
CEM	Done: "Development Policy Review" (draft) Report No. 29607-PA; June 30, 2004
Rural Sector Strategy	Done: Joint with FAO
Financial Sector Update	Done: "Financial Sector Assessment" Joint IMF-World Bank FSAP; May 2006
Evaluation of Secondary Education	Done: "Educación Media en el Paraguay" Report No. 42665-PY; February 7, 2008
Poverty Update	Now planned for FY09
.....	Integrated Fiduciary Assessment (PEFA)
.....	Policy Notes for new administration in 2008

# Attachment 4

## Lending Program Triggers, FY 04-08

Triggers for Continuation in the Base Case	Status as of May 2008
<b>Macroeconomic Triggers</b>	
<ul style="list-style-type: none"> <li>Maintenance of a satisfactory macroeconomic framework.</li> </ul>	<p>Achieved with support from an IMF stand-by program which the Government now treats as precautionary.</p>
<b>Poverty Triggers</b>	
<ul style="list-style-type: none"> <li>Adoption of a national Poverty Reduction Strategy Program.</li> <li>Progress in providing titles to indigenous communities for already demarcated lands.</li> </ul>	<p>Achieved: National Strategy for the Fight against Poverty adopted in 2006            Achieved: Land titles of four communities in Caaguazú have been fully regularized; nationwide, 45 are in the pipeline as of May 2008.</p>
<b>Governance and Public Accountability Triggers</b>	
<ul style="list-style-type: none"> <li>Satisfactory progress in implementing agreed Procurement Action Plan, including, for example, establishment of agency procurement units and an electronic information and procurement system, and strengthened contract management.</li> <li>Satisfactory progress in implementing agreed Financial Management Action Plan, including, for example, introduction of accrual accounting in central administration and implementation of integrated financial accounting system (SIAF) in decentralized agencies.</li> </ul>	<p><b>Partially achieved. Agency procurement units have been established, and information on public procurement is disclosed electronically. However, an e-procurement system is not yet in place and contract management has not been significantly strengthened.</b></p> <p><b>Partially achieved: Commitment stage has been introduced in the budget, but SIAF has not been extended to decentralized agencies.</b></p>
<b>Structural and Pectoral Triggers</b>	
<ul style="list-style-type: none"> <li>No decline in net assets (patrimonio neto) of Petropar below level of December 31, 2003.</li> <li>Substantial progress on tax and Government pension reform, leading to passage and implementation of these proposed laws.</li> <li>Satisfactory progress on financial sector reform, as evidenced by, for example, strengthened bank provisioning standards, satisfactory implementation of a new deposit insurance scheme, and adoption of a modern (least cost) banking resolution process.</li> </ul>	<p>Not achieved: Net Assets of Petropar declined from US\$-22.5 million in 2003 to US\$-83.7 million in 2006.            Achieved: Strategic Plan for Reform of the Pension System adopted in 2007. Tax Reform Law enacted in July, 2004.            Achieved. Deposit insurance fund is operational and had US\$23 million in reserves as of May 2007. Resolution 8 was issued and partially implemented, but changes in provisioning and risk classification have been postponed. New bank resolution practices have been adopted and successfully applied.</p>
<b>Portfolio Implementation Triggers</b>	
<ul style="list-style-type: none"> <li>No more than 20 percent of projects rated Unsatisfactory on either IP or DO, and an annual disbursement ratio of about 20 percent.</li> </ul>	<p>Achieved: These ratios vary greatly from year to year. For the period FY03-08 the average ratio of unsatisfactory projects was 20 percent and the average annual disbursement rate was also 20 percent.</p>



# Annex 3

## CPS Preparation Process

The CPS was prepared on the basis of an extensive consultations process initially (during the third quarter of 2008) focused on strategic policy direction at the country or sectoral level, followed by consultations on the proposed CPS itself. Key results of the consultations processes include:

- The initial client survey offered important insights on the perception (positive and negative) that key stakeholders had about the work of the World Bank in Paraguay. It also indicated a number of broad areas where the Bank could serve as a development partner for Paraguay.
- During the Policy Notes discussions in June 2008, the elected Government expressed strong interest in working with the World Bank in areas such as: land access and rural poverty, the modernization of the public administration and the management of state owned enterprises, regulation, infrastructure (transport, water, and electricity), as well as safety nets and education. Follow-up meetings, including a detailed discussion on the CPS with the enlarged economic cabinet in February 2009, helped to better define areas of Bank support as well as the instruments to be used (e.g., existing portfolio, new lending, and non-lending technical assistance). Consultation with the international community on the draft CPS helped the Bank to better define some of the issues and understand potential synergies with multilateral and bilateral programs.
- Discussions with Civil Society provided ideas for enhancing a number of the proposed activities. For instance, the focus of a proposed Education operation

was sharpened to include a process to review the needs for reforms in higher education, while starting with a small program of scholarships abroad. Also, Civil Society participants proposed that the dialogue on safety nets, which might lead to project preparation when the authorities consider it appropriate, be enhanced with a discussion on the type of training and retraining needs to enhance labor mobility, particularly during the current economic slowdown. Civil Society also encouraged the Bank to clarify the ways in which it can assist the authorities in increasing their participation in the public investment program—especially in those programs that are co-financed by the World Bank—and the Bank agreed to prepare a quick response note for civil society on this matter.

### A. Strategic Dialogue:

- Strategic discussions on policy direction took place with the new Government prior to its coming to office. In particular, the newly elected President, Fernando Lugo, chaired a one day seminar in Asuncion in June 2008 to discuss the findings of fourteen **Policy Notes** prepared by the Bank on topics ranging from fiscal management and the wage bill, to social inclusion and infrastructure. The seminar, and bilateral discussions between Bank and the elected government team organized the day before, generated a close dialogue on key aspects of the new Government's program and in defining the framework for future Bank support.
- To continue with its strategic engagement, the Bank, jointly with other donors, assisted the Government in organizing a high-level seminar on **governance and development**. The seminar, with key note speaker

# Annex 3

## CPS Preparation Process

including Ricardo Lagos (former President of Chile), included participants such as the vice President of the Oriental Republic of Uruguay and Directors of the World Bank and the Inter-American Development Bank, and addressed a large audience, comprising, inter alia, the media, academia, political figures and private sector representatives. At the strategic level, the seminar provided the elected authorities and key

stakeholders with a tool to openly engage on country priorities and direction, and to discuss the role of social and infrastructure policies.

- A *Client Survey* was completed in August 2008 to better understand the overall situation in Paraguay and how the Bank is perceived by its main interlocutors, and other key stakeholders. The Survey provided

### Box 1 : 2008 Client Survey – Aligning World Bank’s Priorities in Paraguay

**Objectives:** A client survey was conducted in August 2008 to assist in understanding how stakeholders in Paraguay perceive the Bank and better inform the preparation of the CPS.

**Methodology:** Mail-in quantitative surveys were sent to 453 potential participants in June 2008. Potential participants were drawn, among others, from the office of the President, Prime Minister, Minister or State Secretary, federal government staff, Parliamentarian members or staff, bilateral or multilateral agencies, private sector, NGOs, academia, the media, professional associations and the judiciary. The response rate was fairly low at 34%. As 93% of respondents were from Asuncion, comparisons among geographic locations were not possible. The process was managed on the ground by a local professional services company.

**Overall Findings:** Governance is identified, overwhelmingly, as key development priority in Paraguay. The Bank’s focus on governance is therefore validated by survey findings. However, education emerges as key contributor to poverty reduction and faster growth.. Therefore, stakeholders would like to see the Bank play a significant role in education, an area where the Bank has been successfully involved in the past. Stakeholders recognized the value of Bank involvement in other critical area such as infrastructure, governance and poverty. Going forward, Paraguay wants the bank to focus on tangibles - i.e. access to education and basic infrastructure – to reduce poverty.

**Perceptions of the Bank:** Overall perception of the Bank and its efforts to collaborate and include stakeholders is very positive. There is a call for greater Bank involvement in Paraguay. However, NGO respondents have a negative perception of the Bank on certain issues (albeit number of respondents in this category was very low), which is often picked up by the press in articles against the Bank in general or specific government interventions supported by the Bank in the past.

**Perceived weaknesses:** Not enough is being done to prevent corruption in Bank projects. The Bank is technocratic in light of political realities, and its flexibility is a concern. Finally, the Banks’ ability to adapt knowledge is somewhat low.

**Familiarity with the Bank:** Familiarity with the Bank is low among certain groups of stakeholders (NGOs, media). This might explain the respondent NGO’s negative perceptions of the Bank on certain issues. There is a need to increase Bank awareness among stakeholders, as higher familiarity is correlated with more positive views of the Bank.

# Annex 3

## CPS Preparation Process

very useful information and was a valuable guide to the Bank as it seeks to move forward in increasing its support to Paraguay. A summary of survey's objectives, methodology and main finding is provided below (see Box 1 below).

### B. Consultations on the Proposed CPS:

*Consultations with the international community and with civil society* were carried out by the Bank, in partnership with the Government of Paraguay, in December 2008 in Asuncion and in February 2009 in Asuncion and Coronel Oviedo (the third or fourth largest city in the country, and a place where it is easy to invite participants from a vast rural part of the Eastern side of the country).

- Consultations with the donor community were very positive. The representatives of the international community were supportive of the Bank's approach as outlined in the CPS and expressed appreciation for the Bank's transparency and for its openness in collaborating with them. In particular, the European Union, Spain, Germany and Uruguay concurred with the Bank on the need to support the state modernization agenda through a series of development policy lending operations (DPLs). Some donors questioned whether governance should be given as much prominence in the CPS, but it was agreed that the CPS's focus on governance is appropriate given that the Government's program itself is heavily centered on this issue. The question of whether the CPS was excessively loaded with non-lending TA was raised, but most, including the

representative of the IDB, welcomed the proposed technical focus and praised the important role that the World Bank has been playing as a leading source of knowledge for both the Government and the entire donor community in Paraguay.

