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***Country Program
Evaluation: Paraguay
1991-2002***

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ABBREVIATIONS

ANDE	Administración Nacional de Electricidad [National Electricity Administration]
BCP	Banco Central del Paraguay [Central Bank of Paraguay]
BNF	Banco Nacional de Fomento [National Development Bank]
BNV	Banco Nacional de la Vivienda [National Housing Bank]
CONAVI	Consejo Nacional de Vivienda [National Housing Council]
CS	Country Strategy
EVO	Evaluation Office
FSO	Fund for Special Operations
GDP	Gross Domestic Product
GMC	Global Microenterprise Credit Program
GMC2	Global Microenterprise Credit Program II
HDI	Human Development Index
IDB	Inter-American Development Bank
IMF	International Monetary Fund
ISP	Investment Sector Reform Program
JBIC	Japan Bank for International Cooperation
LIBOR	London Interbank Offered Rate
MEC	Ministry of Education and Culture
MERCOSUR	Southern Common Market
MIF	Multilateral Investment Fund
MOPC	Ministry of Public Works and Communications
N/N	no number
OVE	Office of Evaluation and Oversight
PCR	project completion report
PPMR	Project Performance Monitoring Report
PROPAIS	Social Investment Program
PTI	Poverty-Targeted Investment
RE1	Regional Operations Department 1
SAS	Secretaría de Acción Social [Secretariat for Social Programs]
SB	Superintendencia de Bancos [Superintendency of Banks]
SEQ	Social Equity Enhancing
SIF	Social Investment Fund
SISFEM	Information, Formulation, Evaluation, and Monitoring System
SME	Small and Medium-Sized Enterprises
SSET	Subsecretaría de Estado de Tributación [Subsecretariat of State for Taxation]
TFP	Total Factor Productivity
VAT	Value-Added Tax

EXECUTIVE SUMMARY

This report presents the evaluation conducted by the Office of Evaluation and Oversight (OVE) of the Bank's country program in Paraguay during the period 1991-2002. Its objective is to present to the Bank's Executive Directors the results achieved by the IDB in the country and to derive lessons that may help enable the Bank to enhance the effectiveness of its future actions.

Paraguay has characteristics which, taken together, distinguish it from the other countries of the region, both in terms of the Bank's relationship with the country and in terms of its social, economic, political, and institutional context.

The Bank is Paraguay's principal external creditor. The relatively limited presence of other international organizations, together with the Bank's continuous support for the country, have given it great capacity for dialogue with Paraguay.

Paraguay is a highly agricultural country, with almost half of its population (45 percent) living in rural areas, where migration from the country to the city is a relatively recent phenomenon by comparison with the other countries of the region. With one of the highest population growth rates in the region (2.5 percent a year), Paraguay is one of the poorest countries in the region (per capita gross domestic product (GDP) in 2000 was US\$1,700) and has one of the worst income distribution patterns. Approximately 34 percent of the population lives below the poverty line, and 15 percent of the people live in conditions of extreme poverty. The country is officially bilingual: according to the 2002 census, Guaraní is the predominant language spoken in 59 percent of households.

Paraguay's history is marked by two key events: the War of the Triple Alliance (1865-1870), and the Chaco War (1932-1935). The first — the outcome of territorial disputes between Argentina, Brazil, and Paraguay — was the bloodiest conflict in the history of Latin America; it ravaged the population and destroyed the Paraguayan economy. The Chaco War, in turn, was the result of the territorial conflict between Bolivia and Paraguay for controlling access to the sea, as well as of the supposition that there were oil reserves in the region. The war took 100,000 lives. The resulting debilitation of the postwar economy contributed to the political instability and centralism that characterized the subsequent decades and ultimately led to the period of authoritarianism headed by General Alfredo Stroessner. This period of dictatorship extended from 1954 to 1989 and was characterized by the alliance established between the Presidency, the armed forces, and the Colorado Party—the latter has dominated the political scene from the second half of the 1940s to the present day.

The country's recent democratization, and hence its embryonic democratic institutional structure, combined with the well-known governance problems and the challenges facing a small economy bounded by two large neighbors, mean that Paraguay represents both an opportunity and a unique responsibility for a development institution like the Bank, whose capacity for dialogue and strong and constant presence in the country give it the potential to have a significant impact on the country and the well-being of its population.

A. Country context during the period under review

During the period covered by this evaluation, economic performance in Paraguay was not able to generate sufficiently high economic growth rates to keep pace with the rapid population growth. In summary:

- The economic reforms initiated in the early 1990s did not have the success anticipated: while in some cases the reforms implemented by the government led to major advances for the economy, the positive results were not sustained over time.
- Beginning in the second half of the 1990s, the economy deteriorated more sharply than it had at any time in the preceding 50 years, with per capita incomes contracting continually, resulting in real values lower than those observed at the end of the 1970s.
- Financial crises occurred, largely of domestic origin, and increased in number and size, leading to a serious weakening of Paraguay's financial system and, therefore, to the dwindling of credit and, consequently, of private investment.
- With regard to the external sector, on the one hand there was deterioration in the terms of trade and a substantial reduction in trade triangulation, factors which, in conjunction with the crisis in the financial sector, had a negative impact on the major economic sectors of the country: agricultural, and commercial and financial. On the other hand, Paraguay's entry into MERCOSUR represented one of the greatest opportunities, and simultaneously (or consequently) one of the major challenges for the country's economic development, owing to the importance of this bloc for Paraguay's external trade and the asymmetries in terms of technical capacity and economic size between Paraguay and its main trading partners.
- The current expenditure of the public sector grew substantially, particularly in areas of high rigidity, such as wages, social security benefits, and debt service, while capital expenditure declined. Tax revenues declined due to problems of evasion, the economic recession, and the crises in neighboring countries. The period under review ended with a mounting fiscal deficit.
- To cover the scarcity of resources and respond to growing social pressures, the government is resorting to domestic borrowing and, principally, external borrowing. This process generates significant fiscal pressures, as evidenced by increasing delays in debt service payments.

The period under review, particularly after 1995, was also characterized by declines in the indicators of governance and by an increase in political instability. Paraguay faces the long-term challenge of improving the quality and effectiveness of its governmental institutions and reducing the size of the informal sector.

All these factors mentioned above have contributed to the rise in poverty, unemployment, and level of inequality observed in the country during the period analyzed

B. Programming

Regarding the Bank's programming, this evaluation found that:

- The programming cycles have consistently focused on three major themes: increasing the efficiency of the productive sector, modernization of the State, and social development. Accordingly, they reflect the country's needs and are consistent with the government's programs, and *in this respect* were relevant.
- However, the Bank's programming in Paraguay is so general that no specific strategic and operational model for the Bank's activities in the country can be identified. That is, there is no observable understanding or description of the factors that determine the organization and structure of the country and, consequently, of the existing interrelationships between the various themes and sectors, so Bank actions can be prioritized and its strategic intent "operationalized." In fact, the lines laid out by the strategies tend to be so general that they could refer to almost any borrowing member country of the Bank.
- While the Bank's programming provides a clear diagnosis of the challenges facing the country, the generality of the proposals does not help the country define its priorities, nor contribute to establishing a new development strategy that is consistent with a reality in which the factors that drove the Paraguayan economy in previous decades are no longer present, issues which the country had difficulty addressing. *In this respect*, the relevance of the Bank's programming may be called into question.
- The Bank's programming in Paraguay does not appear to acknowledge its own warning signs and analysis. Although Bank documents continually refer to project implementation problems and to the lack of resources for national counterpart funding, in practice the operational proposals of the period appear to ignore that sizable financing programs in Paraguay would require significant improvements in project execution capacity and in the country's external and fiscal positions, elements that continue to be major challenges both for the Bank and for Paraguay.
- The technical-cooperation programs have generally been consistent with the loans proposed; however, the strategic nature of the technical-cooperation operations has declined over time as the availability of nonreimbursable resources has waned, and the approval processes tend to promote the dispersion of the technical assistance.

- Only in the latest programming cycles is there a greater concern on the part of the Bank for situating its activities in the more general context of international cooperation.

C. Bank activities in the country

The 1990s were marked by a number of historical peaks in Bank activities in Paraguay in terms of: the number of loans approved; the volume of resources allocated; and the average and median size of loans. There was also an increased dispersion of Bank activities in a growing number of sectors.¹ These results would appear to be explained more by a greater demand for resources on the part of Paraguay due to revenue contraction, to the reduced presence of other donors, as well as by the mandates of the Eighth Replenishment, than by a long-term vision of the Bank-country interrelationship. This growing Bank participation in Paraguay led to a sizable and rapid increase in the number of projects in execution and in the size of the Bank's portfolio.

All these factors exert pressures on the country and on the IDB's Country Office, as they not only increase the volume of operations but also spread their attention to different sectors with distinct characteristics (losing economies of scale), in which there is little local experience. Given the technical constraints and the limited availability of resources frequently highlighted by the Bank, there is some question as to whether the Bank's activities in Paraguay may have been negatively affected, in particular because the resources allocated for the Country Office do not appear to have been suitable for addressing the increased workload.

The data show, consistently with the risk referred to in the preceding paragraph, that the pace of portfolio execution has slowed over the decade. It has been noted that the projects approved in more recent years have a less efficient disbursement pattern. The problems with project execution are clearly reflected in the Bank's Project Alert Identification System: 70 percent of the projects in Paraguay's current portfolio have been in alert status at one time or another. Of particular note are the long periods (one year or longer) for which almost all of these projects were so classified. In this respect, it is surprising that such long periods of disbursement difficulties are not reflected in the probability of achieving their development objectives and that, accordingly, there were no more than three projects classified as "problem projects."²

D. Qualitative aspects of the country program

As regards to programming, this evaluation has found that, while there has obviously been a continuing effort on the part of the Bank to improve the evaluability of its programming, it has yet to achieve a clear and quantifiable definition of its objectives. Moreover, it is also difficult to evaluate the Bank's programming through its projects, because the majority of them express their objectives imprecisely and over-ambitiously, without providing clear and measurable outcome indicators.

It is difficult to evaluate the capacity of programming to foresee the risks to which it was exposed on the basis of the information provided through its loan documents. It must be noted, however, that risks that were not identified originally in project design did arise in most projects during execution. Furthermore, the country's limited technical and institutional capacity were the risks most frequently identified in projects. Given that the Bank had been stressed these weaknesses in all its programming papers throughout the entire period under review, these factors should have not been considered project risks in Paraguay, but rather concrete and foreseeable issues to be incorporated in the design of operations approved for the country.

It was also found that the monitoring and oversight systems pose problems as regards the recording of activities, particularly until 2000, making it difficult to produce a more accurate assessment of Bank activities. External financial oversight exercises show that, for the period for which information is available (1998-2002), between 50 percent and 83 percent of projects were classified as "clean," but that in three of these five years (1998, 1999, and 2001) less than half of the resources disbursed by the Bank were for projects with a "clean" classification. Although six projects had problems in their external financial evaluations in all or several of the years for which there is information, the records indicated that the Bank did not appear to have increased its efforts in overseeing them.

It is also noted that several of the ex post evaluations scheduled to be conducted during the period had not begun by their target dates, which could delay the process of incorporating lessons learned into the Bank's operations in the country.

E. Bank program outcomes

Even though the Bank constitutes Paraguay's principal source of external finance, the problem of attribution continues to exist. Furthermore, the inadequate definition of development objectives in the successive country strategies, and the lack of baselines, indicators, and/or targets relating to anticipated project outcomes, limit the capacity to evaluate the impact of Bank activities and preclude the identification of the marginal contribution of its operations. Consequently, this evaluation does not attempt to establish a direct causal relationship between Bank activities and the country's development outcomes, but instead to analyze how its program in the country has interacted with the events occurring in Paraguay during the period under review.

The continuous growth of the Bank's portfolio in the country, the lack of economic growth, and the recent devaluations of the currency have increased the stock of Paraguay's debt to the IDB, its principal external creditor, from 6 percent of GDP to 16 percent of GDP between 1992 and 2002, and also increased the cost of servicing this debt by a factor of almost 4 from 1991 to 2003. Although the structure of Paraguay's external borrowing may be described as long-term and at relatively low interest rates, the total sums borrowed have generated, in the short term, a heavy fiscal burden and significant delays in the payment of its debt service. In this context, there is the possibility that the recent growth in the Bank's portfolio in Paraguay, and particularly, owing to its nature,

the approval of the emergency loan in 2003, will exacerbate the current liquidity problem in the years ahead.

The lack of baselines, ex post evaluations, indicators, and/or targets relating to anticipated project outcomes, as well as the inadequate definition of development objectives in the successive country strategies, preclude the identification of the marginal contribution of the operations approved by the Bank and make it difficult to assess the impact of Bank activities in the country. This said, the following points bear mentioning:

- With regard to governance, Paraguay faces the long-term challenge of improving the quality and effectiveness of its governmental institutions and reducing the size of the informal sector. However, the period under review, particularly after 1995, was characterized by declines in the indicators of governance and by an increase in political instability. More than a decade following the introduction of major reforms, the Paraguayan State continues to have major limitations, including the low degree of independence in the three branches of government, its excessive centralization, and the low level of citizen participation and control over government actions, resulting in serious problems of corruption. With regard to the Bank's specific activities in the areas in which it has been involved, partial advances have been observed: in the fiscal area, the results obtained were limited. Even though the diagnosis of the problems and of the needs for reform in various strategic sectors defined by the Investment Sector Reform Program (ISP) financed by the Bank were fundamentally correct, the most significant changes driven by the ISP were not sustained over time. The ISP also contributed to supporting a process of institutional modernization that was beginning to be introduced in the country but still needs to be consolidated. In this respect, the limited progress achieved so far and the execution problems faced by the Bank in the area of modernization of the State must be noted.
- The period under review is characterized by a significant downturn in the economy and by various crises in the financial sector. Despite the fact that the strategies approved by the Bank during the period stressed the need for macroeconomic adjustments and for strengthening the financial sector, the ISP (approved in 1992) was the only Bank-financed operation that was directly related to macroeconomic stability. The progress achieved by the country program was partial. In general terms, it was not possible to improve the efficiency and reliability of the financial sector, and several of the objectives established for this operation early in the last decade continue today to be areas awaiting reform.
- The Bank's investments in infrastructure were able to achieve their major physical targets. In this connection, as regards the road system, one might have expected results in terms of reducing transportation costs, but it has not been possible to find any data, at the Bank or from other sources, to substantiate this hypothesis. In the energy sector, a notable success is the

considerable expansion of electricity coverage. However, these infrastructure investments could be compromised by the existing serious sustainability problems relating to maintenance in the case of transportation, and to the inadequate price structure in the case of energy.

- The Bank's activities in key areas, such as the agricultural sector, were not proportional to the economic and social importance of the sector for the country, and have been declining over time. Moreover, the scant evidence available suggests that, in general, the impact of the agricultural projects financed by the Bank in Paraguay has been limited.
- Paraguay's poverty outcomes were also quite disappointing during the period. The overall incidence of poverty increased by about 15 percent and that of extreme poverty by almost 20 percent between 1995 and 2001. Although inequality increased slightly over the decade, the primary source of the increase in poverty was the lack of growth, reflected in a reduction in real wages and in increased unemployment: two-thirds of the increase in poverty between 1995 and 2001 nationwide can be mainly attributed to the economic decline.
- The Bank's activities aimed at combating poverty have generally followed the same line espoused by the country—an approach based on creating capacities, with less emphasis on, or with no interconnection with the creation of opportunities. The primary exception to this was the significant progress achieved in the microenterprise sector. The Bank has also had noteworthy involvement in the area of education, where it has played an important role with its leadership and has contributed to the expansion of school coverage, and shifting the focus of educational reform to the schools. Despite the fact that the challenge of improving the performance of basic education remains, other important achievements have been noted, such as the improvements in the compensation of teachers, in the provision of educational supplies, in school infrastructure, and in the average length of schooling of the Paraguayan population over age 25 (from 5.2 to 6.6 years). These successes contrast with the problems encountered and the limited results obtained in the housing, water supply, and sanitation sectors.
- Bank Management has compiled information on fulfillment of the targets sought through Bank interventions (see Box A-9 in Annex 2). This information is based on the matrix presented in the 2000 country strategy. Thirty-five indicators or targets are presented for 20 areas of intervention. Of these 35 indicators, only 8 relate to development outcomes and are distributed over 8 intervention areas, meaning that the 12 other areas have no indicators for measuring development outcomes. According to the matrix, two development targets were met (in the areas of physical infrastructure development and education), three were partially met (in the areas of support for the executive branch, health and nutrition, and water supply and

sanitation), and one not met (in the area of diversification of the productive exportable base). In two other cases, there was no information available for determining the degree of compliance with development targets. The remaining 27 targets referred to outputs. Of these 27 targets, 2 were met, 15 partially achieved, and 9 not met. To summarize, and bearing in mind that the majority of the indicators presented relate to outputs, the evaluation showed that partial advances were achieved on 51 percent of the targets.

F. Recommendations

The country faces a very clear main challenge: achieve a development and economic growth model consistent with the new (democratic) domestic environment and with an external context of greater competitiveness. To be able to help Paraguay achieve this objective, the Bank will have to ensure (and demonstrate) that its interventions are structured with the objective of maximizing their potential impact on the country's economic growth. To do so, the Bank will have to articulate a specific strategic and operational model for its activity in Paraguay (something that has not yet been observed). This discussion is particularly important, as the Bank must address the challenge of supporting the country's efforts to achieve efficient allocation of resources among the various sectors of the economy with the greatest productivity.

This relates directly to the need to examine more strategically the potential generated by Paraguay's entry into MERCOSUR, incorporating this issue in a cross-cutting manner in its operations, directing investments and promoting policies that aim at the productive reconversion and modernization of the country, and reduction of the informal sector. Similarly, the Bank should adjust its activities in key sectors such as agriculture.

As regards to institutional-strengthening and governance, the Bank should revise its strategy of taking action through isolated interventions, and develop and implement an integrated plan for enhancing the institutional capacity of the country. This process would entail working with the government on developing a professional career plan for public servants, and using instruments similar and comparable to successful programs such as the Inter-American Program of Applied Macroeconomics (PIMA). The governance problem has been, and must continue to be, a priority issue for the Bank in Paraguay.

From a programming standpoint, the Bank should improve its handling of the risks to which its programming is exposed, expressing these risks precisely and transparently and understanding that many of the "risks" identified heretofore (e.g., the limitations of institutional capacity) are in fact a certainty, and therefore, one in respect of which the Bank should act.

There is also a need to improve the evaluation and the evaluability of programming in general, and of its projects in particular, through the incorporation of quantifiable indicators (particularly of outcomes), targets, and baselines. This would make it possible not only to identify lessons learned for the future, but also should improve the efficiency of programming, as it would be the result of an effort to devise a plan of action that has

greater clarity of targets and of the relationships, synergies and externalities between its various components.

Consequently, the Bank's future activities require: (a) clearer definition of the priorities of its programming; (b) action more focused on areas with significant impacts on economic growth; and (c) more detailed evaluation of the impact of its activities on the level of the country's external borrowing and external debt service in the short, medium, and long terms.

I. INTRODUCTION

- 1.1 This report presents the evaluation conducted by the Office of Evaluation and Oversight (OVE) of the Bank's country program in Paraguay during the period 1991-2002. Its objective is to present to the Bank's Executive Directors the results achieved by the IDB in the country and to derive lessons which may help enable the Bank to enhance the effectiveness of its actions in the future.
- 1.2 The Bank is Paraguay's principal external creditor. The relatively limited presence of other international organizations, together with the Bank's continuous support for the country, have given it great capacity for dialogue with Paraguay.
- 1.3 The recently revitalized democratization, and hence the embryonic institutional structure of the country, combined with the known governance problems and the issues facing a small economy with two large neighbors, mean that Paraguay represents both an opportunity and a unique responsibility for a development institution like the Bank, whose action has the potential to have a significant impact on the country and the well-being of its population. It is with these factors in mind that this evaluation was conducted.
- 1.4 The next chapter analyzes the scenario in which the Bank program was conceived and carried out, and discusses the major aspects of the Paraguayan economy in the period, so as to serve as a frame of reference for the report as a whole. Chapter III presents the conclusions of the evaluation as regards the Bank's programming process in Paraguay. In particular it examines aspects relating to the country program's relevance (did the program address the major development challenges facing the country?), consistency (are there contradictions between the various programming cycles over time?), and comprehensiveness (did the program incorporate all Bank instruments and did it coordinate its activities with those of other parties?). Chapter IV examines the Bank's actions in Paraguay and endeavors to evaluate how these activities related to the objectives defined by Bank programming and how efficiently the outputs agreed with the country were prepared and implemented. By introducing a number of qualitative factors relating to the Bank's country program in Paraguay, Chapter V supplements the analysis provided in the two chapters immediately preceding it. Chapter VI describes the major outcomes of the country program financed and implemented by the Bank in Paraguay. In essence, it seeks to answer the question of what were the results in terms of development driven by the Bank's country program over the past decade. Lastly, Chapter VII presents the main conclusions of the report and the recommendations of greatest relevance for future Bank activity in Paraguay.

II. COUNTRY CONTEXT

2.1 The purpose of this chapter is to describe and analyze the scenario within which the Bank's country program was conceived and executed. Accordingly, the aim is not to relate Paraguay's economic performance to Bank actions, but rather to present the major aspects of the Paraguayan economy in the period, so as to serve as a frame of reference for the report as a whole.

A. Economic context and growth

2.2 The Paraguayan economy has traditionally been quite open, with a strong preponderance of agricultural production and a weak base of physical, financial, and human capital.³

2.3 The country has been unable to consolidate a stable and sustained rate of growth in recent decades. In particular, after the end of the boom triggered by the construction of the Itaipú hydroelectric dam and the reduction in the expansion of the agricultural frontier toward the end of the 1970s, Paraguay has been unable to achieve consensus on an economic growth model that permits sound, sustained progress in the economic development process (see Chart A-2.1 in Annex 1).

2.4 In general, during the period covered by this evaluation (1991-2002), economic performance in Paraguay was not able to generate sufficiently high economic growth rates to keep pace with the rapid population growth.⁴ In any event, the period in question may be divided into two distinct stages:

- the 1991-1995 period, which had a low (though positive) average rate of growth in per capita GDP and a relatively stable unemployment rate;⁵ and
- the 1996-2002 period, which may be described as the poorest performance in all of Paraguay's recent economic history, with not only the longest decline in per capita GDP in over 50 years, but also a downward trend in per capita incomes that lasted until 2002 (see Chart A-2.2 in Annex 1), reflected in increased poverty and unemployment beginning in 1997.^{6,7}

2.5 The political, institutional, and economic changes introduced in the early 1990s were aimed at reinserting Paraguay on the world scene, from which the country had been isolated during the dictatorship of General Stroessner. It thus comes as no surprise that, from an economic policy standpoint, the 1990s began with an attempt to bring about changes that reflected the views of the period, including the deregulation of some sectors of the economy, such as the financial and trade sectors, tax reform, and privatization efforts relating to some State-owned enterprises and banks.

- 2.6 In any event, after a period of significant financial repression, the reforms of the early 1990s severely disrupted Paraguay's financial and trade policy through interest rate liberalization and the unification of the foreign exchange regime.⁸ Deregulation of the financial sector generated, on the one hand, an incipient boom and expansion of credit that facilitated a rapid increase in private consumption. On the other hand, the trade reforms, the existence of a system of customs duty exceptions within the Southern Common Market (MERCOSUR), the real overvaluation of the guaraní, and the paucity of customs control at the borders with neighboring countries contributed to an increase in the external demand for imported products in the local market (tourism for shopping purposes at border cities or trade triangulation).^{9,10} These factors, in conjunction with the expansion of public expenditure and the relative stability of investment until 1995, explain the growth observed during the first half of the decade.
- 2.7 In contrast, the factors that explain the economic decline during the second half of the decade were diverse, with both domestic and external causes. Domestically it may be observed that, despite their positive results in the short term, the reforms were generally not sustained and errors may have been committed in their sequencing. The financial and trade liberalization, for example, was associated with the proliferation of short-term undertakings, often entered into outside government control, which subsequently gave rise to successive financial crises in a context characterized by limited regulatory capacity.
- 2.8 In fact, neither the financial liberalization nor the favorable international climate had a significant impact in terms of increases in the efficiency and reliability of the financial system. Beginning in 1995, Paraguay experienced a series of crises and interventions in the financial system which resulted in the closing of some of the major local banks, one of the two State-owned banks (Banco Nacional de Trabajadores), and housing savings and loan institutions (see Box A-1 in Annex 2).
- 2.9 The most direct consequences of the financial crises were interest rate hikes and the reduction in the supply of credit to Paraguay's productive sectors,¹¹ resulting in an accelerated slowdown in private investment. The decline in private investment was further compounded by the stagnation of public investment brought about by controlling the fiscal deficit through the contraction of capital expenditure.¹²
- 2.10 Because its economy is open and small, Paraguay is strongly dependent on developments in the external sector,¹³ which beginning in 1995 was also unfavorable, thus reinforcing the downward trend in economic activity. First, there was a slowdown in trade triangulation.¹⁴ Second, there was a deterioration in the terms of trade beginning in 1997—triggered by the decline in the international prices for soya and cotton—which was compounded by the increase in the price of oil, the reduction in exports resulting from the devaluation in Brazil in 1999, and the effect of the crisis (and subsequent devaluation) in Argentina beginning in 2001.

- 2.11 Paraguay's entry into MERCOSUR in 1990 and 1991 was unquestionably the most important event of the decade as regards the external sector.¹⁵ However, it also posed great challenges for the country. On the one hand, the lack of a tradition of and technical capacity for international trade negotiations proved to be a barrier that prevented Paraguay's more active participation as well as a clearer definition of its trade strategy. These problems were particularly important in light of the sizable existing asymmetries between Paraguay and the other partners, as well as the characteristics of Paraguay's external sector—the dependency on exports of raw materials and trade triangulation—which are poorly suited to the integration process. On the other hand, the complementarities that exist between the countries of the region in terms of comparative advantages give Paraguay the opportunity (which has still not been fully exploited) of developing an alternative industrialization strategy, and hence economic development strategy, within the regional production and export chains, thereby opening up new markets for national products.¹⁶
- 2.12 In sum, it may be argued that, during the second half of the 1990s, the structure of aggregate supply did not change and the anticipated productive reconversion of the country was not only not consolidated, but it would appear that the Paraguayan economy turned inward in recent years toward a traditional structure, with predominance of the agricultural sector and a decrease in industrial activity, accompanied by a significant decline in commercial and financial activity.¹⁷ A global indicator of the poor economic performance observed during this period is total factor productivity (TFP), which had an increasingly negative trend.

B. Public sector

- 2.13 The behavior of the public sector also helps explain the differences in economic performance observed over the review period. During the 1990s, the size of the public sector, judging from its revenue, represented about one third of gross domestic product (GDP) on average, a level that was maintained without major fluctuations but with a slight upward trend.
- 2.14 Tax revenues, almost all of which are collected by the central government,¹⁸ averaged less than 10 percent of GDP for the 1990-2002 period (see Chart A-2.3 in Annex 1 and Box A-2 in Annex 2). Nontax revenue averaged 20 percent of GDP throughout the same period, and hence constituted the primary source of financing for the consolidated public sector. In particular, revenue from the royalties received by Paraguay from Itaipú and Yacyretá represented a sizable proportion of central government revenue, averaging about 19 percent of current revenue for the 1991-2002 period.
- 2.15 Public sector expenditure showed a rising trend in terms of percentage of GDP throughout the 1990-2002 period.¹⁹ This increase is explained in large measure by the growth of fixed current expenditure, such as that on wages and salaries and on pensions and retirement, and by the increase in public debt service payments.²⁰ As

Chart A-2.4 in Annex 1 illustrates, current expenditure increased sharply,²¹ while there was a relative decline in capital expenditure, meaning that fiscal adjustment has occurred at the expense of the latter category.

- 2.16 In general terms, and especially by comparison with the standards of other developing economies, the financial position of the Paraguayan government was maintained without major imbalances until 1999, when it began to reverse and resulted in a deficit of 1.8 percent of GDP in 2002. While some of the deterioration is attributable to cyclical factors—scant GDP growth and declining trade, reflected in lower tax collections in 1999 and 2000—the fiscal and financial problems were aggravated as a consequence of the aforementioned pressures on the revenue and current expenditure of the government.
- 2.17 Of particular note are the financing problems inherent in Paraguay's social security system, where the disequilibrium of one of its major institutions, the Caja Fiscal, is the greatest single financial problem in the public sector structure in recent years (see Chart A-2.5 in Annex 1).²²

C. Public debt

- 2.18 The behavior of the external debt balance is a clear reflection of the gradual deterioration in fiscal conditions analyzed in the preceding section. The external debt as a percentage of GDP dropped significantly until 1996, when it reached the level of 14.5 percent. In subsequent years, however, the debt began to increase significantly and almost tripled that proportion, rising to approximately 41 percent of GDP at end-2002 (see Chart A-2.6 in Annex 1). This is explained in part by the significant deterioration in the value of the domestic currency vis-à-vis the U.S. dollar and by the intensification of the economic recession, but also by the not always appropriate use of borrowing as a revenue source for addressing mounting social demands in a scenario of fiscal decline. The chart also shows that the trend for the external debt measured in dollars is similar: there was a reduction from US\$1.67 billion to US\$1.24 billion between 1990 and 1994 and a significant increase in the following years, in particular beginning in 1999, reaching slightly more than US\$2.28 billion in 2002.²³
- 2.19 According to data as of June 2003, the IDB was Paraguay's single largest external creditor (accounting for 39 percent of the country's total external debt), followed by the (official and private) financial agencies of the Republic of China in Taiwan (24 percent of total debt), the Japan Bank for International Cooperation (JBIC, 14 percent), and the World Bank (11 percent).
- 2.20 The relationship between the growth rates of domestic gross capital formation, both public and private, and the changes in the source of public financing, measured as domestic and external borrowing, suggests that a sizable proportion of the borrowed resources may have been used to pay current expenditure: the upward changes in the growth of the public debt noted beginning in 1998 are not reflected in public

investment, further restricting the chances for growth in private investment (see Chart A-2.7 in Annex 1). It bears noting that borrowed funds must by law be channeled toward financing capital expenditure. Similar conclusions are reached by comparing the aforementioned public borrowing trend with the data reported in the Financial Reports of the Ministry of Finance: the growth rates of the debt have exceeded those for capital expenditure, including physical investment. The assumption that external borrowing was being used as a means of financing current expenditure would appear to be further corroborated by examination of the correlation between various aggregate expenditure headings and the gross disbursements (cumulative by year) made by the Bank in loan operations throughout the decade.²⁴

D. Governance

- 2.21 In Paraguay, a dictatorship that had lasted 35 years came to an end in 1989. A new constitution was approved in 1992, inaugurating a new institutional stage inspired by a democratic framework. Although various major changes came hand in hand with the new constitutional environment, such as the implementation of a new taxation scheme, the designation of a new Supreme Court of Justice, and the beginning of political and economic decentralization in Paraguay, the institutional transformations were not completed: the power structure of political parties was maintained, as were inefficient and selective practices that tended to favor privileged groups in the society. A World Bank study²⁵ warned, at mid-decade, of the continued ineffectiveness, inefficiency, and lack of transparency of the public sector, as well as the weaknesses existing in the institutional framework governing the interrelationships between the three branches of government and the Audit Office.
- 2.22 Political crises and threats to democracy continued during the 1990s, such as the coup attempt by General Oviedo in 1996 and the assassination of Vice President Argaña followed by the removal from office of and impeachment proceedings against then President Cubas in 1999.
- 2.23 A corollary of the “failure” of the State in Paraguay during the 1990s was the proliferation of informal activity, which affected virtually the entire economy. The World Bank estimated the scope of informal activity in the country at the end of the 1990s, and noted that at the time the GDP figures would measure only about 60 percent of total economic activity in the country, while the remaining 40 percent would correspond to activities in the informal sector.²⁶
- 2.24 Corruption and governance problems induce high transaction costs, reduced efficiency and effectiveness, and a lack of resources for investment and the provision of basic services by the public sector. This constitutes a disincentive for private investment (local or foreign), and consequently reduces the country’s chances to achieve economic growth.²⁷ However, the parallel market activities generated a sizable volume of income in Paraguay that might not have existed

otherwise, some of it accruing to the poorest segments of the population, a situation which continues to hold true. In this sense, the desired reduction in illegal activities in the country—with a view to achieving sustained growth—would entail economic and social costs that should be considered and incorporated into a transition and compensation model.²⁸

E. Poverty and the social sector

- 2.25 Paraguay's population is estimated at about 5.5 million, with a sizable proportion (45 percent) living in the country's rural areas. This characteristic, together with the fact that Paraguay is one of the poorest countries of the region²⁹ and has one of the worst income distribution patterns, means that the poverty problem in Paraguay is in large measure a rural one: 56 percent of the poor and 76 percent of the persons in extreme poverty live in rural areas, while these proportions for the population as a whole are approximately 34 percent and 15 percent, respectively.³⁰
- 2.26 Table A-2.2 in Annex 1 shows that per capita income in Paraguay is equivalent to slightly less than half of the average for Latin America and the Caribbean, and, generally speaking, is substantially more concentrated than in similar countries in the region. The table also shows that, despite these conditions, Paraguay's social indicators tend to be higher than expected, in particular when compared with those corresponding to similar Hispanic countries and the average for the region. This phenomenon may be explained in part by Paraguay's advantage of having a small population concentrated in a limited area, which reduces the costs of social policy.³¹
- 2.27 The rural characteristics of poverty in Paraguay mean that the country's social problems in the 1990s have been deeply rooted in developments in the agricultural sector and in the demographic changes generated there. Until the early 1980s, the migratory processes in Paraguay were basically from one rural area to another owing to the predominance of agriculture within the economy and the expansion of the agricultural frontier starting in the 1970s. These generated a process of colonizing new agricultural lands, which increased the demand for public investments for the provision of social services in rural areas. However, the public services deficit and the dropping income levels in rural areas in the first half of the 1980s, particularly in the case of small producers, produced a shift in migration patterns, which increased significantly while migration from the rural areas to urban centers, especially Asunción, continued. These demographic changes were reflected in an increase in the informal sector and generated strong pressures on the supply of basic services in the urban sector. On the other hand, the overthrow of the military regime and the resulting increase in society's capacity to express its demands, as well as Paraguay's rapid population growth, placed even greater pressure on the supply of public services.
- 2.28 Accordingly, public investment in the social sectors increased substantially over the past decade, particularly investment in the education sector.³² In particular, the flow of external financing into investments in social infrastructure represented decisive

support for the expansion of public services in Paraguay, but also generated considerable pressures on additional current expenditure. Moreover, Paraguay has subsequently been experiencing a problem with shortages of the human resources necessary to operate the increased installed capacity for the provision of public services.

