



Country Program Evaluation

Paraguay

2009-2013



This document is the evaluation of the IDB's Country Program with Paraguay for the 2009-2013 period. The period evaluated here (hereinafter, the 'review period') was characterized by a political crisis and the intensification of the agricultural export model. This evaluation has been conducted in accordance with OVE's mandate (RE-238 corr.) and the Protocol for Country Program Evaluation (RE-348-2). Its main purposes are to facilitate accountability and identify lessons learned that may help improve the Bank's future program.

The evaluation took into account the new country strategy document formats (CSD, GN-2468-6) developed by Management. The most significant practical effects of the new CSD formats were: (i) the de facto separation between the preparation of the CSD and country programming; (ii) the new emphasis on sector notes; and (iii) the update of the strategy's results matrix and the programming documents.

To achieve the dual purpose of accountability and learning, the team has put together a portfolio that includes all the operations approved in the period (2009-2013) together with those approved previously, but executed during this period. The specific details of the portfolio and the main sectors are included in the annexes to this document (Portfolio, Energy, Water and Sanitation, Roads, Social Sector, and Agriculture). During the preparation of this document some 150 people were interviewed, including the Bank's main counterparts (the Minister of Finance and his two predecessors), executing units, members of civil society, scholars, representatives of multilateral and bilateral agencies with a presence in Paraguay, the Bank's Representative (ad interim), and two former Representatives of the Bank in Paraguay, IDB staff at the Bank's Country Office and at Headquarters. The mission also visited eight projects to observe the outcomes and challenges of the Bank's program in situ.

Country Program Evaluation:
Paraguay
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OFFICE OF EVALUATION AND OVERSIGHT, OVE



Inter-American Development Bank
February 2014



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RE-452-3

ABBREVIATIONS

ACKNOWLEDGEMENTS

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ABBREVIATIONS

AFD	<i>Agencia Financiera de Desarrollo</i> [Development Finance Agency]
ANDE	<i>Administración Nacional de Electricidad</i> [National Electricity Administration]
BCP	Central Bank of Paraguay
BNF	<i>Banco Nacional de Fomento</i>
CAF	Andean Development Corporation
CCLIP	Conditional Credit Line for Investment Projects
CEDLAS	<i>Centro de Estudios Distributivos, Laborales y Sociales</i> [Center for distributional, labor, and social research of the National University of La Plata]
CELADE	Latin American and Caribbean Demographic Centre
CGN	<i>Contraloría General de la Nación</i> [Office of the Comptroller General]
CONACYT	<i>Consejo Nacional de Ciencia y Tecnología</i> [National Council of Science and Technology]
ConSOC	Civil Society Consulting Group
CPD	Country Programming Document
CPE	Country Program Evaluation
CSD	Country Strategy Document
DNCP	<i>Dirección Nacional de Contrataciones Públicas</i> [Public Procurement Department]
ECLAC	Economic Commission for Latin America and the Caribbean
EIB	European Investment Bank
FOCEM	<i>Fondo para la Convergencia Estructural del MERCOSUR</i> [MERCOSUR Structural Convergence Fund]
FONACIDE	<i>Fondo Nacional de Inversión Pública y Desarrollo</i> [National Public Investment and Development Fund]
FONPLATA	<i>Fondo Financiero para el Desarrollo de la Cuenca del Plata</i> [River Plate Basin Development Fund]
GDP	Gross Domestic Product
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
INCOOP	<i>Instituto Nacional de Cooperativismo</i> [National Institute for Cooperativism]
JICA	Japan International Cooperation Agency
KNL	Knowledge and Learning Sector
MOPC	Ministry of Public Works and Communications
OFID	OPEC Fund for International Development
OMJ	Opportunities for the Majority Sector (IDB)
OVE	Office of Evaluation and Oversight
PAySRI	Sanitation Program for Rural and Indigenous Communities
PBLs	Policy-based loans
PEES	<i>Plan Estratégico Económico y Social</i> [Economic and Social Strategic Plan]
PPP	Purchasing power parity
PROPEF	Project Preparation and Execution Facility
PYG	Paraguayan guaranties
SCF	Structured and Corporate Financing Department (IDB)
SEDLAC	Socio-Economic Database for Latin America and the Caribbean
SNIP	<i>Sistema Nacional de Inversión Pública</i> [National Public Investment System]
TFFP	Trade Finance Facilitation Program
UNASUR	<i>Unión de Naciones Suramericanas</i> [Union of South American Nations]
WDI	World Development Indicators

This document is the evaluation of the IDB's Country Program with Paraguay for the 2009-2013 period. It represents OVE's third opportunity to take an independent look at the Bank's program with Paraguay. OVE's first report (RE 294, June 2004) covered the 1991-2002 period, which was marked by the transition to democracy and the prolonged financial crisis the country experienced between 1995 and 2003. The second evaluation covered the 2003-2008 period and was marked by the significant reforms that helped overcome the crisis and embark on a period of sustained economic growth, based on solid fiscal performance and a strong impetus from the external sector (RE-356, August 2009). The period evaluated here (hereinafter, the "review period") was characterized by a political crisis and the intensification of the agricultural export model.

This evaluation has been conducted in accordance with OVE's mandate (RE-238 corr.) and the Protocol for Country Program Evaluation (RE-348-2). Its main purposes are to facilitate accountability and identify lessons learned that may help improve the Bank's future program. The evaluation took into account the new country strategy document formats (CSD, GN 2468-6) developed by Management. The most significant practical effects of the new CSD formats were: (i) the *de facto* separation between the preparation of the CSD and country programming; (ii) the new emphasis on sector notes; and (iii) the update of the strategy's results matrix and the programming documents.

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This document was prepared by a team comprised of Juan Manuel Puerta, María Elena Corrales, Oliver Azuara, Lucía Martín, Diego Vera, and Ana Ramírez-Goldin. We thank the Bank's Management for its support (particularly the Country Office in Paraguay), as well as the almost 150 Paraguayan public and private sector informants who gave generously of their time. Lastly, we thank the Paraguayan people for their generous hospitality.



The beginning of the Country Program Evaluation of Paraguay period was marked by two key events: the outbreak of the international financial crisis and political changes.

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Executive Summary

Paraguay is a landlocked country, whose main source of wealth is connected to the exploitation of natural resources. Its return to democracy in 1989 was accompanied by a decade of sluggish growth and a persistent banking crisis lasting from 1995 until 2003. The 2003-2004 economic reforms, in conjunction with a favorable economic context, contributed to a resumption of economic growth under an agricultural export model based on a handful of commodities (soybeans, meat). During the period under review (2009-2013), the agricultural export model has been consolidated although with new challenges and opportunities. First, the economy's dependence on its agricultural exports made it more vulnerable to climatic shocks, such as those that materialized in 2009 and 2012. Second, this model exhibited a limited capacity to reduce poverty and inequality. During the period under review, a strategic opportunity presented itself as a result of the growing availability of resources for development, with the creation of a fund (National Public Investment and Development Fund - FONACIDE), comprised of the additional revenue from Itaipú (US\$240 million per year).

At the start of the period under review (2009-2013), the government planned to lay the groundwork for sustainable growth with equity. The first challenge, which arose almost immediately, was the 2008 global financial crisis, which led the government to put forward a short term program to jump-start the economy. In this context, a series of fast-disbursing operations were programmed with the Bank for 2009-2010. The remainder of the program was characterized by a bias toward continuity and a strong focus on infrastructure, both of which can be explained by the nature of the