- The main message emerging from consultations with civil society in both Asuncion and Coronel Oviedo is a call for the Bank to help incorporate civil society's views and participation in the Government's public investment program, particularly those programs with financial support from the Bank. It was explained that the Government's program supported by the World Bank has involved civil society in various ways (e.g., directly, as in the Community Development Project, and less directly, as in the Road Maintenance Project), and it was evident that the mechanisms of engagement promoted by the Bank were not clear to civil society representatives. In this regard, it was proposed that the Bank commission a policy note to address this issue in FY10. This would serve the purpose of both explaining the type of government-civil society partnerships that were forged in the past, and opening a dialogue on new way in which this collaboration can take place in the future. Members of civil society also noted the need for the Bank to facilitate the consensus building dialogue over public policy priorities, such as, for example, on the effects of the global financial crisis in Paraguay and on the appropriate response to the crisis. . It was suggested this could take place in the context of the Bank's proposed dialogue on growth.
- Members of the central or local Government, who attended the consultations, facilitated significantly

# Annex 3

## CPS Preparation Process

the dialogue and helped the Bank explain to the various audiences how it operates in order to support a country's development agenda. In particular, we would like to thank:

o The representatives of the Minister of Finance that took part in the meetings, including:

- Mr. Manuel Caballero, Viceminister for Economy and Trade
- Ms. Veronica Serafini, Head of the Social Unit of the Ministry of Finance
- Mr. Raul Monte-Domec, Head of the Subnational Unit of the Ministry of Finance
- Mr. Pedro Espinola, the recently appointed Advisor to the Executive Director for Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay.

o The representatives of subnational governments in Coronel Oviedo, including:

- The mayor of the city of Coronel Oviedo
- The Governor of the Department of Caaguazú

# Annex 4

## Governance and Anticorruption in Paraguay

### Context

1. Paraguay presents serious challenges in the areas of governance and control of corruption. The recent Presidential elections had a strong focus on the need to improve governance and bring about significant change in what is perceived as a critical handicap for moving into a more advanced phase of development. The Lugo Administration obtained a strong mandate from the electorate to improve governance conditions in the country and has shown a strong commitment and determination to take serious steps in that direction.

2. The root of the problem can be traced back to Paraguay's history and political economy. Under a

dictatorship during most of the second half of the 20th Century, Paraguay started in the early nineties a timid transition to democracy under the same party –the Colorado Party – that had been the cornerstone of the dictatorship and had a firm grip over all state activities. Since the nineties, there has been a steady progress toward political competition and democratic processes. However, there has been limited progress in removing the pervasive culture of patronage, clientelism and political control in the management of Government that continues to be the legacy of the Stroessner's dictatorship. One dimension of this culture is the exorbitant powers provided to Congress over the selection and salary scales of civil servants. As a result, Paraguay's civil service is amongst the

### Box 1: Governance Assessments

According to a recent assessment<sup>36</sup>, the perception of corruption is high for all powers of government, including the state-owned enterprises and the two hydro power plants jointly owned by Paraguay with the governments of Brazil and Argentina, respectively. The lack of transparency and controls over social spending in Paraguay by the Itaipú binational enterprise particularly noteworthy. Corruption affects multiple aspects of daily life of a Paraguayan citizen, including transit policy "fees" and "payments made to ease the handling of key processes by a highly complicated bureaucracy. According to this report, large corruption is associated mainly with campaign finance, and government's contracts or concessions. Although cronyism, patronage, and traffic of influences are present and frequently visible in day to day life, it is the corruption associated with illegal activities on a large scale, such as contraband, money laundering, and drugs, which influences the politics and economy of the country the most, even though it is less visible. Complementing these results are the findings of a 2005 comprehensive survey to diagnose the incidence of corruption conducted by a public/private Council established in 2005 to promote integrity (namely the "Consejo impulsor del Sistema Nacional de Integridad–CISNI"), which signals that the political parties are perceived as the most corrupt institutions in the country. Other institutions perceived as fostering corruption include the Customs Administration, the Supreme Court, the General Prosecutor's office, and congress<sup>37</sup>.

36. See Evaluación de la Corrupción – Paraguay; Mimeo by Benjamin Crosby and Laurence Beck from Management Systems International, July 2008

37. See Patronos de Comportamiento y de Desempeño Institucional, Gobernabilidad y Corrupción en el Sector Público en Paraguay, 2005. CISNI, September 2006

# Annex 4

## Governance and Anticorruption in Paraguay

weakest and most politicized in Latin America, despite the fact that Paraguay's expenditure on public sector salaries is well above the regional average (Figure 1). An independent diagnostic of the key manifestations of corruption is presented in Box 1 below.

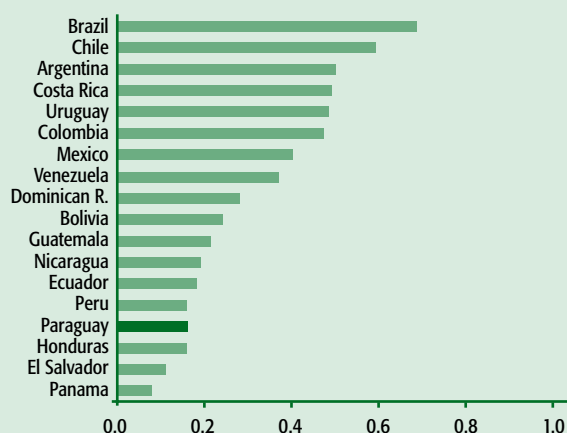
3. Over the past ten years, Paraguay has made some progress in selected areas of governance. The Bank through WBI played an important role in helping the country define its first Anti Corruption Strategy in the late 1990 and, as a result, there has been some tangible progress in the areas of public procurement and customs. Despite this progress, overall achievements remain limited and public distrust in the state and its institutions is deeply rooted. Paraguay has, however, shown some relative improvement in the drive and strength of its civil society, and has exhibited an increase in social and political openness and an improvement in political stability as the

political system has more systematically abided by constitutional rules. As clearly reflected in the recent presidential elections, there is growing impatience in society as a whole for the slow progress achieved in the areas of control of corruption, government effectiveness and the prevalence of rule of law in resolving social and political conflict. The decision by the electorate to vote out the Colorado Party and bring a broad opposition coalition to govern the country is a reflection of both the increased maturity of Paraguayan democratic institutions and the strong urge by the citizenry that there is a need for radical change in all the dimensions of governance.

4. During the last Administration, there was a significant effort to improve governance effectiveness which had been seriously eroded to the point that the state's short term financial viability was at stake. Improving tax collection and strengthening the revenue base became a critical priority. The Duarte Administration achieved an important success in this area, as evidenced by an average budget surplus of 1% of GDP since 2004. This effort has been complemented by important initiatives aimed at modernizing fiscal institutions. The strengthening of the Ministry of Finance and its various dependencies was identified as a key priority and an area in which the Bank played an active role.

5. Despite some accomplishments in modernizing fiscal institutions, most institutions and fiduciary systems remain weak. There is wide scope for collusion in public procurement, despite the progress made in increasing transparency and improving competition. The new Government will continue to face challenges in the fiscal area, including the need to

**Figure 1: Quality of the Civil Service**  
*(índice de desarrollo del servicio civil)*



Source: Iacoviello and Zuvanic (2005).

# Annex 4

## Governance and Anticorruption in Paraguay

develop a fiscal framework to evaluate and prioritize expenditures and to introduce further improvements to public expenditure management. The budget process remains very weak, while treasury and payments systems are rudimentary. In addition, the new Government will have to address the issues of i) reforming public employment and compensation and ii) improving the management of the public investment program.

6. There are also new demands for action in other critical governance areas. The strong stance taken by the new Administration regarding the treatment of corrupt practices is very quickly straining the Government's ability to investigate and sanction corruption. There is also a growing concern that a dysfunctional judiciary may soon become a bottleneck for the type of progress the Government is expecting to achieve in the anticorruption front. There is also the need to make progress in other areas that may help prevent corruption, including improving transparency and access to information on public decision and activities and introducing civil service reform. In all these areas there will be a need to ensure coordination with other donors who are also actively assisting Paraguay in handling this far reaching, emerging agenda.



# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators						
			base	base year	mean point	year	current	year	target
<b>Goal 1: Eradicate extreme poverty and hunger</b>									
Target 1 A: Halve, between 1990 and 2015, the proportion of people whose income is less than \$1 a day	1.1 Proportion of population below \$1 (PPP) per day	Percentage of population in extreme poverty	13,9	1995	21,7	2002	19,4	2007	
	1.2 Poverty gap ratio	Poverty gap ratio	14,3	1997/8	22,7	2002	14,3	2007	
	1.3 Share of poorest quintile in national consumption	Share of homes of the poorest quintile in the total home income	2,1	1999	2,4	2003	3,5	2007	
Target 1 B: Achieve full and productive employment and decent work for all, including women and young people	1.4 Growth rate of GDP per person employed	THIS INDICATOR IS NOT AVAILABLE							
	1.5 Employment-to-population ratio	Activity rate	69,2	1995	61,2	2002	60,8	2007	
		Employment rate	96,6	1995	89,2	2002	94,4	2007	
		Open unemployment rate, population aged 15 -24	6,2	1995	18,6	2002	12,2	2007	
	1.6 Proportion of employed people living below \$1 (PPP) per day	Percentage employed people in extreme poverty	10,7	1999	15,1	2003	14,9	2007	
1.7 Proportion of own-account and contributing family workers in total employment	Percentage of own-account workers	18,3	1995	38,3	2002	36,7	2007		
Target 1 C: Halve, between 1990 and 2015, the proportion of people who suffer from hunger	1.8 Prevalence of underweight children under-five years of age	Estimated percentage of children under 5 with overall malnutrition	3,7	1990	4,6	2000/01	4,2	2005	
	1.9 Proportion of population below minimum level of dietary energy consumption	THIS INDICATOR IS NOT AVAILABLE							
		Registered percentage of undernourished pregnant women		28,0	2000	34,5	2003	30,2	2006

# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators						
			base year	base year	mean point	year	current	year	target
<b>Goal 2: Achieve universal primary education</b>									
Target 2 A: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling	2.1 Net enrolment ratio in primary education	Net pre-school registration rate	17,0	1992	56,0	1998	66,8	2006	
		Net registration rate for 1st Grade to 6th Grade	93,0	1990	91	1997	92,3	2006	
		Net registration rate for 7th Grade to 9th Grade	27,0	1990	44,0	1997	55,6	2006	
	2.2 Proportion of pupils starting grade 1 who reach last grade of primary	Completion rate of primary education, population aged 15 to 24	74,7	1995	84,4	2002	90,2	2007	
		Survival (retention) rate up to to 5th Grade	70,0	1990	78,0	1997	81,3	2005	
	2.3 Literacy rate of 15-24 year-olds, women and men	Literacy rate, population aged 15 - 24	96,5	1995	98,0	2002	98,8	2007	
<b>Goal 3: Promote gender equality and empower women</b>									
Target 3 A: Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015 educational levels by 2015	3.1 Ratios of girls to boys in primary, secondary and tertiary education	Ratio gross joint enrolment primary, secondary and tertiary education for men and women	0,96	1996	0,95	2001	1,00	2006	
			1,03	1995	1,03	2002	1,02	2007	
	3.2 Share of women in wage employment in the non-agricultural sector	Percentage of women in wage-earning non-agricultural employment	41,9	1995	41,4	2002	40,3	2007	
	3.3 Proportion of seats held by women in national parliament	Percentage of positions held by women in the National Parliament	4,6	1989-1993	8,0	1998-2003	13,6	2008-2013	
<b>Goal 4: Reduce child mortality</b>									
Target 4 A: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate	4.1 Under-five mortality rate	Estimated under 5 mortality rate	45,0	1990	41,0	1995/96	48,1	2002	
	4.2 Infant mortality rate	Registered child mortality rate	30,4	1990	19,7	1997	18,0	2006	
		Estimated child mortality rate	59,4	1980	39,1	2000	23,8	2020	
	4.3 Proportion of 1 year-old children immunized against measles	Coverage of MMR vaccination of 1-year old children	71,0	1990	71,4	1999	80,1	2007	

# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators						
			base	base year	mean point	year	current	year	target
<b>Goal 5: Improve maternal health</b>									
Target 5 A: Reduce by three quarters, between 1990 and 2015, the maternal mortality ratio	5.1 Maternal mortality ratio	Registered maternal mortality rate	150,1	1990	101,8	1997	121,4	2006	
		Estimated maternal mortality rate	192,0	1995/96	-	-	169,6	2002	
	5.2 Proportion of births attended by skilled health personnel	Registered percentage of institutional births	83,4	1996	85,5	2001	86,5	2006	
		Estimated percentage of institutional births	53,3	1990	56,3	1998	74,1	2004	
Target 5 B: Achieve, by 2015, universal access to reproductive health	5.3 Contraceptive prevalence rate	Contraceptive prevalence among women (%)	32,7	1990	41,1	1998	50,5	2004	
		Contraceptive prevalence among married or partnered women (%)	44,1	1990	57,4	1998	72,8	2004	
	5.4 Adolescent birth rate	Specific fertility rate among adolescents aged 15 - 19 (births per 1,000 women)	97	1990	87	1998	65	2004	
	5.5 Antenatal care coverage (at least one visit and at least four visits)	Percentage of live births of mothers with one antenatal check-up	3,0	1995/96	3,4	1998	1,6	2004	
		Percentage of live births of mothers with four antenatal check-ups	8,7	1995/96	9,0	1998	7,5	2004	
	5.6 Unmet need for family planning	Percentage of women aged 15 - 44 not using contraceptives	67,3	1990	55,6	1998	49,5	2004	

# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators						
			base	base year	mean point	year	current	year	target
<b>Goal 6: Combat HIV/AIDS, malaria and other diseases</b>			base	base year	mean point	year	current	year	target
Target 6 A: Have halted by 2015 and begun to reverse the spread of HIV/AIDS	6.1 HIV prevalence among population aged 15-24 years	HIV prevalence among persons aged 15 - 24 d (%)	1,19	2006	-	-	1,17	2007	
		HIV prevalence among pregnant women aged 15 or more (%)	0,0	1992	0,2	1997	0,2	2007	
		HIV incidence rate among persons aged 15 - 19 (%)	0,48	1990	3,50	1998	11,47	2007	
		HIV incidence rate among persons aged 20 - 24 (%)	1,01	1990	19,86	1998	36,74	2007	
	6.2 Condom use at last high-risk sex	Prevalence of condom use among women aged 15 - 24 at last sex of last 3 months	15,7	1995/96	21,2	1998	31,8	2004	
		Women aged 15 - 24 with spontaneous and comprehensive knowledge of condom use in all sex for HIV/AIDS prevention	-	-	-	-	35,9	2004	
	6.3 Proportion of population aged 15-24 years with comprehensive correct knowledge of HIV/AIDS	Women aged 15 - 24 with spontaneous and comprehensive knowledge of the three ways to prevent HIV/AIDS (%)	-	-	-	-	2,4	2004	
		Women aged 15 - 44 with spontaneous and comprehensive knowledge of the three ways to prevent HIV/AIDS	-	-	-	-	2,2	2004	
6.4 Ratio of school attendance of orphans to school attendance of non-orphans aged 10-14 years	THIS INDICATOR IS NOT AVAILABLE								
Target 6 B: Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it	6.5 Proportion of population with advanced HIV infection with access to antiretroviral drugs	Percentage of HIV positive population with advanced infection with access to retroviral medications	-	-	-	-	24,29	2006	

# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators						
			base	base year	mean point	year	current	year	target
<b>Goal 6: Combat HIV/AIDS, malaria and other diseases</b>			base	base year	mean point	year	current	year	target
Target 6 C: Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases	6.6 Incidence and death rates associated with malaria	Registered rate of incidence of malaria (per 1,000 inhabitants)	0,79	1990	0,4	1998	0,22	2007	
	6.7 Proportion of children under 5 sleeping under insecticide-treated bednets	THIS INDICATOR IS NOT AVAILABLE							
	6.8 Proportion of children under 5 with fever who are treated with appropriate anti-malarial drugs	THIS INDICATOR IS NOT AVAILABLE							
	6.9 Incidence, prevalence and death rates associated with tuberculosis	Estimated prevalence associated with tuberculosis (per 1,000 inhabitants)	118	1990	-	-	106	2003	
		Registered rate of incidence associated with tuberculosis (per 100,000 inhabitants)	51,4	1990	35,1	1998	34,9	2007	
		Registered rate of incidence associated with pulmonary tuberculosis BK(+)	23,5	1990	15,6	1998	20,9	2007	
		Estimated rate of incidence associated with tuberculosis (per 100,000 inhabitants)	76,0	1990	70,0	2003	71,0	2006	
		Registered mortality rate associated with tuberculosis (per 100,000 inhabitants)	3,0	1990	3,3	1997	3,9	2006	
		Estimated mortality rate associated with tuberculosis ( per 100,000 inhabitants)	11,0	1990	-	-	13,0	2003	
	6.10 Proportion of tuberculosis cases detected and cured under directly observed treatment short course	Percentage of pulmonary tuberculosis cases BK(+) detected and cured under directly observed treatment short course (DOTS)	76,8	2000	85,3	2003	91,3	2006	

# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators						
			base	base year	mean point	year	current	year	target
<b>Goal 7: Ensure environmental sustainability</b>			base	base year	mean point	year	current	year	target
Target 7 A: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources	7.1 Proportion of land area covered by forest	Estimate of the native forest land area of Paraguay	-	-	-	-	46,7	2002	
		Percentage of protected land area to maintain biological diversity	4,26	2000	13,92	2003	13,99	2005	
	7.2 CO2 emissions, total, per capita and per \$1 GDP (PPP)	CO2 emissions (Gigagrams), per sector	3865,81	1990	-	-	18548,99	1994	
	7.3 Consumption of ozone-depleting substances	THIS INDICATOR IS NOT AVAILABLE							
	7.4 Proportion of fish stocks within safe biological limits	THIS INDICATOR IS NOT AVAILABLE							
Target 7 B: Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss	7.5 Proportion of total water resources used	THIS INDICATOR IS NOT AVAILABLE							
	7.6 Proportion of terrestrial and marine areas protected	THIS INDICATOR IS NOT AVAILABLE							
Target 7 C: Halve, by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation	7.7 Proportion of species threatened with extinction	THIS INDICATOR IS NOT AVAILABLE							
	7.8 Proportion of population using an improved drinking water source	Percentage of the population with access to network (drinking) water	39,1	1995	53,3	2002	69,3	2007	
		Percentage of the population with improved water source	66,5	1995	75,9	2002	85,1	2007	
Target 7 D: By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers	7.9 Proportion of population using an improved sanitation facility	Percentage of the population with access to basic sanitation	18,7	1995	18,2	2002	24	2007	
		Percentage of the population with access to improved sanitation	47,2	1995	54,4	2002	66,3	2007	
	7.10 Proportion of urban population living in slums								

# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators					
Goal 8: Develop a global partnership for development			base base	year year	mean point	year current	year year	target target
Target 8 A: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system	Some of the indicators listed below are monitored separately for the least developed countries (LDCs), Africa, landlocked developing countries and small island developing States	THIS INDICATOR IS NOT AVAILABLE						
Includes a commitment to good governance, development and poverty reduction – both nationally and internationally	Official Development Assistance (ODA)	THIS INDICATOR IS NOT AVAILABLE						
	8.1 Net ODA, total and to the least developed countries, as percentage of OECD/DAC donors' gross national income	THIS INDICATOR IS NOT AVAILABLE						
Target 8 B: Address the special needs of the least developed countries	8.2 Proportion of total bilateral, sector-allocable ODA of OECD/DAC donors to basic social services (basic education, primary health care, nutrition, safe water and sanitation)	THIS INDICATOR IS NOT AVAILABLE						
Includes: tariff and quota free access for the least developed countries' exports; enhanced program of debt relief for heavily indebted poor countries (HIPC) and cancellation of official bilateral debt; and more generous ODA for countries committed to poverty reduction	8.3 Proportion of bilateral official development assistance of OECD/DAC donors that is untied	THIS INDICATOR IS NOT AVAILABLE						
	8.4 ODA received in landlocked developing countries as a proportion of their gross national incomes	THIS INDICATOR IS NOT AVAILABLE						
	8.5 ODA received in small island developing States as a proportion of their gross national incomes	THIS INDICATOR IS NOT AVAILABLE						
	Market access	THIS INDICATOR IS NOT AVAILABLE						