- 2.29 The sizable increase in investment in the education sector reflects the recognition by the country of the need to improve the quality of its human capital.³³ In reality, the perception of the importance of education for the future of individuals and of the country has caught hold in Paraguayan society over the past decade, and the sector has assumed the leadership among the social areas in terms of the dynamism and consistency of reform proposals.

III. PROGRAMMING

- 3.1 The aim of this chapter is to present the conclusions of the evaluation as regards the Bank's programming process in Paraguay. Particular emphasis is placed on examining issues relating to program relevance, consistency, and cohesiveness.³⁴
- 3.2 The specific aims of country programs are expressed in country strategy papers, which are based on agreements between the Bank and the country concerned with respect to strategic goals and the lending program contemplated. These papers consequently serve as the major frames of reference for Bank programming in the country and define the institution's programming cycles in relation to its member countries. However, the country strategies are part of a broader *programming process* that includes other instruments that are intended to incorporate a dynamic component and endeavor to reconfirm the priorities set forth in the country strategies.^{35, 36}
- 3.3 The period covered by this evaluation spans four programming cycles: 1991-1993,³⁷ 1994-1997,³⁸ 1998-2000,³⁹ and 2000-2003.⁴⁰ From 1991 to 2003, Paraguay had four administrations: Rodríguez (1989-1993), Wasmosy (1993-1998), Cubas (1998-1999), and Macchi (1999-2003).

A. Issues relating to the consistency and relevance of programming

- 3.4 In general, throughout the period under review in this report, there was a substantive improvement in the quality of the programming papers, in particular those relating to the 1998-2000 and 2000-2003 programming cycles. Various general aspects of the Bank's programming in Paraguay are described below.
- 3.5 **Diagnosis.** All in all, the diagnostic analyses in the programming papers have identified four major themes: macroeconomic equilibrium, the efficiency of the productive sector and the manner in which it relates to the context of integration, modernization of the State, and social development. As noted in the preceding chapter, these themes reflect the country's needs, are consistent with one another, and are cohesive with the government's programs, and, *in this respect*, are relevant. The major shortcoming in the country strategies' diagnoses relates to the analysis of the country's political and institutional context or economic policy. The first two country strategies do not address the implications of the end of the 35 years of dictatorship under General Stroessner through the promulgation of a new Constitution (in 1992), the 1993 election of the first civilian government in almost 40 years, and the election of an opposition Congress (also in 1993).⁴¹ In the last programming cycle (2000-2003), an interesting and to some degree contradictory situation may be observed: whereas the country strategy adopted a cautious position as regards the difficult political and economic context through which the country was passing,^{42, 43} the programming mission that visited Paraguay in July 2000 ultimately defined the most ambitious plan of operations in the Bank's history with

the country: 26 projects in scarcely 3 years (2000-2002).⁴⁴ While the reduction in the presence of other donors in the late 1990s may explain the growth in the Bank's presence in Paraguay (see paragraph 3.18), this argument is never put forward in the programming.

- 3.6 **Objectives and evaluation of anticipated outcomes.** The Bank's programming tends to provide a sound diagnosis of the economic challenges facing the country, but the development objectives laid out by the strategies tend to be so general that they could refer to almost any borrowing member country of the Bank. Such generality does not help the country define a new development strategy that is consistent with the reality in which the factors that drove the Paraguayan economy in prior decades are no longer present. The Bank's inability to define a specific strategic and operational model for its activity in Paraguay has a negative impact on the relevance of its programming: *in this respect*, its relevance may be called into question.⁴⁵
- 3.7 The country strategies for 1998 and 2000 are the only ones to discuss the objectives of the programming cycle, the strategic areas, the portfolio in execution, the (financial and nonfinancial) operating program, the actions of the government and of other donors, and, finally, the anticipated outcomes.⁴⁶ However, the anticipated outcomes are not always presented in a way that makes it possible to evaluate them, nor are baselines or measurable indicators or targets presented.⁴⁷
- 3.8 Hence, the evaluation of the results obtained through Bank activities in previous programming cycles is, when available, quite limited. The first two country strategies contained no analysis of outcomes and were limited to examining the execution of the Bank portfolio. The 1998 and 2000 country strategies do include some discussion of Bank activities in prior periods. However, the 1998 country strategy presents only a description of the general objectives of Bank activities, while the 2000 country strategy tends to refer to the achievements from Bank activities in terms of outputs and not outcomes, and the information presented in the correspondence and action matrix provided in Annex III-2 of the 1998 country strategy is not used to evaluate the Bank's activities during the preceding programming period. Finally, the two country strategies do not present quantitative targets or outcomes.⁴⁸

3.9 In view of these limitations, OVE has had to treat the approvals of operations proposed in the programming papers as a proxy for compliance with the aims of the Bank's programming in the country (see Tables A-3.1 to A-3.8 in Annex 1).⁴⁹ In this regard, what is generally found is that the capacity to anticipate which projects will be effectively approved has been limited to those cases in which the preparation process is relatively well advanced. In this sense, the country strategies resemble documents for the formalization/streamlining of a predefined operational structure more than instruments for establishing a strategic line of programming (for a more detailed discussion of each programming cycle, see Boxes A-3, A-4, A-5, and A-6 in Annex 2):

- Of the nine projects approved during the first programming cycle, seven were anticipated in the country strategy; of these seven projects, four were already in the Profile II stage and two in the Profile I stage before the country strategy was approved. The two projects not foreseen in the programming and approved during the period (PR-0003, Investment Sector Loan; and PR-0024, Municipal Strengthening Program) were the only projects relating to the first priority area defined by the 1991 country strategy (support for the programs to restructure the public and financial sectors).
- The 1994 country strategy anticipated seven of the eight projects approved during the period, while the other four planned projects were not ultimately approved. The one project approved but not anticipated by the country strategy (PR-0094, Global Microenterprise Credit Program II, approved in 1997) is not included on the lists of the missions prior to or after the country strategy, nor in the previous strategy, and is not among the strategic areas defined by the country strategy: (a) development of the social sectors; (b) modernization of the productive sectors; and (c) institutional strengthening and modernization of the State.
- Nine operations were approved during the 1998-2000 period. The country strategy anticipated only five of these projects, two of which were in the Profile II stage and three in the Profile I stage at the time the country strategy was approved. As regards the 4 projects not anticipated by the country strategy but approved during the period, it is noteworthy that: (a) as might be expected owing to its nature, project PR-0112 (Emergency and Infrastructure Rehabilitation Program) is not mentioned in any prior list; (b) project PR-0115 (Fiscal Management Strengthening and Modernization Program) grew out of the March 1999 programming mission; (c) project PR-0116 (Support for National Environmental System) had been mentioned in all the Bank's programming lists from the 1991 country strategy through the February 1996 programming mission, and re-emerged during the March 1999 mission; and (d) project PR-0130 (Support for the 2002 National Population and Housing Census) appears only in the 2000 country strategy (when Profile II had already been approved).

- Fifteen of the 26 projects anticipated by the 2000 country strategy were not approved, and all 11 of the projects approved during the programming cycle were anticipated by the country strategy. However, it should be noted that, of these 11 projects: three had already been approved prior to the country strategy; three others were already in the Profile II stage prior to the country strategy; one project for supporting the national environmental system (PR-0116) had already been proposed by the Bank since the 1991 country strategy; the project for small and medium-sized enterprises (PR-0100) had been mentioned in programming mission reports since 1996 (and accordingly was programmed in the 1998 country strategy);⁵⁰ and a preschool education project had been proposed in the course of programming missions since 1997 (and consequently had also been programmed in the 1998 country strategy).

3.10 **Assumptions and risks.** The Bank's programming in Paraguay does not seem to reflect its own warning signs and analysis. Despite the warning sounded as early as 1994 to the effect that the Bank should *ensure that future lending programs together with loans in the existing portfolio do not exceed the country's institutional capacity*,⁵¹ the number of projects proposed in the various programming cycles increasingly overestimated Paraguay's existing technical, institutional, and financial capacity.

3.11 In terms of amounts, the values proposed were unrealistic given the economic context during the decade, absorptive capacity, and the Bank's exposure in the country. The same 1994 country strategy expressed concern: *The high percentage that would be represented by the Bank's share in the total long-term external debt, in the total multilateral debt, and as a percentage of total external debt service, make it necessary to take into account in the future that the growth of these ratios significantly increases the Bank's exposure in the country. (...) Therefore, the estimated approval amounts for the period should be cautiously analyzed each year* (CP-608 Rev., paragraph 4.47). Accordingly, and although Paraguay's share in the Bank portfolio and in IDB debt service in terms of exports are well below the ceilings recommended by the Bank, *"the indicators for IDB debt service and multilateral debt service out of total debt service are higher than the recommended levels, reflecting the traditional importance of IDB financing in total external financing."* (GN-2118-1, paragraph 2.95)

3.12 Accordingly, although Bank documents continually refer to problems with implementation and the lack of resources for national counterpart funding, in practice the operational proposals during the decade under review appear to ignore that sizable financing programs would require significant improvements in project execution capacity and in the country's external and fiscal positions, elements that continue to be important challenges both for the Bank and for Paraguay.

B. Issues relating to programming cohesiveness

- 3.13 Paraguay's technical and institutional weakness suggest that the Bank could have made use of technical-cooperation operations and economic and sectoral studies as strategic tools for its activity in the country, supporting project identification, definition, and preparation, and supporting improvements in institutional capacity. This suggests that this issue raised by the evaluation can be divided into two related questions: (a) is the programming of technical-cooperation operations and studies cohesive with the Bank's operational program in the country? and (b) is there evidence that Bank programming has made strategic use of these tools in Paraguay?
- 3.14 Generally, it is found, there is cohesiveness between the technical-cooperation proposals and the operational program. However, it bears noting that only in the last two country strategies has an effort been made to show the interrelationships between the technical-cooperation operations and economic and sector studies and the projects proposed for the country. It has also been observed that, while the number of technical-cooperation operations proposed is increasing significantly over time, the dispersion of the proposals is on the rise as well. Thus, while there is thematic cohesiveness, the disparate nature of the proposals leads, on the one hand, to a lower degree of correlation between technical-cooperation operations and loans, and, on the other, to a reduction in their strategic impact. This appears to have been offset in the last two programming cycles (from the standpoint of intent) by a more strategically focused definition of economic and sector studies.⁵²
- 3.15 Although the Bank has not approved any operations for the private sector, it bears noting that in 1997 it prepared a document on strategy guidelines for the development of small and medium-sized enterprises, setting forth the considerations involved in supporting the development of small and medium-sized enterprises in Paraguay and establishing the conceptual basis for the development of PR-0100.
- 3.16 Another issue relating to programming cohesiveness involves the relationship drawn in the various country strategies between the operational programs of the Bank and of other major multilateral and bilateral donors. The country strategies for the first two programming cycles included only a listing and/or general description of the areas in which other donors were active. The 1998 and 2000 strategies, in contrast, provided an analysis of the participation of other institutions in Paraguay in terms of their relationship/coordination with activities financed by the IDB.
- 3.17 However, it must be noted that the Bank's programming does not address the reduced participation of two of the largest donors in Paraguay: Japan and the World Bank.⁵³ The scaling back in Japan's presence was explained to OVE as motivated by the failure to prioritize the projects financed by Japanese cooperation, both as regards execution per se and as regards the implementation of recommended policies.

- 3.18 In the case of the World Bank, it decided not to approve new projects for Paraguay beginning in 1997 as a result of the lack of improvement in the performance of its portfolio and what was perceived as the country's unsatisfactory management of its fiscal deficit, which were conditionalities defined in the World Bank's Country Assistance Strategy. However, the 2000 country strategy makes no reference to these events. According to the Country Assistance Evaluation for 2001,⁵⁴ there are also significant problems as regards coordination with the IDB: *"... the two organizations are far from the point of agreeing on sector policies and jointly financing national programs. There has been limited coordination with the IDB on macro-conditionality."*

IV. BANK ACTIVITIES IN PARAGUAY

- 4.1 This chapter examines the Bank's activities in Paraguay. In particular, it endeavors to evaluate how these activities relate to the objectives defined by the Bank's programming and how efficiently the outputs agreed with the country were prepared and implemented.
- 4.2 Throughout its history, that is, between 1961 and 2002, the Bank has approved 86 loans for Paraguay for a total of approximately US\$3 billion at a constant 2002 value⁵⁵ (see Chart A-4.1 in Annex 1). This represents roughly 3.4 percent of the number of projects and 1.6 percent of the resources lent by the IDB to all borrowing member countries over the same period.⁵⁶
- A. Profile of Bank activities in the period 1991-2002**
- 4.3 The Bank has approved loans in each year of the 1991-2002 period (see Table A-4.1 in Annex 1);⁵⁷ during the period there was a total of 30 operations (see Chart A-4.2 in Annex 1) representing roughly 35 percent of the total projects approved in the Bank's history with Paraguay and US\$1.1 billion in current terms or US\$1.3 billion at constant 2002 values (64.6 percent and 43.2 percent, respectively, of the resources approved for projects in Paraguay in the 1961-2002 period). Of these projects, 29 are investment loans and one is a sectoral operation approved in 1992.⁵⁸ The IDB has not approved any operations in Paraguay through its Private Sector Department (PRI). The levels in question represent historical peaks in Bank activity in Paraguay as regards the number of loans approved; the volume of resources allocated; and the average and median size of loans (see Chart A-4.3 in Annex 1).
- 4.4 In the same period, the Bank also approved 110 nonreimbursable technical-cooperation operations totaling US\$38.1 million (US\$43.7 million in constant 2002 dollars) and 18 Multilateral Investment Fund (MIF) operations (US\$17 million), totaling approximately US\$55.1 million (US\$62.7 million in constant value terms) in nonreimbursable resources. Fund for Special Operations (FSO) resources financed 82 percent of the technical-cooperation operations in terms of their number, and 77 percent of the amount invested in them.
- 4.5 In addition, 12 small projects for a total of US\$5.3 million (US\$6 million in constant value terms) were approved. Of these projects, five are for the microenterprise sector (all approved between 1998 and 2002) and three for the agricultural sector. For its part, the Inter-American Investment Corporation (IIC) approved five projects between 1991 and 2002 for a total of US\$23.1 million.
- 4.6 This growing Bank participation in Paraguay led to a sizable and rapid increase in the number of projects being implemented and in the Bank's portfolio over the 1991-2002 period (see Chart A-4.4 in Annex 1).⁵⁹ In just two years (from 1992 to

- 1994), the number of projects in execution almost doubled, from 7 to 13. In a comparably short period, in this instance from 1991 to 1993, the number of Paraguay projects in the Bank's portfolio increased by two-thirds, from 9 to 15. At the end of the period covered by this evaluation, there were 21 projects in the portfolio, 2.3 times more than at the start of the decade, and the number of projects in execution in 2002 was 2.5 times higher than the number in 1991.⁶⁰
- 4.7 This expansion in the portfolio has gone hand in hand with a broader sectoral spread of the Bank's investments in Paraguay. In the 1991-2002 period, the Bank approved projects in 13 different sectors, so that in the vast majority of cases no more than 10 percent of the Bank's projects were in any given sector.⁶¹ Moreover, every single sector in which the Bank has approved some project in its history is represented in the 1991-2002 period. Doubtless all the sectors in which work has been carried out in Paraguay address country needs, but the diversification process referred to above may be not without its risks because—to the extent that it fractions the resources invested among several areas—it may reduce the marginal impact of the Bank's interventions in the country. This is particularly relevant in the case of Paraguay, where IDB resources play an important role in the financing of public expenditure. In this sense, these data reflect the general nature of the country strategy objectives and corroborate the conclusion set forth in the previous chapter to the effect that Bank programming has not and/or could not prioritize the allocation of its resources, and thereby maximize the anticipated return in terms of development.⁶²
- 4.8 The inability of the programming to set priorities, as discussed in the preceding chapter, and the diversification of the portfolio, are in fact interrelated problems and reflect the "goal congestion" problem identified by OVE in its document on development effectiveness (RE-260, pp. 10 and 11): *"From the mid-1980s through today, international development institutions, including the IDB, pursued a development promotion strategy comprised of policy reform and specific project investment across an ever-broadening spectrum of activity. (...) The steady proliferation of objectives was, in part, a response to this concern that the key to unlock the processes of rapid economic and social development had not yet been found. (...) [T]he expansion of the definition of "development" inevitably leads to the phenomenon of "goal congestion," where the institutions have so many objectives that it is difficult to establish clear priorities because everything is important to development.*"⁶³
- 4.9 Despite the increase mentioned and the dispersion in the number of projects in the portfolio and in execution, the staffing level for the Bank's Country Office has remained relatively stable throughout the 1990-2003 period (see Table A-4.2 in Annex 1). The portfolio growth has had to be absorbed, then, by increasing staff workload and/or by recourse to consultants, solutions which are less than ideal in the majority of cases.⁶⁴

4.10 In conclusion, the increases in the number of projects and amount of resources in the portfolio and in execution are a source of concern if one considers the number of times that Bank documents have called attention to Paraguay's limited technical capacity and the frequent delays in releasing counterpart funding. These factors, together with the excess workload that the volume of operations entails for the Country Office specialists, could reduce the Country Office's capacity to track operations more intensely, an effort that is essential—given the oft-mentioned technical limitations of the country⁶⁵—in order to ensure the efficiency and quality of project execution, and consequently the impact of Bank activities.

4.11 In this connection, it is interesting to note that the Bank appears to have overlooked its own warnings: *The Inter-American Development Bank authorities stressed that expanding the portfolio of loans, by itself, would not constitute a benefit for the country in the absence of support by executing agencies trained to meet program and project execution timetables efficiently*" (review mission for the 1992 lending program. CP-352, Appendix VI, p. 2). *The most important lesson emerging from the analysis of the present portfolio is that it should be a decisive factor in the design and size of future programs. Indeed, the Bank must ensure that the future lending programs, as well as those in the current portfolio, do not exceed the country's institutional capacity for execution.*⁶⁶

B. Project execution

4.12 It has generally been observed that the projects approved in more recent years have a less efficient disbursement pattern, suggesting a decline in the degree of efficiency in project execution in Paraguay during the period under review (see Chart A-4.5 in Annex 1).⁶⁷ These findings are consistent with the hypothesis discussed in the preceding section, namely that the constant increases in the number of projects being executed may have had a negative impact on the disbursement process in Paraguay.⁶⁸

4.13 The problems with project execution in Paraguay are clearly reflected in the Bank's Project Alert Identification System (PAIS). In addition to the fact that 70 percent of the projects in Paraguay's current portfolio have been at one time in alert status, of particular note are the long periods (one year or longer) for which almost all of these projects have been so classified. In this respect, it is surprising that such long periods of disbursement difficulties are not reflected in the assessment of the likelihood of achieving the development objectives and that, accordingly, no more than three projects were classified as "problem loans."

C. Project approval times

4.14 The projects approved for Paraguay over the 1991-2002 period have taken more time for preparation, approval, and initial disbursement than have the Bank's projects as a whole or the projects of other relevant reference groups (see Chart A-4.6 in Annex 1).⁶⁹ The reasons for these differences are not clear, and it

should be noted that, in and of themselves, they may well not be good or bad, but merely reflect the limitations of the counterpart or the preparation of higher quality projects. Even so, the differences observed appear to be too large to be explained by random factors.

- 4.15 Throughout the period under review (see Chart A-4.7 in Annex 1), there is an observable general trend toward improvement in the time that elapsed between approval and the first disbursement; however, the same could not be said as regards design times (from Profile I to approval).

V. QUALITATIVE ASPECTS OF THE COUNTRY PROGRAM

5.1 The aim of this chapter is to present a number of qualitative aspects of the Bank's program in Paraguay. In this respect, the information set forth here supplements the analysis presented in the two immediately preceding chapters.

A. Evaluability

5.2 Various general issues relating to the evaluability of Bank-approved projects in Paraguay in the period under review in this report are set forth below:

- Relevance and diagnosis—The projects approved may be described as relevant, in the sense that they were focused on issues of importance for the country, and they provided a clear diagnosis of the problems affecting the various sectors.⁷⁰
- Objectives and anticipated results—Generally speaking, the problems clearly expressed the objectives and outcomes anticipated (in terms of development). However, some projects expressed their development objectives too ambitiously, as a result of which it could not be said that these objectives, taken at face value, were achievable.⁷¹
- Project logic—The design logic of the projects, understood as the proper formulation of specific activities and other subcomponents and their interconnection with the principal development objectives, was generally satisfactory.⁷²
- Assumptions and risks—First, it was found that for the majority of the projects, risks arose during project execution that were not originally identified in the design.⁷³ This finding allows the inference of three scenarios that are not mutually exclusive: (i) the projects tend to underestimate the risks to which they were exposed, suggesting a problem with analysis during the project design stage;⁷⁴ (ii) the projects do not clearly and/or exhaustively present the various risks to which they are exposed; (iii) the scenario in which projects are executed in Paraguay is so inconstant, and/or the nature of the projects approved by the Bank so complex, that the appearance of unforeseen risks would be virtually unavoidable. While solutions to the first two of these problems would be the simplest—that is, improve the quality of risk analysis and adopt a more transparent position in that evaluation by not limiting oneself, for example, to presenting only those risks that could be mitigated—the third point would mean that the Bank has not been properly reflecting on the nature of its activities in the country. Furthermore, it is found that limited technical and institutional capacity is the risk component that is most frequently mentioned in projects in Paraguay. However, because the Bank has been stressing this weakness in its programming papers throughout the entire period under review, this factor

should not be considered as a project *risk* in Paraguay, but rather as a concrete and foreseeable aspect to be incorporated in the design of operations approved for the country.⁷⁵

- Indicators of development targets—the proper definition of indicators of development targets and the availability of parameters that make it possible to track their development systematically over time are of crucial importance, as they would make it possible to clearly evaluate whether progress had effectively been made toward meeting the targets set. However, the projects for Paraguay have followed the same trend that OVE has observed in other country evaluations, limited availability of target indicators as well as limited possibilities for being able to monitor their development adequately.^{76, 77}
- Output indicators—In the area of specific outputs, it is generally found that the projects analyzed here did define appropriate indicators.^{78, 79}
- Monitoring and evaluation—While the projects approved did indicate that there were monitoring indicators in place,⁸⁰ this evaluation found that of the 29 investment projects approved through 2002, 15 required ex post evaluations, of which eight still had to be concluded but only two had been completed by February 2004. The remaining evaluations were rescheduled. It is important to note that the failure to complete the evaluations on schedule slows down the pace of identifying and applying lessons learned which might improve future Bank activities not only in Paraguay, but in other countries in the region. It also bears noting that since 1995, when the performance of ex post evaluations became optional, there has been a significant drop in the number of such evaluations scheduled. Only six evaluations were proposed for a total of 20 projects, reflecting the scarce availability of resources in the country to apply toward the costs necessary for identifying the results of externally-financed investments.⁸¹

B. Monitoring and oversight

5.3 OVE performed a compilation of the problems reported in the Project Performance Monitoring Reports (PPMRs) between 1997 and 2002 for those cases in which the Bank has evaluated implementation progress as unsatisfactory or very unsatisfactory, or those cases where the likelihood of achieving the development objectives was classified as low or improbable. It was found that the problem reported most frequently to explain these classifications is the institutional capacity of the executing agency, which appeared as the principal problem in 7 of the 11 periods covered.⁸²

5.4 Table A-5.1 in Annex 1 shows the monitoring and supervision activities performed by the Bank in the 1998-2002 period.⁸³ Unfortunately, the information is partial, in that the records of inspection visits did not begin to be registered systematically until 2001.⁸⁴ They highlight the complete absence of administration

missions and the low number of initial missions and midterm review missions; such activities are potentially of great relevance in a context of limited technical capacity and projects with execution problem, as the Bank reports for the case of Paraguay.

5.5 Although it may be said that it is possible to achieve the objectives sought by the Bank by carrying out 70 percent of the technical inspection visits and 65 percent of the institutional and financial inspection visits originally programmed for 2001, it seems unlikely that the same could be said for 2002, when fewer than 50 percent of the technical inspection visits programmed were actually conducted.

5.6 Table A-5.2 in Annex 1 shows the results of the external financial audits (EFAs) conducted between 1998 and 2002. While, on the one hand, the majority of projects (between 50 percent and 83 percent) obtained a “clean” classification, on the other hand there was a sizable proportion of resources disbursed in projects with auditing problems in three of the five years: 1998, 1999, and 2001. Also of note is the sizable reduction in disbursements in respect of projects with audits classified as “with reservations” in 2002.

5.7 It bears noting that project PR-0031 (Program to Support Reorganization of the Housing Sector)⁸⁵ and project PR-0064 (Development of a Regulatory Framework for the Water and Sanitation Sector) had adverse classifications from the external auditors every year.⁸⁶ However, for the latter project, only one administration mission was recorded in 2001 and one institutional-financial visit in 1998,⁸⁷ while for the former there appear to be four technical visits recorded in 1998, three in 1999, and two in 2000.⁸⁸ Other projects for which reservations were frequently expressed in audits were:⁸⁹

- PR-0024 (Municipal Strengthening Program)—“with reservations” in 1998 and 2000;
- PR-0025 (Program to Strengthen Basic Education Reform)—“abstention from opinion” in 1998 and “with reservations” in 1999 and 2000;
- PR-0026 (National Rural Roads Program)—“with reservations” in 1999 and 2000;
- PR-0030 (Yacyretá Transmission System)—“with reservations” as regards the entity between 1999 and 2002.

VI. BANK COUNTRY PROGRAM OUTCOMES

6.1 This chapter describes the major outcomes of the country program financed and implemented by the Bank in Paraguay.⁹⁰ In essence, the basic question this chapter seeks to answer is: what were the results in terms of development driven by the Bank's country program over the past decade?

6.2 It is worthwhile to clarify a number of important issues with respect to the presentation of results provided below:

- Although the Bank is Paraguay's principal source of external financing, the problem of attribution continues to exist, and consequently no effort is made to establish a direct causal relationship between Bank activities and the development outcomes obtained, but instead to analyze how its country program has interacted with the events occurring in the country between 1991 and 2002;
- As discussed in Chapter III, the inadequate definition of development objectives in the successive country strategies precludes identifying the marginal contribution of the operations approved by the Bank;
- The lack of baselines, indicators, and/or targets relating to the desired outcomes of projects, as discussed in the preceding chapter, limits the capacity to evaluate the impact of Bank activities.

6.3 The four major themes identified for the Bank's programming (macroeconomic equilibrium, governance, productivity and integration, and combating poverty, see paragraph 3.5), plus the need for institutional strengthening,⁹¹ have served as the basis for structuring the discussion presented below (see also Table A-6.1 in Annex 1).⁹²

A. Macroeconomic equilibrium

1. External indebtedness

6.4 Other things being equal, the Bank's activities in a country necessarily generate an increase in external indebtedness. This situation is particularly important in the case of Paraguay, in that the program in the 1990s increased the stock of Paraguay's debt to the IDB, its principal external creditor, from 6 percent of GDP to 16 percent of GDP (or from about US\$403 million to US\$894 million) between 1992 and 2002, and also increased the cost of servicing this debt by a factor of almost four from 1991 to 2003 (see Charts A-6.1 and A-6.2 in Annex 1, and Box A-7 in Annex 2). While the structure of this kind of borrowing may be described as long-term and at relatively low interest rates, the excessive

indebtedness has generated, in the short term, a heavy fiscal burden and significant lags in the payment of Paraguay's debt service.⁹³

6.5 The projections of the service on the external debt contracted to date suggest that further increases would generate fiscal pressures that would be difficult to sustain, in particular in the short term (an anticipated increase of over US\$30 million, or approximately 14 percent, in debt service between 2003 and 2005, and holding at that new level until 2007), if not accompanied by a reform process that makes it possible to increase revenue or decrease fiscal expenditure.⁹⁴ Consequently, in late 2003 the country found itself obligated to seek approval of a Stand-By Arrangement with the International Monetary Fund (IMF) and an emergency loan for US\$30 million from the IDB (Social Protection Program, PR-0147).

6.6 However, the short-term nature of the repayment of loan PR-0147 could, in the short term, actually be exacerbating the cash flow problem of Paraguay's external indebtedness.⁹⁵ It is estimated that the repayment of this loan alone would represent an increase of approximately US\$16 million (or 5.6 percent) in Paraguay's total debt service in 2007 and 2008.⁹⁶ This should be interpreted as being over and above the aforementioned 14 percent increase in estimated debt service beginning in 2003.