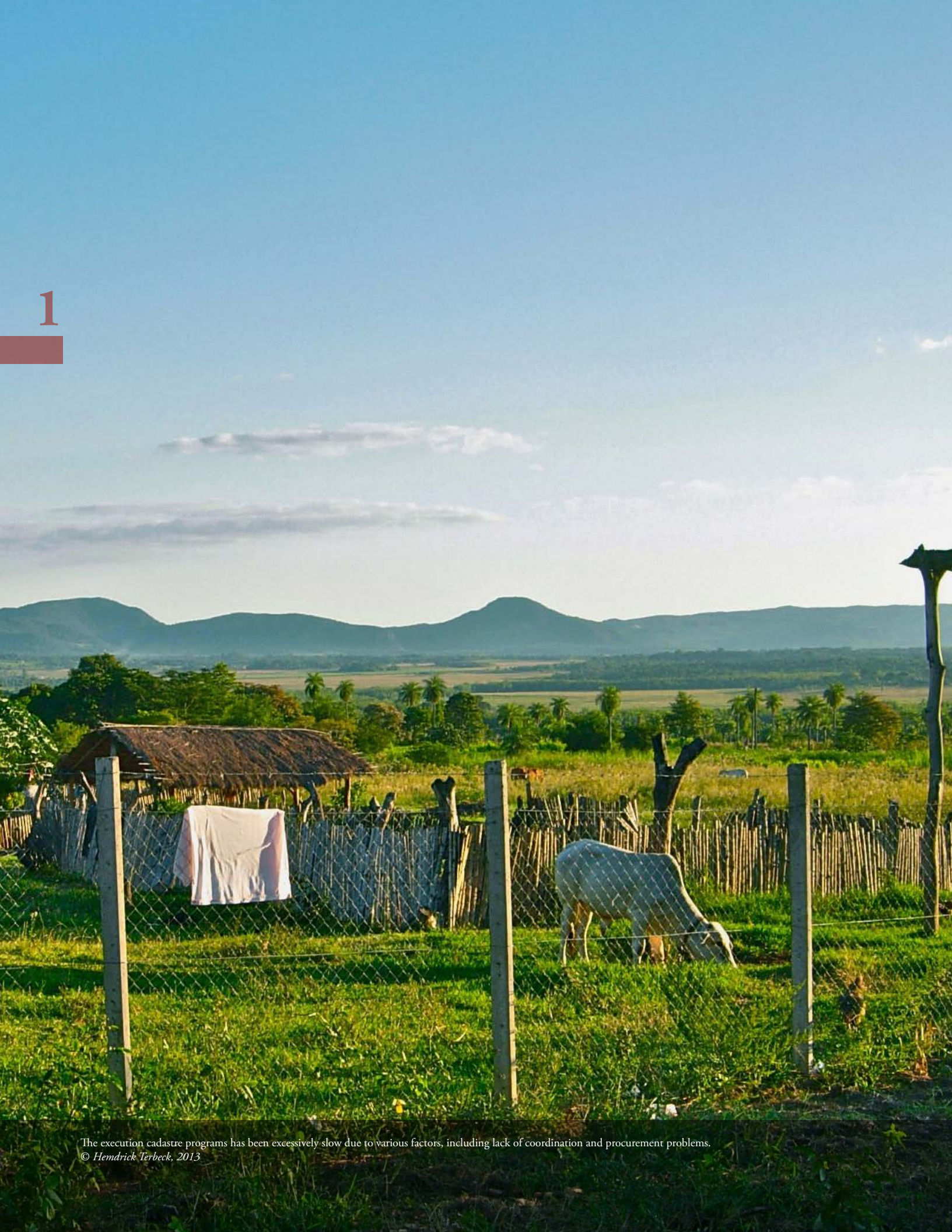
A series of MIF operations, small projects, and OMJ operations sought to support value chain development for specific products, such as milk.
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parliamentary ratification process. With the political crisis in 2012 the Bank rapidly adapted to the needs of the incoming government's programming, but took too long to appoint a new representative.

With one of the oldest portfolios of projects in execution (primarily because of the slowness of parliamentary ratification) as well as image problems, the Bank's Country Office in Paraguay faced significant challenges. Efforts were made on both fronts, by implementing a communication strategy and strengthening links with civil society. On the execution side, the Country Office adopted an original operational support model based on "service units." Although the impact on portfolio efficiency is not yet visible, this model has achieved significantly shorter response times to client requests.

The results achieved showed a mixed picture. Execution in the infrastructure sectors tended to be slow, but the objectives were met. The greatest weaknesses were observed in the road sector. The reform and funding of second-tier banks (AFD) remains one of Bank's main accomplishments in Paraguay. Lastly, the Bank's outcomes in the modernization and social sectors are limited and piecemeal, basically concentrated in small, isolated interventions. The interruption of three important reform projects (customs, cadastre and property registry, decentralization) thwarted progress in key directions for the country's development.

In this context, the Office of Evaluation and Oversight (OVE) recommends moving in five directions: first, support the country to leverage its investment in infrastructure with the private sector and other cooperation agencies; second, deepen the use of the Bank's concessional instruments to work on the agendas delayed by the parliamentary ratification process; third, build on the opportunity to support the country by giving priority to and executing FONACIDE's social projects; fourth, support the dialogue and consolidation of the institutional framework for the sustainable management of natural resources. Lastly, OVE recommends drawing on the lessons learned by the Bank in other countries that require legislative ratification.



1 The Country Program Context, 2009-2013

The Republic of Paraguay is a predominantly agricultural country, situated in South America's Southern Cone.¹ Its economy is relatively small and has a low income level: per capita GDP was approximately US\$6,200 in 2012, the fifth lowest in the region.² Farming accounts directly for 25% of Paraguay's GDP and, together with indirect activities (agroindustry, services), it is estimated to represent 41%. As well as being a member of the IDB and the World Bank, it is a member country of the Southern Cone integration structures, namely MERCOSUR and the River Plate Basin Development Fund (FONPLATA). Paraguay is also a member of the Andean Development Corporation (CAF) and the Union of South American Nations (UNASUR).

The country is divided into two parts by the Paraguay River, which crosses it from north to south. To the west of the river is the Chaco, comprised of semi-arid woodlands with a very low population density. Although it accounts for 60% of the country's area (250,000 square kilometers), it is inhabited by just 150,000 people (2.7% of the total). The majority of the Chaco's inhabitants belong to indigenous groups or Mennonite colonies that have adapted their farming practices to the arid environment. At the same time, almost 6.4 million Paraguayans (97.3%) live in the eastern region extending over 150,000 square kilometers between the Paraguay and Paraná rivers and the Amambay mountain range. Almost a third of the population lives in the metropolitan area of the capital city, Asunción. Although urban development has progressed rapidly in recent years, the country remains predominantly rural (46%). Although virtually the entire population is bilingual (Spanish-Guaraní), only a small fraction (1.7%) of the population, living mostly in Chaco, self-identifies as indigenous.

BOX 1: BRIEF HISTORY OF PARAGUAY

In the words of the writer Augusto Roa Bastos, Paraguay is “a landlocked island in the heart of the continent.” This description, in addition to illustrating the challenges of being landlocked, highlights its historical tendency towards self-sufficiency. Indeed, Paraguay’s history is characterized by long periods of stability and self-sufficiency framing an intermediate period of instability, marked by internal and external conflict.

The Jesuit missions’ experiment with autonomy in the seventeenth century was followed, after Paraguay gained its independence, by the dictatorships of José Gaspar de Francia (1813-1840), Carlos Antonio López, and Francisco Solano López (1841-1870). Paraguay’s defeat in the War of the Triple Alliance or *Guasú* (Great) war, which pitted Paraguay against Argentina, Brazil, and Uruguay between 1865 and 1870, had indelible consequences for the country, such as the loss of 40% of its territory and 60% to 70% of its population, and it led to a period of foreign occupation.³ The war gave way to a period of instability that was to last throughout the first half of the twentieth century, and included another war, this time with Bolivia, over control of the northern part of the Gran Chaco region, known as Chaco Boreal (1932-1935).⁴ From 1954 until 1989 the country was under the dictatorship of General Alfredo Stroessner, who turned to external financing for support and reoriented the economy towards Brazil, with the construction of Itaipú, and encouraged Brazilian immigration.⁵

With the return of democracy in 1989, attempts began to consolidate a modern and plural State. The 1992 Constitution guaranteed the balance of power and tried to avoid concentrating it in a few hands. With a sort of “attenuated presidential system,” Paraguay’s Legislative Branch has broad powers over the budget, including approval of operations with multilateral agencies. The Constitution also confirms the decentralization of Paraguay into subnational governments (departments and municipios), the protection of minorities through proportional representation, and the promotion of cooperative enterprise, guaranteeing autonomy and freedom of organization.