# Annex 5

## Meeting the Millenium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS							
		Indicators	base	base year	mean point	year	current	year	target
<b>Goal 8: Develop a global partnership for development</b>			base	year	point	year	current	year	target
Target 8 C: Address the special needs of landlocked developing countries and small island developing States (through the Programme of Action for the Sustainable Development of Small Island Developing States and the outcome of the twenty-second special session of the General Assembly)	8.6 Proportion of total developed country imports (by value and excluding arms) from developing countries and least developed countries, admitted free of duty	THIS INDICATOR IS NOT AVAILABLE							
	8.7 Average tariffs imposed by developed countries on agricultural products and textiles and clothing from developing countries	THIS INDICATOR IS NOT AVAILABLE							
	8.8 Agricultural support estimate for OECD countries as a percentage of their gross domestic product	THIS INDICATOR IS NOT AVAILABLE							
	8.9 Proportion of ODA provided to help build trade capacity	THIS INDICATOR IS NOT AVAILABLE							
	Debt sustainability	THIS INDICATOR IS NOT AVAILABLE							
Target 8 D: Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term	8.10 Total number of countries that have reached their HIPC decision points and number that have reached their HIPC completion points (cumulative)	THIS INDICATOR IS NOT AVAILABLE							
	8.11 Debt relief committed under HIPC and MDRI Initiative	THIS INDICATOR IS NOT AVAILABLE							
	8.12 Debt service as a percentage of exports of goods and services	Debt servicing as percentage of exports of goods and services	4,8	1995	12,2	2001	5,1	2007	

# Annex 5

## Meeting the Millennium Development Goals (As of February 2009)

Goals and Targets extracted from the Millennium Declaration	Indicators for Follow-up of Advances	PARAGUAY INDICATORS	Indicators					
			base year	base year	mean point	year	current year	target
<b>Goal 8: Develop a global partnership for development</b>			base	year	mean point	year	current year	target
Target 8 E: In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries	8.13 Proportion of population with access to affordable essential drugs on a sustainable basis	THIS INDICATOR IS NOT AVAILABLE						
Target 8 F: In cooperation with the private sector, make available the benefits of new technologies, especially information and communications	8.14 Telephone lines per 100 population	Percentage of the population with access home landline telephone	11,5	1995	13,8	2002	17,8	2007
	8.15 Cellular subscribers per 100 population	Percentage of the population with access to cellular phone at home	5,0	1999	31,7	2003	78,2	2007
		Percentage of the population with access to personal computer at home	2,1	1997 /98	6,3	2003	11,2	2007
		Percentage of the population with access to personal computer connected to internet at home	1,0	2000 /01	1,8	2003	3,0	2007
8.16 Internet users per 100 population	Percentage of the population of internet-users aged 10 or more	7,9	2005	8,0	2006	11,2	2007	

Has reached the target or is about to reach it  
 Insufficient progress to reach the target if the prevailing tendency continues  
 Insufficient progress to reach the target if the prevailing tendency continues  
 No progress or deterioration is observed  
 Insufficiency or absence of data  
 Not included in the report  
 Prepared by: DGEEC and the United Nations System Paraguay

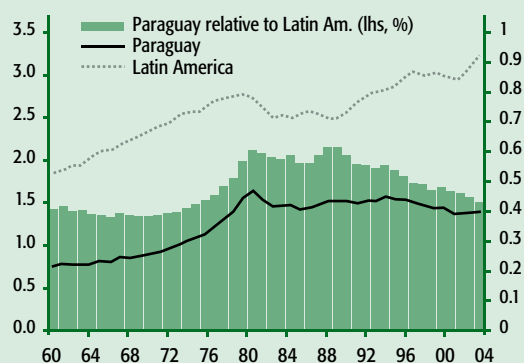
# Annex 6

## Growth Prospects in Paraguay<sup>38</sup>

1. **Paraguay's long-run growth performance has been disappointing.** GDP per capita grew by 1½ percent on average since 1960, but over the past 25 years, GDP per capita declined by ½ percent on average per year. The improvement in the 1970s was largely related to the construction of the Itaipú hydropower plant, with important spillovers to the economy, and to the development of agriculture in the eastern part of the country. Higher growth in the 1970s contributed to bridge the gap with other Latin American countries, but then the gap stagnated in the 1980s. Paraguay fell behind throughout the 1990s and has only now returned to the same per-capita income relative to the rest of Latin America where it started 45 years earlier.<sup>39</sup>

2. **The recent growth acceleration between 2004 and 2008, the largest expansion since the 1970s, was welcomed, but it highlighted a number of weaknesses of the economic structure.**<sup>40</sup> At the aggregate level, as demand accelerated over the past years, the economy started to show signs of overheating. Analyses prepared by the IMF suggest that current growth may be higher than its potential. Equally important, while some diversification occurred (the demise of cotton production was met with a major supply response by country producers to opportunities that arose in the world market for soy bean and beef;

**Figure 1: Per capita income**  
(in '000 of constant 2002 US\$)



Source: World Bank Development Indicators.

also, new products such as stevia, sesame seeds and sugar cane, are now important source of income for small and medium farmers). The challenge of a growth strategy is, thus, to find a mixture of policies that will lift sustainable growth upwards over the long run, while at the same time help diversifying in terms of both products and markets.

### Growth Accounting and Determinants<sup>41</sup>

3. **The growth accounting methodology allows analyzing the contribution of factor accumulation**

38. Prepared by Pedro L. Rodriguez, Country Manager, LCC7

39. The trend is similar if GDP per capita is measured in purchasing power parity or at market exchange rates.

40. For example, as construction demand accelerated in 2006, the state-owned cement company, which enjoys a monopoly given the recent ban imposed on clinker imports, collapsed due to lack of maintenance and continued political interference on the company's operations. This situation paralyzed the construction sector—which is a key channel of transmission from the export boom into employment generation.

41. This section relies heavily on the comprehensive analysis of growth accounting and growth determinants in Latin America and the Caribbean developed by Loayza, Fajnzylber, and Calderon (2005). It extends their results for the most recent period not covered in their paper.

# Annex 6

## Growth Prospects in Paraguay

**and productivity to growth.** Table 1 summarizes the findings of a growth breakdown made by Loayza et. al. (2005) for the period 1960–2000 and extends their results for 2000–2006. In the first breakdown, TFP is constructed as the residual of the contribution of labor force and of capital. In the second breakdown, labor is adjusted by increases in education accomplishments. Finally, in the third breakdown, both labor and capital are adjusted for their level of utilization, proxied by the employment rate.

4. **The contribution of total factor productivity has been negative during the 1980s, as in other Latin American countries, but, unlike them, it has not recovered until the early 2000s.** Negative productivity growth was a common trend in Latin America during the 1980s (17 countries experienced such negative TFP according to Loayza et. al.), but most countries showed positive TFP contribution during the 1990s. Paraguay is one of the few countries in the region that was unable to recover from the fall in its productivity growth of the 1980s. The continued

Table 2 . Growth Accounting, 1960-2000 (percentage)

	1961-70	1971-80	1981-90	1991-00	2001-06	2003-06
Simple						
GDP	4,3	8,9	2,8	2,0	2,8	3,7
Labor	1,4	2,1	1,9	1,8	0,6	0,5
Capital	2,1	4,7	2,9	1,7	1,0	1,1
TFP1	1,9	5,3	-0,5	-1,1	1,3	2,1
Adjusted for Human Capital						
GDP	4,3	8,9	2,8	2,0	2,8	3,7
Labor	2,0	2,9	2,9	1,9	0,6	0,5
Capital	2,1	4,7	2,9	1,7	1,1	1,2
TFP1	0,9	3,9	-2,2	-1,2	1,2	2,0
Adjusted for Human Capital and Input Utilization						
GDP	...	...	2,8	2,0	2,8	3,7
Labor	...	...	2,7	1,3	0,7	1,1
Capital	...	...	2,8	1,5	1,2	2,0
TFP1	...	...	-1,7	-0,2	0,9	0,6

Sources: Loayza, Fajnzylber, Calderon (2005); and author's estimates after 2000

# Annex 6

## Growth Prospects in Paraguay

negative TFP growth in the 1990s may reflect the political uncertainty in this period which has reduced the incentives to invest in Paraguay, as suggested by Fernandez and Monje (2004). By contrast, Paraguay experienced positive TFP growth since 2000, and all the more so since 2003. As is shown in the next section, this is related to better terms of trade, but also to improvements in the macroeconomic situation and to the implementation of structural reforms.

**5. Another methodology to assess growth performance consists in studying the determinants of growth, such as structural and stabilization policies and cyclical factors.** Loayza et al. (2005) have estimated the impact of such factors over 1976–2000 for a panel of Latin America countries. Table 3 presents the coefficients of these models, as well as the results for Paraguay and extends the analysis to the most recent period. According to the model, the decline of per capita GDP growth in the early 1980s is explained mainly as a correction after the overheating of the late 1970s, combined with growing economic instability and a negative terms-of-trade shock. The economy recovered somewhat in the late 1980s, in part because of improved terms of trade, higher trade openness, and a favorable exchange rate. The continued deterioration of economic growth during the 1990s was caused mainly by the succession of banking crises that affected Paraguay from 1996 until 2002. Since 2000, economic growth recovered, following a cyclical upturn after the banking crises, but also because of improved terms of trade and structural reforms.

**6. Economic instability has been one of the main factors explaining the poor performance of**

**Paraguay until recently.** The lack of macroeconomic stability became a significant constraint on the overall performance of the economy during the 1990s period and contributed negatively to growth for the entire period of analysis—Trade shocks over the 1995–2003 period, and financial sector instability between 1998 and 2003 explain instability during these years. Thus, maintaining the achieved macroeconomic stability, and reducing overall macroeconomic volatility, will continue to be an important component of the growth agenda for Paraguay.