6.7 Another issue of concern with respect to the evolution of the public debt relates to the possibility that a substantial proportion of the borrowed resources may have been used to cover current expenditure (see Chapter II). There is hence the possibility that resources that must be repaid in foreign currency may not be generating a corresponding amount from investment, thereby restricting the chances for growth and the generation of foreign exchange.⁹⁷

2. Reform of the financial sector

6.8 As discussed in Chapter II, Paraguay liberalized its financial and exchange system at the start of the 1990s. Since that time, the Bank has proposed, through successive programming exercises, that a more comprehensive reform of the sector be carried out. The 1998 country strategy in particular defines a number of results that might be expected from Bank activity in the sector: (i) improvements in the efficiency, competitiveness, and transparency of the system, making it possible to increase the mobilization of domestic savings and improve its allocation; (ii) increase in the supply of and access to credit; and (iii) reduction in intermediation costs. These objectives are quite similar to the conditionalities for the financial sector defined by the Investment Sector Program (ISP) approved in 1992 (see Box A-8 in Annex 2),⁹⁸ which aimed to achieve three fundamental points: (i) create an adequate regulatory framework and strengthen the oversight and transparency of financial institutions; (ii) redefine the role of public banking and enhance its efficiency; and (iii) increase the efficiency and competitiveness of the financial system.

- 6.9 In the area of regulation and oversight, it bears noting that while the ISP led to the approval of a new Organic Charter for the Central Bank of Paraguay (BCP) (Law 489/95) and a new General Law on Banks and Financial Institutions (Law 861/96), the years following the entry into force of these laws were characterized by a rising incidence of irregularities and by the fact that the BCP began being requested to serve as lender of last resort, a process which resulted, beginning in 1995, in a series of crises that led to the closure of various institutions, the flight of savings from the system, and public sector indebtedness (see Box A-1 in Annex 2).⁹⁹
- 6.10 Furthermore, the supervision of the system is still far from satisfactory owing to the effect of at least three factors: (i) the lack of independence of the Superintendency of Banks (SB) within the BCP; (ii) the existence of a substantial number of savings and loan cooperatives outside the scope of BCP oversight; and (iii) the use by the SB of a tracking and monitoring system that may be overestimating the capital solvency of a number of financial institutions subject to its supervision.¹⁰⁰
- 6.11 With regard to the reform of public banking, there were few advances made. The major public bank in Paraguay (Banco Nacional de Fomento, BNF) had been operating at the cost of progressive deterioration in its solvency, administration, management, and loan-quality indicators.¹⁰¹
- 6.12 Lastly, in terms of system efficiency, the differentials between borrowing and lending rates remained high, both in guaraníes and in dollars, which tended to limit domestic investment.¹⁰² At present, the high cost of credit is partly the result of the widespread lack of confidence in the system after the successive crises, and partly the outgrowth of the low quality loan portfolios of various institutions.

B. Governance

- 6.13 Improvement in Paraguay's governance was clearly one of the strategic goals of the Bank's programming in Paraguay throughout the 1991-2002 period. The four country strategy papers prepared during this period all mention the issue of governance as a key factor in the country's development.
- 6.14 Despite Bank intervention through various operations and technical-cooperation projects,¹⁰³ the objective of improving the country's governance was not achieved; quite the contrary, the country was affected throughout the decade by mounting difficulties with implementing the necessary reforms and improving the functioning of its institutions in order to stimulate sustainable economic and social development. More than a decade following the proposal of major reforms, the Paraguayan State continues to have major limitations, including the low degree of independence among the three branches of government, its high level of intervention in the country's productive process, and its excessive centralization,

- compounded by the low level of citizen participation in and control over its actions, resulting in serious problems with corruption.
- 6.15 The country's institutional weakness has been documented in a number of different studies. For example, in accordance with the indicators used by Kaufman et al., in 2002 Paraguay ranked last among the Latin American and Caribbean countries in four of the dimensions defined for assessing a country's governance, and next-to-last in the other two.¹⁰⁴ Perhaps of greater concern is the fact that, in comparisons over time, the results show declines in the country's six dimensions from the figures for 1996. Moreover, Huther and Shah, who used a different methodology to produce a governance quality index for various countries, ranked Paraguay last among the countries of the region.¹⁰⁵
- 6.16 Another important component of the institutional reform promoted by Paraguay in the 1990s, and supported by the Bank, related to enhancing the efficiency and equity of the country's tax system.¹⁰⁶ The precariousness of tax collections is attributable in large measure to the problem of tax evasion, which has had a strong impact throughout the economy owing to the sizable amount of informal economic activity and persists in the case of large taxpayers. According to information cited by the Bank itself, in 2000 more than a fourth of those listed in the "large taxpayer" registry were either inactive or had limited participation in tax collections.¹⁰⁷ According to information obtained by OVE from the Subsecretariat of State for Taxation (SSET), the proportion of domestic taxes corresponding to large taxpayers has been dropping continually since 1999.
- 6.17 Tax collections showed a rising trend in the first half of the 1990s, explained principally by the application of the new tax regime approved in late 1991 as well as by the boom in triangulation trade. However, beginning in 1994, when the tax law was to have been fully implemented, laws granting benefits, incentives, and/or privileges to various sectors began to be passed, thus eroding the base for the largest taxes.¹⁰⁸ Moreover, the restrictions at the border imposed beginning in 1995 reduced the flow of trade triangulation, thereby creating the need to identify new alternative revenue sources. Thus, toward the end of the 1990s, as the country's economic situation was deteriorating gradually, the collection of selective consumption taxes increased, especially taxes on fuels.¹⁰⁹
- 6.18 The goal of improving the functioning of the justice system has particularly critical importance in the case of Paraguay in view of the natural weakness of a recently restored democratic regime. In the 1998 country strategy the Bank mentioned its intention of "*modernizing operating and administrative capacity in ministries and autonomous agencies in the public sector,*" and, in the 2000 country strategy, the objective of consolidating "*the efforts already begun to establish a reliable, independent, effective, predictable, and responsive judicial system that is accessible to all Paraguayans.*"

6.19 As noted in the chapter on country context, the restoration of democracy and the approval of a new constitution early in the decade led to the creation of a new Supreme Court of Justice, inaugurating a new phase of striving to obtain a more transparent, efficient, and independent judicial system. However, more than a decade later, the judicial branch continues to have low reliability and prestige in Paraguayan society, and in addition to being beset by problems of congestion and poor territorial coverage, continues to function with major deficiencies as regards its independence and predictability.

6.20 The main project related to the objective of improving the functioning of the judicial system was called the “Program on Modernization of the State” (PR-0081), approved in 1996,¹¹⁰ which supported the institutional modernization of the Supreme Court of Justice. Its objective was to *increase the predictability, independence, impartiality, transparency, swiftness, security, legality, and accessibility of judicial decisions*. The project design incorporated various indicators for evaluating the achievement of development targets.¹¹¹ However, the Bank has not provided any information on how these indicators changed during program execution. Moreover, it is noteworthy that no reliable information is published periodically on basic statistics relating to the functioning of the system, such as the number of cases outstanding per judge, the average number of new cases to be heard by the various courts, the rates of case resolution, etc. According to a recent consultant’s study, the program *made significant strides as regards the administrative and jurisdictional reforms of the Supreme Court of Justice*¹¹² with a view to decentralizing its functions, but once again, no information was provided on the impact of these changes on the management capacity and transparency of the system. The foregoing is compounded by recent events affecting the Supreme Court, such as the resignation of three of its ministers and the impeachment of three others.¹¹³

C. Productivity and integration

6.21 The Paraguayan economy may be characterized as having a fragile capital base, in terms of physical and financial capital as well as human capital. In addition, because the economy is small and open, and dependent on a small number of export products, it is affected significantly by changes in the external market.

6.22 Paraguay’s entry into MERCOSUR considerably increases trade relations with the countries of the bloc and poses major challenges for the country, ranging from improving its trade negotiation capacity to redefining its economic strategy in keeping with this new external context. However, despite the priority placed on this issue by all the country strategies during the period, the Bank’s support has concentrated on technical assistance through technical-cooperation operations, and there have been no lending operations directly relating to trade integration or seeking to exploit Paraguay’s comparative advantages in the bloc, or the potential for trade expansion (access to other markets) generated by the integration process.

6.23 Thus it comes as no surprise that the productivity and integration issue has been emphasized in the objectives of the country strategies prepared by the Bank with Paraguay: as support for increased production in the 1991 country strategy; as modernization of the productive sectors in the 1993 country strategy; to achieve “*rapid and sustainable growth by developing the production structures under a competitive approach...*” in the 1998 country strategy (paragraph 3.17); and lastly, as the promotion of competitiveness “*to ensure effective participation by Paraguay in the regional integration process*” in the 2000 country strategy (paragraph 2.15).

6.24 Among the performance indicators relating to productivity and integration in the 2000 country strategy are the achievement of a positive rate of per capita economic growth and advances in the diversification of the productive and exportable base, while the 1998 country strategy hoped that Bank activity would generate an increase in the productivity and efficiency of capital and labor. The analysis in Chapter II indicated that these objectives were not met, as per capita GDP growth was almost -5 percent in 2002, there was no change in the structure of aggregate supply, and it was not possible to consolidate the productive restructuring of the country. Moreover, there was an increasingly negative trend in total factor productivity (TFP) in the late 1990s.

6.25 Owing to its own nature, as well as the diversification of Bank activities throughout the period under review, the productivity and integration issue involved projects in various sectors, of which the most important in terms of Bank activity were transportation, energy, and agriculture (see Table A-6.2 in Annex 1).

1. Transportation

6.26 All Bank investment in transportation was concentrated in the road sector. In principle, investment in this sector makes sense in Paraguay: the highway system, Paraguay’s commercial and economic backbone, is extremely underdeveloped, in particular by comparison with the systems of its partners in MERCOSUR. Therefore the precariousness of the road system poses an obstacle to the country’s competitiveness, to the development of rural areas, and thus to economic growth in general.

6.27 Historically, the country’s investment has tended to be concentrated on building and paving the main roads, to the detriment of secondary and rural roads.¹¹⁴ In this context, the Bank’s support for the sector has been directed toward financing the construction, paving, and maintenance of a basic road network, but has also promoted the development and maintenance of community roads in order to facilitate access to the major markets by those living in rural areas.

6.28 The three projects focused on financing major road works, PR-0080, PR-0035, and PR-0113, generally share the same objective of reducing transportation costs and facilitating access to major trade corridors. For their part, the two projects on rural roads (PR-0026 and PR-0104) seek to increase the value

added of agricultural production by reducing transportation costs, and to collaborate in the preservation of the rural road network. The Rural Roads I program (PR-0026) identifies two categories of quantifiable economic benefits: an increase in the value added of agricultural production, and a reduction in nonagricultural transport costs.

6.29 However, it should be noted that despite the investments by the Bank and other donors, the planning capacity of the sector and the maintenance efforts made continue to be deficient: *The budgets for road maintenance are the first to suffer cutbacks in times of fiscal restraint. The deterioration resulting from the lack of funding for routine maintenance is reflected in high vehicle operating costs, gradually reduces the passability of roads, and generates the need to move up the rehabilitation of roadways. (...) An analysis of the portfolio of road projects of the Ministry of Public Works and Communications (MOPC) during the last five years reveals that the situation in the last two years has been precarious. In 2002, the funds allocated to maintenance amounted to 23 percent of the level recorded in 1999 in the case of the Highway Administration Directorate and 14 percent in the case of the Rural Roads Directorate.*¹¹⁵

6.30 The ex post evaluations required for the two transport projects completed (PR-0080 and PR-0026) are not available, for which reason there is not sufficient information to conduct an impact analysis of them.¹¹⁶ However, the discussion above suggests that if the problems relating to the latter project are not resolved, the sustainability of the investments could be compromised.

2. Energy

6.31 The enormous energy potential of the Paraguayan river basin gives the country one of its major comparative advantages and constitutes one of its major revenue sources. The Bank, cognizant of the potential of this resource, has provided a considerable amount of financing for the energy sector (two projects totaling US\$150 million).

6.32 The Electrical Transmission and Distribution Program (PR-0109) approved in 1991 and completed in 1998 had three main objectives: meeting the unsatisfied demand for electrical energy; improving the quality and reliability of the electrical system; and institutionally strengthening the National Electricity Administration (ANDE). On the one hand, in terms of desired outputs, the project managed to significantly expand the coverage of electrical energy in the country, which improved from 48 percent to 79 percent of households. On the other hand, the expansion of coverage led to an increase in the technical losses of the system, while the inability to generate adequate tariff collection put the viability of ANDE at risk. As the ex post evaluation required for the project is not available, it has not been possible to learn precisely what results were achieved. Oral reports and observations obtained from inspection missions suggest that the project had made it possible for small businesses to proliferate, but there is no quantification or empirical corroboration (from a technical and scientific standpoint) of the causes of

this phenomenon. In addition, the positive results of the program (if they exist) could be compromised in the absence of corrective measures in the short term: *the sustainability of the progress made depends, in large measure, on new investments in infrastructure and on an increase in the efficiency, quality, and productivity of ANDE.*^{117, 118}

3. Agricultural sector

6.33 The characteristics of the agricultural sector in Paraguay, a preponderantly agricultural country, and recent developments in that sector, show that:

- Paraguay is basically self-sufficient in foodstuffs: almost all of the supply of foods is produced domestically, with the partial exception of wheat;
- The agricultural sector is the largest source of employment in the country;
- The rural population represents 45 percent of Paraguay's total population. However, as rural-urban migration is slower than the population growth rate, the rural population is continuing to grow, resulting in mounting (and unmet) demand for employment in the sector, aggravating the existing serious problems of rural poverty;
- The rural poor number about 1.5 million persons—just under one-third of the country's population or approximately 60 percent of the total rural population;
- Agricultural production has increased in the past two decades largely as a result of expanding the area under cultivation, particularly with soya, which currently is grown on over 30 percent of the total area cultivated;
- Inasmuch as soya production increased by 8 percent a year over the last decade, the other main crops had an increase of 1 percent annually;
- The yields of the main crops declined in comparison with other countries with ecological conditions comparable to those of Paraguay;
- Despite the devastating effects of the boll weevil, Paraguay remains competitive, though less so, in the production of cotton, the main cash crop within the means of many small producers;
- The public sector has been involved for a number of decades in the transformation of public lands into rural settlements. This effort has been partial, and consequently its results have been modest,¹¹⁹ and
- The agricultural sector is the country's largest source of exports of goods. If agroindustry is included (primarily the production of soybean oil), agriculture as a whole accounts for 70 percent of Paraguay's total exports.

- 6.34 In this sense, it is obvious that development of the sector is an extremely important factor in growth for Paraguay as well as for poverty alleviation, and that the policies and programs relating to agriculture and rural life should receive priority attention. However, although the IDB's interventions in the agricultural/rural sector of Paraguay have been focused on important aspects of rural life (rural roads, development of cotton farms), they have not been on a scale that reflects these sectors' enormous economic and social importance (the agricultural sector corresponds to roughly a fourth of Paraguay's GDP). What is more, the Bank's agricultural portfolio in Paraguay has been shrinking over time.
- 6.35 In the period under review, the Bank approved three (strictly) agricultural projects relating to boosting productivity and promoting integration: (i) the Project for Consolidation of Rural Settlements (PR-0083) in 1992; (ii) the Program to Support Small-scale Cotton Producers (PR-0082) approved in 1998; and (iii) Program for Modernization and Diversification of Small-scale Farming (PR-0084) approved in 2000. The first has been completed, the second is well along in the execution stage, and the third, with two-thirds of the time planned for project execution having passed, has disbursed just 6 percent of the approved loan amount.¹²⁰
- 6.36 The rural settlements program was an extremely complex project (three subprojects and nine components).¹²¹ In the review of the project completion report at Bank headquarters (June 2001), the lessons learned included the impossibility of measuring program impact.¹²² The Program to Support Small-scale Cotton Producers was affected by the weakness and instability of the institutional framework, the inadequate generation of appropriate technologies for the small farmers participating in the project, and the lack of sufficient support for introducing third-party technical assistance.¹²³
- 6.37 OVE estimates indicate that while the increase in agricultural production in the 1980s doubled the levels of the 1970s, and compared favorable with developments in the region during the same period, in the past decade the Paraguayan agricultural sector expanded by 2.1 percent a year while the figure for the region was 2.7 percent. Most of this growth corresponds to soya, while the growth of basic foodstuffs was much smaller.
- 6.38 All these findings suggest that Paraguay has still not been able to achieve *a sustained increase in the productivity of the agricultural sector* as defined in the objectives of the 2000 country strategy and that the effects of the IDB's agricultural program in Paraguay in the 1990s were quite modest, a conclusion reached by the Bank itself following an evaluation exercise conducted by the Environment and Natural Resources Management Division for Regional Operations Department 1 (RE1).¹²⁴

D. Combating poverty

- 6.39 Paraguay is not only one of the poorest countries in the region, but also has one of the worst income distribution patterns. This being so, and given the sizable share of the population living in rural areas, Paraguay's poverty problem is in large measure a rural problem.
- 6.40 As discussed in Chapter II, the apparent contradiction between high levels of poverty and relatively positive social indicators may be explained in part by the concentration of Paraguay's small population in a limited area, which reduces the costs of social policy, and in part by the poverty reduction strategy traditionally pursued by Paraguay: an approach based on capacity building, with less emphasis on and no interconnection with the creation of opportunities. Consequently, the country has not generated the opportunities necessary for expanding social investments to be reflected in sustainable reductions in the levels of extreme poverty.¹²⁵
- 6.41 Consequently, the slow growth of the early 1990s and the loss of almost 13 percent of per capita GDP since 1995 resulted in a highly negative country performance in terms of jobs and incomes. In addition, the adjustment of the agricultural sector to the decline in international cotton prices resulted in significant declines in the incomes of small agricultural producers, thereby increasing even more the disparity between incomes in the urban and rural areas. As a consequence, overall poverty, and extreme poverty in particular, increased significantly between 1995 and 2001.¹²⁶ Overall poverty increased by 15 percent (from 31 percent to 36 percent of households,¹²⁷ while extreme poverty rose by 19 percent (from 14 percent to 17 percent of households).
- 6.42 As a result of Paraguay's negative economic returns during the 1990s, achieving the millennium development goal of reducing the incidence of extreme poverty by half before 2015 was an even more distant prospect than it was at the start of the decade. Based on 2001 data, Paraguay would need to achieve an increase in per capita incomes of 3.2 percent or more per year in order to reduce the level of extreme poverty to 7 percent, or half the incidence observed in 1995. Although this figure does not appear particularly high, the possibility of achieving it is virtually nil in light of recent history.
- 6.43 Chart A-6.3 in Annex 1 shows clearly that if the history of the 1990s were to be repeated in the years ahead, Paraguay will not only not achieve the millennium development goal, but will be even farther from doing so. Nevertheless, although recent history cannot be used to measure the possibilities of achieving a millennium development goal, it is important to point out that, in the absence of significant changes in income distribution, with average per capita growth of 1 percent a year it would take about 45 years to achieve the goal, and if this rate were to be doubled the time needed would be reduced to less than half that.

6.44 The Bank's investment in combating poverty follows the pattern observed in Paraguay and has been focused basically on improving capacities and to a lesser extent on supporting opportunities, as in the case of microenterprise and the agricultural sector.¹²⁸ Table A-6.3 in Annex 1 indicates the operations whose primary objective was poverty reduction. Of the 12 projects listed in the table, five have been completed, and one (Global Microenterprise Credit Program II, PR-0094) has disbursed almost all of its resources.

1. Social sectors

6.45 As may be observed, the Bank has focused a significant proportion of its activities on combating poverty by supporting the development of capacities: eight of the 12 projects, or approximately US\$275 million out of the total of US\$345 million (80 percent), involved Bank investment in this area. Of these eight projects, four have been completed and will be discussed in greater detail below.

6.46 **Housing**—Approved in March 1992, the Program to Support Retooling the Housing Sector (PR-0031) was the Bank's first operation of this type in the housing sector; it involved not only the construction of basic housing solutions, but also sought reform of the sector, supporting the implementation of a new housing policy, as regards both its technical and its financial and administrative aspects.¹²⁹

6.47 The program was not very effective in achieving its development objectives. First, the number of program beneficiaries was considerably smaller than planned.¹³⁰ Second, a program designed to avoid benefiting relatively less poor groups ultimately benefited a substantial number of them. However, the main decisive factors for this evaluation would suggest that the program's effectiveness was low, as there were unquestionably few achievements attributable to the program as regards reform of the housing sector, and that the sustainability of the investments made was low as well. The National Housing Council (CONAVI) and the National Housing Bank (BNV) have limited resources for their operation, and persist in their policy of promoting the construction and direct financing of housing units. Moreover, the traditional banking system has little interest in financing the housing sector, which is even further complicated by the as yet unresolved crisis of the financial sector. In addition, the financing system created by the program also experienced problems in respect of: the weaknesses in the implementation of housing loans by savings and loan associations, resulting in the creation of a portfolio of poor quality loans (with a high delinquency rate and poor quality collateral); the deficiencies of BNV's capacity for oversight and regulation of the savings and loan associations, which makes it impossible to identify the risk to which they are exposed; and the lack of protection against moral hazard resulting from the BNV having to assume the management of the loan portfolios of companies that have gone bankrupt.

6.48 However, the fact that the program will be amending its original guidelines to include lower income groups as beneficiaries of the program has demonstrated that

construction programs based on mutual assistance can be functional in Paraguay, which was not regarded as possible in the original design.¹³¹

- 6.49 **Education**—In the early 1990s, Paraguay experienced one of the greatest enrollment increases in primary education in the region, ensuring that the vast majority of school-age children were able to attend primary school (90 percent). Preschool enrollment grew at an even faster pace, but the coverage level is considerably lower (32 percent). Despite the success with expanding the educational system, it continued to produce poor results in terms of the quality of instruction, learning, and the terminal efficiency rate. In late 1992, as the result of a broadly participatory process, agreement was reached on the general guidelines of an educational reform that accorded priority attention to the qualitative aspects of education, especially as regards improving preschool and primary education. In January 1993, the Ministry of Education and Culture decided to reorganize primary education into a basic cycle lasting nine years, including a six-year primary cycle and three years of middle school. The reforms also included lowering the entry age for preschool to five and for primary school to six, broadening the coverage of preschool and primary school, developing and implementing new curricula for primary school and teacher training, and improving the physical infrastructure of the schools and teacher training institutes.
- 6.50 Approved in late August 1993, the Primary Education Improvement Program (PR-0025) supported these reforms and sought to improve academic performance, reduce repetition rates and optimize the use of the resources intended for financing basic education, through two general policy approaches.¹³² First, the program included a proposal aimed at directly improving the quality of instruction and of teachers (new curricula, teacher training, the provision of textbooks and educational materials, improvements in the physical infrastructure of the schools, changes in the curriculum for teacher training, training the trainers of teachers, and introducing a permanent system for in-service teacher training).¹³³ Second, the program proposed that the Ministry of Education and Culture be institutionally strengthened in its roles in the management, administration, and supervision of the system (management information, administration, and education evaluation systems, and retooling of the supervision model).
- 6.51 The program met with important successes in reforming the basic educational system and became one of the hallmarks of Bank activities in Paraguay. Notable among these successes are the fact that the Bank was instrumental in generating the necessary conditions for implementation of the reform, through an ongoing technical and policy presence in the processes taking place within the country. In addition, the program successfully established sustainable information systems necessary for informed policy decision-making. Finally, the broad coverage of the program in the rural areas of the country is noteworthy.
- 6.52 However, the results are less positive from the standpoint of an analysis of the pedagogical proposals flowing out of the program. One of its major pedagogical

proposals (at the pilot level), known as active schooling, had mixed results. First, an impact analysis conducted at the end of the program noted that while the learning measurements in the active schooling institutions were significantly higher than the results in traditional schools, they fell far short of achieving satisfactory results. It should be pointed out, however, that this evaluation had technical weaknesses, in particular as regards the impact on learning, which make it impossible to identify the causes for the different learning levels from one school to another (the evaluation ascribed the entire difference to the program, without distinguishing between the effects of the various inputs provided by the program). In Paraguay there is a general impression that the program was not effective in terms of improving academic performance. However, there is consensus as to the program's capacity to generate other types of benefits of equal importance, such as the participation of students in the educational process and an incipient transformation in teaching strategies. Moreover, the aim of generating a bilingual education proposal for Paraguay resulted in a disjointed model owing to the underestimation of the complexities of Paraguayan bilingualism.¹³⁴

- 6.53 **Water and sanitation**—According to 1993 figures, Paraguay had among the lowest levels in the region for drinking water (29 percent) and sanitation services (11 percent) coverage. While considerably less dramatic, urban coverage for these services still showed a sizable deficit (53 percent and 22 percent, respectively). The lack of a tariff policy that managed to cover costs, on the one hand, and the lack of a clear definition of the operating rules for the sector, the entities making it up, and the specific functions thereof, on the other hand, made it difficult to obtain and tap the resources necessary for expanding those systems.
- 6.54 The Urban Water Supply and Sewerage Program (PR-0064) approved by the Bank in early 1995 proposed establishing a new legal and institutional framework for the sector and improving the efficiency of the entity responsible for services to urban communities (the Corporación de Obras Sanitarias [Sanitary Works Corporation], CORPOSANA) through institutional strengthening, with a view to ensuring the sustainability of the increased coverage of drinking water and sewerage services for the urban population that would result from the works financed by the program.
- 6.55 The program proved to be ineffective in terms of achieving its objectives. First, the coverage levels achieved by the program in the urban areas outside Asunción were less than a third of those planned. In its works component, the program ran up against public rejections of plans to construct wastewater treatment facilities as well as technical design problems. Second, it was not possible to introduce the legal and institutional framework for the sector in a timely or sufficiently sound manner. Lastly, the program had scant results in the area of institutional strengthening, as demonstrated by the low level of compliance by the executing agency with the targets established in the loan contract. This is explained in part by the difficulties experienced with modernizing the tariff system, but doubtless the fact that only half of the planned studies were completed, and the fact that majority of the recommendations they made were not implemented, are factors behind the scant

success of the component, and cast doubt on the sustainability of the investments financed by the program.

- 6.56 **Social investment**—By the mid-1990s, there was evidence of clear deterioration in the poverty indicators in the rural areas, despite a slight improvement in Asunción. In 1992, while 15 percent of the population of Asunción was living in conditions of poverty, the corresponding figure for the rural population was 55 percent. In addition to rural poverty, there is concern about the levels of social risk to which Paraguay's vulnerable groups are exposed (street children and adolescents, women at risk, persons exposed to situations of urban marginality, the elderly, indigenous people, and the disabled). Moreover, Paraguay did not have an explicit policy aimed at resolving the problems of the poor and those in vulnerable situations, and the scant national and private resources devoted to social welfare programs—the vast majority of the few such programs that have been implemented in Paraguay depend on external financing—suffered from low degrees of effectiveness.
- 6.57 In April 1996, the Bank approved the Social Investment Program (PR-0075), known in Paraguay as PROPAIS. This program was aimed at helping to improve the quality of life of the vulnerable population groups and those in extreme poverty through two lines of action. First, it would provide a Social Investment Fund (FIS) that would finance small projects focused on vulnerable population groups and those in extreme poverty.¹³⁵ In addition to directly and significantly increasing the supply of social welfare services, this component endeavored to tap the potential of private and nonprofit institutions, as well as community organizations, in the delivery of social services. Second, it would strengthen the Secretariat for Social Programs (SAS) in respect of its functions of designing social welfare policies and streamlining, targeting, and consolidating public spending on such programs. Finally, the lending program would be accompanied by a nonreimbursable technical-cooperation operation intended to finance projects targeting street children and adolescent workers.
- 6.58 To speed up execution, which was extremely sluggish, the hiring of consultants to prepare projects was approved. However, the more rapid pace of disbursements disrupted the original dynamics established for the Social Investment Fund: the program began to be supply-driven, with a negative impact on targeting the benefits and on the relevance of the projects financed by the program. Therefore PROPAIS disproportionately served population groups that, while poor, were not in extreme poverty or in more remote areas. That is, PROPAIS disproportionately served communities where the cost of participating in projects was lower.
- 6.59 One year after the end of the project, it is difficult to assess the impact of PROPAIS in the beneficiary communities. This is attributable, at least in part, to the fact that the project did not implement on schedule the Information, Formulation, Evaluation, and Monitoring System (SISFEM) financed by the program as part of its institutional strengthening component. Consequently, there is no baseline against which to compare the current situation of the program beneficiaries.¹³⁶

- 6.60 However, OVE's analysis indicates that the distribution of projects as a whole is quite uniform across the poverty groups, indicating a lack of targeting. The analysis further shows that 51 percent of the projects were carried out in districts that were not eligible under the program's first technical eligibility requirement, and that only 54 percent of the education and training projects financed with investment funds were carried out in districts that were eligible in accordance with the two technical eligibility requirements. In total, only 47 percent of the projects financed by PROPAS with investment funds were in districts that complied with both technical requirements.
- 6.61 Finally, it bears noting that at the end of the program, SAS had achieved some progress in terms of positioning itself within the executive structure and making itself visible to civil society, as revealed in a technical evaluation report on the program. However, it is still possible to see major institutional weaknesses within the SAS, in particular the great dependence on resources from outside the national budget in order to finance the national government's social welfare policy, which constitutes a risk to the sustainability of program investments.

2. Credit to microenterprises

- 6.62 The Global Microenterprise Credit Program (PR-0013) (GMC) was developed in the early 1990s in response to an initiative by the Bank and the Government of Paraguay in the effort to increase and enhance the efficiency of access to credit for microentrepreneurial activity, for which the alternative financing sources were limited to self-financing or informal agreements entered into at a very high cost. The main objective of this first program was *"to increase the flow of reasonably priced credit to microenterprises through regulated financial institutions in accordance with market rules and mechanisms"* (document PR-1848). It also sought to foster *"awareness of the special requirements of microenterprise credit within the country's regulatory institutions"* and also, through the technical-cooperation component, *"to develop a new institutional framework, which would assure microenterprises a continued access to financial and technical assistance services."*
- 6.63 The Global Microenterprise Credit Program II (GMC2) (PR-0094, approved in June 1997), was designed quite similarly to the previous program (it had one component on lending to microenterprises and another on institution-strengthening).
- 6.64 With regard to the results available, the project completion report (PCR) for the first program indicated, on the one hand, that *the results sought from both components of this program were exceeded.*¹³⁷ However, the report added that while *it increased the flow of credit to the microenterprise sector and the attitude of international financial institutions (IFIs) toward microentrepreneurs evolved favorably*, it was not possible to achieve *a duly established self-sufficient channel (of credit for microenterprise).*¹³⁸ The reasons identified in the paper to explain the failure to

reach this objective are that: (i) the “effective” execution period for the program was quite short; and (ii) credit to microenterprise still constitutes a tiny fraction of the overall portfolio of the IFIs participating in the program. It should be added that both these justifications are endogenous to the project programming and execution process, and ultimately are not suitable explanations of the failure to achieve the programmed objective.