The period since the return of democracy (1989 to 2003) was marked by a context of financial and economic crisis. In line with the prevailing development recipes at the time, in the early 1990s Paraguay deregulated its financial market, but without strengthening the central bank’s regulatory capacity.⁶ Two banking crises followed between 1995 and 2003, resulting in the liquidation of 70% of the country’s banks, a drastic reduction in credit to the private sector, and the deterioration of the portfolio of the Banco Nacional de Fomento (BNF), the public development bank. The financial crisis ended up deteriorating the fiscal position of the government, which had to take on significant financial sector liabilities (16% of GDP) in a context of recession (GDP growth of -0.4% between 2000 and 2002). As a result, by 2003 living standards in Paraguay were similar to those in 1989.⁷

After two years of negotiations and close to default, in 2003 the Government of Paraguay concluded a stand-by arrangement with the International Monetary Fund (IMF). It was the first agreement of this kind in 43 years. Financial equilibrium was restored through a series of tax reforms and financial system reorganization. Tax revenues increased from 9.1% to 11.5% of GDP between 2002 and 2005. The country went from a primary deficit of 1.9% of GDP in 1999-2002 to a surplus of the same size over 2003-2005.⁸

These reforms were accompanied by very favorable external conditions for Paraguay. Between 2003 and 2008 exports grew by 7.7% a year, driven mainly by soybean exports, which went from a value of US\$285 million in 2000 to US\$1.6 billion in 2010, due to a combination of rising prices and a doubling of the tonnage.⁹ The two main export items (soybeans and beef) went from representing 35.4% of the total in 2003 to 50.6% in 2008, intensifying the concentration of exports. In a sharp break with the preceding trend, per capita GDP grew by 38% between 2002 and 2008 (4.1% per year), compared with a drop of 12% between 1996 and 2002 (2% per year).

The start of the review period (2009) was marked by two key events: the outbreak of the international financial crisis and political changes. In 2008 a coalition led by President Lugo, supported by the party with the second-highest number of votes (the Liberal Party), formed a government, bringing about the first change in political party since 1947. Despite this change, economic policy remained relatively stable.¹⁰ Even in the wake of the political crisis of 2012, which ended with the President being removed from office (see Box 2), the new Minister of Finance indicated a strategy of continuity (see paragraphs 3.22 and 3.23).

Another important event during the period was the conclusion of new policy agreements between Brazil and Paraguay.²⁵ Among other things, agreement was reached on the construction of a new bridge joining the two countries, a 500-kv transmission line between Itaipú and Villa Hayes (with funding from FOCEM), and the review of the price of electricity sold to Brazil by Paraguay under the Itaipú Agreement. This renegotiation yielded additional revenue of about US\$240 million per year (1.6% of GDP), with which FONACIDE was established in 2012 (see Box 3).



Almost a third of the population lives in the metropolitan area of the capital city, Asunción. Although urban development has progressed rapidly in recent years, the country remains predominantly rural (46%).
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BOX 2. THE 2012 POLITICAL CRISIS

On 21 June 2012 the Congress of Paraguay began impeachment proceedings (under Article 225 of the Constitution) against the then president Fernando Lugo, as a result (among other reasons) of the death of landless campesinos and policemen in Curuguaty. The following day the Paraguayan Senate—by a majority of 39 to 2—voted to remove the president from office for poor performance of his functions. In response, the presidents of MERCOSUR and UNASUR considered that there had been a “breach of the democratic order in the Republic of Paraguay” and suspended the country from the two bodies.¹¹ Some countries withdrew their ambassadors from Asunción or called them back for consultation.^{12, 13, 14, 15, 16, 17, 18}

For its part, Paraguay “regret[ted] that the other States parties concerned had penalized the Paraguayan government and people and admitted a new full Member to MERCOSUR before completion of the legislative procedures necessary for that purpose in the penalized country.”¹⁹ In September, Paraguay’s new president, Federico Franco, mentioned the “difficult international situation caused by our neighbors, who are members of MERCOSUR and UNASUR.”²⁰

In the meantime, the Organization of American States (OAS) and the European Union (EU) each sent a mission to study the situation *in situ*. After visiting Paraguay the Secretary General of the OAS concluded that although the “rapidity of the impeachment process was very unfortunate and gave it an aura of illegitimacy,” Paraguay’s suspension would not contribute to achieving the OAS’s goals. Moreover, the Secretary General reported that there was a state of “political, social, and economic normality that [was] appropriate to preserve” and the suspension “would have serious economic implications for the country given the direct impact of the decision on other institutions in the inter-American system.”²¹ In November 2012 some countries’ ambassadors officially resumed their diplomatic functions.²² After President Cartes took office in 2013, UNASUR normalized relations and MERCOSUR lifted Paraguay’s suspension.^{23, 24}

Box 3. THE NATIONAL PUBLIC INVESTMENT AND DEVELOPMENT FUND (FONACIDE)

In May 2011, the Brazilian Congress approved the agreement under which the price of power transfers from Paraguay to Brazil was renegotiated, thereby increasing Paraguay's revenue from US\$120 million to US\$360 million (1.6% of GDP in 2011).²⁶ Given the magnitude of those additional resources, a debate ensued regarding their use, which included civil society (education NGO "*Juntos por la Educación*"), which advocated using the

resources to finance investments in the sector. In September 2012, the second bill was passed: Law 4758 creating the National Public Investment and Development Fund (FONACIDE). Under this law, 30% of the funds would be earmarked for a National Fund for Excellence in Education and Research (FNEEI), 28% for infrastructure, 25% for departmental and municipal governments, 10% for health, and 7% to finance the Development Finance Agency (AFD). The law also provided that, under the FNEEI, a series of minimums and maximums would be distributed among various investment categories (information and communication technology, education supply, scholarships) (see box above). With regard to municipal and departmental transfers, it was agreed that the same distribution system used for royalties (Law 3984/10) would be used, which is biased in favor of municipios directly affected by the dams, regardless of their needs or poverty levels.

Under the FONACIDE law (Articles 14 and 15), the Fund will be administered financially by the AFD and will be governed by a board of directors chaired by the Minister of Finance and made up of the Minister of Education and Culture, the Minister of Public Health and Social Welfare, the Technical Secretary for Planning, and the President of the National Science and Technology Council (CONACYT). In addition, four education experts appointed by the President of the Republic would participate in the leadership of the board, though with no voting rights. The main function of the board is to decide on the proposed investment projects, ensuring the proper use of FONACIDE's resources (Article 16). The list of projects already approved and under consideration can be found on the website of the Technical Planning Department ([Link](#)).

Program to be financed	Min	Max
Incorporation of ICT	30%	40%
Teacher training	10%	
Improvement of educational offerings		15%
Early childhood services		10%
Parent and guardian school cooperation	3%	5%
Domestic and foreign scholarships	30%	40%
CONACYT programs and projects, including PRONI	20%	30%
Evaluation agencies		5%
TOTAL	93%	

TABLE I. SELECTED ECONOMIC INDICATORS

Indicator	2009	2010	2011	2012
Real Sector				
GDP constant prices (billions of Guaraníes)	20,282.25	22,937.80	23,933.46	23,646.26
Real GDP growth (%)	-4	13.1	4.3	-0.9
GDP by sector (% real change)				
Agriculture	-17.3	34.2	3.7	-19.3
Industry	-0.1	7.9	-0.8	4.4
Services	0.5	7.4	5.8	5.4
Population and income				
Population (millions)	6.3	6.5	6.6	6.7
Per capita GDP (US\$ PPP)	5,249	5,913	6,195	6,145
Open unemployment rate (%)	7.9	7	6.6	6.9
Fiscal indicators (% of GDP)				
Central government revenue	17.6	17.1	17.4	18.2
Revenue from taxes	12.9	13.2	13.4	13.8
Central government expenditures	17.5	15.9	16.7	19.9
Central government primary balance	0.1	1.2	0.7	-1.7
Net public debt	16.9	14.7	12.4	14
Prices				
Inflation (end of period; %)	1.9	7.2	4.9	4
Lending rates – PYG (average; %)	28.3	26	28.9	29.1
Current account (US\$ million)				
Trade balance	-1,043	-1,397	-1,678	-1,495
Current account balance	68	-654	-220	334
International reserves (US\$ billion)				
International reserves (US\$ billion)	3,862	4,167	4,983	4,995

Source: IMF, WDI, Central Bank of Paraguay, ECLAC

A. PARAGUAY'S DEVELOPMENT CHALLENGES

At the start of the period under review, Paraguay continued to face a series of structural difficulties. Although it had achieved macroeconomic stability, its tax burden (13% of GDP) remained among the lowest in the Americas. The country continued to depend on transfers from the Itaipú and Yacyretá binational hydroelectric plants (2.5% of GDP), which contributed to fiscal laxity, especially at the subnational level.²⁷ In addition to low tax collection, the Paraguayan tax system lacked equity. In particular, the agriculture sector, which accounts for almost 25% of GDP directly, made only a marginal contribution (0.02% of GDP) to tax revenue, in part because of the inefficient agriculture tax.²⁸ Two thirds of tax collection come from indirect taxes (VAT and customs tariffs), while the personal income tax had not been implemented.²⁹

Public expenditure also faced problems of inefficiency and poor quality, mainly as a result of the political economy of the budget process.³⁰ In particular, the budget process was inefficient and lacked credibility since the Congress had broad powers to change the budget sent by the Executive Branch and has used that power to increase spending without identifying alternative revenue to finance it, as the law requires.³¹ In response, the Executive Branch limited the actual execution of the budget based on resource availability through an annual financial plan generating a high level of underexecution (17%), particularly in the physical investment budget (42%).³² Despite progress on decentralizing resources to subnational governments (through royalties), there were shortcomings in terms of the assignment of responsibilities at the subnational level and a lack of accountability for expenditures. Lastly, public spending exhibited problems of quality due to the sector policies (e.g. social program overlaps).