**7. By contrast, structural reforms have generally been supportive even during bad times.** The contribution of structural reforms has been positive although their contribution to growth fell during the second half of the 1990s. Over the entire period of analysis, the contribution of structural policies has generally been higher than in other Latin American countries, reflecting mostly Paraguay's increased trade openness, improved education, and financial deepening. Strengthening policy efforts in all these areas should also remain high on the growth agenda.

**8. While a consensus is reached over the sources of growth and the policies that are to be used to foster it, there are a number of sectoral policies that are important in any case.** These include five important areas:

- **Transport.** The high costs of transport and logistics, together with access to finance, are the major obstacles to private sector development, especially for export industries. The share of costs associated with

# Annex 6

## Growth Prospects in Paraguay

Table 3. Growth Determinants, 1976-2005

Econometric growth regression		Contribution to change in GDP growth						
Determinant	Variable	Coeff.	Stdev	81-85 76-80	86-90 81-85	91-95 86-90	96-00 91-95	01-05 96-00
Dependant variable	Change in growth rate of GDP per capita							
Convergence Factors:								
Initial GDP Per Capita		-0,0176	-3,8	-0,65	0,11	-0,06	-0,04	0,17
Cyclical Reversion:								
Initial Output Gap		-0,2371	-8,52	-1,83	0,99	-0,05	-0,19	0,27
<b>Structural Policies and Institutions:</b>								
Education	Secondary enrolment	0,0172	6,7	0,43	-0,01	0,31	0,44	0,35
Financial Depth	Private domestic credit/GDP	0,0066	4,28	-0,03	-0,16	0,36	0,18	-0,21
Trade Openness	Structurally adjustment consumption/GDP	0,0096	3,14	-0,11	0,34	0,54	-0,01	0,12
Government Burden	Log of government consumption/GDP	-0,0154	-3,18	-0,15	0,05	-0,04	-0,30	0,19
Public Infrastructure	Log of main telephone lines per capita	0,0071	2,71	0,25	0,15	0,18	0,26	0,05
<b>Total:</b>				<b>0,39</b>	<b>0,37</b>	<b>1,35</b>	<b>0,57</b>	<b>0,5</b>
<b>Stabilization Policies:</b>								
Lack of Price Stability	Inflation rate. In log (100+Inf. Rate)	-0,0048	-1,89	0,00	-0,05	0,04	0,04	0,00
Cyclical Volatility	Std. Dev. Of output gap	-0,2771	-3,76	-0,18	0,68	0,19	-0,04	0,23
REER Overvaluation	Log Index. Overvaluation If > 100	-0,0061	-3,9	-0,06	0,30	0,05	-0,01	0,12
Banking Crises	Frequency of years under crisis: 0-1	-0,0289	-7,42	0,00	0,00	-0,58	-2,31	1,73
<b>Total:</b>				<b>-0,24</b>	<b>0,93</b>	<b>-0,30</b>	<b>-2,32</b>	<b>2,09</b>
<b>External Conditions:</b>								
Terms of Trade	Growth rate of terms of trade	0,072	4,98	-0,85	0,76	-0,40	-0,35	0,26
Other								
Period shift	Specific to 5 year periods			-1,45	0,44	-0,64	-0,13	...
Intercept		0,1216	2,79					
<b>No. Countries / No. Observations</b>			<b>78 /350</b>					
Projected change				-4,63	3,62	-0,10	-2,46	3,29
Actual change				-8,64	1,99	-0,20	-2,45	2,82
<b>Memorandum</b>								
Average GDP growth per capita				-1,97	0,02	-0,18	-2,63	0,18
Change of GDP in Latin America and the Caribbeans				-3,6	1,7	1,8	-0,6	...
Contribution of structural policies in Latin America and the Caribbeans				-0,68	0,15	0,39	0,07	...
Contribution of stabilization policies in Latin America and the Caribbeans				0,23	0,39	0,87	0,61	...

Source: Loayza and al. for the panel estimation of the model and the results until 2000; author's estimation for the extension in 2000-05.

# Annex 6

## Growth Prospects in Paraguay

transport is by far the largest among the logistical costs faced by private sector enterprises. The main causes for high transport costs include factors such as the poor condition of the road network, lack of coordination among operators and users of fluvial ports, and a lack of dredging and signaling along the fluvial transport system. The inefficiency of the customs system further contributes to increasing costs. Currently only 14% of the total road network is in good condition, which largely corresponds to the total proportion of the network which is paved. While 50% of imports and 47% of exports (2006) are transported by river, the lack of sufficient dredging and signaling along major waterways (particular the Río Paraguay) imposes additional transport costs estimated at US\$150 million/year, since barges cannot be fully loaded and – in many areas – can only operate during daylight. Finally, air transport is also plagued by institutional weaknesses in sector planning and airport operations as well as underinvestment in airport infrastructure which limit airfreight volumes and passenger traffic. In view of the current constraints and the importance of the transport sector to private sector development, it will be necessary to strengthen management of the road network, and to prioritize the allocation of scarce resources to rural roads and to the overall network maintenance. In the medium-term, important steps may include an improvement in the systems used for

road network planning, as well as a modernization of the toll system, and improved budgetary execution. In terms of fluvial transport, there is a urgent need to improve dredging and signaling as well as customs processing. Air transport could benefit, among others things, from integrated multi-modal sector planning, and a separation of the roles of sector planning, regulation and airport operations under efficient operators.

- **Telecommunications.** Paraguay continues to face bottlenecks in fixed-line telecommunications services due largely to underinvestment and inefficiencies in the public telecoms monopoly (COPACO) that undermine growth opportunities in information technologies and call centers as well as the use of the internet for e-government and in schools. At only 0.9%, the depth of broadband penetration lags significantly behind MERCOSUR partners such as Brazil (4%), Argentina (6.6%) and Chile (8.8%)<sup>42</sup>. COPACO's monopoly on fiber optic cable access has led to internet access charges that are approximately 10 times higher than those in the US or 12 times higher than those in Korea<sup>43</sup>. While COPACO charges about US\$0.41/minute for calls to the US and Canada and about US\$0.66/minute for calls to Europe, average prices from Latin American countries that have liberalized internet access<sup>44</sup> run about US\$0.03 and US\$0.05 respectively.

42. Source: CISCO broad band barometer, IDC, CONATEL, December, 2007.

43. Charges for 1 Mb/s service from COPACO under a 1 year contract run about US\$600/month, while 1.44 Mb/s services (without a time-bound contract) by VERIZON (USA) run about US\$60/month and 2 Mb/s, services (without a time-bound contract) from Korea Telecom cost about US\$50/month.

44. Chile, Perú, Panamá, El Salvador, Guatemala, Colombia, Argentina, México, Brazil, Bolivia, and República Dominicana have been used for comparison.



# Annex 6

## Growth Prospects in Paraguay

• **The Electricity Sector.** While Paraguay is blessed with abundant hydropower generation capacity (primarily from the Itaipú and Yacyretá dams), key weaknesses in transmission and distribution hamper the development of productive activities in both rural and urban areas, as well as the prospects for true formal exports. While electricity coverage reaches 93.8% of all households (just below the LAC average of 94.6%), average per capita consumption per year was only 853 kWh, far lower than in Chile (2.745 kWh/capita/year) or in Brazil (2.166 kWh/capita/year). Moreover, system losses (31.1% overall -- 8.1% in transmission and 23% in distribution) are very high and well above the 13.5% weighted average for the LAC region.

• **Agriculture and Natural Resources.** The agriculture sector is the mainstay of Paraguay's economy, representing approximately 21% of GDP and 55% of exports. It also employs about 32% of the national labor force. During 1991-2005 the agriculture sector's share of GDP grew at a rate of 3.7% annually and experienced a shift in production, away from cotton and increasingly concentrated in soy and beef, which together represent about 90% of total exports. Although overall productivity in the sector has increased, that of small farmers has deteriorated, thus contributing to an increase in extreme poverty in the rural areas. The uneven distribution of agricultural land, a high concentration of both production and exports in a few products, and the lack of off-farm employment and processing of agricultural crops in rural areas, are among the most pressing challenges. Paraguay's land ownership GINI coefficient is the highest in the world. The sector is also faced with limited access to

neighboring markets. Important priorities in a reform agenda for the short term include (i) development of a coherent national policy for land administration and land access combined with financing to promote land acquisition and productive investments by small (or landless) farmers; (ii) efficient agricultural extension services specifically targeted to small farmers ideally through cooperation with agricultural enterprises and cooperatives which could transfer know-how; and (iii) the creation of rural off-farm employment. In the medium-term, it will be important to develop a strategy of agricultural diversification and to attract additional investment to rural areas in order to encourage local processing of agricultural products. Perhaps the single greatest weakness in terms of natural resource management in Paraguay lies in the forestry sector. Paraguay has lost at least 80 percent of its forests over the last 50 years and losses of 500 ha/day occurred between 1966 and 1991. Of the remaining 2 million ha in the Upper Parana Atlantic Forest (UPAF, i.e. forests east of the Paraguay River), only an estimated 800,000 are still considered productive. This is due to destructive logging practices that have degraded the forests, and a result of deforestation that has fragmented much of the UPAF into unmanageably small remnant patches. While deforestation appears to have slowed recently in the east -- due both to resource depletion and some success with a "Zero Deforestation" law -- it seems to have now moved west into the Arid Chaco, which is home to 78 percent of Paraguay's remaining native forests.

• **Business Climate:** Paraguay's overall ranking dropped from 108 in the 2008 report to 115, which is below the average for LAC and for low-middle

# Annex 6

## Growth Prospects in Paraguay

income countries (see Table 1). The change reflects stronger downward shifts in four areas: “starting a business”, “registering property”, “getting credit” and “trading across borders”. While Paraguay continues to fare comparatively well in the first three areas, the deterioration in the latter area puts the country

in the lowest quartile. Improvements in ranking were achieved in two areas - “closing a business” and enforcing contracts”, but Paraguay continues to lag behind comparator countries in those areas. Paraguay’s weakest areas are “employing workers”, “trading across borders”, and “closing a business”.