- 6.65 A case study conducted by the Bank’s Evaluation Office (EVO) in 1998 gleaned the following conclusions from the midterm and ex post evaluations:¹³⁹ (i) GCM became the largest source of external financing for microenterprises; and (ii) it had a favorable impact as evidenced by the increase in the incomes of microenterprises as a consequence of the credit assistance from the program: Some 80 percent of the microenterprises surveyed indicated that their sales had increased, while 74 percent of this group attributed this to the credit they had received. Also noteworthy is the systematic monitoring and oversight effort as regards midterm and final outcomes through the executing agency, the Bank, and external audits.¹⁴⁰
- 6.66 As regards the impact of the GMC, the EVO case study reported the following:¹⁴¹ (i) lower-income microentrepreneurs continued to have low levels of access to credit by comparison with those in middle- or high-income levels, regardless of whether or not they belonged to the group of direct program beneficiaries. In particular, the 40 percent of microentrepreneurs making up the low-income or subsistence group had access to approximately 5 percent of the credit; (ii) it was possible to verify that, for the low- and middle-income strata, the proportion of women participating in microentrepreneurial activities was somewhat higher in the beneficiary group than in the comparison group, while the opposite held true for the high-income group. The study did not report any information on the environmental impact of the program. It also bears noting that the PCR did not address program impact in any of the three topic areas mentioned (poverty, participation of women, and environment) beyond a few passing observations.
- 6.67 Moreover, despite the fact that program execution was finalized and there was a general lack of adequate monitoring indicators, a reading of the information available in the Bank’s project performance monitoring system (PPMR) indicates that, for GMC2, beyond the brief references in some instances to specific agreements and consultancies, there is no information or estimates of any kind on what the medium-term impact of the program would be as regards poverty reduction, extending microcredit to rural areas, the participation of women, and environmental conservation and protection. The same PPMR calls attention to problems relating to the high interest rates ultimately charged to microentrepreneurs, such that *the program (...) would not ultimately benefit those seeking credit, inasmuch as the final rates are not conducive to conducting and developing business under current macroeconomic conditions.*¹⁴²

E. Institutional strengthening

- 6.68 While the need for institution-strengthening may be regarded as an element subsumed in the four goals discussed earlier, its acknowledged importance to the Bank and to Paraguay justifies including a brief discussion specifically focused on this issue.
- 6.69 As already mentioned on various occasions in this report, the IDB has regularly been observing throughout the entire 1991-2002 period that the institutional limitations existing in Paraguay are an obstacle to its development and have a negative impact on achieving the objectives proposed by the Bank in its operations. This being so, not only do the projects financed in Paraguay contain an institution-strengthening component, but it is also estimated that approximately half the technical-cooperation resources approved for Paraguay in the period were intended for institution-strengthening.
- 6.70 These limitations are recognized by the country itself, as a consequence of which institution-strengthening is the fourth largest component of its external borrowing, surpassing areas such as education and health. However, the problems still present in the functioning and organization of the public sector frustrate the government's expectations, and its officials note the ineffectiveness of such investments.
- 6.71 This lack of effectiveness is, in part, the result of the very nature of Bank intervention, which tends in large measure to: (i) create executing units that, because they are outside the line ministries, do not transfer know-how or strengthen the institution; (ii) finance "means" such as information systems and processes, without necessarily changing the effectiveness of the end activities; (iii) be based on hiring outside consultants; and (iv) be based on individual actions that are isolated from the general framework of Paraguayan public service. To sum up, the programming is not perceived to be adopting a long-term vision aimed at increasing the efficiency of the portfolio through an *integrated* plan for strengthening local execution capacity.¹⁴³
- 6.72 Moreover, the Inter-American Applied Macroeconomics Program (PIMA), one of the Bank's most effective actions for generating technical capacity in the Paraguayan public sector, has lost its financing in a context in which the government, owing to the shortage of resources, is unable to pay the cost of the necessary training with its own resources.

VII. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

- 7.1 The period under review in this report was marked by two major factors: the democratization process in the country, which began with the overthrow of General Stroessner's dictatorship after 35 years in power, and the deterioration of the economy, particularly in the second half of the 1990s, at a pace unprecedented in at least the last 50 years.
- 7.2 The period was further characterized by various historical peaks in Bank activities in Paraguay: the number of loans approved; the volume of resources allocated; and the average and median size of loans. The continuous growth of the Bank's portfolio in the country, the absence of economic growth, and the recent devaluation of the currency have increased the stock of Paraguay's debt to the IDB, its principal external creditor, from 6 percent of GDP to 16 percent of GDP between 1992 and 2002, and also increased the cost of servicing this debt by a factor of almost four from 1991 to 2003. Although the structure of Paraguay's external borrowing may be described as long-term and at relatively low interest rates, the total sums borrowed have generated, in the short term, a heavy fiscal burden and significant delays in the payment of its debt service. In this context, there is the possibility that the recent growth in the Bank's portfolio in Paraguay, and particularly, owing to its nature, the approval of the emergency loan in 2003, will exacerbate the current liquidity problem in the years ahead.
- 7.3 The lack of baselines, ex post evaluations, indicators, and/or targets relating to anticipated project outcomes, as well as the inadequate definition of development objectives in the successive country strategies, preclude the identification of the marginal contribution of the operations approved by the Bank and make it difficult to assess the impact of Bank activities in the country. This said, the following points bear mentioning:
- With regard to governance, Paraguay faces the long-term challenge of improving the quality and effectiveness of its governmental institutions and reducing the size of the informal sector. However, the period under review, particularly after 1995, was characterized by declines in the indicators of governance and by an increase in political instability. More than a decade following the introduction of major reforms, the Paraguayan State continues to have major limitations, including the low degree of independence in the three branches of government, its excessive centralization, and the low level of citizen participation and control over government actions, resulting in serious problems of corruption. With regard to the Bank's specific activities in the areas in which it has been involved, partial advances have been observed.¹⁴⁴ In the fiscal area, the results obtained were limited. Even though

the diagnosis of the problems and of the needs for reform in various strategic sectors defined by the Investment Sector Reform Program (ISP) financed by the Bank were fundamentally correct, the most significant changes driven by the ISP were not sustained over time. The ISP also contributed to supporting a process of institutional modernization that was beginning to be introduced in the country but still needs to be consolidated. In this respect, the limited progress achieved so far and the execution problems faced by the Bank in the area of modernization of the State must be noted.

- The period under review is characterized by a significant downturn in the economy and by various crises in the financial sector. Despite the fact that the strategies approved by the Bank during the period stressed the need for macroeconomic adjustments and for strengthening the financial sector, the ISP (approved in 1992) was the only Bank-financed operation that was directly related to macroeconomic stability. The progress achieved by the country program was partial. In general terms, it was not possible to improve the efficiency and reliability of the financial sector, and several of the objectives established for this operation early in the last decade continue today to be areas awaiting reform.
- The Bank's investments in infrastructure were able to achieve their major physical targets. In this connection, as regards the road system, one might have expected results in terms of reducing transportation costs, but it has not been possible to find any data, at the Bank or from other sources, to substantiate this hypothesis. In the energy sector, a notable success is the considerable expansion of electricity coverage. However, these infrastructure investments could be compromised by the existing serious sustainability problems relating to maintenance in the case of transportation, and to the inadequate price structure in the case of energy.
- The Bank's activities in key areas, such as the agricultural sector, were not proportional to the economic and social importance of the sector for the country, and have been declining over time. Moreover, the scant evidence available suggests that, in general, the impact of the agricultural projects financed by the Bank in Paraguay has been limited.
- Paraguay's poverty outcomes were also quite disappointing during the period. The overall incidence of poverty increased by about 15 percent and that of extreme poverty by almost 20 percent between 1995 and 2001. Although inequality increased slightly over the decade, the primary source of the increase in poverty was the lack of growth, reflected in a reduction in real wages and in increased unemployment: two-thirds of the increase in poverty between 1995 and 2001 nationwide can be mainly attributed to the economic decline.

- The Bank's activities aimed at combating poverty have generally followed the same line espoused by the country—an approach based on creating capacities, with less emphasis on, or with no interconnection with the creation of opportunities. The primary exception to this was the significant progress achieved in the microenterprise sector. The Bank has also had noteworthy involvement in the area of education, where it has played an important role with its leadership and has contributed to the expansion of school coverage, and shifting the focus of educational reform to the schools. Despite the fact that the challenge of improving the performance of basic education remains, other important achievements have been noted, such as the improvements in the compensation of teachers, in the provision of educational supplies, in school infrastructure, and in the average length of schooling of the Paraguayan population over age 25 (from 5.2 to 6.6 years). These successes contrast with the problems encountered and the limited results obtained in the housing, water supply, and sanitation sectors.
- Bank Management has compiled information on fulfillment of the targets sought through Bank interventions (see Box A-9 in Annex 2). This information is based on the matrix presented in the 2000 country strategy. Thirty-five indicators or targets are presented for 20 areas of intervention. Of these 35 indicators, only 8 relate to development outcomes and are distributed over 8 intervention areas, meaning that the 12 other areas have no indicators for measuring development outcomes. According to the matrix, two development targets were met (in the areas of physical infrastructure development and education), three were partially met (in the areas of support for the executive branch, health and nutrition, and water supply and sanitation), and one not met (in the area of diversification of the productive exportable base). In two other cases, there was no information available for determining the degree of compliance with development targets. The remaining 27 targets referred to outputs. Of these 27 targets, 2 were met, 15 partially achieved, and 9 not met. To summarize, and bearing in mind that the majority of the indicators presented relate to outputs, the evaluation showed that partial advances were achieved on 51 percent of the targets.

7.4 While the Bank's programming provides a clear diagnosis of the challenges facing the country, the generality of the proposals does not help the country define its priorities, nor contribute to establishing a new development strategy that is consistent with a reality in which the factors that drove the Paraguayan economy in previous decades are no longer present, issues which the country had difficulty addressing. The analysis of programming suggests that the Bank's growing participation in the country and the increased dispersion of the portfolio during the period under review would appear to be explained more by a greater demand for resources on the part of Paraguay due to revenue contraction, to the reduced presence of other donors, as well as by the mandates of the Eighth Replenishment, than by a long-term vision of the Bank-country interrelationship.¹⁴⁵

- 7.5 The growing Bank participation in Paraguay led to a sizable and rapid increase in the number of projects in execution and in the Bank's portfolio. Given the technical constraints and the limited availability of resources frequently highlighted by the Bank, there is some question as to whether the quality of the Bank's activities in Paraguay may have been negatively affected, in particular because the resources allocated to the Country Office do not appear to have been suitable for handling the increased workload. Thus the Bank's programming in Paraguay does not appear to acknowledge its own warning signs and analysis. Although Bank documents continually refer to project implementation problems and to the lack of resources for national counterpart funding, in practice the operational proposals of the period appear to ignore that sizable financing programs in Paraguay would require significant improvements in project execution capacity and in the country's external and fiscal positions, elements that continue to be major challenges both for the Bank and for Paraguay.
- 7.6 Despite the fact that, throughout its programming cycles, there has been a continuing effort on the part of the Bank to improve the evaluability of its programming, it has yet to achieve a clearer and more quantifiable definition of its objectives. Moreover, it is difficult to evaluate the Bank's programming through its projects, because the majority of them express their objectives imprecisely and over-ambitiously, without providing clear and measurable outcome indicators.
- 7.7 It also proves difficult to evaluate the capacity of programming to foresee the risks to which it was exposed on the basis of the information provided through loan documents. It must be noted, however, that risks that were not identified originally in project design did arise in most projects during execution. Furthermore, the country's limited technical and institutional capacity were the risks most frequently identified in projects. Given that the Bank had been stressed these weaknesses in all its programming papers throughout the entire period under review, these factors should have not been considered project risks in Paraguay, but rather concrete and foreseeable issues to be incorporated in the design of operations approved for the country.
- 7.8 It is also noted that several of the ex post evaluations scheduled to be conducted during the period had not begun by their target dates, which could delay the process of incorporating lessons learned into the Bank's operations in the country.

B. Recommendations

- 7.9 The foregoing indicates that the country faces a very clear main challenge: achieve a development and economic growth model consistent with the new (democratic) domestic environment and with an external context of greater competitiveness. To be able to help Paraguay achieve this objective, the Bank will have to ensure (and demonstrate) that its interventions are structured with the objective of maximizing their potential impact on the country's economic growth. To do so, the Bank will have to articulate a specific strategic and operational model for its activity in

- Paraguay (something that has not yet been observed). This discussion is particularly important, as the Bank must address the challenge of supporting the country's efforts to achieve efficient allocation of resources among the various sectors of the economy with the greatest productivity.^{146, 147}
- 7.10 This relates directly to the need to examine more strategically the potential generated by Paraguay's entry into MERCOSUR, incorporating this issue in a cross-cutting manner in its operations, directing investments and promoting policies that aim at the productive reconversion and modernization of the country, and reduction of the informal sector. Similarly, the Bank should adjust its activities in key sectors such as agriculture.
- 7.11 As regards to institutional-strengthening and governance, the Bank should revise its strategy of taking action through isolated interventions, and develop and implement an integrated plan for enhancing the institutional capacity of the country. This process would entail working with the government on developing a professional career plan for public servants, and using instruments similar and comparable to successful programs such as the Inter-American Program of Applied Macroeconomics (PIMA). The governance problem has been, and must continue to be, a priority issue for the Bank in Paraguay.
- 7.12 From a programming standpoint, the Bank should improve its handling of the risks to which its programming is exposed, expressing these risks precisely and transparently and understanding that many of the "risks" identified heretofore (e.g., the limitations of institutional capacity) are in fact a certainty, and therefore, one in respect of which the Bank should act.
- 7.13 There is also a need to improve the evaluation and the evaluability of programming in general, and of its projects in particular, through the incorporation of quantifiable indicators (particularly of outcomes), targets, and baselines. This would make it possible not only to identify lessons learned for the future, but also should improve the efficiency of programming, as it would be the result of an effort to devise a plan of action that has greater clarity of targets and of the relationships, synergies and externalities between its various components.
- 7.14 Consequently, the Bank's future activities require: (a) clearer definition of the priorities of its programming; (b) action more focused on areas with significant impacts on economic growth; and (c) more detailed evaluation of the impact of its activities on the level of the country's external borrowing and external debt service in the short, medium, and long terms.

Recommendations and Lessons Learned from Bank Activities and the Country Program Evaluation: RE1 Comments
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The analysis of the political and institutional context in Paraguay leads to the conclusion that it is necessary to promote the development of the private sector in order to ensure sustainable economic growth. Only sustained levels of private investment will make it possible to increase average per capita GDP growth rates enough to

reduce poverty. The Bank must intensify its support for the development of conditions conducive to the expansion of the private sector, both in respect of the business environment in general (legal safeguards and transparency) and in specific sectors (for example, the participation of private capital in maintaining road investments).

The risks of high volatility and external vulnerability indicate that prudence and flexibility are required when defining possible lending scenarios, adjusting the scheduling of operations in the event of any external shocks affecting the country's institutional capacity, borrowing capacity, and capacity to absorb resources.

To the extent that other multilateral and bilateral institutions increase their presence in Paraguay, it is desirable to target the Bank's interventions more towards those sectors that have a greater impact and make greater use of their comparative advantages, selecting priority programs in which to concentrate efforts. At the same time, this entails identifying opportunities for greater participation by other donors and multilateral and bilateral credit institutions. This would help the country diversify its sources of financing and make it possible for Bank activities to be more selective.

The diagnoses emphasize the need for institution-strengthening as a sine qua non condition for the success of the strategy and the projects. The main factor affecting most operations in the portfolio is institutional weakness, and while the case-by-case efforts to strengthen institutions have had positive results, they have been partial in scope. It is necessary to incorporate this kind of support into a comprehensive approach to the public-sector management problem. Areas requiring immediate attention include the professionalization of the civil service as part of a long-term vision and long-term objectives, and institutional strengthening of the entities involved in foreign trade, tax administration, and the control of public expenditure, among the issues of greatest relevance.

Efforts to further education reforms need to continue, with actions aimed at shifting the focal point from the central level in the ministry to the schools and at moving from interventions centered around the provision of inputs (textbooks, educational materials) to ones that focus on processes (teaching methods, school management) and results. The focus, in the short and medium terms, must be on strengthening an increasingly autonomous management structure and the instructional renewal of schools and on developing various targeted strategies that discriminate in favor of the most vulnerable groups. This will increase the likelihood of education reforms having the anticipated impact.

Building on the experience gained with education reform, the participation of civil society should be promoted in support of execution and social oversight of projects, so as to promote a sense of ownership of the investments to be carried out with Bank financing. Parent involvement, coupled with improvements in and expansion of school infrastructure through parent organizations (school partnering associations (ACEs)), is a proven, cost-effective way of both meeting school infrastructure needs and encouraging and building parent involvement in school management.

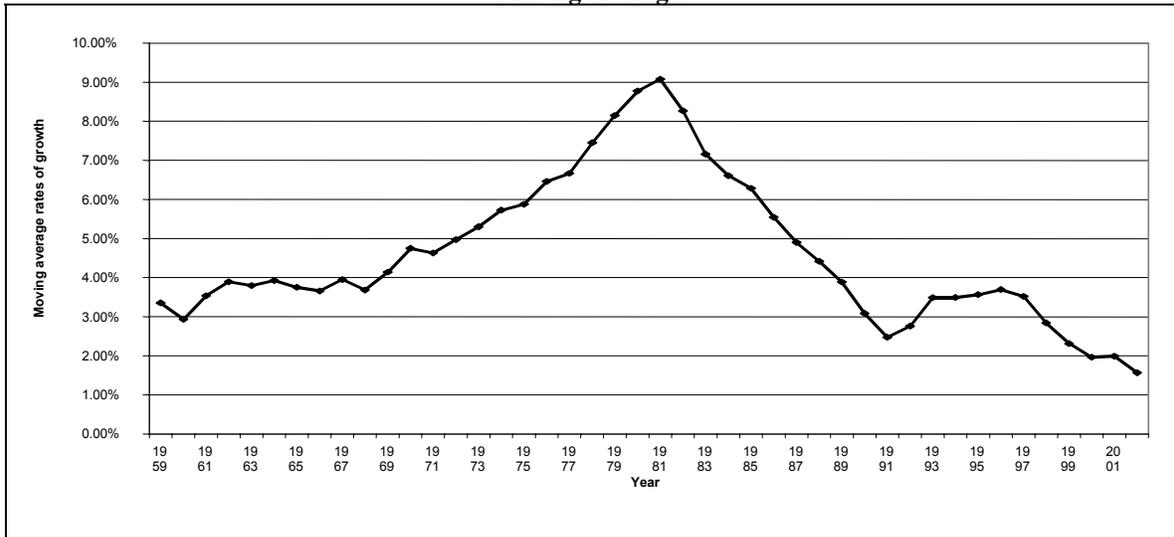
Past experience also indicates the need to impart a new focus to the strategy targeting rural development and the agricultural sector, centering the Bank's activities on a priority basis on the modernization of the management of public services that promote production, seeking to make fiscal spending for the sector more efficient and effective.

The efficacy of economic growth in reducing poverty will depend on access by the poorest to productive opportunities and to the benefits derived from their human and physical capital. Along these lines, it is vital to continue making progress in education, supporting increased schooling and improved quality and efficiency in the sector, including in bilingual education. Moreover, given the rural nature of poverty in Paraguay, all efforts aimed at stabilizing and increasing legal safeguards with respect to land ownership rights must be supported.

ANNEX 1
CHARTS AND TABLES

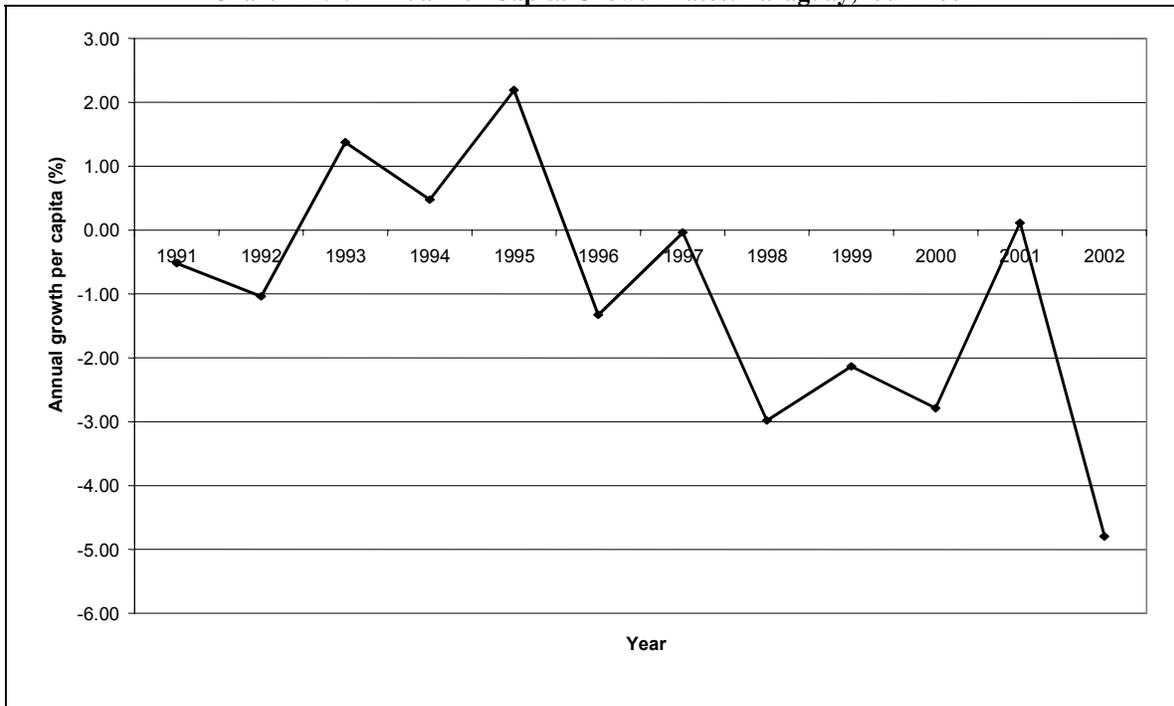
CHAPTER II

Chart A-2.1: Cumulative Annual Rates of Growth of the Paraguayan Economy (1959-2002): Ten-Year Moving Averages



Source: *Boletín de Cuentas Nacionales* [National Accounts Bulletin], GEE, Central Bank of Paraguay (BCP). Various years.

Chart A-2.2: Annual Per Capita Growth Rates: Paraguay, 1991-2002



Source: World Bank, *World Development Indicators*.

**Table A-2.1: Changes in Sectoral Composition of the Economy:
Paraguay, Principal Sectors, 1961-2000**

Sector/Indicator	Period			
	1961-1970	1971-1980	1981-1990	1991-2000
Agriculture				
% of GDP	34.5	29.3	26.2	26.8
average annual growth (%)	3.0	6.7	4.0	1.7
employment (%)	54.71	47.92	42.93	35.64
Industry				
% of GDP	17.1	17.7	16.5	14.7
annual growth	6.5	8.3	2.2	0.8
employment (%)	15.11	14.02	12.03	12.54
Trade and finance				
% of GDP	25.8	26.3	26.7	24.9
average annual growth (%)	4.8	9.0	2.8	-0.5
employment (%)	7.11	8.02	9.33	13.94
Services				
% of GDP	11.1	12.9	12.6	12.3
average annual growth (%)	N.A.	N.A.	N.A.	N.A.
employment (%)	17.3 ¹	23.4 ²	26.2 ³	27.5 ⁴

Notes: ¹1962; ²1972; ³1982; ⁴1992. - N.A.: Not available

Source: Fernández Valdovinos, Carlos G., and Monge Naranjo, Alexander (2003), "Economic Growth in Paraguay," preliminary version

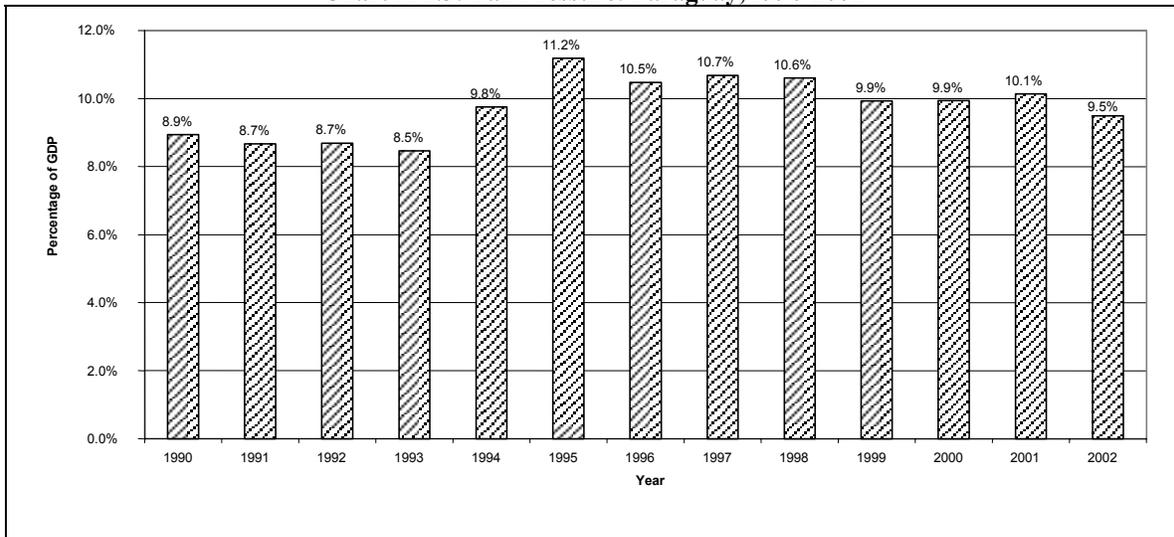
Table A-2.2: General Statistics: Paraguay, Latin America, and Selected Countries from the Region

Country	GDP per capita ¹	Gini coef. ²	Population growth ³	Illiteracy ⁴	Infant mortality ⁵	HDI ⁶
Paraguay	1,700	57.7	2.5	6.8	23.2	0.751(84)
Jamaica	1,785	37.9	1.6	13.1	19.6	0.757(78)
Dominican Rep.	2,062	47.4	1.6	16.4	38.9	0.737(94)
Ecuador	1,425	43.7	1.9	8.4	27.6	0.731(97)
Guatemala	1,558	55.8	2.6	31.4	38.8	0.652(119)
Surinam	994		0.6		26.6	0.762(77)
Bolivia	952	44.7	2.3	14.5	57.2	0.672(114)
El Salvador	1,752	52.2	2.0	21.3	29.1	0.719(105)
Guyana	941	40.2	0.6	1.5	53.6	0.740(92)
Latin America and the Caribbean	3,856		1.5	11.6	29.0	

Notas: ¹2000, 1995 dollars; ²1998, except: Jamaica 2000, Ecuador 1995, Bolivia 1999, Guyana 1993; ³Annual percentage, 2000; ⁴Percentage of population age 15 and over; ⁵Per 1,000 live births, 2000; ⁶Human Development Index for 2001, with value in parentheses indicating country's relative ranking

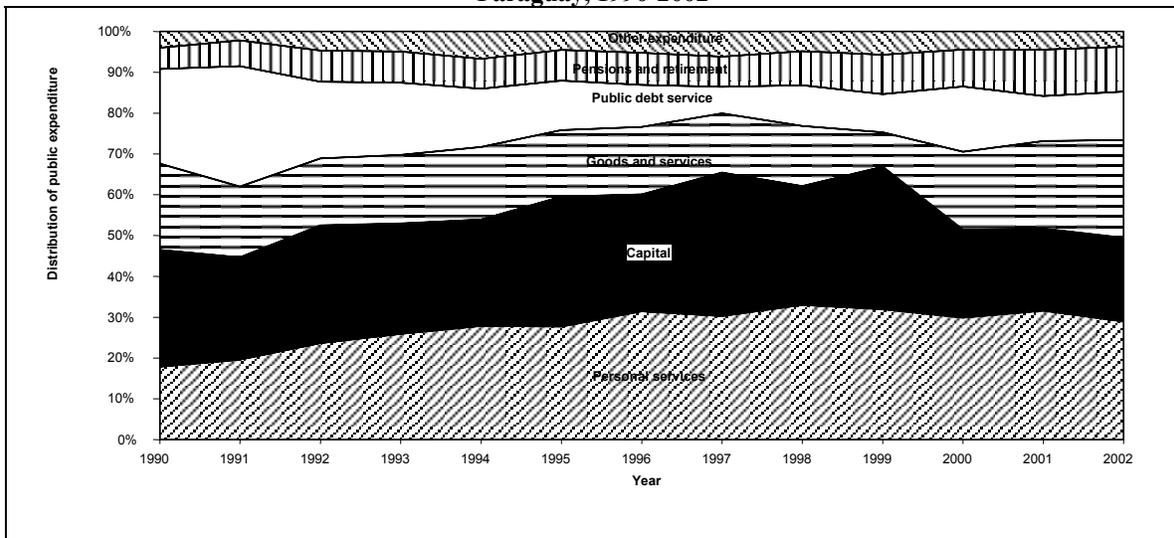
Sources: World Bank, *World Development Indicators*; United Nations Development Programme (UNDP)

Chart A-2.3: Tax Pressure: Paraguay, 1990-2002



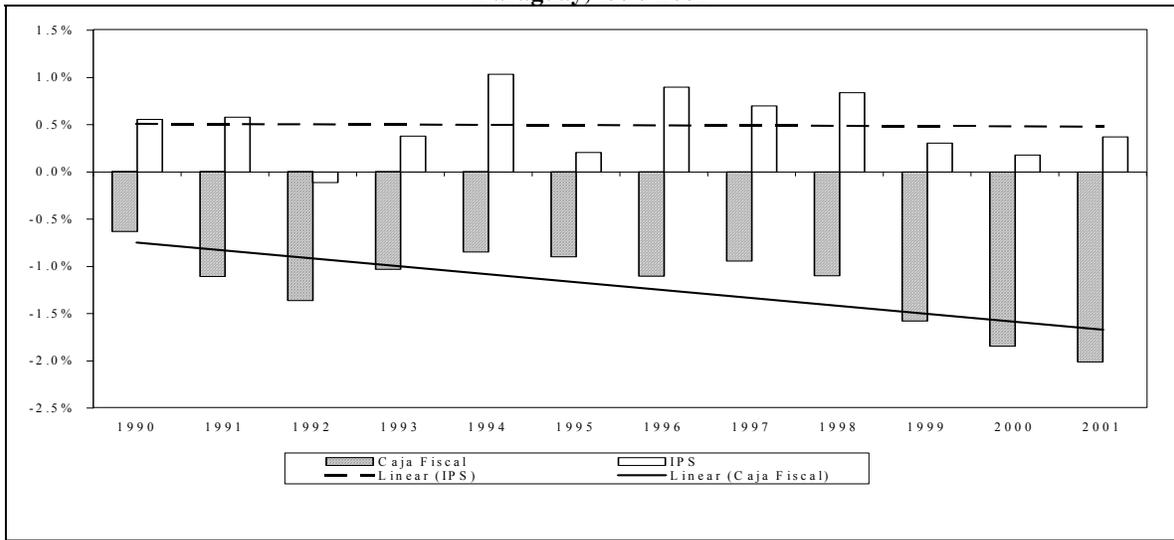
Source: *Informe Financiero* [Financial Report] of the Ministry of Finance, various years.

Chart A-2.4: Percentage Breakdown of the Expenditure of the Consolidated Public Sector: Paraguay, 1990-2002



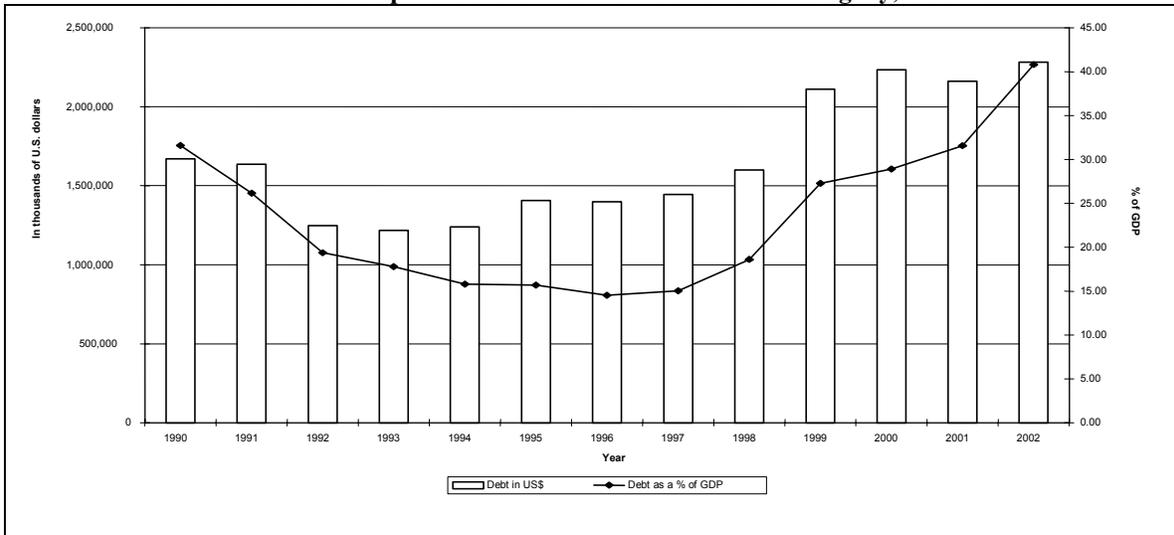
Source: *Informe Financiero* [Financial Report] of the Ministry of Finance, various years.