The agricultural export model firmly established in Paraguay since 2003 was also beginning to present new challenges and vulnerabilities. With increases in planted area between 2003 and 2012 (from 1.5 million to 3 million hectares), the possibilities of future expansion are limited in the eastern part of the country.³³ Moreover, the concentration of agricultural production on soybeans and the economy's dependence on its agricultural exports significantly increased the country's economic vulnerability. This vulnerability became evident during the droughts of 2009 and 2012, which caused a drop in the soybean harvest of 39% and 48%, resulting in a 4% and 1% drop in the GDP, respectively (see Table 1).³⁴ Moreover, these extreme events (droughts/floods) are likely to be increasingly frequent in Paraguay as a result of climate change, which will compound these vulnerabilities.³⁵

In addition, the soybean model carries socioeconomic implications for the Paraguayan agriculture sector, deepening the duality between a sector of small farmers with a low level of modernization coexisting with a modern and very technologically sophisticated sector. Small family producers account for the majority of farms (90%) and rural employment (94%), but farm only a small fraction of the land (8%). They specialize in the production of vegetables, fruit, cassava, and cotton. The large producers have higher levels of technology and more capital, most of it foreign, and focus on the monoculture of soybeans over large areas (more than 500 hectares).³⁶ Indeed, 1.8 million hectares in the eastern region were bought by foreigners between 2006 and 2010, who now own 25% of the large farms.³⁷ The expansion of the modern agriculture sector was coupled with a drop in income for the campesinos, their displacement, and an increase in conflicts.³⁸ In addition, there are problems related to insecure land tenure and overlapping claims, since 54% of the farms have uncertain titles or none at all, a situation that is worst among the smallest farms.³⁹

The agricultural export model also poses challenges for the sustainable use of natural resources. Intensive agriculture, coupled with low sanitation coverage (25%), represent a risk to water resources (for example, pollution of the Patiño



The biggest challenge the sector faces in Paraguay concerns the low level of wastewater collection and the lack of effluent treatment.

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aquifer, Lake Ypacaraí). The expansion of the agricultural frontier also aggravates the problem of deforestation, which has been particularly thorough in the eastern region. Between 1945 and 1991, Paraguay lost 73% of its tropical forest and the forested areas in the Chaco region are threatened by the expansion of agriculture and livestock farming.⁴⁰ Deforestation is not only caused by the use of land for agriculture but also by the high level of domestic use of wood as a fuel (biomass), which stands in contrast with the ample capacity for hydroelectric energy generation.

Lastly, the agricultural export model has traditionally been incapable of generating jobs and combatting poverty. The connections between the agriculture sector and the rest of the economy are weak and, given its high level of mechanization, soybean

production generates very few jobs directly.⁴¹ In addition, as a consequence of its low tax contribution and the high concentration of land ownership, the agricultural export model compounds Paraguay's already regressive income distribution. In fact, Paraguay has one of the most unequal income distributions in the region (Gini 0.51) and is one of the most unequal in terms of land distribution.⁴²

Ranking sixth lowest in terms of human development index in the region and fourth in terms of highest infant mortality, Paraguay faces numerous social challenges.⁴³ Although the emergence from the crisis and the establishment of a fledgling social safety net together helped to reduce poverty during the period that precedes this evaluation (between 2001 and 2008), progress has been much slower since then.⁴⁴ Beginning in 2005, the government has been increasing its levels of social spending with the creation of a social safety net (*Tekoporã*), but its investments in education and the social sector are still among the lowest in the region.⁴⁵ The latest data available from 2011 indicated that in Paraguay 32% of the population is poor and 18% is extremely poor, while in rural areas, the figures climb to 45% and 30%.⁴⁶

Unlike most countries in the region (11 of 18) whose principal concern is crime, Paraguayans are concerned about the lack of jobs.⁴⁷ Although open unemployment is not very high, informality (65%) and underemployment (20%) are significant concerns.⁴⁸ The unemployment problem is closely connected to the problems of coverage and quality of the Paraguayan education system. In fact, net enrollment rates in primary and secondary school are among the lowest in Latin America and overage pupils and dropout rates are significant problems.⁴⁹ The lack of preparation and training of the workforce also affects the country's competitiveness.

Paraguay has the region's second least competitive economy and the low quality of its infrastructure (ranks 140 out of 144 economies) and its low level of investment (14% of GDP)⁵⁰ are the main obstacles. This situation is compounded by the pressure on infrastructure arising from Paraguay's landlocked location, as it makes foreign trade disproportionately reliant on roads and ports. An additional logistic challenge is the high cost of shipping (20% *ad valorem*), four times that of neighboring Argentina.⁵¹ Apart from infrastructure, according to business owners, Paraguay's main competitiveness challenges are corruption, informal sector practices, and the untrained workforce.⁵² These are compounded by the challenges of a financial sector that, while sound, has excessive liquidity and high intermediation costs (spread of 2,000 basis points).⁵³ On the other hand, Paraguay does have a number of competitive advantages, such as significant renewable energy, low corporate income taxes, and preferential access to MERCOSUR.

B. FUTURE TRENDS

Although Paraguay's suspension from MERCOSUR (see Box 1) was lifted, the effects that it could have on the future course of Paraguay's integration policy are not clear. The transition government that ended in August 2013 expressed willingness to deepen its relations with new partners: it joined the Pacific Alliance as an observer and has expressed its wish to sign a free trade agreement with Mexico. Moreover, Paraguay's trade flows with its MERCOSUR neighbors (50% of exports), particularly Brazil (30%), remain strong. The new investment and maquila sector (textiles, automotive parts) opportunities are oriented towards the Brazilian market, which already represents 35% of the maquila sector.⁵⁴ Moreover, Paraguay is the main beneficiary of MERCOSUR's cohesion funds (FOCEM), of which it received US\$550 million over the 2009-2013 period. As a landlocked country, the definition of its integration strategy will be one of the main topics to be decided, and it looks unlikely that there will be any major changes in the short term.

In the search for a new model of growth and job creation Paraguay has yet to reach consensus on the future role of industry. The options include a proposed industrial park based on a major aluminum investment, a proposal to expand the maquiladora industry (e.g. auto parts) for markets in MERCOSUR, and to add value to agricultural production through agroindustry.⁵⁵ Although they are not entirely exclusive, each of these options has different costs (e.g. implicit subsidy in the price of electricity), benefits (e.g. direct and indirect jobs), and risks (market, environmental) that should be carefully considered in the future.

The abundant availability of natural and human resources represent a strategic opportunity for Paraguay going forward. Its unique position in the energy field stands out in particular: the country's installed electric power (8,000 MW) exceeds its peak consumption threefold, all its power is generated from renewable sources (hydroelectricity), and it represents 30% of total exports.⁵⁶ The eastern part of the country is located on the Guaraní aquifer, one of the world's largest reserves of fresh water, ensuring the country's future access to this strategic resource. Additionally, there is the possibility of oil wealth opening up for the country, currently being explored. Lastly, in the midst of a demographic transition, Paraguay also has the opportunity of a future "demographic bonus" from a growing young, working-age population, provided young people are able to join the labor market effectively.⁵⁷

The country is also at a favorable juncture that could prove to be a turning point in its process of economic development. Not only are the new FONACIDE resources available to finance infrastructure investments in education, health, science, and technology, but the government has successfully issued a US\$500 million sovereign bond to finance infrastructure works. Lastly, the Paraguayan Congress has approved a new law on public-private partnerships that could increase flows

of private investment for infrastructure works. However, a growing concern has been the rapid rise in current expenses since 2010 due to the stimulus programs and salary increments in the budget laws, which have led to a deterioration in the primary surplus.⁵⁸



Beginning in 2005, the government has been increasing its levels of social spending with the creation of a social safety net (*Tekoporá*), but its investments in education and the social sector are still among the lowest in the region.
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2 The IDB, its Strategy, and its Programming in Paraguay (2009-2013)