Table 4: Doing Business in Paraguay: A comparison

Area of Doing Business	Paraguay	LAC average	Low-middle income countries (average)
overall ranking	115	92	103
Starting a Business	82	93	104
Construction Permits	96	79	102
Employing Workers	177	88	95
Registering Property	70	99	95
Getting Credit	68	73	85
Protecting Investors	53	81	91
Paying Taxes	102	107	102
Trading Across Borders	138	89	99
Enforcing Contracts	103	113	100
Closing a Business	116	99	105

# Annex 7

## Principal Areas of Assistance by Donor

Development Challenges	Governance & Anticorruption		Poverty Reduction				Sustainable Growth							
	Consensus Building	Anticorruption	Modernization of the State/Tax and Expenditure Management	Agrarian Reform / Rural Development	Poverty Alleviation	Social Inclusion / Participation	Health	Education	Water and Sanitation	Macro Management/Financial Vulnerability	SME Development	Power	Transport	Environmental Management/Forestry
IBRD	X	X	X	X	X	X		X	X	X		X	X	X
IFC											X		X	
IDB	X	X	X	X	X	X	X	X	X	X	X	X	X	X
IMF			X							X				
UNDP	X	X	X		X	X		X	X					X
UNICEF			X		X	X	X	X	X					
UNFPA			X			X	X							
PAHO							X							
EU			X		X	X		X	X	X	X			
IFAD				X	X	X								
FAO				X	X	X								
IICA				X	X	X								
CAF													X	
MERCOSUR				X	X	X			X				X	
Taiwan				X	X	X				X			X	
Japan / JICA	X		X	X	X	X	X	X	X	X	X	X	X	X
Germany / GTZ											X			X
US/USAID	X	X	X				X			X	X			X
Spain	X							X	X					
Korea			X	X	X	X		X			X			
Chile	X		X					X						

Source: Staff assessment based on consultations with International Community, UNDP, and data from the External Debt Department of the Ministry of Finance.

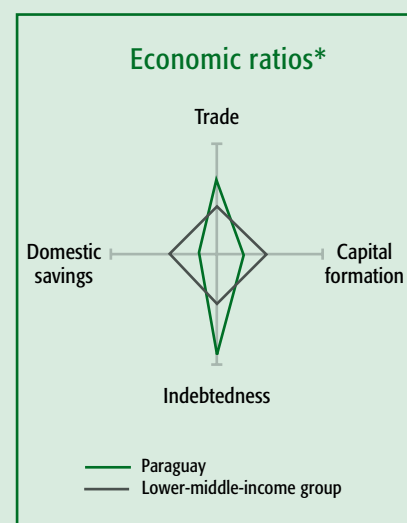
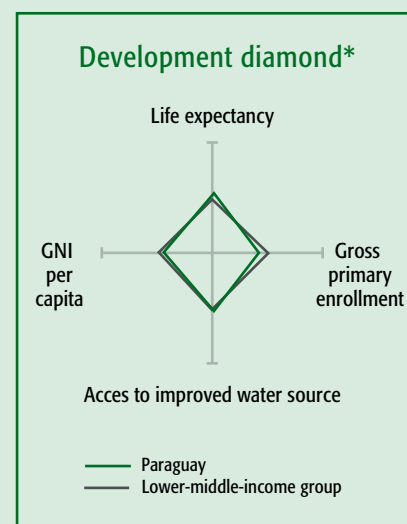
# Annex A2

## Paraguay at a Glance

POVERTY and SOCIAL	Paraguay	Latin America & Carib.	Lower-middle-income	
<b>2007</b>				
Population, mid-year (millions)	6,1	563	3.437	
GNI per capita (Atlas method, US\$)	1.710	5.540	1.887	
GNI (Atlas method, US\$ billions)	10,5	3.118	6.485	
<b>Average annual growth, 2001-07</b>				
Population (%)	1,9	1,3	1,1	
Labor force (%)	3,6	2,1	1,5	
<b>Most recent estimate (latest year available, 2001-07)</b>				
Poverty (% of population below national poverty line)	36	..	..	
Urban population (% of total population)	58	78	42	
Life expectancy at birth (years)	72	73	69	
Infant mortality (per 1,000 live births)	32	22	41	
Child malnutrition (% of children under 5)	4	5	25	
Access to an improved water source (% of population)	61	91	88	
Literacy (% of population age 15+)	95	90	89	
Gross primary enrollment (% of school-age population)	104	118	111	
Male	106	120	112	
Female	103	116	109	
<b>KEY ECONOMIC RATIOS and LONG-TERM TRENDS</b>				
	<b>1987</b>	<b>1997</b>	<b>2006</b>	<b>2007</b>
GDP (US\$ billions)	3,5	8,9	9,3	12,2
Gross capital formation/GDP	25,1	26,5	19,6	18,0
Exports of goods and services/GDP	26,4	44,0	53,7	50,9
Gross domestic savings/GDP	16,5	11,7	15,1	15,0
Gross national savings/GDP	14,4	14,3	24,8	21,1
Current account balance/GDP	..	-7,3	0,8	0,2
Interest payments/GDP	..	1,1	1,8	1,3
Total debt/GDP	..	27,7	36,9	29,1
Total debt service/exports	22,0	6,3	7,3	6,4
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..

Note: 2007 data are preliminary estimates.

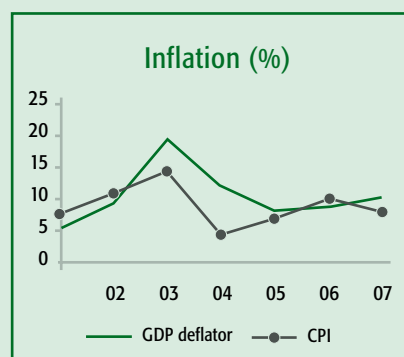
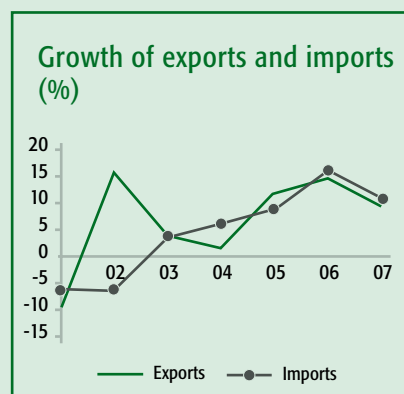
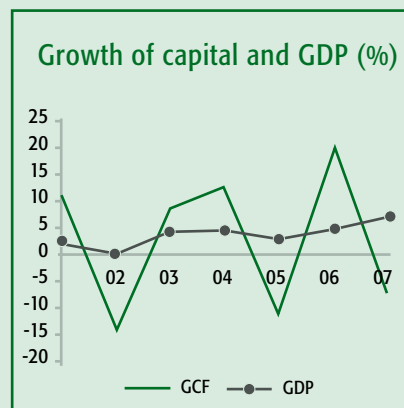
\* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.



# Annex A2

## Paraguay at a Glance

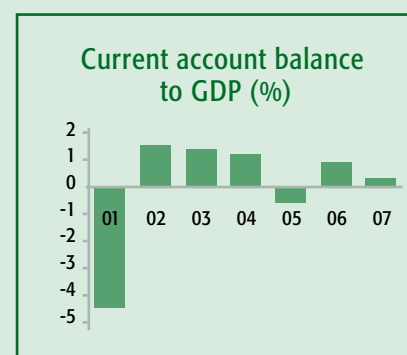
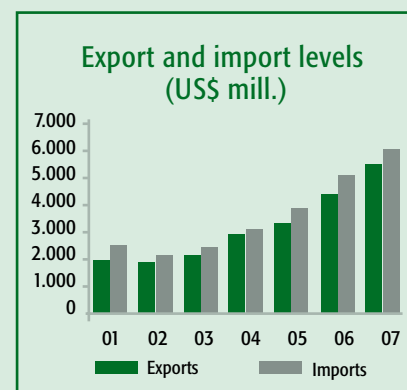
<i>(average annual growth)</i>	1987-97	1997-07	2006	2007	2007-11
GDP	3,6	1,8	4,3	6,8	4,2
GDP per capita	1,1	-0,2	2,4	4,8	2,2
Exports of goods and services	11,9	3,0	14,6	9,6	2,0
<b>STRUCTURE of the ECONOMY</b>	<b>1987</b>	<b>1997</b>	<b>2006</b>	<b>2007</b>	
<i>(% of GDP)</i>					
Agriculture		27,3	18,5	20,2	22,0
Industry		22,5	22,7	20,4	20,0
Manufacturing		14,1	15,4	13,7	12,8
Services		50,1	58,8	59,3	58,0
Household final consumption expenditure		76,4	76,9	73,7	74,1
General gov't final consumption expenditure		7,1	11,4	11,2	10,8
Imports of goods and services		34,9	58,8	58,2	53,9
<i>(average annual growth)</i>	1987-97	1997-07	2006	2007	
Agriculture		4,4	3,8	3,4	14,3
Industry		3,4	0,5	1,8	1,0
Manufacturing		-0,5	0,4	2,5	-1,2
Services		3,5	1,4	5,7	5,3
Household final consumption expenditure		3,9	0,6	1,3	11,6
General gov't final consumption expenditure		9,6	0,3	4,0	5,3
Gross capital formation		6,5	-1,3	19,8	-6,7
Imports of goods and services		14,0	-0,4	16,5	10,8
<b>PRICES and GOVERNMENT FINANCE</b>	<b>1987</b>	<b>1997</b>	<b>2006</b>	<b>2007</b>	
<b>Domestic prices (% change)</b>					
Consumer prices		21,8	6,9	9,6	8,1
Implicit GDP deflator		30,3	4,3	8,5	10,2
<b>Government finance</b> <i>(% of GDP, includes current grants)</i>					
Current revenue		8,1	16,9	18,3	17,6
Current budget balance		1,5	2,3	4,6	4,6
Overall surplus/deficit		0,7	-2,3	0,5	1,0