Chart A-2.5: Operating Results (as a % of GDP) of the Major Social Security Institutions: Paraguay, 1990-2001



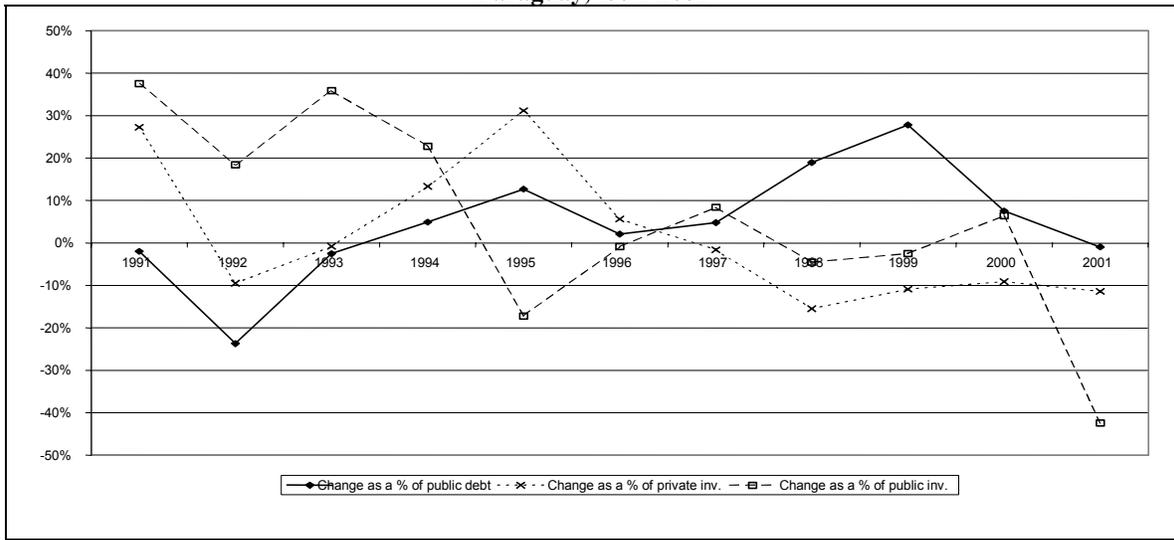
Source: *Informe Financiero* [Financial Report] of the Ministry of Finance, various years.

Chart A-2.6: Development of the External Public Debt: Paraguay, 1990-2002



Source: Based on figures from the Central Bank of Paraguay.

**Chart A-2.7: Growth Rates of Total Public Debt and of Public and Private Investment:
Paraguay, 1991-2001**



Source: Based on figures from the *Boletín de Cuentas Nacionales* [National Accounts Bulletin], GEE, BCP, 2001, and data from the Ministry of Finance.

CHAPTER III

Table A-3.1: Anticipations and Approvals: 1991-1993 Programming Cycle

	Anticipated in country strategy (CS)	Not Anticipated in CS	Total
No. of projects approved during cycle	7	2	9
Not approved during cycle	6	0	6
Total	13	2	15

Table A-3.2: Lending Program and Approvals: 1991-1993 Programming Cycle

Project – Projected Year	Amount (US\$ millions)		Identified in CS	Approved during cycle
	Projected	Approved	Yes/No	Yes/No - Year
PR-0080 Concepción-Cuero Fresco Road – 1991 High	56.0	62.0	Yes	Yes – 1991
PR-0109 Energy Distribution and Transmission – 1991 High	101.0	100.0	Yes	Yes – 1991
PR-0031 Reorganization of Housing Sector – 1991 Basic	54.0	54.0	Yes	Yes – 1992
PR-0083 Consolidation of Settlements – 1991 Basic	33.0	55.6	Yes	Yes – 1992
PR-0013 Microenterprises – 1992 High	20.0	10.0	Yes	Yes – 1992
PR-0026 Rural Roads – 1992 High	32.4	40.9	Yes	Yes – 1993
PR-0102 Financial Sector and Multisectoral – 1992 High	80.0		Yes	No
PR-0017 National Environmental Program – 1992 Basic	14.0		Yes	No
PR-0025 Basic Education – 1992 Basic	30.0	52.8	Yes	Yes – 1993
PR-0064 Water in Interior Cities – 1993	24.0	79.6	Yes	No – 1995
PR-0088 Enhancing Agricultural Technology III – 1993	20.0		Yes	No
PR-0103 Rural Aqueducts – 1993	13.5		Yes	No
PR-0111 Asunción Sewerage – 1993	60.0		Yes	No
PR-0003 Investment Sector		81.5	No	Yes – 1992
PR-0024 Municipal Strengthening		16.2	No	Yes – 1993
Total	537.9	473.0*		

Note: *Excludes PR-0064, which was not approved during the programming cycle

Table A-3.3: Anticipations and Approvals: 1994-1997 Programming Cycle

	Anticipated in CS	Not Anticipated in CS	Total
No. of projects approved during cycle	7	1	8
Not approved during cycle	4	0	4
Total	11	1	12

Table A-3.4: Lending Program and Approvals: 1994-1997 Programming Cycle

Project – Projected Year	Amount (US\$ millions)		Identified in CS	Approved during cycle
	Projected	Approved	Yes/No	Yes/No - Year
PR-0017 National Environmental Program – 1994	30.0		Yes	No
PR-0038 Professional Training – 1994	15.0	20.7	Yes	Yes – 1994
PR-0088 Agric. Technology and Diversif. – 1994	50.0		Yes	No
PR-0064 Urban Water and Sewerage – 1994	100.0	79.6	Yes	Yes – 1995
PR-0075 Social Investment Program – 1994	20.0	20.0	Yes	Yes – 1996
PR-0030 Energy Distribution and Transmission – 1995	60.0	50.0	Yes	Yes – 1996
PR-0035 National Road Corridors	150.0	82.3	Yes	Yes – 1996
PR-0028 Health Reform and Investments – 1996	50.0	39.0	Yes	Yes – 1997
PR-0081 Modernization of the State – 1996	30.0	22.0	Yes	Yes – 1996
N/N River Transport – 1996	30.0		Yes	No
N/N Development of Asunción Coastal Margins – 1996	80.0		Yes	No
PR-0094 Microenterprise II		20.0	No	Yes – 1997
Total	615.0	333.6		

Table A-3.5: Anticipations and Approvals: 1998-2000 Programming Cycle

	Anticipated in CS	Not Anticipated in CS	Total
No. of projects (basic scenario) approved during cycle	5	4	9
Not approved during cycle	8	0	8
Total	13	4	17
No. of projects (high scenario) approved during cycle	5	4	9
Not approved during cycle	14	0	14
Total	19	4	23

Table A-3.6: Lending Program and Approvals: 1998-2000 Programming Cycle

Project – Projected Year	Amount (US\$ millions)		Identified in CS	Approved during cycle
	Projected	Approved	Yes/No	Yes/No - Year
PR-0082 Small Cotton Farms – 1998 High	25.0	25.7	Yes	Yes – 1998
PR-0093 Preinvestment Program – 1998 High	4.0	5.0	Yes	Yes – 1998
PR-0088 Agric. and Forestry Development – 1998 Basic	79.5		Yes	No
PR-0100 SMEs – 1998 Basic	16.0	10.0	Yes	No – 2001
PR-0043 Asunción Coastal Margins – 1999	27.0		Yes	No
PR-0084 Agric. Tech. and Diversif. – 1999	13.0	10.0	Yes	Yes – 2000
PR-0104 Rural Roads II – 1999	80.0	67.0	Yes	Yes – 1999
N/N Road Corridors II – Rte. 10 – 2000 Basic	90.0	100.0	Yes	No
N/N Preschool Education – 2000 Basic	20.0	23.4	Yes	No – 2003
N/N Women’s Support Program – 2000 Basic	10.0		Yes	No
N/N Consolid. Exp. Electr. Transmission – 2000 Basic	70.0		Yes	No
N/N Drinking Water and Sanitation II – 2000 Basic	70.0		Yes	No
N/N Consolidation of Basic Educ. Ref. – 2000 Basic	60.0	40.0	Yes	Yes – 2000
N/N Multisectoral Credit Program – 2000 High	50.0		Yes	No
N/N Improvement of Public Admin. – 2000 High	40.0		Yes	No
N/N Social Security Reform – 2000 High	50.0		Yes	No
N/N Rural Sector Development – 2000 High	80.0		Yes	No
N/N Health Sector Program II – 2000 High	50.0		Yes	No
N/N Municipal Development Program II – 2000 High	30.0		Yes	No
PR-0112 Emerg. El Niño Phenomenon – 2000		35.0	No	Yes – 2000
PR-0115 Strengthening Fin. Admin. Subsecr. – 2000		6.0	No	Yes – 2000
PR-0116 National Environmental System – 2000		8.0	No	Yes – 2000
PR-0130 Support for Census Implementation – 2000		9.2	No	Yes – 2000
Total	544.5* 844.5**	307.9***		

Notes: * Considers basic scenario for 2000;
 ** Considers high scenario for 2000;
 *** Excludes PR-0100 and Preschool Education not approved during the programming cycle

Table A-3.7: Anticipations and Approvals: 2000-2003 Programming Cycle

	Anticipated in CS	Not Anticipated in CS	Total
No. of projects (with pipeline) approved during cycle	11	0	11
Not approved during cycle	15	0	15
Total	26	0	26

Table A-3.8: Lending Program and Approvals: 2000-2003 Programming Cycle

Project – Projected Year	Amount (US\$ millions)		Identified in CS	Approved during cycle
	Projected	Approved	Yes/No	Yes/No - Year
PR-0084 Agric. Technology and Diversif. – 2000	10.0	10.0	Yes	Yes – 2000
PR-0113 Western Integration Corridors – 2000	80.0	100.0	Yes	Yes – 2000
PR-0115 Strengthening of Fin. Admin. Subsecr. – 2000	6.0	6.0	Yes	Yes – 2000
PR-0116 National Environmental System – 2000	10.0	8.0	Yes	Yes – 2000
PR-0117 Consolidation of Basic Educ. Ref. – 2000	40.0	40.0	Yes	Yes – 2000
PR-0130 Support for Census Implementation – 2000	7.2	9.2	Yes	Yes – 2000
PR-0043 Asunción Coastal Margins – 2001 High	55.0		Yes	No
PR-0100 SMEs – 2001 High	10.0	10.0	Yes	Yes – 2001
PR-0118 Small Comm. Water and Sewerage – 2001 High	12.0	12.0	Yes	Yes – 2001
PR-0125 Social Investment Program – 2001 High	30.0	28.4	Yes	Yes – 2002
PR-0129 Improvement of Public Admin. – 2001 High	20.0		Yes	No
PR-0132 Land Tenure Program – 2001 High	20.0	9.0	Yes	Yes – 2003
PR-0137 Reform of Public Banking – 2001 High	10.0		Yes	No
PR-0138 Social Security Reform – 2001 Basic	20.0		Yes	No
PR-0120 Agricultural Services – 2002	36.0		Yes	No
PR-0122 Support for Housing Sector – 2002	30.0		Yes	No
PR-0123 Epidemiological Shield – 2002	40.0		Yes	No
PR-0124 Preschool Education – 2002	30.0	23.4	Yes	Yes – 2003
PR-0127 Credit to Rural Microenterprise – 2002	25.0		Yes	No
PR-0131 Support for Decentralization – 2002	15.0		Yes	No
PR-0119 Small-scale irrigation – Pipeline	14.0		Yes	No
PR-0126 Science and Technology – Pipeline	10.0		Yes	No
PR-0128 Road Corridors II – Pipeline	90.0		Yes	No
PR-0139 Export Diversification – Pipeline	10.0		Yes	No
PR-0140 Citizen Security – Pipeline	15.0		Yes	No
PR-0141 Airport Repair and Moderniz.– Pipeline	95.0		Yes	No
Total	740.2	256.0		

CHAPTER IV

Chart A-4.1: Approvals by Decade: Paraguay, 1961-2000

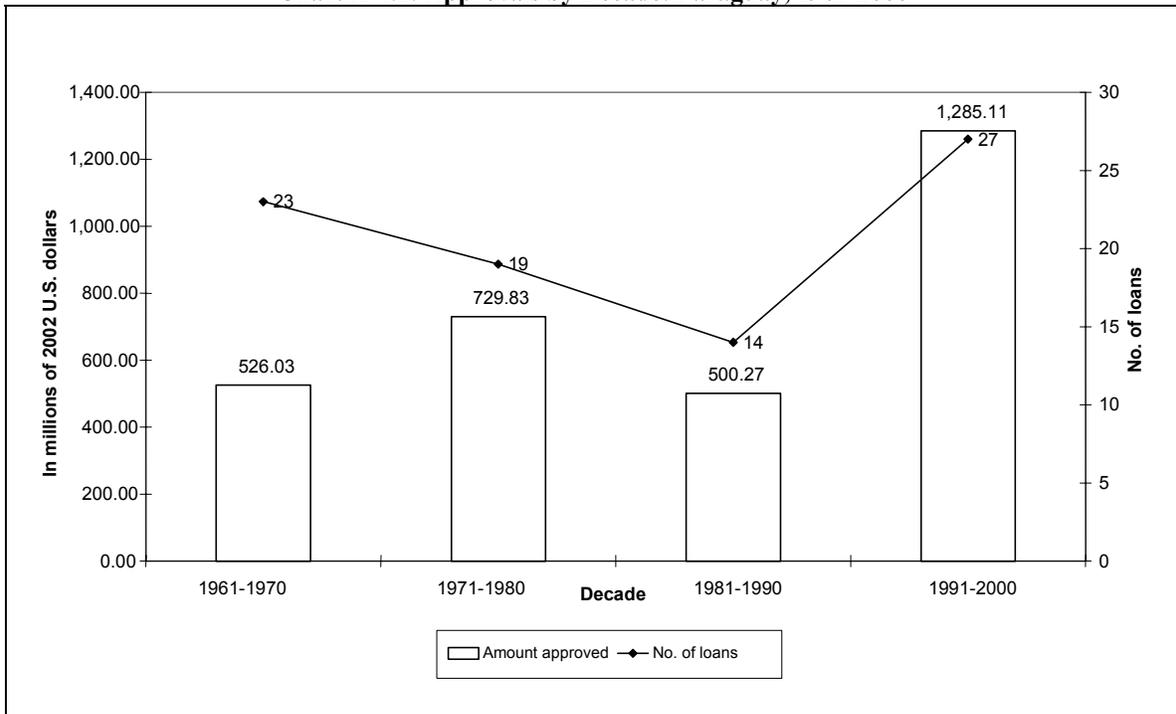


Table A-4.1: Approved Projects: Paraguay, 1991-2003

Project Number	Loan Number	Project Name	Sector	Year Approved	Amount Original	Amount Current	SEQ	PTI
PR-0080	635/OC-PR	Cuero Fresco Highway and Maintenance Program	TR	1991	62.00	56.41	0	0
PR-0109	648/OC-PR	Electricity Transmission and Distribution	EN	1991	100.00	98.27	0	0
PR-0003	727/OC-PR; 728/OC-PR	Investment Sector Reform and RTC	RM	1992	81.50	80.40	0	0
PR-0013	707/OC-PR	Global Microenterprise Credit Program	ME	1992	10.00	10.00	0	0
PR-0031	683/OC-PR; 884/SF-PR	Housing Sector Reorganization Support Program	DU	1992	54.00	52.94	0	0
PR-0083	694/OC-PR; 891/SF-PR	Consolidation of Rural Settlements	AG	1993	55.60	53.50	0	0
PR-0024	793/OC-PR; 794/OC-PR; 920/SF-PR	Municipal Strengthening	DU	1993	16.20	14.73	0	0
PR-0025	770/OC-PR; 908/SF-PR	Primary Education Improvement	ED	1993	52.80	49.07	0	0
PR-0026	744/OC-PR; 745/OC-PR	National Rural Roads Program	TR	1993	40.90	39.96	0	0
PR-0038	851/OC-PR	Vocational Training Program	ED	1994	20.75	20.75	1	0
PR-0064	861/OC-PR; 862/OC-PR	Urban Water Supply and Sewerage	OS	1995	79.60	70.27	1	0
PR-0030	918/OC-PR	Yacyretá Transmission System	EN	1996	50.00	50.00	0	0
PR-0035	933/OC-PR	HighwayCorridors	TR	1996	82.30	82.30	0	0
PR-0075	929/OC-PR	Social Investment Program	IS	1996	20.00	20.00	1	0
PR-0081	934A/OC-PR; 934B/OC-PR	State Modernization Program	RM	1996	22.00	22.00	0	0
PR-0028	1006/OC-PR-1; 1006/OC-PR-2; 1006/OC-PR-3	Primary Health Care Reform Program	SA	1997	39.00	39.00	1	0
PR-0094	1016A/OC-PR; 1016B/OC-PR; 1016C/OC-PR	Global Microenterprise Credit II	ME	1997	20.00	20.00	1	0
PR-0082	1109/OC-PR	Support for Small-scale Cotton Producers	AG	1998	25.65	25.65	1	1
PR-0093	1143/OC-PR	Preinvestment Program	PR	1998	5.00	5.00	0	0
PR-0112	1117/OC-PR-1; 1117/OC-PR-2	Emergency and Infrastructure Rehab.	IS	1998	35.00	35.00	0	0
PR-0104	1230/OC-PR-1; 1230/OC-PR-2	National Rural Roads Program II	TR	1999	67.00	67.00	1	1
PR-0084	1255/OC-PR	Diversification of Agricultural Prod.	AG	2000	10.00	10.00	1	0
PR-0113	1278/OC-PR	Western Integration Corridors Program	TR	2000	100.00	100.00	1	0
PR-0115	1253/OC-PR	Fiscal Management Strengthening and Modernization	RM	2000	6.00	6.00	0	0
PR-0116	1300/OC-PR	National Environmental System	PA	2000	8.00	8.00	0	0
PR-0117	1254/OC-PR	Strengthening of Educational Reform	ED	2000	40.00	40.00	0	0
PR-0130	1301/OC-PR	Support for National Pop. Census	RM	2000	9.20	9.20	0	0
PR-0100	1349/OC-PR	Business Development SMEs	IN	2001	10.00	10.00	0	0
PR-0118	1312/OC-PR	Small Community Water Supply and Sanitation	OS	2001	12.00	12.00	1	1
PR-0125	1422/OC-PR	Social Investment Program II	IS	2002	28.40	28.40	1	1
PR-0124	1467/OC-PR	Preschool and Early Education	ED	2003	23.40	23.40	1	1
PR-0132	1448/OC-PR	Cadastral Registry	AG	2003	9.00	9.00	0	0
PR-0147	1520/OC-PR	Social Protection Program	IS	2003	30.00	30.00	0	0
Total					1,225.30	1,198.25	12	5

Legend:

AG	Agriculture
DU	Urban development
ED	Education
EN	Energy
IN	Industry
IS	Infrastructure
ME	Microenterprise
OS	Sanitation
PA	Environmental programs
PR	Preinvestment
RM	Reform
SA	Health
TR	Transportation

Chart A-4.2: Approvals by Year and Programming Cycle: Paraguay, 1991-2002

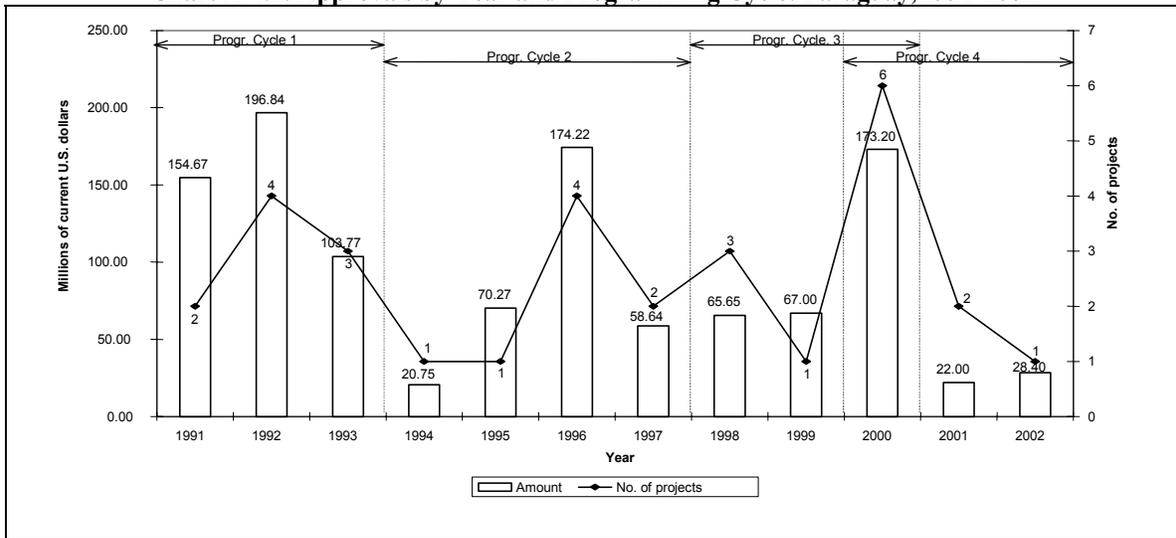


Chart A-4.3: Average and Median Size of Projects Approved by Decade: Paraguay 1961-2000

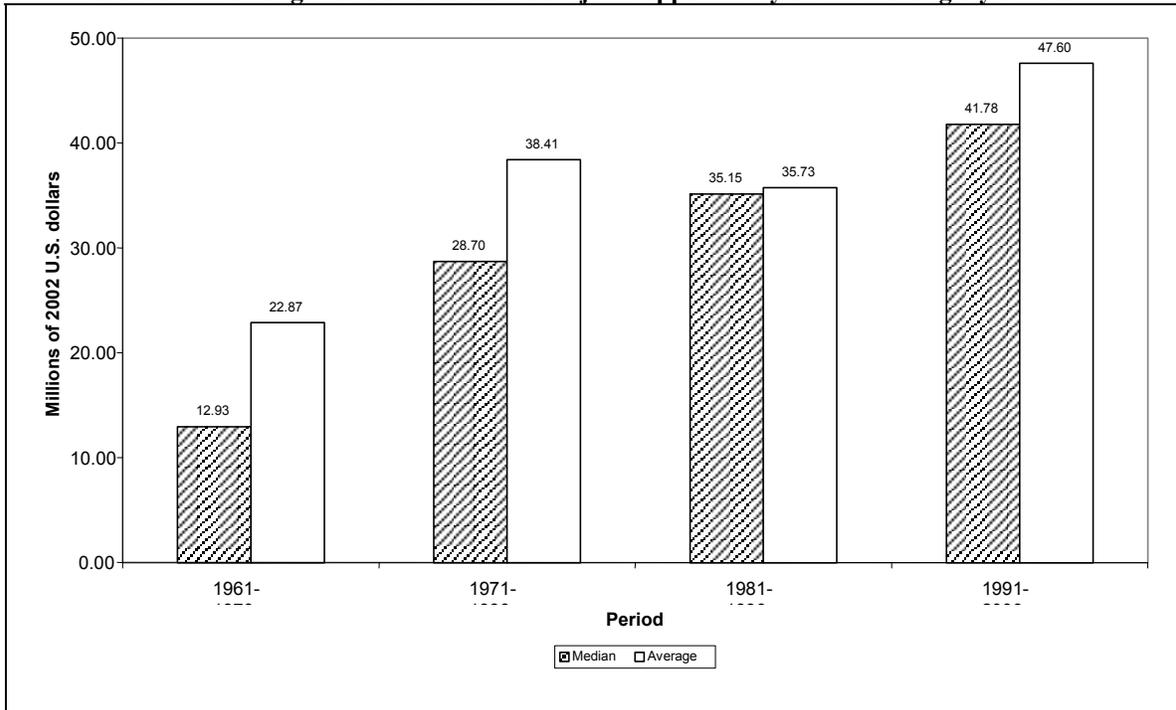


Chart A-4.4: Projects in Portfolio and in Execution: Paraguay, 1991-2002

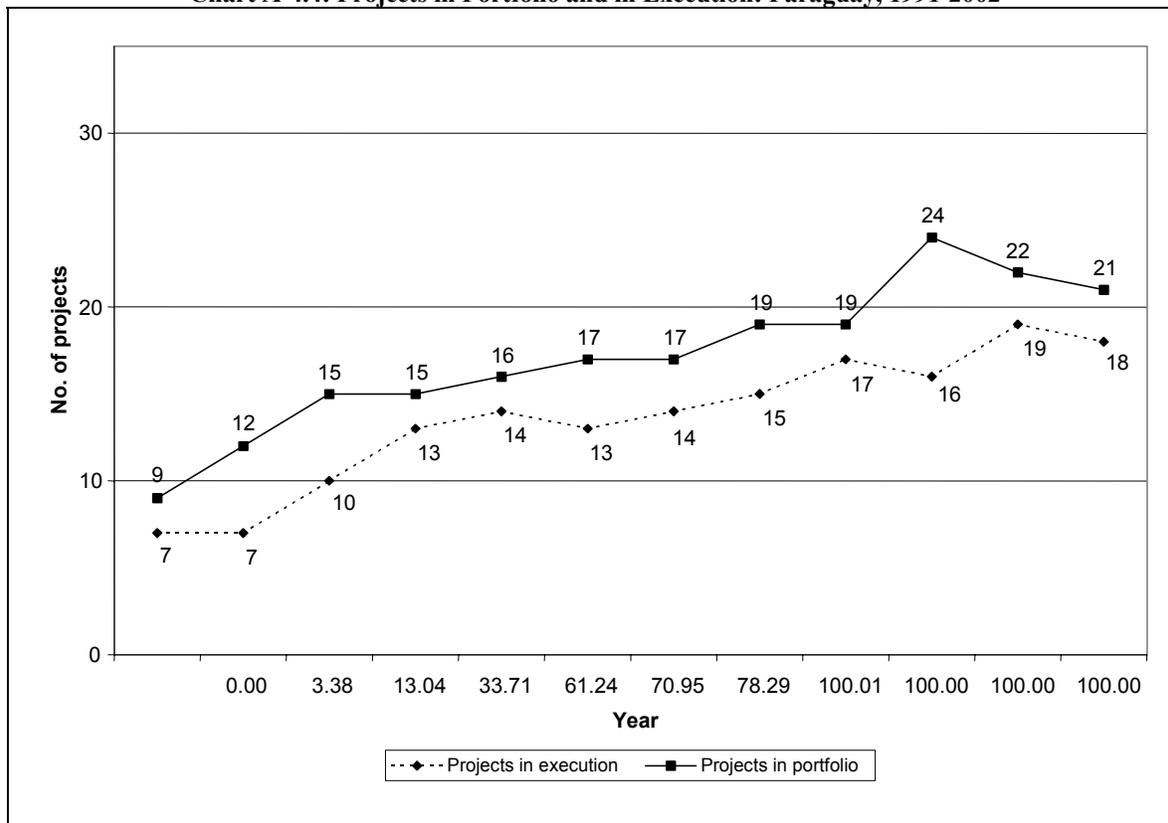


Table A-4.2: Country Office Staffing. Paraguay 1990-2003

Year	Professional		Administrative		Total
	International	Local	Secretaries	Other	
1990	8	4	5	4	21
1992	8	4	5	4	21
1994	8	3	5	4	20
1996	8	2	5	4	19
1997	8	3	5	4	20
1998	8	3	4	4	19
1999	8	4	5	4	21
2000	8	4	6	4	22
2001	8	5	6	4	23
2002	8	5	6	4	23
2003	8	5	6	4	23

Notes: 1990-1998, international staff estimated 1999, two vacant positions for international staff

Source: Country Office in Paraguay

Chart A-4.5: Percentage Change in Disbursements in Relation to Two-Year Period 1991-1992