During the review period (2009-2013), the country had a long-term development strategy (PEES, 2008-2013) that included an economic stimulus program for the 2009-2010 period. The Bank's operations between 2009 and 2013 were guided by the country strategy (GN-2541-1, February 2010) and the annual country programming documents (CPDs) between 2010 and 2013.⁵⁹

THE GOVERNMENT OF PARAGUAY'S STRATEGIES FOR THE 2008-2013 PERIOD. After a period of growth and macroeconomic stability, the government sought to make progress on generating socially inclusive growth and promoting human development.⁶⁰ To do so, its program envisaged eight pillars: (i) macroeconomic policies; (ii) financial system development; (iii) management of public enterprises; (iv) modernization of public administration; (v) agrarian reform; (vi) infrastructure development; (vii) competitiveness and business climate; (viii) generation of employment and poverty reduction. Specific actions were associated with each of these pillars: in total 112 policy measures and actions with indicators per action and state agency in a results framework. The strategy's level of detail made it an evaluable government program (see Portfolio Annex).⁶¹

THE IDB'S STRATEGY. The 2009-2013 Country Strategy Document is a relatively short 11-page document, the main component of which is a summary of the sector technical notes and the identification of the possible general areas for Bank intervention (see Portfolio Annex).⁶² The original strategy (GN-2541) was questioned by the Board of Executive Directors owing to its lack of evaluability. This resulted in the final version (GN-2541-1) incorporating a results matrix with "indicative targets."⁶³ Although they are only indicative, Management indicated that these targets would be "revised or replaced as necessary through the programming documents prepared during the period of the country strategy."⁶⁴

EVALUATION OF THE COUNTRY STRATEGY AND COUNTRY PROGRAMMING DOCUMENTS.

By concentrating on clearly sectoral considerations, the IDB's country strategy with Paraguay lacks a general diagnostic assessment of the situation in the country and does not set priorities for the Bank's action.⁶⁵ Nor does it offer any guideline for dealing adequately with crosscutting elements, some of which are crucial given Paraguay's development challenges (e.g. regional integration or natural resources). Other crosscutting elements (climate change) are considered on a sector basis, reflecting the Bank's bureaucratic logic rather than an exigency of development. Given their breadth and generality, the nine country strategy objectives (e.g. expanding productive infrastructure) are aligned tautologically with the national strategy (PEES).⁶⁶ Lastly, although it includes 10 sectors, the Bank's programming was much more focused, leaving entire sectors with no programming (e.g. climate change).

The annual programming documents (CPDs) provide a snapshot of the state of the Bank's program and a summary of the various operations slated for approval in the year (See Portfolio Annex). However, these documents are weak in terms of the presentation of results.⁶⁷ First, there is no obvious connection between the strategy indicators (e.g. building 140 km of roads) and the operations that, according to the CPDs, support these indicators (e.g. technical cooperation operations and a private sector loan for a cement factory).⁶⁸ Unfortunately, this example is not unique: in 14 of the strategy's 25 indicators there is no logical connection between the indicator and the program. There are no associated operations for six of the indicators.

Second, the majority of operations disappear from the CPDs without results ever being reported. Between 2010 and 2013, 63 operations are mentioned (loans, technical cooperation operations, knowledge and capacity-building products) in the CPDs' results matrixes. Of these, Management only reports tangible results in any areas for 16 of them (two complete, 14 partial). Of the remainder, 19 are still in progress (the whole loan program) and 23 disappeared from the CPDs' results matrixes, execution having been completed but with no results being presented. Even when results are stated, this is done in an ambiguous or confusing way. For example, in the 2012 CPD it was reported that the target number of households in the conditional cash transfer program (Tekoporá) had been exceeded, even though the Bank only financed a social protection survey (PR-T1123/PR-T1126).⁶⁹ Given the weak links between the operations and the indicators, and the limited follow-up of operations, the evaluability analyses are of little use.

In summary, the strategic documents continue to present weaknesses in terms of guiding the Bank's actions. In particular, the strategy lacks a general diagnostic assessment, a prioritization of the challenges, and given its sector-based approach, is not suited to addressing the crosscutting challenges. The number of sectors included

in the strategy seems to respond more to the political economy of the various internal Bank divisions than the needs of the country. Lastly, the monitoring and evaluation arrangements for both the strategy and the CPDs are deficient, with a matrix of indicators that bears no relationship to the Bank's operations.

A. THE BANK'S PROGRAM

Although the country strategy and the CPDs do not seem to be particularly relevant to guiding the Bank's program in Paraguay, this does not mean that the Bank's program is irrelevant. On the contrary, the Bank's program is closely aligned with the country's priorities, its development strategy during the period (PEES), and the independent diagnostic assessments of Paraguay's main development challenges. (See Portfolio Annex, Alignment with the PEES).

The portfolio being evaluated includes 140 operations, for a total of US\$1.768 billion, including operations approved prior to 2009 (46 operations for a total of US\$701 million) but whose execution or results were in the review period. On top of this are approvals for US\$1.067 billion over the 2009-2013 period, divided among 21 sovereign loans (US\$921 million), nine private sector loans (\$236 million), and 65 technical cooperation operations (\$36 million). At the sector level, almost 60% of the sovereign portfolio approved between 2009 and 2013 is related to infrastructure sectors (highways 40%), 22% corresponded to fiscal PBLs, and 12% to financing public development banks. Infrastructure, PBLs, and public banks represented 94% of the portfolio approved in 2009-2013 and these percentages are similar for the full portfolio.⁷⁰

The Bank's portfolio demonstrated a strong focus on infrastructure sectors, with a significant component of continuity. Not only is it one of the countries with a larger portfolio in infrastructure (see Portfolio Annex), but in most of these sectors, the Bank's work has been based on lines of intervention established over time. For example, the Bank has supported the country in the area of rural roads with four consecutive loans since 1993. The same is true for rural water and sanitation or the reform of public development banks since 2002.

The high transaction costs involved in legislative ratification are consistent with the continuity and focus on infrastructure. In terms of continuity, the limited evidence available supports the hypothesis that the initial phases take longer to be approved in Congress. One example is the case of projects to reform second-tier banks, in which the first operation spent two years in Congress, whereas subsequent operations were approved in 0.7, 0.4, and 0.9 years.

The bias in favor of infrastructure projects, for its part, is illustrated by the fact that the Bank's projects related to State reform took almost 50% longer to obtain legislative ratification than infrastructure projects (9.6 versus 6.3 months).⁷¹ Furthermore, in

the discussion of a reform project, one senator addressed the matter explicitly: “[...] the only loans of any use to the country have been those for infrastructure. All the loans we approved for State modernization, for street children, etc. were useless, it was impossible to comply with the program, the cadastre and property registry, indigenous peoples [...] I’d like to conduct a study of these past 20 years and see how many millions of dollars we have wasted on loans that were ill spent, on consulting, offices, clerks, coffee, trucks [...]”⁷² It is important to emphasize that, on top of the Legislative Branch delays (8.3 months), there are Executive Branch delays (8.6 months) in submitting projects to Congress for consideration, often as a result of waiting for a favorable context (see Portfolio Annex). Lastly, the bias in favor of infrastructure is not exclusive to Paraguay, as it is a feature shared by countries with legislative ratification (see Figure I.3, Portfolio Annex).

Despite the infrastructure bias, the Bank’s program with Paraguay is generally relevant. After all, Paraguay’s infrastructure challenges are significant (see paragraph 1.16). And there is evidence that the Bank used its technical cooperation program—which focuses on reform sectors—to partially offset for this bias in its loan program. Almost a third of the US\$36 million in grants approved during the period supported education and social investment areas (One Laptop Per Child and *Pequeños Matemáticos* [young mathematicians]), while another third went to the agriculture sector and to promoting competitiveness. Almost 15% targeted policy reform, including the strengthening of the Ministry of Finance (decentralization, debt office) and the Comptroller General’s Office.⁷³

Conversely, the Bank does not seem to have used the concessional funds (FSO) strategically. In particular, there is no evidence that the Bank used these concessional resources to act as an incentive for the portfolio in sectors (e.g. social sectors) that, although important, have not been given priority, most of which are consistent with the FSO mandate.⁷⁴ Moreover, there is no evidence that the Bank used the FSO funds any differently from nonconcessional funds. Nor is it clear that the established FSO-OC mix (80-20) or the restrictions for programming (e.g. timeframes for approval) are consistent with the strategic use of that fund.