# Annex A2

## Paraguay at a Glance

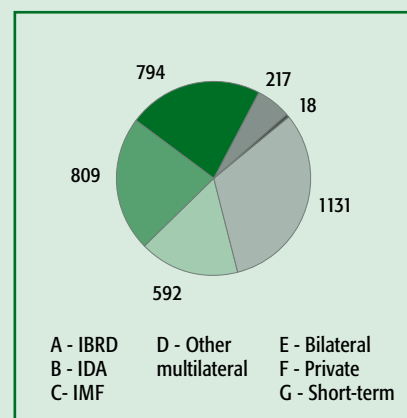
<b>TRADE (US\$ millions)</b>	<b>1987</b>	<b>1997</b>	<b>2006</b>	<b>2007</b>
Total exports (fob)	803	3.328	4.401	5.471
Soy products	125	494	439	890
Cotton	101	73	34	47
Manufactures	450	2.239	2.495	2.686
Total imports (cif)	1.049	4.192	5.022	6.027
Food	532	1.252	533	451
Fuel and energy	103	267	691	715
Capital goods	14	928	1.754	2.577
Export price index (1994=100)	..	116	96	113
Import price index (1994=100)	..	128	126	153
Terms of trade (1994=100)	..	91	76	74
<b>BALANCE of PAYMENTS (US\$ millions)</b>	<b>1987</b>	<b>1997</b>	<b>2006</b>	<b>2007</b>
Exports of goods and services	1.036	3.983	5.154	6.324
Imports of goods and services	1.304	4.847	5.406	6.487
Resource balance	-267	-864	-252	-163
Net income	-93	33	-96	-184
Net current transfers	27	181	426	373
Current account balance	-334	-650	78	26
Financing items (net)	347	867	309	701
Changes in net reserves	-13	-216	-387	-727
<b>Memo:</b>				
Reserves including gold (US\$ millions)	..	846	1.703	2.462
Conversion rate (DEC, local/US\$)	..	2.177,9	5.635,5	5.032,7



# Annex A2

## Paraguay at a Glance

EXTERNAL DEBT and RESOURCE FLOWS (US\$ millions)	1987	1997	2006	2007
Total debt outstanding and disbursed	2.522	2.461	3.422	3.561
IBRD	372	143	234	217
IDA	44	33	19	18
Total debt service	239	279	421	450
IBRD	65	36	39	38
IDA	1	2	2	2
Composition of net resource flows				
Official grants	15	23	12	7
Official creditors	60	145	-15	-36
Private creditors	35	84	-10	61
Foreign direct investment (net inflows)	5	236	171	244
Portfolio equity (net inflows)	0	0	0	0
World Bank program				
Commitments	0	40	74	30
Disbursements	19	41	32	11
Principal repayments	37	28	28	29
Net flows	-18	14	4	-18
Interest payments	30	11	13	11
Net transfers	-48	3	-8	-29





# Annex B2

## Selected Indicators\* of Bank Portfolio Performance and Management

As Of Date 02/23/2009

Indicator	2006	2007	2008	2009
<b>Portfolio Assessment</b>				
Number of Projects Under Implementation a	6	4	4	4
Average Implementation Period (years) b	3,2	2,9	3,4	4,0
Percent of Problem Projects by Number a, c	33,3	50,0	0,0	50,0
Percent of Problem Projects by Amount a, c	19,1	74,4	0,0	40,1
Percent of Projects at Risk by Number a, d	50,0	75,0	50,0	75,0
Percent of Projects at Risk by Amount a, d	39,6	93,0	63,8	88,3
Disbursement Ratio (%) e	26,5	23,7	10,0	4,7
<b>Portfolio Management</b>				
CPPR during the year (yes/no)	YES	YES	YES	NO
Supervision Resources (total US\$)	677	626	380	274
Average Supervision (US\$/project)	85	89	76	68

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	34	4
Proj Eval by OED by Amt (US\$ millions)	768,0	101,8
% of OED Projects Rated U or HU by Number	39,4	33,3
% of OED Projects Rated U or HU by Amt	41,5	14,7

a. As shown in the Annual Report on Portfolio Performance (except for current FY).

b. Average age of projects in the Bank's country portfolio.

c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).

d. As defined under the Portfolio Improvement Program.

e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

\* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

# Annex B3

## Proposed IBRD/IDA Base-Case Lending Program

As Of Date February 23, 2009

Fiscal year	Proj ID	US\$(M)	Strategic Rewards b (H/M/L)	Implementation b Risks (H/M/L)
	<b><i>Identified Lending</i></b>	265,0		
2009	Public Sector DPL 1	100,0	H	H
2010	Land Access and Administration	35,0	H	H
	Public Sector DPL 2	50,0	H	H
	Secondary Education III	30,0	H	M
	Electricity Transmission	a/	H	M
2012	Public Sector DPL 3	50,0	H	H
2011-2013	<b><i>Lending to be identified</i></b>	235,0	tbd	tbd
<b>Overall Result</b>		<b>500,0</b>		

a. Amount to be determined

# Annex B3

## Paraguay - IFC and MIGA Program, FY 2006-2009

as of 1/31/09

	2006	2007	2008	2009
IFC Commitments (US\$m)	0	0	0	63,4
<b><i>Sector (%)</i></b>				
Infrastructure	--	--	--	95
Financial Sector	--	--	--	5
<b><i>Investment instrument(%)</i></b>				
Loan	--	--	--	95
Guarantee	--	--	--	5
MIGA guarantees (US\$m)				

# Annex B4

## Summary of Nonlending Services

As Of Date February 23, 2009

Product	Completion FY	Cost (US\$000)		Audience <sup>a</sup>	Objective <sup>b</sup>
<b>1. Recent completions</b>					
<b>ESW/Dialogue</b>					
Land Taxes	FY07	202	BB	PD	Public debate
Joint Integrated Fiduciary Assessment	FY07	173	BB	Gov/Donor	Knowledge
- Follow Up	FY08	237	BB	Gov/Donor	Public debate
Education Sector Study	FY08	153	BB	PD	Prob. solving
Policy Notes	FY08	409	BB	Gov/PD	Public debate
Mercosur Trade Study	FY09	130	BB	Gov	Public debate
Transport Sector Assmt	FY09	80	BB	PD	Public debate
Social Protection Dialogue	FY09	40	BB	Gov	Knowledge
<b>Grants</b>					
Institutional Support to Congress	FY08	400	TF	PD	Prob. solving
Social Capital Strengthening for Poor Communities	FY08	867	TF	PD	Prob. solving
<b>2. Underway</b>					
<b>ESW</b>					
Programmatic Poverty Assesment	FY09	300	BB	Gov/PD	Knowledge
- with women in the economy grant	FY10	25	BB	Gov/PD	Knowledge
<b>Fee For Service</b>					
Payments System (w/ FFS)	FY08-12	319	FFS	Gov	Prob. solving
<b>Grants</b>					
JSDf Indigenous Land Regularization	FY08-12	1710	TF	PD	Prob. solving
JSDf Development of Indigenous Communities	FY08-12	1599	TF	PD	Prob. solving
DFID Governance Dialogue	FY08-09	170	TF	PD	Public Debate
Compensation for Environmental Services	FY09-12	200	Dev Market Place	IDEA/PB	Prob. solving

# Annex B4

## Summary of Nonlending Services

As Of Date February 23, 2009

Product	Completion FY	Cost (US\$000)		Audience <sup>a</sup>	Objective <sup>b</sup>
<b>3. Envisaged</b>					
<b>ESW</b>					
Quick Response Notes (civil society, taxation, pensions, etc)	FY10-13	TBD	BB	Gov/PD	Public Debate
Programmatic Public Sector Reviews (civil service, SOEs, PER)	FY10-11	TBD	BB	Gov/PD	Knowledge
State of the Environment Report	FY10	TBD	BB	Gov/PD	Knowledge
Municipal Service Provision in Asuncion	FY10	TBD	BB	PD	Knowledge
Programmatic Dialogue on Sources of Growth	FY10-11	TBD	BB	PD	Public Debate
Health Service Delivery (regulation)	FY10-11	TBD	BB	Gov/PD	Knowledge
Programmatic Social Protection Dialogue (CCTs, labor market, etc.)	FY10-11	TBD	BB	Gov/PD	Knowledge
Financial Sector NLTA	FY10-13	TBD	BB/TF	Gov	Knowledge
Programmatic Poverty NLTA (continued from 2. above)	FY10-13	TBD	BB	Gov/PD	Knowledge
Participatory Policy Notes	FY12-13	TBD	BB	Gov/PD	Public Debate
<b>Grants to be mobilized</b>					
GEF in Support of Biodiversity and the North Atlantic Forest	FY09-14	4500	GEF	PD	Prob. solving
IDF for Congress 2	FY09-13	400	TF	Congress	Prob. solving
TFSCB Country Statistical Strategy	FY09-13	103	TF	Gov	Prob. solving
TFSCB Statistical Capacity Building	FY09-13	394	TF	Gov	Prob. solving
Governance TFs (actual mobilization depends on awards rules)	FY09-15	1500	TF	Gov	Prob. solving
JSDF for Inclusion of Vulnerable Groups	FY10-15	1000	TF	PD	Prob. solving
Communication for Development Grant (to be mobilized)	FY10-13	200	TF	Gov	Prob. solving

a. Government, donor, Bank, public dissemination.

b. Knowledge generation, public debate, problem-solving.