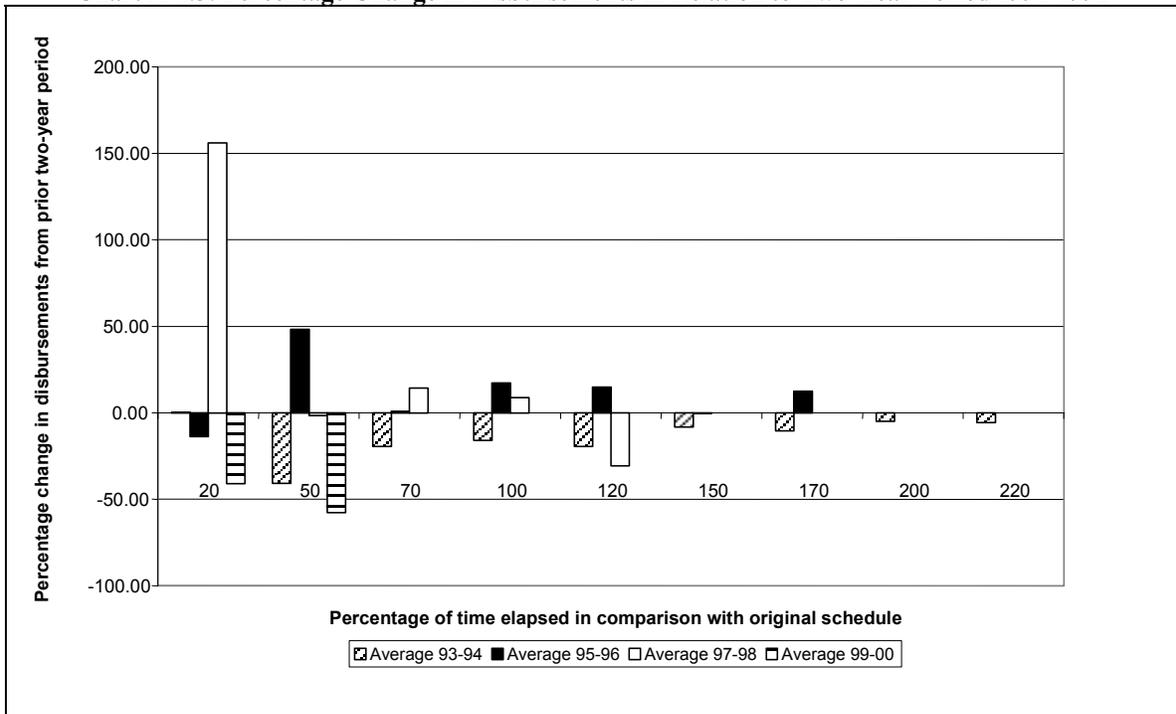


Chart A-4.6: Average Project Preparation Times, 1991-2002

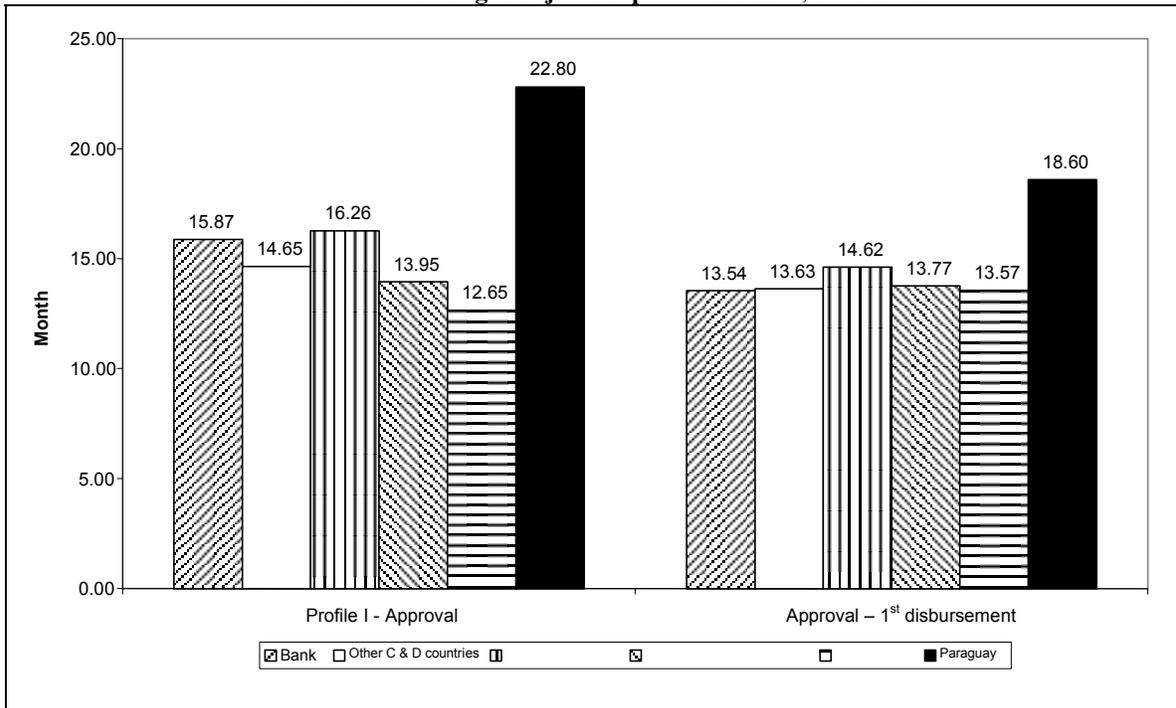
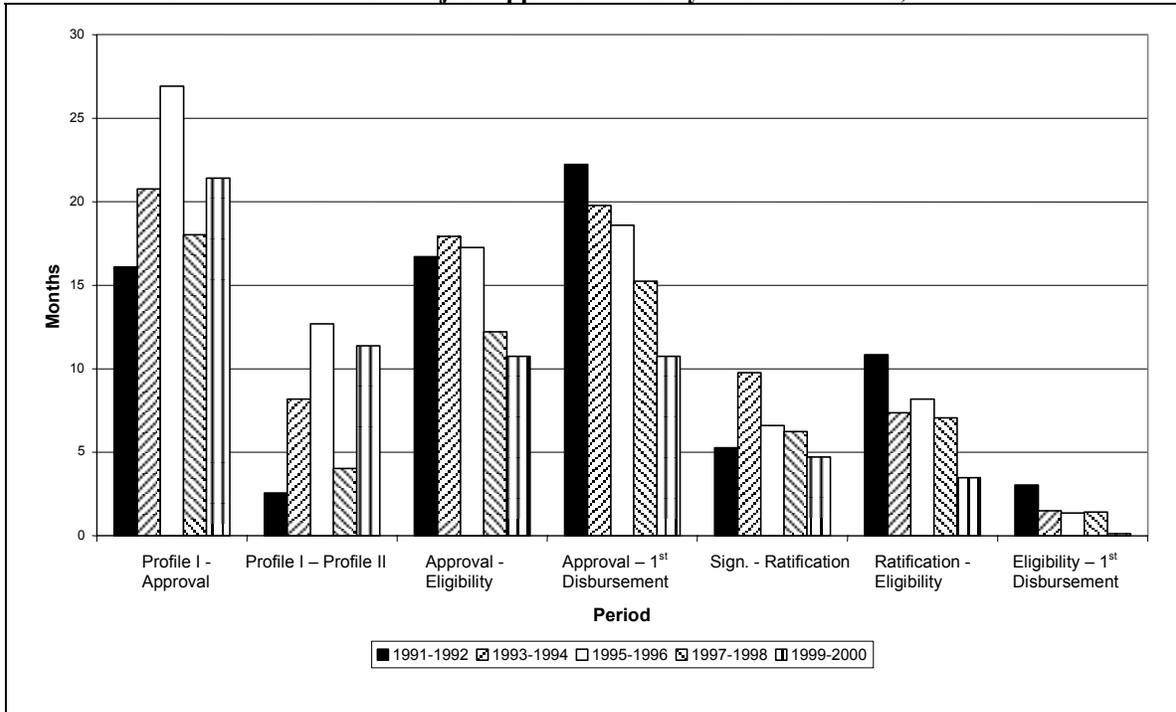


Chart A-4.7: Median Project Approval Times by Two-Year Period, 1991-2002



CHAPTER V

Table A-5.1: Monitoring and Oversight by the Bank (1998-2002)

	1998	1999	2000	2001	2002
Loan administration mission					
Initial mission	0	0	0	1	1
Annual review mission	0	0	0	0	0
Specific mission	3	7	8	5	8
Midterm review mission	1	1	0	0	0
Sectoral portfolio review mission					
Agricultural sector	0	1	0	1	0
Technical inspection visits					
Programmed	0	0	0	85	81
Completed	9	7	7	60	39
Institutional and financial inspection visits					
Programmed	0	0	0	23	23
Completed	1	0	5	15	16
Unprogrammed visits (conducted by Representative)	0	0	0	4	0

Source: Country Office in Paraguay

Table A-5.2: Results of External Financial Oversight (1998-2002)

	1998	1999	2000	2001	2002
Total number of projects	16	17	16	18	17
Evaluation					
Clean	8	11	10	11	14
With reservation or adverse	4*	5**	6***	5*	3*
Abstention from finding	2	0	0	0	0
Waived	2	1	0	2	0
Total amount disbursed ¹	78,5	96,6	118,8	59,2	51,7
Evaluation					
Clean	33,4	42,6	70,6	28,9	46,5
With reservation or adverse	35,8	54,0	48,2	29,6	5,2
Abstention from finding	9,3	0	0	0	0
Waived	0	0	0	0,7	0

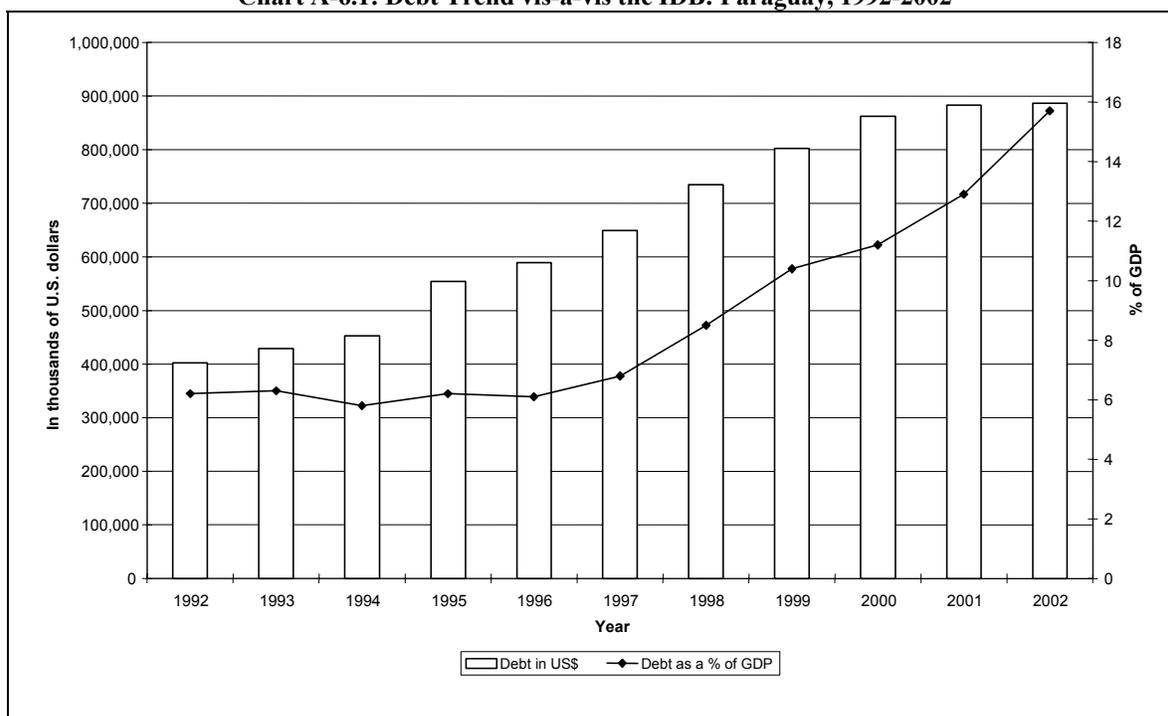
Source: Data from oversight results, Country Office in Paraguay. Disbursement data from Bank system

Notes: ¹ US\$ millions

- * Includes one operation ranked as “clean” as regards the project, but with the audit of the entity classified as “with reservation.”
- ** Includes one operation ranked as “clean” as regards the project, but with the audit of the entity classified as “with reservation” and another ranked as “clean” as regards the project, but with the audit of the entity classified as “adverse.”
- *** Includes two operations ranked as “clean” as regards the project but with the audits of the entities classified as “with reservation,” and another with the project ranked as “clean” but with the audit of the entity classified as “abstention from finding.”

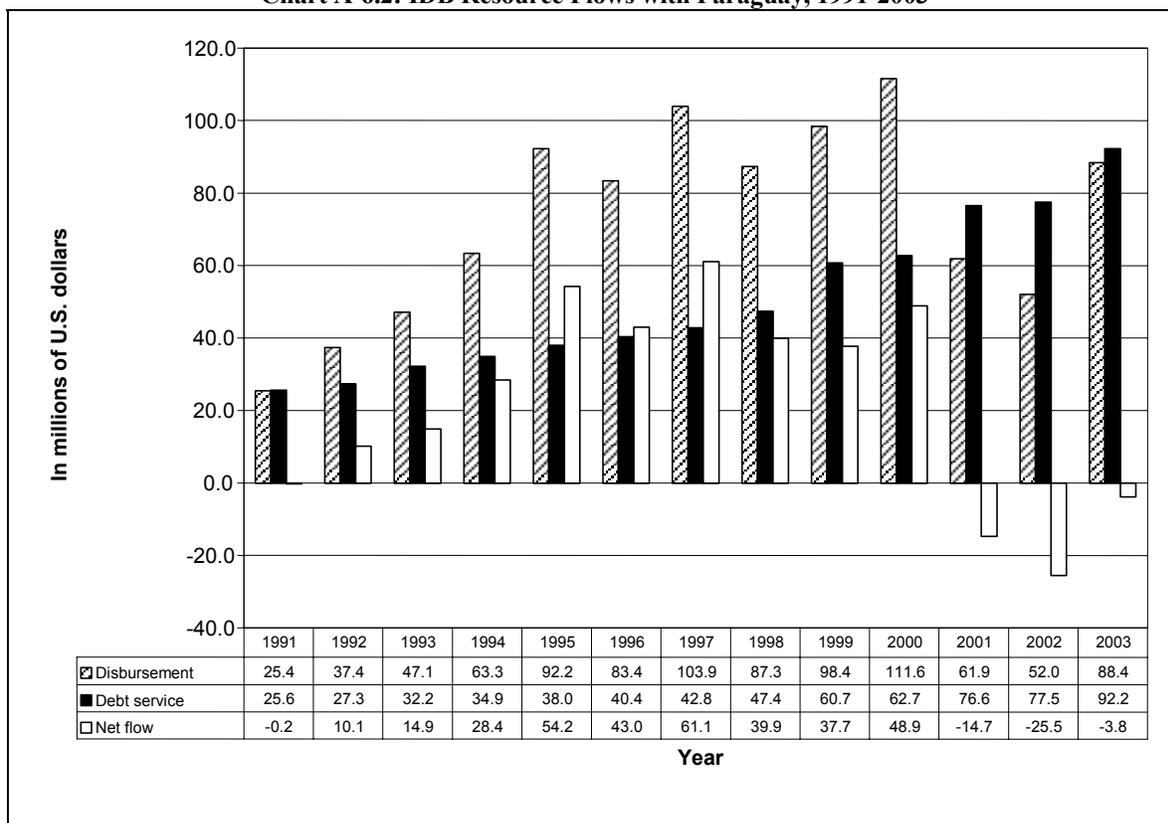
CHAPTER VI

Chart A-6.1: Debt Trend vis-à-vis the IDB: Paraguay, 1992-2002



Source: Central Bank of Paraguay.

Chart A-6.2: IDB Resource Flows with Paraguay, 1991-2003



Source: IDB

Table A-6.2: Projects Relating to Productivity and Integration

Project No.	Name	Year of Approval	Completed
Transportation			
PR-0080	Concepción-Cuero Fresco Highway	1991	Yes
PR-0026	National Rural Roads Program	1993	Yes
PR-0035	Road Corridors	1996	No
PR-0104	National Rural Roads Program II	1999	No
PR-0113	Western Integration Corridors	2000	No
Energy			
PR-0109	Electricity Transmission and Distribution	1991	Yes
PR-0030	Yacyretá Transmission System	1996	No
Agriculture			
PR-0083	Consolidation of Rural Settlements	1992	Yes
PR-0084	Diversification of Agricultural Production	2000	No
Other			
PR-0038	Vocational Training	1996	No
PR-0100	Business Development of SMEs	2001	No

Chart A-6.3: Projection, Millennium Development Goal

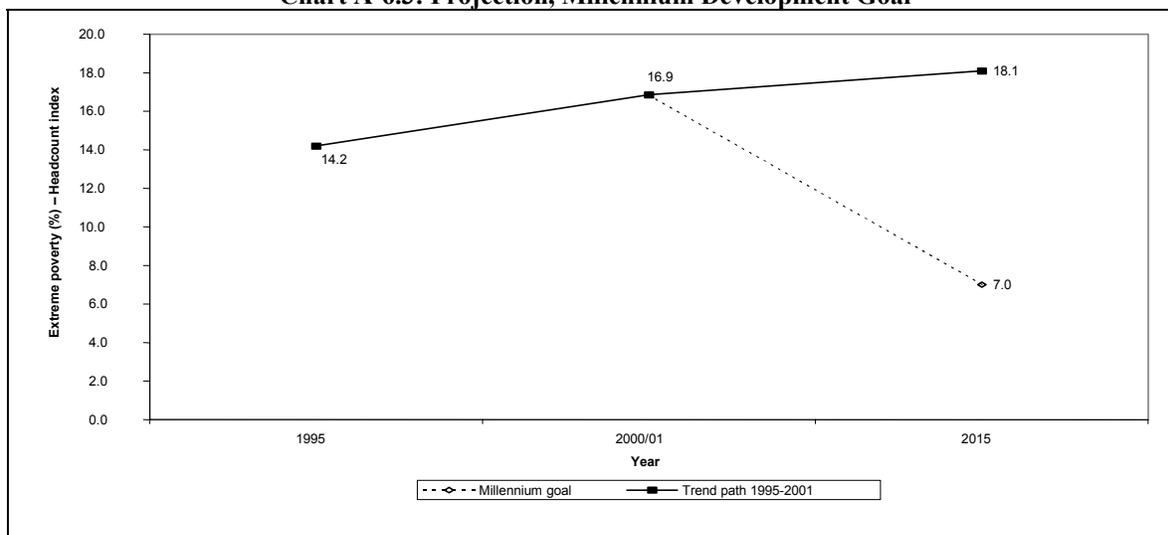


Table A-6.3: Projects Relating to Combating Poverty

Project No.	Name	Year of Approval	Completed
Social			
PR-0031	Housing Sector Support Program	1992	Yes
PR-0025	Improvement of Primary Education	1993	Yes
PR-0064	Urban Water Supply and Sewerage	1995	Yes
PR-0075	Social Investment Program	1996	Yes
PR-0028	Primary Health Care Reform	1997	No
PR-0117	Strengthening Education Reform	2000	No
PR-0118	Small Community Water Supply and Sanitation	2001	No
PR-0125	Social Investment Program II	2002	No
Microenterprise			
PR-0013	Global Microenterprise Credit Program	1992	Yes
PR-0094	Global Microenterprise Credit Program II	1997	No
Agriculture			
PR-0082	Program to Support Small-scale Cotton Production	1998	No
Other			
PR-0112	Emergency Support in Response to El Niño	1998	No

ANNEX II

BOXES

Box A-1: The Financial Crisis

At end-1994, the degree of dollarization of the economy had increased considerably, financial intermediation margins remained high, banks were inadequately capitalized, and arrears in loan payments were not being fully taken into account in savers' decision-making. As the second half of the decade began, the precariousness of the system was clearly evidenced by the increasing number of irregularities and by the fact that the Central Bank of Paraguay (BCP) began to receive requests to serve as lender of last resort, a process which, beginning in 1995, resulted in a series of crises and interventions in the financial system that led to the closure of some of the largest local banks, one of the State-owned banks (Banco Nacional de Trabajadores), and housing savings and loan associations.

During the first crises, the public sought greater security by redirecting its savings toward branches of foreign banks or toward savings and loan cooperatives, which, while it did reduce the market share of domestic banks, helped to maintain the deposit base within the system, and no massive capital flights outside of the national system were recorded. However, the later failure of the largest local banks had a significant impact on the public and a contagion effect on national private banking, resulting in capital flight (not only to branches of foreign banks, but also to outside the system) as well as an increase in the degree to which the financial system was dollarized. Between 1995 and 1998, private-sector deposits in guaraníes declined by 21 percent, from approximately 60 percent to 40 percent of total deposits, while dollar-denominated deposits increased by 59 percent in the same period.

BCP interventions occurred even as changes were being made in the prevailing legislation on banking regulation and supervision.¹ The government further reacted with a series of measures supplementing intervention in insolvent institutions, ranging from providing financial assistance to struggling institutions, both before and after intervention, to the approval of laws that increased the liability of the State as guarantor of deposits—including those not officially recorded²—and granting facilities to renegotiate loans extended by the public banking system to the production-oriented sectors. Consequently, a sizable amount of resources was injected into the system by the monetary authorities, not only through payment of the State's guarantee, but also in the form of assistance granted to problem banks, with a view to preventing the crisis from spreading to other intermediaries. It is estimated that between principal and interest, the government's net credit to safeguard the financial system amounted to almost 5 percent of GDP.³

It bears noting that, in contrast to the experiences in a number of other countries in the region where financial crises broke out owing to the contagion effect of crises in third countries and were accompanied by a vicious circle of massive withdrawals of deposits, the loss of international reserves, the flight of foreign capital, etc., the crises in the Paraguayan financial sector arose fundamentally because of the appearance of problems inherent in its internal functioning.

Notes:

¹ The New Organic Charter of the BCP was approved in 1995, and the General Law on Banks, Financial Companies, and Other Credit Institutions was passed in 1996.

² Many of the liabilities were not duly recorded; a great many of the assets recorded were overvalued; and a substantial proportion of the loans had been extended to enterprises or individuals connected with the same shareholder group as that of the financial institutions, which even further aggravated their net worth position.

³ Nearly ten years after the end of the first financial crisis the proceedings have not yet been settled, and consequently there is no certainty as to the total cost to the National Treasury of that crisis. This is because Article 101 of Law 861/96 stipulates that, in the event that a financial institution is liquidated and the liquidation process fails to generate sufficient resources, the National Treasury will provide the funds necessary to guarantee the deposits.

Box A-2: The Taxation Context

Paraguay's tax ratio (somewhat below 10 percent of GDP) is significantly lower than the ratios observed in its partner countries in MERCOSUR: Argentina (18 percent), Uruguay (20 percent), and Brazil (33 percent). A high proportion of tax revenue is derived from indirect taxes, particularly the value-added tax (VAT), collection of which is heavily dependent on levying the tax on imported goods. It bears noting that Paraguay has no individual income tax.¹

In general, tax collections were on the rise in the first half of the 1990s, explained largely by the application of the new tax regime approved in late 1991,² as well as by the boom in triangulation trade. However, starting in 1994, when the tax law was to have been applied in its entirety, laws began to be passed that granted sectoral benefits, incentives, and/or privileges, thereby eroding the base for the most important taxes.³ Furthermore, the border restrictions imposed starting in 1995 reduced the flow of trade triangulation, making it necessary to identify new, alternative revenue sources. Consequently, toward the end of the 1990s, in response to the gradual deterioration in the country's economic situation, increased collection of selective consumption taxes, especially those applied to fuels, was initiated.

Notes:

- 1 Recently, the government submitted to the National Congress a draft reform of the Tax Regime, proposing the creation of this tax.
- 2 Law 125/91 reduced the number of taxes from 150 to 9, simplified the administrative system, and incorporated the VAT. As a result, VAT collections, associated in large measure with international trade, have become the largest single source of tax revenue (43 percent), followed by specific consumption taxes (on fuels, alcoholic beverages, and cigarettes (21 percent), with business income taxes in third place. Tax revenues accounted for approximately 65 percent of the central government's current revenue between 1991 and 2002.
- 3 Almost 50 laws granting tax advantages or incentives were introduced.

Box A-3: The 1991-1993 Programming Cycle

The 1991-1993 programming cycle¹ was the first to occur after the ouster of General Stroessner after 35 years in power. However, the country strategy makes no more than a general mention of this important political development and its impact on the country and on Bank activity.²

The government of General Rodríguez, who assumed power in 1989, began a political and economic liberalization process. In political terms, the administration committed itself to restoring democracy through the establishment of a new Constitution and free elections in 1993. In economic terms, it proposed changes to the country's fiscal and taxation structures, as well as to the financial and exchange systems. In keeping with this context, the country strategy defines three priorities for Bank activities during the 1991-1993 period:³ (1) support for actions to restructure the public sector and financial sector: programs to strengthen tax administration and the tax structure, budget programming and control, economic policy formulation and coordination, and the national financial system, as well as to support the privatization and restructuring of State-owned enterprises; (2) support for increased production: expanding and enhancing the efficiency of the transportation and electricity systems, and increasing the availability of credit for productive investments; and (3) social development: support for the national housing program and the strengthening of public institutions in the areas of education, health, and sanitation. It is noteworthy that the country strategy does not alter the approach, in terms of the projects to be carried out, from what had been designed in earlier years. The proposed projects are basically the same as those identified by the programming mission that visited Paraguay in November 1989.

It is difficult to understand the origin the projections of investment loan resources to be approved during the cycle, as they are not consistent with the amounts indicated in the documentation from programming missions that occurred either before or after the strategy, and are also significantly higher (US\$722 million over the three years) than the total external financing requirements estimated by the Bank itself, namely US\$144 million a year, a figure cited in the country strategy itself.⁴

Approximately one year after the country strategy was approved, in May 1992, the Bank conducted a country program review mission which divided the country strategy into short-term actions (through the first half of 1993) and medium-term actions (for the second half of 1993 and 1994) in light of the *political situation entailing the drafting of a new Constitution and preparation of presidential elections, and the economic climate of transforming and modernizing the economy* (Aide-Mémoire of the 1992-1994 country program review mission, in the mission report (CP-352)). Basically, the mission assigned the majority of the programs proposed by the country strategy to the short-term horizon, with the medium-term strategy including the strengthening of the education, health, and sanitation sectors, as well as municipal development and the organization of a national environmental protection system. Even so, the Bank continued to overestimate the possibilities for loan approvals for Paraguay: the mission projected approvals in 1993 that ranged from US\$166 million to US\$321 million. Lastly, for the long term, the mission recommended that programs and projects be developed with a view to increasing the international competitiveness of the Paraguayan economy.

Notes:

- 1 The 1991 country strategy paper (CP-178) dated 25 April 1991, for consideration by the Programming Committee on 8 May.
- 2 The only mention in this programming cycle of the implications of the democratic opening refers to the fact that the government assigns high priority to the settlement programs for landless rural populations, in order to respond to the social tensions that surfaced with the political opening.
- 3 The 1991 country strategy draws heavily on an exhaustive Socioeconomic Report prepared in 1988 (GN-1646).
- 4 See paragraphs 3.03 and 1.04 of the country strategy.

Box A-4: The 1994-1997 Programming Cycle

The second programming cycle¹ began in a Paraguay that was very different, and virtually unimaginable just five years earlier. The country had a new Constitution (promulgated in 1992), the first civilian government (elected in 1993) in almost 40 years, and a Congress controlled by the opposition. Once again, however, the political climate was not a consideration in the Bank's programming. The 1994 country strategy makes no mention of these changes.

As noted in the preceding box, Paraguay had been endeavoring since 1989 to implement changes in its economy aimed at promoting market mechanisms. The government of President Wasmosy, who took office in 1993, proposed not only to continue in the same direction, but also to strengthen the reform process through a strong economic liberalization program, including the privatization of various State-owned enterprises and the (re)definition of the role of the State. The strategic areas defined by the 1994 country strategy thus basically continue the same approach laid out by the previous strategy: (a) development of the social sectors; (b) modernization of the productive sectors; and (c) institutional strengthening and modernization of the State. The 1994 country strategy continued to stress the need for major adjustments in macroeconomic areas (in particular through the Investment Sector Program approved in 1992) and for reform of the State in order to achieve sustainable development, but emphasized the importance of social actions: *Paraguay is faced by the urgent need to speed up social development. The scant progress made up until 1993 stems principally from the budgetary restrictions which grew principally out of the inflexibility associated with enormous current expenditures, the expenditure programming process, the widespread institutional weakness of the public sector, and the lack of participation by municipalities and departments other than those of the three largest cities* (CP-608, Rev., para. 1.9). However, since the country strategy did not prioritize the actions proposed, it was not possible to *affirm* that it emphasized the social sectors over the two other strategic areas defined by the document. However, the 1994 country strategy did ascribe greater importance to social issues than the 1991 country strategy did, possibly already reflecting the guidelines of the Eighth Replenishment approved the same year.

Once again the Bank significantly overestimated the volume of resources to be approved for Paraguay. The amounts effectively approved (almost US\$334 million) are in many cases well below those estimated by the country strategy (US\$615 million).

Perhaps the most distinctive aspect of the country strategy is the inherent contradiction between its analysis and the actions proposed. The document emphasized the difficulties encountered with project execution as a result of the *combined effect of the institutional weakness of various executing agencies, the lack of timely availability of local counterpart resources, and the delays in reaching fundamental technical and operational decisions relating to the projects* (CP-608 Rev., para. 3.11), concluding that the Bank would have to *ensure that future loan programs and those in the current portfolio do not outstrip the country's institutional capacity* (para. 3.12). However, notwithstanding these problems and this recommendation to exercise caution, the paper ultimately puts forward as sectoral priorities (paragraphs 4.10 to 4.40) a list of actions which effectively includes a great diversity of topics and sectors. This dispersion in respect of areas is clear in the proposed pipeline, which included projects in education, agriculture, sanitation, social investment, energy, transportation, health, the environment, and modernization and reform of the State.

Notes:

¹ The final version of the 1994 country strategy (CP- 608 Rev.) is dated 11 March 1994.

Box A-5: The 1998-2000 Programming Cycle

The country strategy for the 1998-2000 programming cycle¹ differs significantly from the previous ones. In a fundamental sense, it embodies a more exhaustive analysis than did the previous ones.² The chapter on the socioeconomic context provides a detailed diagnosis of the country and its economy, and it is the first country strategy to incorporate analysis of the political and institutional changes that had taken place in the country since early in the decade. From the standpoint of the economy, it is clear from reading the country strategy that the adjustments made during the decade, while they had had beneficial effects in the short term, fell short of promoting the structural changes needed to restore fiscal and financial stability and higher and sustainable economic growth rates to Paraguay. Thus the country strategy was prepared in an eminently unfavorable context, with the Paraguayan economy experiencing negative or marginally positive per capita growth rates, a rapid drop in the fiscal surplus of the public sector, and the financial sector experiencing the most severe crisis in all its history.

In this sense it is hardly a surprise that the country strategy defines the key objective as "*achieving rapid and sustainable growth by developing production structures under a competitive approach, in order to promote social development and poverty reduction*" (GN-1990-1, para. 3.17). Even though this objective reverses the emphasis placed on the social sectors by the 1994 country strategy—and quite apart from the question of whether or not the growth process per se would result in social development and poverty reduction—this general objective implies that the Bank's activities should be focused on activities aimed at economic growth. However, the specific objectives set forth in the country strategy do not go in that direction, and instead constitute a list of principles which, except in the case of the first, are broad rather than specific, and generally are not *directly* related to promoting economic growth: "*(i) help improve the workings of the financial system and support capital market development; (ii) make the State more efficient in delivering public services and strengthen governance; (iii) foster economic efficiency; (iv) promote social sector development; and (v) reduce poverty and raise living standards, particularly for the disadvantaged*" (GN-1990-1, para. 3.18). In other words, the country strategy did not define proposed actions focused on the major obstacles to economic growth, despite the major advances relating to the Bank's operational strategy as described below.

The country strategy specifically addresses the relationship between the development challenges facing the country, the objectives and actions under the country strategy, the results expected from such activities, and the instruments necessary for achieving those objectives, thus seeking to ensure the logical cohesiveness of the programming. These relationships are noted throughout the document and summarized in a detailed correspondence and action matrix (Annex III-2 of the country strategy). Also worthy of note is the inclusion of a "social agenda matrix" in the 1998 country strategy (Annex III-1). This matrix lists the major social problems identified by the strategy and how they relate to the policies and programs in force, and makes proposals to broaden government action, complete with the fiscal and intersectoral implications of these proposals. It is hence a very innovative initiative that could be of great value, not only for Bank activities, but also for the authorities as they define their social policy. In this sense, and even though the matrixes do not include indicators or baselines to measure and assess fulfillment of the objectives, it is reasonable to state that the 1998 country strategy as a whole represents a unique effort heretofore not seen by OVE in its other evaluations of country strategies.

The fact that a number of the operations identified by the country strategy were not approved meant that the Bank significantly overestimated the volume of resources to be allocated to the country during the programming cycle. Moreover, given the difficult economic and financial circumstances in the country, it would appear difficult to argue in favor of average annual borrowing of US\$180 million to US\$280 million, which would have contributed to an increase in Paraguay's multilateral debt of at least 55 percent in scarcely three years, as shown by the projections in the country strategy itself (Table 2 in Annex III-5 of the country strategy).

Notes:

- 1 The initial version of the country strategy (GN-1990) is dated 29 August 1997, but its final version (GN-1990-1) was not approved until 21 April 1998, and incorporated the comments made by the Programming Committee of the Board of Executive Directors at its meeting of 6 November 1997 (PGA/97/24).

2 The body of the text is 64 pages long, and the three annexes account for an additional 32 pages. It should be noted that the country strategy was not accompanied, as were those of the two prior cycles, by separate socioeconomic reports. It would appear that the country strategy endeavors to offset this by providing a more detailed analysis in the body of the document itself.

Box A-6: The 2000-2003 Programming Cycle

The last of the programming cycles evaluated in this paper relates to a country facing a serious political crisis resulting from the assassination of Vice President Luis Maria Argaña and the resignation of President Cubas in March 1999. In economic terms, the country was also in an extremely difficult position: per capita incomes had been decreasing since 1996, and in 1999 were lower in real terms than in 1980; fiscal performance deteriorated, the prices for soya—Paraguay’s principal export—had dropped, the crises in Argentina and Brazil were reducing Paraguayan exports, while the increased cost of debt service was putting pressure on the country’s payment capacity. Paradoxically, it was in this context that the Bank proposed the most ambitious work plan in its history with the country: 26 projects in just three years (2000-2002). It could be assumed that the abrupt change in government between the Cubas administration and that of González Macchi, in a highly conflict-laden context, would trigger negative reactions toward everything that had been done (or attempted) under the previous administration; as a consequence, it would come as no surprise that some of the projects included in earlier programming might have slipped in their priority ranking or been canceled in the new one. However, what in fact occurred was that the portfolio originally programmed in the 1998 country strategy essentially was retained, with new projects added in the 2000 country strategy.