Lastly, the Bank’s programming was practically nonexistent (or experienced cancellations) in some key areas of Paraguay’s development agenda. Although this was not entirely attributable to the Bank, there was no programming in areas such as promotion of transparency or adaptation to climate change. In addition, key projects in the reform portfolio (customs, cadastre and property registry, environment) were cancelled.

Consistent with the parliamentary ratification dynamic, the Bank tended to use instruments that favor continuity and there was a move towards greater execution, particularly of the technical cooperation program. Paraguay’s portfolio was characterized by the use of loan modalities that facilitate the transition between different phases

of a single program (CCLIPs, multiphase programs) and, in particular, use of the Project Preparation and Execution Facility (PROPEF). PROPEFs are used to provide continuity and advance investments while the parliamentary ratification is under way. Paraguay made heavy use of this instrument (particularly through 2010), accounting for almost half of the Bank's PROPEF amounts approved. Moreover, during the 2009-2013 period the government's tendency to reduce the execution of technical cooperation operations became more pronounced when, beginning in 2003, they too had to be subjected to legislative ratification.⁷⁵

Although PROPEFs have been a useful means of avoiding interruptions linked to the ratification of subsequent project phases, their use is not cost-free for the country, as in the case of cancellations or excessive delays (e.g. Customs, PR-L1026/PR-L1052).⁷⁶ More generally, the long ratification periods entail significant costs for the country in terms of credit fees.⁷⁷

During the period under review, the lack of a contingent liquidity instrument to address crisis situation also became apparent. Instead, the necessary liquidity was provided through the reform instrument (PBL), a practice that, although used in the past, counteracts the reform objective of PBLs.⁷⁸ The importance of a contingent instrument to the country was pointed out by the Governor for Paraguay in his statement to the Board of Governors in 2012, and this lack was recently rectified by the new contingent facility (AB-2890).⁷⁹

B. THE BANK'S OPERATIONAL RESPONSE

The Bank's program successfully provided financial resources rapidly and in line with the country's strategic plan (See Portfolio Annex). In the 2009 Recovery Plan the Government decided to focus the IDB's program towards (i) a programmatic "contingency" operation (US\$150/200 million in two tranches), and (ii) a funding operation for the AFD. With these operations the Bank covered 30% of the government's anti-crisis plan. Both operations received expedited processing from both the Bank and the country: the PBL was fully disbursed on 21 December 2010, while the AFD loan disbursed 20%, 30%, and 50 % in 2010, 2011, and 2012, respectively. As anticipated in the CSD, almost 50% of the Bank's 2009-2013 program was approved in the first two years, and 55% of disbursements were confirmed in the same period.⁸⁰ In addition, during the period the Bank slightly increased its disbursements (excluding PBLs) from about US\$90 million to US\$100 million between 2008 and 2012.

The Bank proved flexible in adjusting to the priorities of the new authorities, which took office in June 2012 (see Box 2). The new Finance Minister aimed to continue with previous economic policy and certain measures in the fiscal (e.g. implementing an income tax, correcting tax distortions linked to the agriculture sector) and monetary (e.g. recapitalizing the BCP) areas. Additionally, certain medium-term objectives were set, such as the strategic use of additional resources from Itaipú for social projects

(FONACIDE), the development of a long term financial market, the strengthening of Paraguay's image in the world (through the issue of a sovereign bond), and the use of a major aluminum investment (about US\$4 billion) as a catalyst for industrial development.⁸¹

The new priorities were soon reflected in the Bank's program. In December 2012 the Bank approved a technical cooperation operation to support the design of an industrial park associated with the aluminum industry (PR-T1131), another to support public debt management, which now includes the new sovereign bonds (PR-T1142), and one more to support the management of FONACIDE (PR-T1148).⁸² The Bank also supported the country with various technical studies on the BCP recapitalization bond, a diagnostic assessment of the pensions sector, and another for the development of the securities market with funds from the C and D Action Plan and the administrative budget.

However, the Bank's relationship with the country was affected by the fact that the Bank's post of Representative in the country was left vacant for a protracted period (12.5 months), which overlapped almost entirely with the new government's tenure. The prolonged interim period in Paraguay not only far exceeded the average period (three months) and the most frequent length (0 months) of interim appointments at the Bank, but also occurred during a time of regional isolation as a result of the political crisis.

C. MANAGEMENT OF THE IDB PROGRAM IN PARAGUAY

The Bank had to overcome problems with its public image in Paraguay, stemming from the period preceding the one under review.⁸³ In an effort to address this difficulty, at the start of the period the Bank hired a specialized consultant to help it work on a communication strategy.⁸⁴ At the same time, the Bank gave strong impetus to its civil society consultation and outreach mechanisms through the Civil Society Consulting Groups (ConSOCs).

Paraguay's ConSOC is subdivided into five thematic discussion forums: Education and Employment, Early Childhood Development, Climate Change, Citizen Security, Information and Communication Technology, involving the participation of 34 civil society organizations. The thematic discussion forums, which are organized and coordinated by Bank staff, facilitate debate on sector public policies. In some cases the Bank provided the discussion forums with resources to finance specific studies (e.g. mapping of organizations working on early childhood development).⁸⁵

Given the importance of the role of civil society in policy making in Paraguay (e.g. the debate fostered around the FONACIDE Law, see Box 3), the Bank's support to this sector not only has high potential impact in terms of its image but also has a high profile.⁸⁶ As to the outcomes, although there is no baseline, the Bank's survey

of Paraguay's public and private sectors in 2012 confirms the high regard in which it is held in the country and negative comments about the Bank in the press have become more sporadic.

A second topic receiving considerable attention in the period was the slow execution of the Bank's projects, which are among the Bank's most protracted, to a large extent as a consequence of the time it takes for sovereign loans to obtain legislative approval (see paragraphs 2.11 and 2.12).⁸⁷ Management ran two initiatives aiming to improve portfolio management efficiency. First, a project management training course (PM4R) closely aligned with Ministry of Finance priorities, aimed at executing units, was conducted with KNL support.

Progress was also made on reorganizing the work of the Bank's Country Office, improving the efficiency of its operational services and stressing monitoring for results. A "services unit" was set up, providing 84 fiduciary support and management services (e.g. disbursement processing, terms of reference review, bidding document preparation) to the Bank's sector specialists.⁸⁸ The aim of centralizing operational support functions is to provide a more efficient (by standardizing processes), equitable (by distributing the load between operations analysts), and uniform service for customers.⁸⁹ At the same time, the Bank's Country Office sought to tap into the planning documents required by the Bank (annual work program, procurement plan) and other inputs (audited financial statements) to adjust the workload and provide operational support in accordance with projects' needs. The Bank's Country Office also designed a new semiannual report format to follow up on projects' tangible outputs, rather than just financial aspects.

Several fiduciary challenges were noted by the Auditor General in his 2010 report. These included problems with audit quality and the excessive workload relating to procurement topics due to the universal use of *ex ante* reviews. There is evidence that the Bank's Country Office in Paraguay made progress in this regard, with a series of initiatives for improvements. Progress was made on implementing ex post financial supervision in 2011 and with the streamlining of procurement specialists' work through the Service Units. Audit reports were also used to determine executing unit risks, improve the Bank's support for executing units, and raise the quality of future audits.

In terms of strengthening country systems, progress was made on two fronts: public procurement (DNCP) and external audits (Office of the Comptroller General, CGN).⁹⁰ Following on from the Bank's continuing support since 2001 (TC0002087, PR-T1043, and PR-T1130), a pilot program is currently being implemented in order for the CGN to audit three Bank projects.⁹¹ As part of the general process of using country systems, in 2013 the Board approved the use of the reverse auction system for procurement in Paraguay (GN-2538-11).



OVE observed the sustainability of rural interventions during on-site visits, but did not confirm the sustainability of those in indigenous communities, which face significant socio-cultural constraints in terms of project ownership.

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Although the reforms are relatively recent, there is evidence that the Bank has made progress in terms of the efficiency of its processes. Given that service units were recently implemented (mid-2012), it is difficult to determine outcomes at the aggregate portfolio level (age of portfolio, annual disbursements). However, various process efficiency measures support the effectiveness of these reforms. Between July and December 2012 Management shortened response times to executing units' requests by 25%. The response times on disbursement issues were cut from 23 to 12 days between 2011 and 2013 and disbursement times were brought down to the Bank's average over the same period. The biggest efficiency gains took place in response to international competitive bidding and national competitive bidding (a 30% time reduction between 2009 and 2013). As regards audited financial statements, since 2009 there has been a positive

trend towards a reduction in the number of observations and a marked improvement in compliance with procedures: the on-time delivery of audit reports reached 95% in 2012, with just one late report (compared with 50% in 2009-2010). Although these process outcomes are encouraging, the extent to which they are reflected across the portfolio depends on other, numerous factors, not all of which are under the Bank's control (e.g. legislative ratification, budgetary process).