# Annex B6

## Paraguay - Key Economic Indicators

Indicator	Actual			Estimate			Projected		
	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>National accounts (as % of GDP)</b>									
Gross domestic producta	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Agriculture	21,7	21,1	20,2	22,0	22,0	20,0	19,8	19,8	19,8
Industry	21,2	20,7	20,4	20,0	19,4	19,7	19,6	19,6	19,3
Services	57,1	58,2	59,3	58,0	58,5	60,2	60,6	60,6	60,8
Total Consumption	84,8	84,6	84,9	85,0	88,9	89,1	88,2	86,9	86,6
Gross domestic fixed investment	18,7	19,3	19,1	17,4	17,6	15,7	16,2	17,0	17,4
Government investment	4,0	4,1	4,2	3,8	2,6	4,0	4,6	4,8	4,9
Private investment	14,7	15,2	14,8	13,6	15,0	11,7	11,6	12,2	12,5
Exports (GNFS)b	46,0	51,2	53,7	50,9	56,4	51,0	52,3	54,4	55,1
Imports (GNFS)	50,0	55,6	58,2	53,9	60,5	55,8	56,7	58,3	59,1
Gross domestic savings	15,2	15,4	15,1	15,0	11,1	10,9	11,8	13,1	13,4
Gross national savingsc	17,8	17,8	24,8	21,1	13,0	12,9	13,4	14,5	14,8
<i>Memorandum items</i>									
Gross domestic product (US\$ million at current prices)	6.950	7.473	9.275	12.222	15.421	14.277	14.290	14.581	15.237
GNI per capita (US\$, Atlas method)	1.080	1.240	1.490	1.710	2.070	2.260	2.320	2.270	2.310
Real annual growth rates (% , calculated from 94 prices)									
Gross domestic product at market prices	4,1	2,9	4,3	6,8	5,8	-0,5	1,5	3,0	4,5
Gross Domestic Income	5,7	1,3	4,5	8,4	9,3	0,6	1,1	2,7	4,0
Real annual per capita growth rates (% , calculated from 94 prices)									
Gross domestic product at market prices	2,1	0,9	2,4	4,8	4,0	-2,2	-0,2	1,2	2,7
Total consumption	2,6	2,8	-0,3	8,9	10,5	1,9	-1,2	-0,4	1,9
Private consumption	2,5	2,0	-0,6	9,5	11,3	0,7	-0,8	-0,3	2,2
<b>Balance of Payments (US\$ millions)</b>									
Exports (GNFS)b	3.489	4.045	5.218	6.324	8.701	7.274	7.471	7.937	8.392
Merchandise FOB	2.861	3.352	4.409	5.471	7.951	6.510	6.699	7.126	7.538
Imports (GNFS)b	3.406	4.158	5.406	6.487	9.334	7.966	8.109	8.503	8.998
Merchandise FOB	3.105	3.814	5.022	6.027	8.763	7.410	7.543	7.923	8.390
Resource balance	83	(113)	(188)	(163)	(633)	(692)	(638)	(566)	(606)
Net current transfers	131	160	426	373	374	314	319	332	346
Current account balance	79	(11)	219	26	(344)	(404)	(405)	(359)	(394)

# Annex B6

## Paraguay - Key Economic Indicators

Indicator	Actual			Estimate			Projected		
	2004	2005	2006	2007	2008	2009	2010	2011	2012
Net private foreign direct investment	32	47	179	194	209	105	110	115	121
Long-term loans (net)	-30	-138	-25	-96	-48	199	-1	131	-4
Official	-80	-40	-15	-67	-34	217	94	139	29
Private	50	-98	-10	-29	-14	-18	-95	-9	-33
Other capital (net, incl. errors & omissions)	99	248	14	603	678	-690	259	220	407
Change in reserves <sup>d</sup>	-180	-146	-387	-727	-495	790	38	-107	-130
<i>Memorandum items</i>									
Resource balance (% of GDP)	1,2	-1,5	-2,0	-1,3	-4,1	-4,8	-4,5	-3,9	-4,0
<b>Public finance (as % of GDP at market prices)<sup>e</sup></b>									
Current revenues	18,4	18,2	18,3	17,6	17,8	16,6	17,2	17,7	18,3
o/w tax revenues	11,9	11,8	12,0	11,4	12,2	10,8	11,0	11,6	12,3
o/w royalties	4,3	3,9	4,0	3,6	3,2	3,5	4,0	4,0	4,0
Current expenditures	12,9	13,5	13,7	12,9	12,4	14,2	14,2	14,2	14,2
o/w personnel spending	7,2	7,2	7,5	7,2	7,3	7,8	7,6	7,5	7,3
Current account surplus (+) or deficit (-)	5,5	4,8	4,6	4,6	5,4	2,4	3,0	3,5	4,1
Primary surplus (+) or deficit (-)	2,7	2,0	1,5	1,8	3,4	-1,0	-0,9	-0,5	0,1
Capital expenditure and Net Lending	3,9	4,0	4,2	3,7	2,6	4,0	4,6	4,8	4,9
Foreign financing	-1,6	-1,1	-0,6	-1,0	0,0	1,7	1,4	1,6	1,5
<b>Monetary indicators</b>									
M2/GDP	14,4	15,0	15,3	18,2	17,2	17,9	18,2	18,2	18,2
Growth of M2 (%)	24,6	16,1	15,3	40,2	10,3	10,3	10,1	9,2	10,8
Total private sector credit growth (%)	13,0	14,0	6,8	46,3	48,6	...	...	...	...
<b>Price indices( YR94 =100)</b>									
Merchandise export price index	100,4	91,8	96,1	113,3	131,5	120,5	121,7	122,8	123,7
Merchandise import price index	80,8	104,9	126,0	153,4	171,7	154,6	157,3	159,6	162,0
Merchandise terms of trade index	124,3	87,6	76,3	73,8	76,6	77,9	77,4	77,0	76,3
Real exchange rate (US\$/LCU) <sup>f</sup>	58,4	56,4	62,0	69,3	76,9	70,2	68,5	67,9	67,7
Consumer price index (% change)	4,3	6,8	9,6	8,1	10,2	7,0	6,5	6,0	6,0
GDP deflator (% change)	11,8	8,1	8,5	10,2	10,2	7,0	6,5	6,0	6,0

a. GDP at market prices

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Consolidated central government.

f. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.



# Annex B7

## Key Exposure Indicators

As of 3/23/2009

Indicator	Actual				Estimate		Projected		
	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total debt outstanding and disbursed (TDO) (US\$m) <sup>a</sup>	3.331	3.054	3.022	3.092	3.088	3.267	3.437	3.427	3.456
Net disbursements (US\$m) <sup>a</sup>	-30	-138	-25	-96	-48	199	-1	131	-4
Total debt service (TDS) (US\$m) <sup>a</sup>	478	476	421	435	445	530	528	503	506
Debt and debt service indicators (%)									
TDO/XGS <sup>b</sup>	88,0	69,2	51,6	44,0	32,9	41,6	42,8	40,4	38,6
TDO/GDP	47,9	41,7	32,6	25,3	20,0	22,9	24,0	23,5	22,7
TDS/XGS	12,6	10,8	7,2	6,2	4,7	6,8	6,6	5,9	5,7
Concessional/TDO	26,3	25,8	25,8	25,1					
IBRD exposure indicators (%)									
IBRD DS/public DS	13,9	11,8	12,3	12,8	14,4	11,8	12,8	15,3	14,2
Preferred creditor DS/public DS (%) <sup>c</sup>	90,2	84,6	79,9	80,8	72,9	80,3	83,8	94,8	96,7
IBRD DS/XGS	1,2	0,8	0,6	0,6	0,5	0,6	0,7	0,7	0,6
IBRD TDO (US\$m) <sup>d</sup>	246	223	234	227	222	297	329	369	371
Of which present value of guarantees (US\$m)	...	...	...	...	...	...	...	...	...
Share of IBRD portfolio (%)	0,2	0,2	0,2	0,2	0,2	0,3	0,3	0,4	0,4
IDA TDO (US\$m) <sup>d</sup>	22	21	19	18	17	15	14	12	11
IFC (US\$m)									
Loans	0,0	0,0	15,0	0,0	0,0	61,0	..	..	..
Equity and quasi-equity /c	0,0	0,0	0,0	0,0	0,0	0,0	..	..	..
MIGA									
MIGA guarantees (US\$m)									

Source: Central Bank of Paraguay and staff estimates.

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital. Excludes debt of Itaipu and Yacyreta.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

# Annex B8

## Paraguay Operation Portfolio (IBRD/IDA and Grants)

As of 1/31/2009 (In US Dollars Millions)

FY Committed	Company	Committed				Outstanding			
		Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
2009	Banco Continent	0,00	0,00	0,32	0,00	0,00	0,00	0,32	0,00
2009	Interbanco	0,00	0,00	0,39	0,00	0,00	0,00	0,20	0,00
2003/ 2009	UABL	60,00	0,00	0,00	0,00	60,00	0,00	0,00	0,00
<b>Total Portfolio:</b>		<b>60,00</b>	<b>0,00</b>	<b>0,71</b>	<b>0,00</b>	<b>60,00</b>	<b>0,00</b>	<b>0,52</b>	<b>0,00</b>

# Annex B8

## Paraguay Statement of IFC's Held and Disbursed Portfolio

Closed Projects		47
<b>IBRD/IDA *</b>		
Total Disbursed (Active)		34,5
of which has been repaid		1,9
Total Disbursed (Closed)		830,6
of which has been repaid		793,1
Total Disbursed (Active + Closed)		865,1
of which has been repaid		795,0
<hr/>		
Total Undisbursed (Active)		119,0
Total Undisbursed (Closed)		0,0
Total Undisbursed (Active + Closed)		119,0

Active Projects											Difference Between Expected and Actual Disbursements <sup>b/</sup>	
Project ID	Project Name	Last PSR Supervision Rating		Fiscal Year	Original Amount in US\$ Millions					Undisb.	Orig.	Frm Rev'd
		Development Objectives	Implementation Progress		IBRD	IDA	GRANT	Cancel.				
P069269	PY Pilot Community Development Project <sup>c/</sup>	S	S	2002	18					9		
P073526	PY Education Reform Project	MS	MU	2004	24					1,5	1,5	
P082026	PY Road Maintenance	S	MS	2007	74					71,0	38,1	
P088799	PY Sustainable Agric. and Rural Devlp.	U	U	2008	37,5					37,5	1,0	
Overall Result					153,5					119,0	40,5	

a. A \$63M Water Project is expected to be approved on March 25,2009, the last project to be approved under the previous CAS.

b. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

c. Additional Finance was approved for this project in June 2008.



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