The projects are divided among the four strategic areas defined by the country strategy for Bank activities during the period: “(i) *competitiveness, to ensure effective participation by Paraguay in the regional integration process; (ii) modernization of the State, with the objectives of strengthening governance, reinforcing the role of the State as regulator and promoter of development, building institutional capacity, and improving efficiency in the delivery of basic services; (iii) rural development, taking an integrated multi-sector approach for sustainable development and poverty reduction; and (iv) social sector reform to contribute to human capital development*” (GN-2118-1, para. 2.15). Despite the general nature of the four areas, there is a degree of consistency among the projects proposed for each of them, in particular as regards the development of the rural sector and modernization of the State. However, notwithstanding the observation that “*economic growth in the 1990s has been discouraging*” (GN-2118-1, paragraph 1.7), the country strategy neither highlights the growth problem, as the prior country strategy did, nor prioritizes among the strategic areas.

The country strategy describes and justifies the Bank’s activities in the four strategic areas comprehensively, relating the proposed projects to operations being executed and to technical-cooperation operations (existing or projected). As in the previous country strategy, the 2000 strategy summarizes these elements in a matrix (see Annex II of the strategy) that relates the objectives of the programming cycle, the strategic areas, the portfolio being executed, the (financial and nonfinancial) operating program, the actions of the government and of other donors, and, finally, the anticipated outcomes. Although the country strategy does not contain indicators or baselines, it bears noting that the strategy does explicitly propose evaluation of the following: “*Follow-up and monitoring of strategy implementation and evaluation of progress or difficulties in attaining the objectives defined by the Bank will be performed through an evaluation of the expected results established in the matrix of actions*” (GN-2118-1, para. 2.102).

In turn, the programming mission of July 2000 reached agreement with Paraguay on a volume of loan approvals of approximately US\$740 million and 26 projects (including six in the pipeline) over just three years (2000-2002), figures that are considerably higher than those in previous years (programming mission report (CP-1706-2, para. 2.12)). This contrasts with the cautious tone of the country strategy, which posited two possible approval scenarios (a basic scenario and a high scenario), and stressed that approval of the high scenario (identical to the program agreed with the programming mission) would require: “*economic modernization and reform of the State, which would translate into a considerable acceleration in introducing structural reforms, a substantial improvement in the country’s institutional capacity and aggressive participation by the private sector which, in turn, would lead to high economic growth rates. (...) Apart from the stronger external and fiscal positions that would result from the reforms, this scenario assumes considerable streamlining of portfolio execution*” (GN-2118-1, Executive Summary). In this sense, the country strategy adopted a more well-organized stance and projected approvals for the period that were between the basic and high scenarios, namely, annual approvals of US\$86 million to US\$161 million during the 2000-2003 period (see GN-2118-1, paragraph 2.94). It is interesting to note that these differences between the programming mission and the country strategy remained despite the fact that

the former had occurred before the latter was approved.

In this regard, the programming mission appears to have had an overly optimistic view of the resolution of the political situation and underestimated the weakness of the governing coalition—two factors that formed the backdrop for the economic difficulties of the period—given that the programmed amount corresponded to a much more favorable context than the one observed. In so doing, there was no mention of the fact that Paraguay's debt had recently increased by almost US\$500 million. Finally, the amount approved during the period was scarcely US\$256 million, slightly over a third of the projected total. This position by the Bank could reflect the institution's desire to support Paraguay at a time when international donors were significantly scaling back their activities in the country. However, neither the country strategy nor the programming mission make reference to this context.

As regards these approvals, there is a concentration in terms of dollar amounts in two sectors: transportation (one project, PR-0113, Western Integration Corridors, in the amount of US\$100 million) and education (two projects, PR-0117, Consolidation of Basic Education Reform, in the amount of US\$40 million, and PR-0124, Preschool Education, in the amount of US\$23.4 million), which received almost two-thirds (64 percent) of the resources. However, the remaining third was ultimately spread among eight projects in six different sectors.

Notes:

1 The final version of the 2000 country strategy (GN-2118-1) was approved on 30 October 2000.

Box A-7: External Debt

Total external debt

Paraguay's external debt increased from approximately US\$1.249 billion in 1992 to US\$2.283 billion in 2002.

This level of external indebtedness has generated a sizable fiscal burden for debt service, as evidenced by the growing lags in making debt service payments. In June 2003 these arrears amounted to almost US\$40 million, even without considering that the government had failed to honor the early redemption clauses stipulated in some of the National Treasury Bill issues marketed domestically. These factors, plus the projections that the debt service on the external debt contracted to date was expected to increase by approximately 14 percent between 2003 and 2005 and more than 18 percent in 2007, implied strong fiscal pressures that would be difficult to sustain in the absence of fiscal reform that would make it possible to increase revenue or decrease fiscal expenditure.

While annual external debt service is a crucial component of the analysis of fiscal projections, it is important to mention that the structure of borrowing is characterized by being long-term and at relatively low interest rates, given the sizable proportion of the total accounted for by multilateral and bilateral organizations.

It should also be noted that the country's external borrowing increased significantly in 1999 owing to an unrestricted loan of US\$400 million granted by the Republic of China in Taiwan.¹

Debt to the IDB

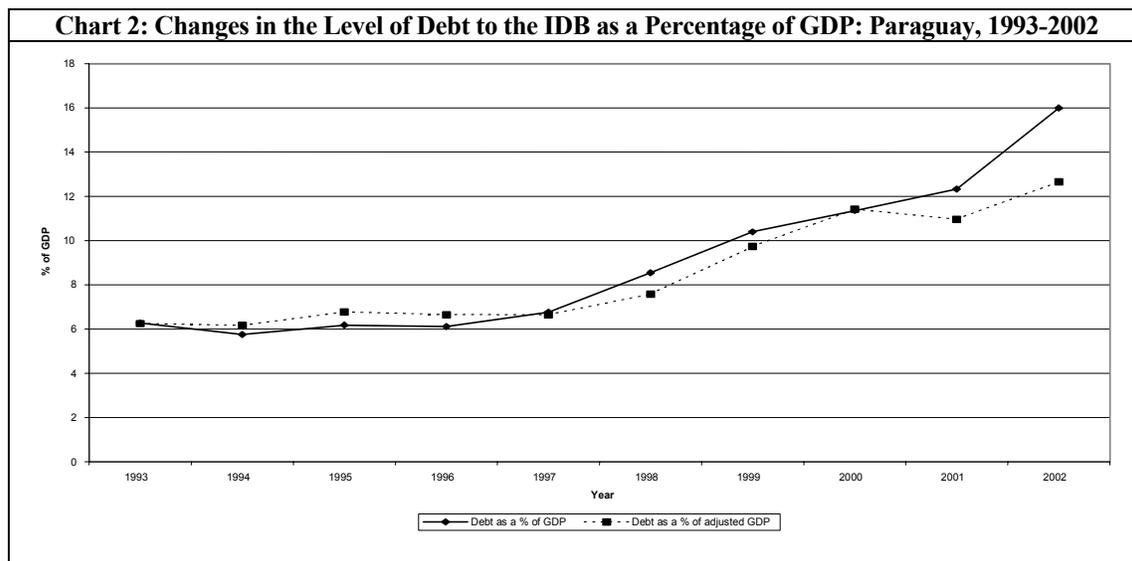
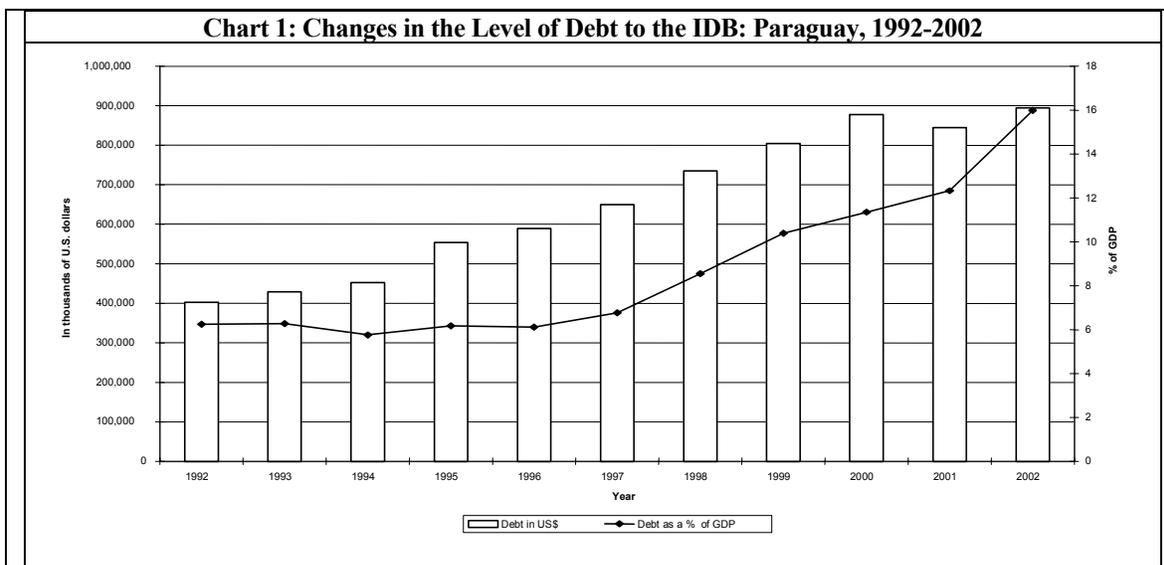
Debt to the IDB increased from approximately US\$403 million in 1992 to US\$894 million in 2002 (see Chart 1 below). Along these lines, the Bank's share of Paraguay's external debt increased in the early 1990s to reach a maximum of 46 percent in 1998, declined in the following year to 38 percent, and remained in the vicinity of 39 percent for the remainder of the period under review. In terms of relative importance among all creditors, the IDB is followed by the Republic of China in Taiwan (24 percent in 2002), Japan (15 percent in 2002), and the World Bank (11 percent in 2002).

Chart 1 also shows an increase by a factor of 2.5 in Paraguay's debt to the IDB as measured as a proportion of GDP in dollar terms between 1993 and 2002 (from 6.25 percent of GDP to 16 percent of GDP). However, part of this increase is explained by the depreciation in the real exchange rate after 1998, as a consequence of which, in those years, GDP expressed in dollars declined more than proportionately than the rate of growth of the external debt.² If this exchange rate effect is removed, the country's debt to the IDB measured as a percentage of GDP grew by a factor of about 2 between 1993 and 2002 (see Chart 2).^{3,4} Considering that the effect of the exchange rate depreciation was proportional for all creditors, the increase of 22 percentage points in the external debt measured as a percentage of GDP between 1992 and 2002 (from 19 percent to 41 percent) is explained principally by the 10 percentage point increase in the debt to the IDB (from 6 percent of GDP to 16 percent of GDP) and by the other 10 percentage point increase in the debt to official bilateral creditors taken together (from 9 percent of GDP to 19 percent of GDP, here including the bonds for the Taiwan loan).

It should also be borne in mind that while Paraguay's debt to the IDB increased in dollars by a factor of 2.2 between 1992 and 2002, the debt to other multilateral organizations increased by a factor of 1.4 and the debt to official bilateral agencies by a factor of 1.8 in the same period (note that this group includes the T-bills on the Taiwan loan, an unusual operation that is unlikely to be replicable).

Finally, it should be noted that the cost of debt service to the IDB (which increased by a factor of about 2.8 between 1992 and 2002) doubled as a proportion of Paraguay's exports in the same period.

Both because of the decline in the value of the local currency vis-à-vis the U.S. dollar, and because of the increase in the debt in absolute terms, the external indebtedness level observed in Paraguay poses the challenge of achieving a greater productive and fiscal effort.



Notes:

- 1 US\$400 million in National Treasury Bills were purchased by Taiwanese banks (at present, the entire issue is held by the China Trust Bank).
- 2 Obviously, the ratio of debt to GDP is also affected (positively or negatively) by the performance of the economy. Real growth rates were negative in 1998 (-0.4 percent), 2000 (-0.4 percent), and 2002 (-2.3 percent).
- 3 The trend in the ratio of inflation to depreciation of the exchange rate was detected by economic agents as early as the second half of the 1990s. Hence the economy gradually dollarized in those years, reversing the trend of saving in guaraníes and borrowing in dollars (characteristic of the first half of the 1990s) to one of saving in dollars and borrowing in guaraníes (second half of the 1990s).
- 4 In Chart 2, the adjusted curve removes the effects of overvaluation and over-devaluation of the currency.

Box A-8: Investment Sector Program

The Investment Sector Program (ISP) could be termed an “emblematic” operation both for the Bank and for Paraguay during the 1990s, owing to a series of special circumstances surrounding it. First, from the standpoint of the operation’s design, it was an extremely ambitious project of great relevance to the country, with anticipated effects in numerous strategic areas.¹

Second, from an execution standpoint, there were sizable delays owing to failure to fulfill the conditionalities established for each tranche of the project in the agreed time frame. As in any sector operation, the loan was to be fast-disbursing (24 months) and was divided into three tranches.² However, the execution period for this loan was much lengthier: 90 months elapsed from the time the loan was approved until the last disbursement was made, considerably exceeding the time stipulated as well as the Bank’s average disbursement time for this kind of operation (41 months). In fact, the period between approval and last disbursement for this operation is the longest of all operations of this type (sector and emergency loans) approved by the Bank during the past decade. Moreover, the inefficiency in terms of disbursement times associated with this project called its very viability into question, inasmuch as a policy-based loan (PBL) project is designed to respond to shocks by providing immediate funds in order to inject liquidity into a country in exchange for the approval of reforms that help put it on the path of sustained growth.

Third, from the standpoint of the outcomes, the advances made in terms of financial sector reform—one of the pillars of the ISP—were not only accomplished with great delays, but were insufficient. This can be verified in two ways: on the one hand, by taking into account that various key points of the reform (adequate oversight and control, creation of a deposit guarantee fund, reform and modernization of public banking, etc.) were not accomplished, and that the flaws in the system that economic agents flagged at the time owing to the absence of these measures were largely responsible for the crises affecting the sector beginning in 1995.³ On the other hand, the lack of efficacy of the ISP in terms of achieving its development objectives is reflected in the fact that several of the objectives of the reform proposed under this operation in the early 1990s are still today pending areas of reform in the sector. Note for example the observation contained in the recent Stand-by Arrangement that Paraguay entered into with the International Monetary Fund (15 December 2003): “*The authorities will also take important steps to improve the financial system. These measures include restructuring the public banks, strengthening the bank resolution framework, strengthening regulation and supervision of financial entities, including cooperatives, and requiring independent credit ratings of banks.*”

From a broader perspective, perhaps the most important point of the ISP case was that the lack of timely execution, and in some cases the failure to achieve the desired results, had much more to do with the disproportionate scope of the conditionalities required than with execution problems associated with internal or exogenous shocks. Based on an analysis of the political and socioeconomic context of the country at the start of the decade, and on interviews with various officials in Asunción, OVE favors the interpretation that this operation was conceived from its very outset with serious design flaws. While the diagnosis of the problems and the needs for reform in various strategic sectors were in the majority of cases quite accurate, the reform requirements erred by being excessively ambitious, relying too heavily on the reform intentions of the government of that period and not taking sufficiently into account the structural restrictions that prevailed: a country in the throes of a transition toward democracy, after a legacy of decades of military dictatorship, and with a very weak institutional base. In other words, the operation design was not compatible with the realities in the country, or with its actual possibilities for introducing substantial changes in an effective manner.

Notes:

- 1 The ISP was also the only sector loan (or PBL) in the entire portfolio of operations approved by the Bank for Paraguay.
- 2 The technical-cooperation loan had a longer planned horizon for disbursements, namely four years.
- 3 The project completion report (PCR) observes, as regards the reform of the financial sector, that *while progress was effectively made with the establishment of a new legal framework applicable to the financial sector by introducing a new Organic Charter of the BCP and a new Banking Law, together with the completion of a plan of action for an initial strengthening of the Superintendency of Banks, among others, there is still a need to take action in some aspects of the reform that were diagnosed and*

even initiated during the program, as in the case of the reform of public banks and the creation of a private guarantee fund (PCR, Part I, p. 8, second paragraph).

Box A-9: Fulfillment of the Outcomes Anticipated by the 2000 Country Strategy	
This box provides the Bank's evaluation of fulfillment of the goals set forth in the 2000 country strategy.	
Intervention and Objective	Targets for Achieving Anticipated Outcomes
Diversification of productive and exportable base	Economic growth rate exceeds population growth rate: Not achieved . Strategy for regional integration defined and being implemented: Partially achieved . Advances in diversification of the productive and exportable base: Partially achieved . Advances in the exportable base: PROPARAGUAY (TC-0007053) was not approved.
Environmental protection and natural resource management	National environmental management system established and in operation: Partially achieved . It is necessary to complete the strengthening of the National Environmental Council (CONAM) and the Environment Secretariat (SEAM), which are key institutions in the National Environmental System. Industrial pollution monitoring system installed: Not achieved . Reduction in rate of deforestation: No measurement data. The Environment Secretariat is purchasing satellite maps that will enable it to evaluate deforestation rates.
Support for micro, small, and medium-sized enterprises	Policy on supporting SME development introduced: Partially achieved . Among the objectives there is a need to involve the principal cooperatives in the financial system and IFIs. This aspect has yet to be achieved, and is being incorporated within the Bank's overall strategy on reform of public banking. The substantial progress made with regard to microfinance bears noting.
Develop regulatory framework for private investment	Advances with third-party management or privatization of public enterprises: Not achieved . The third-party management and privatization process has been paralyzed.
Development of physical infrastructure	National Transportation Plan introduced: Partially achieved . Process of introducing the measures contained in the Plan is ongoing. Expansion of coverage of electricity service in the rural sector: Achieved . National coverage reached 85 percent in December 2002.
Modernization of labor market	Reforms of labor legislation (Labor Code and pension system) introduced: Not achieved . It was not possible to move forward clearly and concretely with either aspect.
Development of science and technology	Strategy for the technological development of the productive sector introduced: Partially achieved . In 1997 Paraguay approved the General Law on Science and Technology (1028/97) which establishes the National Science and Technology System and creates the National Council on Science and Technology (CONACYT) responsible for coordinating and managing the System. Loan 1349/OC-PR (PR-0100), Business Development Program for SMEs, has been in effect since 5 March 2003.

Intervention and Objective	Targets for Achieving Anticipated Outcomes
Strengthening of financial sector	Private financial sector totally restructured: Partially achieved , fundamentally in aspects relating to the private financial system with the promulgation and entry into force of Law No. 489/95—the Organic Charter of the BCP—and Law No. 861/96 on the private financial system. There is a proposal to update the restructuring of the financial system as a whole (pending objectives as regards the private financial system and overall objectives as regards the public financial system) through a global sector strategy involving the World Bank, the IMF, and the IDB. Public banking reform introduced: Not achieved .
Support for executive branch	Sustainable increase in tax burden and reduction of tax evasion: Partially achieved . Beginning in August 2003 there have been sizable and sustained increases in the tax burden, on the order of 35 percent a month on average. Consequently, tax evasion is being reduced in the same proportion. Gradual progress in the administrative decentralization process: Partially achieved . Integrated Financial Administration Systems are being introduced at the subnational level. In addition, under PR-0024, the 15 largest municipalities in the country (six in the metropolitan area) have a modern multipurpose cadastral system and municipal accounting systems implemented. Civil service reform (Law No. 200) introduced: Partially achieved . Law No. 1626/00 was promulgated, amending Law No. 200—the Civil Service Statute. Public-sector trade unions argue that it is unconstitutional. Public-sector procurement system in operation: Achieved . The new procurement law has been passed and the implementing decree issued. Procurement portal is operational. Standard documentation now being developed.
Support for legislative branch	Reduction in time required for legislature to approve laws. No measurement data. Information system to support legislative work developed: No evidence of its implementation.
Support for judicial branch	Modernized civil registry in operation: Not achieved .
Strengthening of role of civil society	Mechanism established for participation of civil society: Not achieved .
Development of rural sector	Strategy for development of the rural sector designed and being implemented: Partially achieved . Projects being executed to support sustainable production systems, the diversification of production, and the broadening of microfinance services in rural areas.
Formal education	Education sector reform introduced: Achieved . Increased coverage of basic education among rural and monolingual guaraní population: Achieved . Gross coverage rate in 3rd cycle of basic education increased by 35 percent in past ten years.

Intervention and Objective	Targets for Achieving Anticipated Outcomes
Vocational training	<p>New Law on Vocational Training promulgated, regulations issued, and implemented: Partially achieved. Law No. 1652/00 approved and regulations issued. Pending administration of the budget by the System's governing body.</p> <p>Vocational Training System introduced and National Career Development Service (SNPP) restructured: Partially achieved. Law No. 1652/00 approved and regulations issued. Pending administration of the budget by the System's governing body. Not achieved as regards the National Career Development Service.</p> <p>Mechanisms for interagency coordination and private-sector participation established: Partially achieved. Private sector in process of consolidating its organization. There is coordination with the public sector through the governing body established in Law No. 1652/00.</p>
Health and nutrition	<p>Model for decentralization of health sector management agreed at the central, departmental, and municipal level: Not achieved.</p> <p>Increase in percentage of rural population with access to health services. Since 1996 there have been increases recorded which need to be reliably measured. There is circumstantial evidence of increases recorded which need to be reliably measured.</p>
Water supply and sanitation	<p>Increased coverage of water supply and sanitation: Partially achieved. Number of connections increased in seven cities in the interior that are recipients of systems built or expanded using resources from loans 861/OC-PR and 862/OC-PR. Coverage increases are as follows: 40% in water supply and 30% in sewerage. However, there is a need for a more aggressive plan for new users to ensure full utilization of the new systems constructed.</p>
Housing	<p>Consolidation of the reform and reorganization of the housing sector: Not achieved.</p>
Social assistance and vulnerable groups	<p>Reorganization of the social assistance sector completed: Not achieved. In 2002 the executive branch sent the legislature a bill on reform of the State administration, which includes the creation of the Ministry of Social Development. The bill was not passed and consequently the Ministry of Social Development was not created. In addition, the Secretariat for Social Programs (SAS) has prepared a draft National Strategy to Reduce Poverty and Inequality. The strategy remains in draft form, and the Social Cabinet has yet to complete its analysis of this strategy.</p> <p>Design of social protection networks for vulnerable groups (youth, women, adult and indigenous populations): Partially achieved. For end-May 2003 it is planned that SAS will fulfill the eligibility requirements for ATN/SF-8167-PR, Support for the Design of a Social Protection and Promotion Network. The SAS is executing the project in accordance with the execution schedule.</p>

Intervention and Objective		Targets for Achieving Anticipated Outcomes	
	Urban and municipal development	Advances with the administrative decentralization process and financial administration system extended to municipalities and departments: Partially achieved. Integrated Financial Administration System (SIAF) in process of implementation in subnational governments. In addition, under PR-0024 the 15 largest municipalities in the country (six in the metropolitan area) have a modern multipurpose cadastral system as well as municipal accounting systems implemented.	
		Total number of goals: 35	
Qualitative Summary of Box			
	Outcomes	Outputs	Total (%)
Number of goals	8	27	35 (100%)
Goals achieved		2	4 (11.4%)
With evidence of achievement	2	1	2
With partial evidence	1	1	1
Without evidence		1	1
Goals partially achieved		15	18 (51.4%)
With evidence	3	3	4
With partial evidence	1	8	10
Without evidence	2	4	4
Goals not achieved	1	9	10 (28.6%)
With no indicators for goals	2	1	3 (8.6%)

ANNEX III

LIST OF PERSONS CONTACTED

LIST OF PERSONS CONTACTED

The Office of Evaluation and Oversight and the team that prepared this report extend their thanks to all who shared their time and knowledge with us.

- Luis Castiglioni, Vice President of Paraguay
- Dionisio Borda, Minister of Finance
- Antonio Ibáñez Aquino, Minister of Agriculture and Livestock
- Blanca Ovelar de Duarte, Minister of Education and Culture
- Aurelio Varela, Minister-Executive Secretary of the Secretariat for Social Programs
- José E. Büttner Limprich, Vice Minister of Economy and Integration—Ministry of Finance
- Fernando R. Villalba, Vice Minister of Industry—Ministry of Industry and Commerce
- Juan Angel Alvarez, Director of Public Credit—Ministry of Finance
- Francisco Ogura, Director of Borrowing Policy—Ministry of Finance
- Oscar Pérez, Director of Economic Research—Ministry of Finance
- Manuel Alarcón, Counsel, Subsecretariat of Economy and Integration—Ministry of Finance
- Fernando Masi, Advisor to the Minister of Finance
- Bernardo Navarro, Advisor to the Vice Minister of Economy and Integration
- Gabriel González Cáceres, Superintendent of Banks—Central Bank of Paraguay (BCP)
- Carlos G. Fernández Valdovinos, Economic Research Manager—BCP
- José Aníbal Insfrán Pelozo, Director of Monetary Research—BCP (on temporary assignment to the Economic Research Department)
- Jorge Corvalán—BCP
- Javier Contreras, Counsel, Coordinator of the Economic Crimes Unit of the Office of the Public Prosecutor of the Republic
- Lina Matto, Director of Planning and Development—Supreme Court of Justice
- Ángel María Recalde, President—National Electricity Administration (ANDE)
- Pedro A. Ferreira Estigarribia, Financial Manager—ANDE
- Nicanor Fleitas Bareiro, Chief, Investment Supervision Division—ANDE
- Oscar Caballero, President – National Housing Council (CONAVE)
- Dionisio Santos, Director General – National Agrarian Health Service (SENASA)
- César Pastore Britez, President – Health Services Enterprise of Paraguay (ESSAP)
- Oscar Camé, General-Coordinator– Environment Secretariat (SEAM)

- Parisio Pinedo Ayala, Director-General—Directorate-General of Planning, Ministry of Agriculture and Livestock
- Nicolás Zárate, Director-General—National Directorate of Project Coordination and Administration (DINCAP), Ministry of Agriculture and Livestock
- Justo Lopez Portillo—Directorate of Agricultural Research, Ministry of Agriculture and Livestock
- Reinaldo Macchi, Director—Directorate of Rural Roads, Ministry of Public Works and Communications (MOPC)
- Alfredo Bordón, Chief of Maintenance—Directorate of Rural Roads, MOPC
- Carlos Filippi, Director—Directorate-General of Statistics, Surveys, and Census
- Stella Legal de Schreiner, Account Administration Division, Program Technical Executing Unit—BCP
- Manuel Sarquis, Executive Director—National Emergency Committee
- Teresa Fleitas, Coordinator, Project Coordination Unit —Ministry of Health
- María Ester Jiménez and Project Coordination Unit Technical Team—Ministry of Education
- Oscar Ovelar Gomez, Coordinator, Project Execution Unit—Ministry of Justice and Labor
- Juan Domingo Scarone, Project Coordination Unit Coordinator—Secretariat for Social Programs
- Armando Hermosilla, General Coordinator—Preinvestment Program
- Miguel Cereceda, General Technical Coordinator—Institutional Strengthening Project for the Judicial Branch
- Ramón Maciel, General Coordinator—Business Development Program for SMEs
- Luz Antúnez Ortiz, Administrative and Financial Coordinator of the Project Coordination Unit—Business Development Program for SMEs
- Alberto Ríos, Consultant—Ministry of Justice and Labor
- Cecilia Navarrete, Consultant—Ministry of Justice and Labor
- Antonio Boselli, Consultant, Country Office in Paraguay
- Hiroshi Sato, Resident Representative—Japan International Cooperation Agency
- Hiroyuki Takeda, Deputy Resident Representative—Japan International Cooperation Agency
- Takeo Ishikawa—Japan International Cooperation Agency
- Alberto Acosta Garbarino, Vice President—Association of Financial Enterprises of Paraguay (ADEFI)
- Fabio Fustagno Viola—Association of Passenger and Freight Land Transport Enterprises
- Domingo Rivarola, National Council on Education and Culture
- Jesús Montero Tirado, National Council on Education and Culture

- Dominique Demeleme, Catholic University
- Rafael Luis Aguayo—National Coordinating Council of Campesino Organizations
- Roberto B. Casás Roberto, Representative in Paraguay—Inter-American Institute for Cooperation on Agriculture
- Luis Cubilla Ramos, Agricultural Advisor—Paraguayan Chamber of Cereal Grain and Oilseed Exporters
- Ignacio Santiago Chase, Manager— Paraguayan Chamber of Cereal Grain and Oilseed Exporters
- Luis Galeano—Rural Sociology Research Center
- Domingo Rivarola— Rural Sociology Research Center
- Fernando Martínez, President—Rural Development Fund
- Cayo Silvera, Advisor—Rural Development Fund
- José R. Molinas, Director—Training and Research Institute
- Raul Baginski, Former Bank Representative
- Stephen Oliver, Senior Specialist—World Bank
- Ricardo Pedretti, Consultant
- Melissa Birch, Consultant – Regional Operations Department 1
- Beneficiaries of the PROPAIS program
- Beneficiaries of the “Active Schooling” program
- Beneficiaries of the “Living School” program
- Alberto Passos – Former Sector Specialist, Country Office in Paraguay

Bank staff:

- Ricardo Santiago, RE1/RE1
- Luisa Rains, RE1/RE1
- Álvaro Cubillos, COF/CPR
- Oscar Casasco, COF/CDR
- Alicia Ritchie, RE1/SO1
- Jaime Sujoy, RE1/OD1
- Marcial Abreu, COF/CPR
- Carlo Arce, COF/CPR
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- Alberto De Egea, COF/CPR
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- Felipe Gomez-Acebo, RE1/FI1
- Hector Malarin, RE1/EN1
- André Medici, SDS/SOC
- Marília Mirza, RE1/OD1
- Pablo Molina, RE1/OD1
- Silvia Raw, RE1/SO1
- Riccardo Rietti, RE1/SO1
- Maria Elena Sanchez, COF/CPR
- Raul Tuazon, RE1/RE1
- Gustavo Zuleta, RE2/SO2

ENDNOTES

- ¹ The inability of programming to define priorities and the diversification of the portfolio are two interrelated problems, which reflect the “goal congestion” problem identified by OVE in its paper on development effectiveness (RE-260). This is hence an internal Bank problem, which is reflected in a number of the (country and sector) strategies and papers.
- ² It was further noted that the projects approved for Paraguay throughout the 1991-2002 period took more time to be prepared, approved, and begin disbursements than for the Bank as a whole or by comparison with other relevant reference groups. However, while there was an observable trend toward improvement (throughout the period) with regard to the time that elapsed between approval and the first disbursement, the same could not be said with regard to project design times (Profile I through approval).
- ³ OVE estimates indicate that the contribution of the labor factor to total factor productivity has been small and relatively constant over the past 40 years.
- ⁴ It is estimated that the population of Paraguay has been increasing at rates close to 2.5 percent a year.
- ⁵ The unemployment data refer to Asunción only.
- ⁶ Estimates based on World Bank data (“World Development Indicators”) project a per capita income of US\$1,620 for 2002 (in 1995 dollars), which is similar in real terms to the level observed in 1979 (US\$1,688).
- ⁷ The unemployment data are for the entire country. The figures for years prior to 1996 are not comparable with those for subsequent years.
- ⁸ Other complementary measures were taken that had a significant impact, such as the placement of short-term securities through open market operations by the Central Bank of Paraguay, the transfer of the social security and public enterprise deposits to commercial banks, the authorization of domestic banks to extend loans in U.S. dollars, and the reduction in the cash reserve requirement for deposits denominated in local currency.
- ⁹ According to estimates, in 1995 some 200,000 Brazilian tourists crossed into Ciudad del Este each month only to then take back to their country goods imported by Paraguay from third countries. This generated a significant increase in liquidity and in financial intermediation in the local market.
- ¹⁰ It bears noting that the trade and finance sector is one of the largest in Paraguay’s economy, and accounts for nearly 27 percent of GDP (see Table A-2.1 in Annex 1).
- ¹¹ This rise in the cost of credit had a significant impact on the economy as a whole, as may be verified by observing the continual reduction in gross domestic capital formation since 1995, reaching a low of 14.7 percent of GDP in 2002.
- ¹² See paragraph 2.15 below.
- ¹³ The degree of openness of the economy, measured as total recorded foreign trade (imports plus exports) as a percentage of GDP, with some fluctuations was around 40 percent during the period under review. Paraguay’s trade balance was negative throughout the entire 1990-2002 period, and particularly so until 1995, principally as a result of the overvaluation of the guaraní. All data are from the Central Bank of Paraguay (National Accounts Bulletin and International Research Department).
- ¹⁴ This resulted from the strengthening of customs controls and the amendment of the legislation to restrict the free transit of goods within MERCOSUR.
- ¹⁵ The importance of the agreement for the country may be seen by the increase in trade relations between Paraguay and the countries of the bloc: in 1990, Paraguayan imports from MERCOSUR

countries represented approximately 31 percent of the country's total imports, a proportion which rose to almost 56 percent by 2002; similarly, while 40 percent of Paraguay's exports were intended for MERCOSUR countries in 1990, in 2002 this percentage was up to 58 percent.