D. OTHER DONORS

Over the 2009-2013 period other cooperation agencies approved projects worth around \$2.030 billion, primarily in the infrastructure sector (56%), and particularly in energy transmission (US\$670 million, 33%), of which US\$400 million correspond to a FOCEM grant to build a 500-kV line between Itaipú and the Asunción area. The European Investment Bank (EIB) and the Andean Development Corporation (CAF) cofinanced energy-sector loans with the IDB, while the OPEC Fund for International Development (OFID) also provides support in this sector. CAF and FONPLATA have positioned themselves with loans in the road sector. The World Bank opted for a strategy of cash-flow loans (US\$200 million) and a cofinanced loan for power transmission (US\$100 million), as a way to mitigate its resource disbursement difficulties (its disbursements came to only US\$12 million per year).⁹² Among bilaterals, the major Japan International Cooperation Agency (JICA) program, which includes US\$216 million for power generation (Yguazú), stands out.

The Government of Paraguay, through the Ministry of Finance, headed donor coordination during the 2008-2013 period. As a result, it is likely that traditional donor coordination mechanisms (e.g. discussion forums) were not very relevant. The significant coordination among donors on the operational level, through the cofinancing of operations, is remarkable. In fact, in the period the IDB approved loans that provide for cofinancing with the EIB (energy), CAF (energy and roads), FONPLATA (roads), and JICA (rural roads). In this case also, it is possible that the reason for the widespread use of cofinancing is the difficulty with ratification and execution challenges in Paraguay.



In general, significant progress has been made on providing rural water coverage in Paraguay, which rose from 25% in 1990 to 66% in 2010.
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3 Implementation and Outcomes

A. OVERVIEW

A summary view of the progress of the Bank's portfolio with Paraguay is presented in Table 2. The interpretation of each of the valuations in the table constitutes a valuation of portfolio performance in three dimensions: execution, outcomes, and construction of sector institutionalality.⁹³ While useful in providing an overall view of the program, the table is only a summary of projects that can be a mixed bag. Reading the detailed sector analyses in this chapter and the specific annexes is therefore recommended.

In terms of the portfolio, an initial aspect that stands out is that execution of the Bank's projects varies. While the contingent loan and the AFD funding loans were executed rapidly, after parliamentary ratification, the investment loan portfolio faced serious challenges. Several investment projects closed after over 10 years of execution (roads in the western region, preinvestment). There were varied reasons for the delays, the most common being hold-ups in legislative ratification and the lack of counterpart resources.

Outcomes were achieved for sovereign-guaranteed operations in the infrastructure sector and for the AFD funding but were piecemeal in the rest of the portfolio. Although execution was slow, infrastructure investment projects generally achieved their results, with some cost overruns and quality problems in one specific project (roads in the western region). AFD funding loans have also successfully been turned into long-term loans to finance housing and productive activities, although they are small relative to the market. The results were isolated and partial in the remaining sectors, with the sustainability of some interesting projects, such as civil service reform, still unclear.

Perhaps the most distinctive feature of Paraguay's portfolio is the limited contribution of the Bank's projects to institutional strengthening, both at the central level (State modernization projects) and in the individual institutional

TABLE 2. PROGRESS OF THE BANK'S PROGRAM

Sector	TCs	Loans	\$ (%) ^a	Progress		
				Execution	Outcomes	Sector institutional framework
Water and sanitation	5	7	9%	MEDIUM	HIGH	LOW
Transportation and Urban Development	8	9	37%	LOW	MEDIUM	LOW
Energy	4	2	7%	MEDIUM	HIGH	LOW
Public Development Banks	3	5	9%	HIGH	HIGH	MEDIUM
Private Sector (SCF, OMJ, TFFP) ^b	0	14	8%	HIGH	N/A	N/A
Social Sector	18	9	8%	LOW	MEDIUM	LOW
Public Administration (incl. customs, civil service, justice)	11	9	2%	LOW	MEDIUM	LOW
Statistics and Cadastre and Property Registry	4	5	3%	MEDIUM	LOW	LOW
Budget Support (PBLs)	0	2	11%	HIGH	N/A	N/A
Agriculture, Competitiveness, and Exports	14	5	4%	MEDIUM	MEDIUM	LOW
Support operations	6	0	0%			
Total	73	67	100%			

Source: Prepared by the authors based on OVEDA information.

^a Percentage of total amount approved. Note that this portfolio includes not only operations approved in the period, but also those approved previously, but executed in the period.

^b Private sector approvals do not include those of the IIC during the period.

strengthening components of each of the sector projects. In practically all the projects the Bank proposed various institutional support targets. However, they generally had difficulty obtaining the desired outcomes. Even in the project with the biggest impact in terms of institutional reform (AFD), first-tier banking reform and cooperative sector regulation objectives were not accomplished. In others, the institutional framework is weak (highway maintenance), compromised by the dual governance/execution role (water), or affected by weaknesses in the sector's legal framework (energy). In all cases, the limited effect that the Bank's projects have had on the sector institutional framework stands out.

B. SECTOR ANALYSIS

Transportation and urban development sector. Paraguay's landlocked position means that roads play a fundamental role in the country's integration in the regional and global economy. The Bank's sector diagnostic assessment highlighted the need to support multimodal transport in order to integrate the country's waterways with an effective and efficient network of roads, ports, and logistic services enabling trade in goods and services, so as to overcome the disadvantages of the country's lack of direct access to the sea. However, programming remained geared to the road subsector, coupled with an urban modernization operation in Asunción that included an urban transportation subproject.

The program's focus on the road subsector was relevant in that Paraguay's road network is limited and the quality is low—one of the world's lowest (only 25% of the inventoried network is paved or improved). On top of the low coverage and quality, demand from increased foreign trade (particularly soybeans) and internal transport is growing due to the considerable expansion of the vehicle fleet (74% growth over the last five years).

More specifically, the Bank's program focused on three areas. First, paving, rehabilitation, and maintenance of roads in the primary network in both the eastern (phase I PR-L1007 and phase II PR-L1075 approved in 2013) and western (PR-0113) regions. Second, the upgrading and rehabilitation of the network of rural and local roads (PR-0104, PR-L1019). These two areas of intervention aimed to continue previous intervention models. Lastly, a third line of intervention focused on urban improvement in Asunción, including the development of a mass transport system (metrobus) for the city (PR-L1044).⁹⁴ This latter program was approved in April 2010. After twice being rejected by the Congress, among other things because of a lack of consensus over the technology to use, everything points to the project finally being approved with the electric metrobus option.⁹⁵ The project has also faced challenges of political economy with the current private service providers, which are still unresolved.

The road program encountered numerous challenges, which extended execution periods by more than 10 years in the first phases (PR-0104 and PR-0113) and seven in the second (PR-L1007). Some of the main challenges were: problems with the land registries affecting rights-of-way (PR-L1007), weak designs that led to significant cost overruns or changes in routes originally identified for rehabilitation (PR0113), lack of counterpart resources (PR-0104), delays in calls for tender (PR-0104), and termination of contracts due to time taken or quality of works (PR-L1007).

Differences in project effectiveness were apparent in the outcomes obtained. The integration corridors program showed a high level of attainment of the proposed targets in terms of the number of kilometers of roads rehabilitated and maintained under service level maintenance management contracts. The outcomes obtained in the rural roads program surpassed the targets originally set and it was highly successful at adapting a decentralized maintenance model that incorporated the community and provided opportunities for microenterprises. Lastly, although works in the western region roads program were completed and maintenance responsibility was successfully handed over to local private actors, sustainability issues arose as a result of problems with the road-surfacing materials used, compounded by delays in implementing the maintenance component.

In all cases the road programs showed vulnerabilities stemming from the lack of a sustained road maintenance strategy with own funds. With the exception of the rural roads program, progress on the sector's institutional framework was limited. Despite

the studies financed by Bank operations and the various strengthening programs carried out, the management and execution capacity of the Ministry of Public Works and Communications (MOPC) remains limited. The regulatory framework approved to address the country's acute road safety problem (road safety law) has yet to be implemented. Moreover, although the Bank's program promoted the creation of a transparency and safety office, it was not provided with either staff or infrastructure. Importantly, in trunk network operations, the MOPC was found to have limited capacity to manage measures for environmental mitigation and compensation of indigenous peoples. This was because of the Department of the Environment's shortcomings, which led to delays and to questions about its effectiveness by the Independent Investigation and Consultation Mechanism.