16 See "Paraguay: Nota Técnica Sobre Comercio e Integración" [Paraguay: Technical Note on Trade and Integration] INT/ITD, September 2003.

17 The industrial sector has not managed to consolidate the bases to become the leader of the Paraguayan economy. Its annual growth rates were lower than the GDP growth rate in most years during the decade, with few exceptions. Among the reasons for the deterioration of the industrial sector, mention may be made of: (a) the overvaluation of the guaraní vis-à-vis the dollar at the start of the 1990s, which had an impact on the massive importation of consumer goods that were substitutes for domestic industrial production; (b) the major drops in customs tariffs resulting from the economic liberalization of 1989 and by Paraguay's entry into MERCOSUR (if the level of smuggling occurring in Paraguay is taken into account, the effective average tariff is even lower); (c) credit restrictions; and (d) shortcomings in the physical infrastructure and in human capital. For the most part, Paraguayan industry is made up of factories for processing agricultural and forestry products.

18 Despite the decentralizing spirit embodied in the Constitution, the annual tax collections of the subnational levels of government is no higher than one percentage point of GDP.

19 On average, 29 percent of GDP for the 1990-1994 period, 35 percent for the 1995-1998 period, and 37 percent between 1999 and 2002.

20 Wages and salaries for the consolidated public sector, for example, increased from approximately 6 percent of GDP in 1990 to 11 percent of GDP in 2002 (with a spike of 13 percent in 2000).

21 Current expenditure rose from about 18 percent of GDP in 1990 to 28 percent of GDP in 2002.

22 As regards the balance sheet of the social security institute—Instituto de Previsión Social (IPS)—Chart A-2.5 shows that the relatively stable and positive trend of approximately 0.5 percent of GDP has begun to deteriorate in recent years.

23 The sizable increase in external debt observed in 1999 stems from operations to sell US\$400 million in national treasury bills to the China Trust Bank of the Republic of China in Taiwan.

24 It is noteworthy that disbursements for each year have a virtually linear relationship (equal to 0.9112) to the ratio of current expenditure to GDP during the decade. However, when annual disbursements are evaluated with respect to capital expenditure, the index of correlation drops significantly (to 0.5344 in period "t") and continues to drop when disbursements are related to the capital expenditure of successive following years (0.1346 for "t+1" and 0.1065 for "t+2"). Of greater importance than the values observed for the correlations is their downward trend over time.

25 "Paraguay, The Role of the State." World Bank Report No. 15044-PA, 1996.

26 These 40 percent were broken down as: 25 percent for the "traditional" informal sector (unregistered microenterprises and small businesses), 6 percent for triangulation trade ("tourism"), and 9 percent for large-scale smuggling. "Country Economic Memorandum. Macroeconomic Policies to Reactivate Growth," World Bank Report No. 18392-PA, March 1999.

27 See, for example, Paolo Mauro, "Why Worry About Corruption?" Economic Issues No. 6, International Monetary Fund, 1997; and Vito Tanzi and Hamid R. Davoodi, "Corruption, Growth and Public Finances," IMF Working Paper, WP/00/182, November 2000. In the case of Paraguay, it is observed that foreign direct investment fell off significantly beginning in the late 1990s, in large measure owing to the country's instability. On the other hand, a study by Raul Barreto ("Institutional Corruption and Paraguayan Economic Development," University of Colorado at Boulder, 1996) finds that corruption would not necessarily have a negative impact on the country's growth, but would have a sizable (and negative) impact on income distribution. However, these results could be affected by the magnitude of the foreign investments in Itaipú and

Yacyretá on the growth of the Paraguayan economy during the period analyzed, which extends only to the early 1990s and accordingly does not include the crisis in the latter half of the past decade.

28 It is estimated that trade triangulation declined by about 40 percent during the second half of the 1990s, which had a considerable impact on Ciudad del Este, one of Paraguay's largest urban centers.

29 Of the member countries of the Bank, only Bolivia, Ecuador, Guatemala, Honduras, Nicaragua, and Haiti have per capita GDP figures lower than those of Paraguay.

30 Data from the Integrated Household Survey 2000-2001. The persons in conditions of extreme poverty are those with incomes below the cost of a basic food basket.

31 This takes into account that almost all of the country's population lives east of the Paraguay River, in an area corresponding to approximately one-third of the national territory.

32 Until the beginning of the 1990s, the level of public spending in the social areas was relatively low as a percentage of GDP in comparison with other countries of the region. This was more a reflection of the relatively low taxation capacity of Paraguay's tax system than of a bias against the social sectors. Social spending overall—on health, education and culture, social security, sanitation, housing and town planning, social promotion and social action, science and technology, labor relations, and other social services—rose from 3 percent of GDP to 10 percent of GDP between 1990 and 2000. Notable are the relatively low level of spending on health (1.4 percent of GDP in 2000), housing, and urban sanitation (both with spending of less than 0.1 percent of GDP at the end of the 1990s). In contrast, education expenditure rose from slightly over 1 percent of GDP in 1990 to almost 5 percent of GDP in 2000.

33 OVE estimates of the contribution of the labor factor to Paraguay's total factor productivity (TFP) show that it was small and relatively constant over the past forty years.

34 Relevance, consistency, and cohesiveness are examined by posing the following questions: Does the country program address the major development challenges facing the country? Are there contradictions between the various programming cycles over time? Did the program incorporate all the Bank's instruments and coordinate its activities with those of other parties?

35 These instruments are programming memoranda, programming missions, and the corresponding reports. In addition, this process is supported by economic and sector studies. See OP-201.

36 This evaluation uses the current terminology, "country strategy," to refer also to documents previously called programming papers or country papers.

37 The 1991 country strategy document (CP-178) is dated 25 April 1991 and was considered by the Programming Committee on 8 May.

38 The final version of the 1994 country strategy (CP-608 Rev.) is dated 11 March 1994.

39 The 1998 country strategy has an initial version (GN-1990) dated 29 August 1997, but its final version (GN-1990-1) was only approved on 21 April 1998, and incorporates the comments made by the Programming Committee of the Board of Executive Directors at its meeting of 6 November 1997 (PGA/97/24).

40 The final version of the 2000 country strategy (GN-2118-1) was approved on 30 October 2000.

41 The 1998 country strategy was the first to incorporate the political and institutional changes in the country since the start of the decade into its analysis.

42 In 1999 Vice President Luis Maria Argaña was assassinated and President Cubas resigned. In economic terms the country was still in a rather difficult situation: per capita incomes had been declining since 1996, and in 1999 were already lower in real terms than in 1980; fiscal performance had deteriorated; prices for soya—Paraguay's major export product—had fallen; the

crises in Argentina and Brazil were reducing Paraguayan exports; and the cost of debt service was exerting pressures on the country's payment capacity.

43 The country strategy put forward two possible approval scenarios (a basic scenario and a high scenario), and warned that approving the high scenario (which equaled the country program ultimately approved by the programming mission) would require *“support for economic modernization and reform of the State, which would translate into a considerable acceleration in introducing structural reforms, a substantial improvement in the country's institutional capacity and aggressive participation by the private sector which, in turn, would lead to high economic growth rates. (...) Apart from the stronger external and fiscal positions that would result from the reforms, this scenario assumes considerable streamlining of portfolio execution”* (GN-2118-1, Executive Summary).

44 Includes six projects in the pipeline.

45 By the term “strategic and operational model” we refer to the understanding of the factors that determine the country's organization and structure and, as a result, the existing interrelationships between the various issues and sectors. This makes it possible to define the priorities for the Bank's activities and ensures that the strategic intent becomes operational. This strategic and operational model must take into account matters relating to the economic policy of Bank activity in the country.

46 These relations are summarized in the matrix in Annex III-2 of the 1998 country strategy and the matrix in Annex II of the 2000 country strategy.

47 The 1998 country strategy, for example, defines one outcome of Bank activities as the *“reform of central government and strengthening of local and regional government”* (Annex III-2, p. 2), or *“remove barriers to private investment growth”* (Annex III-2, p. 3). While in some cases the 2000 country strategy does provide indicators that could be expressed in quantifiable terms (e.g. *“the economy grows faster than the population”* GN-2118-1, Annex II, p. 1), most of them are difficult to measure. For example, *improvements in transportation infrastructure* (Annex II, p. 2), or *increase in formal sector participation in the economy* (Annex II, p. 1).

48 The 2000 country strategy, for example, describes the impact of Bank activities in the financial sector as follows: *“the Bank's action: (i) gave microenterprises better access to credit through the development of self-sustaining market mechanisms; and (ii) helped to improve the solvency and efficiency of the financial system and strengthen bank regulation and supervision”* (paragraph 2.2). The 1998 country strategy states: *“Although accomplishments have varied from one issue and sector to another, it can be concluded that the strategies adopted have generally been appropriate to the country's needs, consistent with national priorities, realistic in design, and successful in terms of implementation”* (paragraph 3.14).

49 Tables A-3.1, A-3.3, A-3.5, and A-3.7 in Annex 1 summarize the information on the anticipation and approval of projects for the 1991-1993, 1994-1997, 1998-2000, and 2000-2003 programming cycles, respectively. Similarly, Tables A-3.2, A-3.4, A-3.6, and A-3.8 in the same Annex 1 list the projects identified and/or approved in the various programming cycles.

50 The document “Lineamientos de Estrategia para el Desarrollo de Pequeñas y Medianas Empresas” [Strategy Guidelines for the Development of Small and Medium-sized Enterprises] prepared by the Finance and Basic Infrastructure Division for Regional Operations Department 1 in 1997 establishes the conceptual bases for the preparation of PR-0100.

51 CP-608 Rev., paragraph 3.12. All the country strategies for the decade under review make explicit reference to the country's limited project execution capacity.

52 It bears noting that these results are explained, at least in large measure, by the change in the financing structure for technical-cooperation operations, inasmuch as concessional and/or nonreimbursable resources were on the decline and the approval mechanisms favored projects for smaller amounts.

53 The JBIC did not approve any operations in Paraguay between 1998 and 2002. Whereas Paraguay
was the eighth largest beneficiary of resources from the Japan International Cooperation Agency
(JICA) in 1991, by 2001 it had fallen to sixteenth place (JICA Annual Report 2002).

54 “Paraguay Country Assistance Evaluation,” 17 September 2001, Operations Evaluation
Department, World Bank.

55 US\$1.76 billion in current terms.

56 For the value as well as number of loans, we have excluded the operations of the Project
Preparation and Execution Facility (PROPEF), the Project Preparation Facility (PPF), and small
projects. The U.S. dollar values were corrected by the Consumer Price Index estimated by the U.S.
Bureau of the Census.

57 Table A-4.1 in Annex 1 provides the basic information on the loans approved in the 1991-2003
period. Three projects were approved in 2003: PR-0124 (1467/OC-PR) “Preschool and Early
Education Improvement Program” (US\$23.4 million); PR-0132 (1448/OC-PR) “Cadastre and
Property Registration Program” (US\$9 million); and the emergency loan PR-0147 (1520/OC-PR)
“Social Protection Program” (US\$30 million).

58 PR-0003 (727/OC-PR, 728/OC-PR).

59 Existing projects in the portfolio refer to those operations in the execution stage plus those already
approved but not yet eligible for disbursements. Projects in execution were defined as eligible
projects for which the disbursement percentage was less than 100.

60 As expected, the large number of loans approved for Paraguay in the 1991-2002 period was also
reflected in the volume of resources in the Bank’s portfolio. The average size of the portfolio over
the 12-year period was US\$426 million, and it increased from approximately US\$264 million at
end-1991 to US\$400 million at end-2002. The volume of resources in the portfolio at year’s end is
the sum of the balance of all loans in execution, plus the value of the loans approved during the
year, minus the volume of resources disbursed during the same period.

61 Until the start of the 1990s, the transportation, energy, and agriculture sectors represented between
50 percent and 65 percent of the projects approved for Paraguay.

62 To be sure, while the diversification of the portfolio could, theoretically, increase the efficiency of
the Bank’s actions owing to the potential existence of complementarities between sectors, the
Bank has not used such argumentation in its programming.

63 In this respect, it is an institutional problem that has been reflected in a number of (country and
sector) papers and strategies.

64 This issue merits greater consideration when one takes into account the increased responsibilities
assigned to Country Offices following the Bank restructuring of the mid-1990s. The assessment of
the operational and administrative workload carried out by the Country Office in Paraguay in late-
2003 concludes that the Country Office *has sufficient staffing, in current and projected
circumstances, to be able to address the anticipated workload* (report of the operational and
administrative workload review mission, dated 20 March 2003). However, the same study
identified overwork by five of eight specialists and in the financing and accounting areas (the
excessive workloads tend to be offset by hiring consultants), and the parameters of the study did
not take into account the country’s specific characteristics and limitations in terms of institutional
capacity, which require the Bank to more closely track projects, while the study’s figures on
revised workloads were based on “average” loads.

65 Paraguay’s limited technical and execution capacity, as well as the frequent shortage of
counterpart funding, have been flagged by the bank on various occasions in its Project
Performance Monitoring Reports (PPMRs) and country papers. Moreover, the national authorities
informed the OVE mission that in its view, the Bank tended to prepare projects that were
inconsistent with Paraguay’s capacity to execute them as initially planned.

66 “Paraguay. Country Paper” (CP-608 Rev.), March 1994, par. 3.12.

67 In the chart, the projects in the portfolio were clustered into two-year clusters by approval year and then compared—at specific points during execution—with the first two-year period of the decade (1991-1992). Negative values indicate execution rates lower than those observed for the baseline period.

68 The two-year period 1991-1992 has the fewest projects in execution of the entire period, and the projects approved during the two-year period 1997-1998, those with the highest execution rate in their initial stage, generally entered the execution stage between 1999 and 2000, a period during which the number of projects in the execution stage was declining.

69 The average time required for project approval for Paraguay was almost 23 months, seven months (or about 43 percent) more than for the Bank as a whole, or six and one-half months longer than for all other Intermediate Financing Facility (IFF) countries. The time lag between project approval and initial disbursement was 19 months, while the median for the Bank is approximately 13½ months. These data exclude sector loans and emergency loans, as well as private sector projects. Doing so is particularly necessary for comparison purposes, as Paraguay has but one sector loan approved during the period and not even one private sector operation.

70 The Primary Health Care Reform Program (PR-0028) merits particular attention for the diagnostic effort made in a complex area. In its design, the project used surveys of households, providers, and beneficiaries (in the case of Paraguay, such surveys are particularly important given the scarcity or low reliability of the available health data). Of particular interest, however, is that the project analyzed and compared different alternatives in order to justify the action proposed for addressing the development problem.

71 Project PR-0083 (Consolidation of Rural Settlements), for example, described its objective as “*to introduce a process of sustainable development in a typical agricultural area in the Paraguayan campesino agriculture sector.*”

72 A good example in this regard was the design of the Program on Strengthening and Modernization of the State (PR-0081), where there was clear and precise definition of the actions that would lead to meeting the objectives of each of its two subprograms (Civil Registry and Supreme Court of Justice). Another good example is the Program to Support the 2002 National Population and Housing Census (PR-0130).

73 In the group of projects analyzed, risks not originally foreseen were found to occur in approximately 62 percent.

74 In the case of the governance projects, for example, there was a tendency to underestimate the risks of lack of political support for introducing the anticipated changes. While such risks were mentioned in some cases (see, for example, PR-0115 and PR-0081), there was a deficiency as regards the identification of obstacles and specific limitations associated with the functioning of the country’s scheme of government, which has a long tradition of resistance to change.

75 See also paragraph 5.3.

76 The Primary Health Care Reform Program (PR-0028) is an exception, as the project has indicators, baselines, milestones, and verifiable targets for the development objectives.

77 Out of a sample of 18 projects examined in greater detail, it was found that 47 percent of the indicators for development objectives had baselines, a finding that resembles OVE observations for other countries, while the same indicators had “milestones” in only seven percent of cases, a figure that is significantly lower than that observed in other cases. The projects analyzed cover the entire 1991-2002 period, and were as follows: PR-0013, PR-0026, PR-0028, PR-0030, PR-0031, PR-0035, PR-0075, PR-0080, PR-0082, PR-0083, PR-0084, PR-0094, PR-0100, PR-0104, PR-0109, PR-0113, PR-0117, and PR-0125.

78 Two projects that were advanced in terms of providing output indicators and monitoring methods for them were the Program on Strengthening and Modernization of the State (PR-0081), which had an extensive and detailed logical framework, and the Primary Health Care Reform Program (PR-0028), which had relatively clearly defined indicators. In contrast, the loan document for Project PR-0115 did not have a satisfactory logical framework in this regard, despite the fact that in the body of the text it was stated that *the program design has taken into account the lessons learned by the Bank in similar programs on institutional strengthening, including earlier projects in Paraguay*, and among these listed *the inclusion of quantifiable and clearly observable monitoring indicators for the various components* (loan document, paragraph 1.38).

79 As regards outputs, it was found that 62 percent of the indicators proposed had baselines; this result is similar to what OVE has found in other countries. However, only 10 percent of these indicators had milestones, a result lower than the level commonly observed by OVE.

80 In the Social Investment Program (PR-0075, PROPAS) the gathering of the data required for the project only occurred during its final stage, and thus limited the information available (including baselines) for the preparation of its second phase (PR-0125).

81 The Bank's borrowing member countries argue that the ex post evaluations constitute a regional public good, since the lessons from them may be of value in various other scenarios and countries, and that they should therefore be financed by the Bank. This argument has been acknowledged by the IDB, and OVE has received the mandate to begin a pilot ex post evaluations exercise.

82 The PPMRs are produced half-yearly, ever since December 1997.

83 The data referring to monitoring and supervision are limited to the 1998-2002 period, the period for which OVE has compiled information for its evaluation of the project supervision system (RE-293) and spans the same period as the effective execution of the Bank's supervision system.

84 The Country Office could only recover partial supervision and inspection data for the period 1998-2000, as the files are destroyed three years after the close of operations; consequently, the information corresponds only to those projects for which it was available.

85 It must be mentioned that this program was affected by corruption problems. In order to be eligible to participate in the Mortgage Loan Rediscount Fund, intermediary financial institutions had to comply with certain internal requirements of the program. Exemptions from these regulations for interests alien to the program made it necessary to apply administrative sanctions against a Bank official.

86 In the period for which external oversight information is available (1998-2002), project PR-0031 was in execution between 1998 and 2000, and project PR-0064 was being executed throughout the entire period.

87 The data on Bank oversight could be confirmed only until 2001.

88 As noted previously, these figures reflect the records of the Bank, and do not necessarily indicate that there were no other inspection or supervision visits.

89 There are records on two technical visits in 1998, one in 1999, and one administration mission in 1999 for project PR-0024; and annual administration missions between 1998 and 2000 for project PR-0025. In the other cases no oversight activities were recorded.

90 The discussion in this chapter does not endeavor to analyze each and every project approved by the Bank during the period under review.

91 Inclusion of institution-strengthening reflects its cross-cutting presence among the factors hindering the country's development.

92 Table A-6.1 in Annex 1 summarizes the breakdown of projects among these major themes.

93 In June 2003, these arrears amounted to about US\$40 million, without considering that the
government had not complied with the early redemption clauses included in some issues of
National Treasury Bills marketed domestically.

94 Projections based on figures from the Ministry of Finance.

95 During preparation of the loan, the government used the working assumption of an increase in tax
collections resulting from reform of the Tax Law submitted to Congress, and the results of the
public indebtedness controls to be introduced.

96 The country's total debt service would also increase by approximately 1 percent in 2004 and
0.5 percent in 2005 and 2006. For purposes of these calculations, an annual interest rate of
5.24 percent was used (six-month Libor of 1.24 percent + 400 points). The fact that part of the
interest charges will be calculated on the more favorable bases defined by the Intermediate
Financing Facility (IFF)—a change that occurred after the operation was approved—implies that
there will be a marginal reduction in the impact of the loan on debt service.

97 It is therefore important to improve the manner and transparency of recording expenditure
categories so that they impart a more accurate idea of how the resources from public borrowing
are being used.

98 The Investment Sector Program (PR-0003) proposed major reforms in various sectors of the
economy, and identified the financial sector as a priority. The operation contained the sector loan
727/OC-PR in the amount of US\$70 million and the reimbursable technical-cooperation project
728/OC-PR in the amount of US\$11.5 million.

99 It is estimated that between principal and interest, the government's net credit for bailing out the
financial system amounts to almost 5 percent of GDP.

100 The latter is because risk factors were not incorporated into the calculation of capital solvency
indexes. The current administration is working (in order to fulfill one of the conditions of the new
arrangement with the IMF) to amend and strengthen the legislation on banking supervision.

101 In 2002, the BNF operated with a capital gap of approximately US\$47 million; high operating
costs (the ratio of personnel to the total loan portfolio was twice the average for the local banking
system); severe distortions in management (board decisions traditionally reflected political
interests and pressures from economic interest groups); and almost half of its loan portfolio had
problems of payment lags or uncollectibility. See "Paraguay, Financial Sector Review," Report
24249-PA, The World Bank, November 2002.

102 The Economist Intelligence Unit (Paraguay, Country Report, Feb. 2004) reports that, because of
high prevailing interest rates, the commercial banks reached an agreement in October 2003 to
reduce the maximum lending rate to 15 percent within 90 days.

103 The projects approved by the Bank for which the primary objective related to enhancing
governance were: Municipal Strengthening Program (PR-0024), Program on Strengthening and
Modernization of the State (PR-0081), Preinvestment Program (PR-0093), Fiscal Management
Strengthening and Modernization Program (PR-0115), and Support for the 2002 National
Population and Housing Census (PR-0130), and directly concerned the strengthening of the tax
system. In addition, the Investment Sector Program (PR-0003) had important conditionalities
relating to governance. It is estimated that about US\$18 million has been directed, through
technical-cooperation operations and MIF projects, to the reform and modernization of the State,
corresponding to a third of the resources from these two sources during the period.

104 Daniel Kaufmann, Aart Kray, and Massimo Mastruzzi, "Governance Matters III: Governance
Indicators for 1996-2002," The World Bank, 30 June 2003. Paraguay was in last place for
"control of corruption," "effectiveness of government," "rule of law," and "voice and
accountability." Paraguay ranked next-to-last for the indicator on "regulatory quality" and came
ahead of only Colombia for "political stability."

105 Jeff Huther and Anwar Shah, “Applying a Simple Measure of Good Governance to the Debate on
Fiscal Decentralization.” The World Bank, Working Paper Series No. 1894, 2003.

106 Three projects, the Investment Sector Program (PR-0003), Municipal Strengthening Program
(PR-0024), and Fiscal Management Strengthening and Modernization Program (PR-0115), were
directly related to strengthening the tax system.

107 Document PR-2493, p. 4.

108 At this writing there are almost 50 laws that grant tax advantages or incentives.

109 The high share of indirect taxes in total tax revenue is noteworthy, particularly the value-added tax
(43 percent of total collections) followed by specific consumption taxes (fuels, alcoholic
beverages, and cigarettes) (21 percent), with business income taxes ranking third.

110 This project involved two subprograms, including one on strengthening the judicial branch.

111 For example: *80 percent acceptance of the judicial branch by the citizenry, and reduction of case
processing time by 70 percent.*

112 Gonzalo D. Bernal Brito, “Apoyo al Programa de Fortalecimiento del Poder Judicial II” [Support
for the Program on Strengthening the Judicial Branch II], Asunción, November-December 2002.
Of particular note are major advances in the information technology and communications areas,
and the creation of a judicial career stream was mentioned.

113 Of these three who agreed to go to trial, one resigned during the trial and the other two were
removed from their positions after trial. The six new members of the Supreme Court were
appointed by the Senate on 15 March 2004 and are now fulfilling their duties.

114 Renato Schulz, “Paraguay: A Survey of Transport Issues,” Economic Notes, The World Bank,
June 1997.

115 Peter G. Smith, “Paraguay: Nota Técnica Sector Transporte” [Paraguay: Technical Note,
Transport Sector] RE1, 2003, paragraphs 2.12 and 2.13.

116 The expansion of the road system has surely facilitated the distribution of goods. Persons
interviewed by OVE confirm that cargo transport costs have dropped. However, no data could be
found at the Bank or elsewhere to quantify and/or substantiate these results.

117 Project Completion Report—Electricity Transmission and Distribution Program (648/OC-PR,
PR-0109), August 1998.

118 The Yacyretá Transmission Program (PR-0030), approved in 1996, supplements the investments
made by PR-0109, and has the basic objective of addressing the increased demand for energy (in
particular in the eastern part of the country), taking advantage of the installed capacity of the
Yacyretá Hydroelectric Plant. The project is still in the execution stage, and has met with
implementation problems principally because of the economic and financial difficulties of ANDE
resulting from an inadequate tariff structure.

119 The Rural Welfare Institute estimates that that 10.7 million hectares were distributed to 157,000
small farmers between 1960 and 2002. Only 5 percent of the lots transferred have been titled.

120 A number of different factors may have led to the delays in the execution of this program,
including the fact that neither its potential beneficiaries nor the public sector responsible for
executing it assumed ownership of the program, or perhaps that the program design was not
conducive to its execution as scheduled.

121 This project sought to improve the productivity of rural agriculture through a sustainable process
of increasing productivity in a framework of rational use of natural resources.

122 It should also be noted that the same report (paragraph 4.17) confirms the existence of an
agreement with the executing agency that the ex post evaluation of this operation would be

financed with resources from another one in execution at that time (March 2001), without identifying which one.

123 The PPMRs indicate that project implementation is unsatisfactory and that there is little likelihood that the assumptions regarding implementation of the components will be borne out. As regards achieving the development objectives, the PPMRs indicated “low probability” except with regard to the last, where the classification is “probable,” a finding that appears inconsistent with the rest of the analysis. As a whole, the results anticipated from the project are meager.

124 One possible attenuating factor could be the absence of an institutional framework and policies more favorable to project execution. In this regard it should be noted that in the first half of the decade the Bank processed, up to the Profile II stage, a sector operation (Modernization Program for Agricultural Development) intended to create such a framework, but it was not completed owing to disagreements with the Government of Paraguay.

125 As mentioned in Chapter II, a substantial proportion of the increase in infrastructure for the provision of basic services was financed by international organizations, and Paraguay now faces the challenge of maintaining it in an economic situation that is squeezing public spending, and without the institutional capacity to make qualitative changes in its social sectors.

126 This increase in poverty is explained principally by the decline in economic growth and, to a lesser extent, by the negative shift in income distribution: estimates by OVE and RE1 indicate that just over three-fourths of the increase in total poverty, and 71 percent of the increase in extreme poverty, may be explained by the reduction in economic growth.

127 *It is estimated that the number of poor increased by over 500,000, while the number of those in extreme poverty rose by 227,000. All the indicators considered were down. The incidence, gap, and severity of poverty increased both in the metropolitan area of Asunción, the other urban areas, and rural areas, indicating that the shortfall in the incomes of the poorest, as well as inequality among the poor, have increased. The incidence of extreme poverty also rose between 1995 and 2001. “Paraguay: Retos en la Lucha Contra la Pobreza” [Paraguay: Challenges in the Fight against Poverty], RE1, October 2003.*

128 It bears noting that various projects associated with productivity and integration, in particular those on agriculture and rural roads, could be considered as relating to combating poverty. The criterion used for classification here is based on the manner in which the operations define their development objectives.

129 In May 1989 the national government took a first step toward restructuring activities in the housing sector by creating the National Housing Council (CONAVI), which gathered together all the agencies active in the sector, both public and private. The law creating the Council included the new National Housing Policy. The fundamental objective of this new policy was to provide a modern guide for the sector, incorporating operational criteria that would maximize the impact of public resources through the streamlining of subsidies and the clear separation of the functions that were to be carried out by the public sector and the private sector.

130 It must be noted that this project was affected by corruption problems. Waivers of program regulations in order to permit the eligibility of financial intermediaries contributed to undermining the credibility of the executing agencies. Administrative sanctions against a Bank employee are currently being considered.

131 Meanwhile, it bears noting, given the aforementioned problems with respect to corruption, that the program is under investigation.

132 The Bank program was focused on the first six years of basic education, while the World Bank was responsible for middle school and secondary school.

133 Specifically, the program generated a proposal aimed at revitalizing the roles of teachers and the family in the educational process through a pedagogical strategy focused on the child and on active and collaborative learning.

134 In June 2000, the Bank approved a Program to Strengthen Basic Educational Reform (PR-0117). While the loan document for the program does not explicitly refer to the problems experienced by the previous project, in fact it incorporates a great many of the lessons learned from it. The pedagogical proposal under the program, known as the Living School program, maintains the basic model of the previous proposal while strengthening a number of processes necessary for its success. Its targeted approach is aimed at generating greater benefits for those sectors where the shortcomings in terms of the quality of educational services received are the greatest. Moreover, the program endeavors to increase the participation of parents in the basic education process.

135 By design, PROPAS is part of the second generation of Social Investment Funds in Bank experience. The first generation (1990-1995) was characterized by addressing community demand on a first-come, first-served basis. Second-generation SIFs (1996-1999), in contrast, are characterized by greater concern with targeting intervention towards the poorest communities. The SIFs in these two generations are also characterized by a single focus in the interventions in a given community (health or education, for example). In contrast, third-generation SIFs are characterized by greater emphasis on targeting investment toward maximizing their impact. The recently approved Social Investment Program II (PR-0125) is an example of a third-generation SIF.

136 While an evaluation was conducted on the perceptions of beneficiaries, and showed a high level of satisfaction, this process did not make it possible to establish the degree to which the beneficiaries' vulnerability or marginality may have been reduced, or the sustainability of the interventions.

137 PCR, September 1998, p. 4.

138 PCR, p. 5.

139 WP-4/98.

140 Neither the Country Office nor RE1 has been able to find the ex post evaluation required for the GMC.

141 The findings are from two random samples of microenterprises in Greater Asunción, one of 191 direct beneficiaries of the program and the other of 96 nonbeneficiary microenterprises.

142 June 2003 PPMR, paragraph on compliance problems with other important contractual clauses.

143 Although the Bank organizes training workshops on its procedures, the limited local technical capacity is aggravated by the lack of professional career streams for civil servants.

144 It bears noting that the majority of the projects are still in the execution stage.

145 The fact that the democratization process is not referred to in Bank programming papers until 1998 tends not to support the hypothesis that the increase in Bank activities in the 1990s was the result of an explicit intention to support the democratization process that began in 1989.

146 A. Chanda and C.J. Dalgaard ("Dual Economies and International Total Factor Productivity Differences," Economic Policy Research Unit, University of Copenhagen, 2003) have shown that a significant proportion of the changes in TFP between countries may be attributed to the allocation of resources between sectors. There is thus a potential for offsetting Paraguay's institutional limitations and increasing the country's TFP through traditional public policies, inasmuch as its productive structure is affected more by economic policies than institutional variables.

147 However, it bears noting that the institutional context has a significant impact on the *efficiency* with which resources are distributed to the economy's most productive sectors.