Water and sanitation. Despite the country's considerable water resources, Paraguay's treated-water (56%) and sanitation (25%) coverage remains among the lowest in the region.⁹⁶ The lack of public investment over many years and the abundance of water resources led to a highly decentralized system in which a multiplicity of public, private, and community actors coexist. The leadership and regulation functions are insufficiently developed to organize such a complex and diverse delivery system. Coupled with this complexity is the sector's institutional fragility, lack of consistent rate and subsidy policies, and significant investment gaps that make it difficult to fill coverage gaps.

The biggest challenge the sector faces in Paraguay concerns the low level of wastewater collection and the lack of effluent treatment. This situation is having a negative impact on the country's water resources. In addition to the deterioration and overexploitation of the Patiño aquifer, the lake is being polluted by effluents from intermediate cities in greater Asunción. This has led to Lake Ypacaraí, a cultural icon of Paraguay and its main domestic tourism destination, recently being closed to recreational activities.⁹⁷

The Bank's country strategy with Paraguay proposed financing investments in rural areas; supporting technical, managerial, and financial improvements in the sanitation company ESSAP (urban); and supporting improvements to the sector's institutional and regulatory framework through the Water and Sanitation Division and the Sanitary Services Regulatory Agency. However, the programming focused on investments and ignored the sector's institutional framework. Specifically, the Bank's program mainly concentrated on supporting the National Environmental Sanitation Service's PAySRI model of investment in water and sanitation in rural and indigenous communities (PR-0118 and its continuation, PR-L1055/ PR-X1003, approved in 2010) and on financing solutions for intermediate cities in the eastern region and the Chaco (PR-L1060/PR-G1001). Apart from these operations and their corresponding preinvestment activities, only one small technical-cooperation operation was approved (US\$250,000), to provide institutional support to the MOPC's lead agency (Water and Sanitary Sewerage Services Unit) in order to equip it with a new organizational structure and with tools to enhance its capacity.

It is important to stress that the Bank's program was scaled up significantly over this period (US\$135 million) with the approval of US\$100 million in investment grants from the Spanish Cooperation Fund (PR-G1001 and PR-X1003).

In terms of execution, the first phase of PAYSRI experienced delays in legislative ratification, delays in contracting the management firm, and difficulties identifying the communities and obtaining acceptance of the project due to the differences in the level of subsidies provided by SENASA. After subsidy level unification in 2004 (Decree 3617/04), the project has proceeded more smoothly. As regards the second operation approved in 2010, in anticipation of ratification delays, a PROPEF (PR-L1055) was used successfully to ensure continuity and finance the PAYSRI's first year of execution. In 2013 the second phase was 30% executed. The Chaco and intermediate cities program was ratified by the Legislative Branch in late 2012 and execution has recently begun. Although the Water and Sanitation Division's new role as this operation's executing agency may bolster its operational capacity, it may also put pressure on the already weak capacity to lead the sector.

In terms of outcomes, PAYSRI-I achieved the targets set, benefiting 100 rural and 10 indigenous communities, although it missed its target for the number of beneficiaries, since the target communities were smaller than initially anticipated. It also identified 50 additional rural communities (10 indigenous communities) for the next phase and created the corresponding water boards. According to the program's Project Completion Report, the sustainability of the systems built is high (94%), although this measurement was taken shortly after the completion of the works (2008). OVE observed the sustainability of rural interventions during on-site visits, but did not confirm the sustainability of those in indigenous communities, which face significant socio-cultural constraints in terms of project ownership. In general, significant progress has been made on providing rural water coverage in Paraguay, which rose from 25% in 1990 to 66% in 2010. The intermediate cities program has begun initial work, in terms of the involvement of the governments and main actors in the intermediate cities of the Ypacaraí basin, where the treatment and sanitation systems will be expanded. The Chaco component, linked to national investment in the Central Chaco aqueduct, has not yet started.

Energy. Historically the Bank has supported Paraguay's power sector by financing transmission and distribution works since the early 1990s (PR-0109 in 1991, PR-0030 in 1996). Although these investments ended satisfactorily, the country's refusal to adopt the sector reform proposal stemming from the Bank's public utilities policy (OP-708, 1996) caused an interruption in sector approvals, not only by the Bank but by most donors.⁹⁸ Despite the fact that in 2006 both the Bank and other donor agencies reversed their position, delays in the investment program were significant by then, particularly in the case of the weakest link: power transmission. By 2012 the investments needed to overcome the company's operational deficiencies

and meet faster demand growth will exceed an estimated US\$2.5 billion over the next 10 years. Additionally, the sector needs an update to its regulatory framework so as to promote greater efficiency in the sector and improve the management of the National Electricity Administration (ANDE).

The diagnostic assessment in the 2009-2013 country strategy sector note highlighted the challenge of redressing the imbalances between electricity supply and demand (through investments in transmission), making the power company more efficient, and promoting the sector's institutional and regulatory development. In fact, the transmission constraints explain in part Paraguay's atypical energy matrix: even though it is one of the world's biggest energy exporters, it has one of the lowest rates of per capita consumption in the region. Instead, the country's energy demand is still mainly met through biomass (firewood) and imported hydrocarbons for transportation.

In this context, the Bank approved a multiphase project to support investments in transmission and modernization of ANDE, applying for a waiver of the public utilities policy.⁹⁹ The sector also received substantial grants and investment loans from other development agencies to build transmission lines and substations (US\$670 million, FOCEM, World Bank, OFID, EIB) and a generation project (US\$216 million, JICA). The portfolio of projects currently being executed also included three technical cooperation operations. The first is to prepare the preinvestment for the second phase and the second is to finance an exchange of experiences to improve the environmental management of electricity projects. Lastly, the Bank approved a third operation aimed at supporting the country in the analysis and design of a project to install an aluminum production plant and associated industrial park, as a way of increasing domestic electricity consumption.

Execution of the transmission project was significantly delayed due to the slowness of parliamentary ratification (1.1 years), changes in the government authorities (2008) and the ANDE, and some of the problems associated with tendering processes. However, between 2008 and 2012, 75% of the program was executed—the level necessary to start processing the subsequent phase (PR-L1058, with CAF and EIB cofinancing)—and Phase II was approved in 2012. Phase I achieved the construction of 268 km of transmission lines, interventions in 10 substations, the installation of 300,000 meters, and a reduction in losses from 34% to 30.9%, just short of the 29% target.

The lack of a national consensus regarding private participation in the sector and the particularities of the Paraguayan power industry have made the approval of a specific law for the sector difficult so far. The bill is currently being discussed in the Paraguayan Congress. In order to increase national use of generated electricity, the previous government held discussions with the company Rio Tinto concerning the construction of an aluminum plant and an associated industrial park, which were suspended by the new government. This has diluted the possibility of implementing

this strategy, which from the beginning was the subject of strong criticism over the potential environmental impacts of a project of this kind and the lack of consensus about the most appropriate use of the country's huge surplus of electricity from Yacyretá and Itaipú.¹⁰⁰

Public development banks. Public development bank reform is an action line the Bank launched during the 2001-2002 economic and financial crisis, when the biggest first-tier public development bank (BNF) was in a situation of technical insolvency, compromising the stability of the financial system and generating significant contingent liabilities for a government in virtual default. As part of a stabilization program with the IMF, the Bank proposed reforming the development bank as an alternative to liquidation. Although the original program envisaged a series of comprehensive reforms, the lack of consensus led the Bank to give priority to a partial reform of second-tier banks. Thus, with Bank support, the Agencia Financiera de Desarrollo (AFD) was created in 2006 as a new second-tier entity to replace the four existing institutions. In the interim, the government restored the BNF to health, recapitalized it, and placed maximum limits on its lending, so as to eliminate fiscal and financial system risks. Comprehensive reform of the first-tier banking system has yet to be carried out. The BNF is now profitable but lacks a development finance role.

During the review period, the Bank had three lines of action. First, it provided financing to the AFD for the granting of long-term credit (housing, productive activities). Thus, three CCLIP loans for US\$50 million each were approved during the period (PR-L1024 approved in 2008 but executed during the period; PR-L1032 and PR-L1062, not yet disbursed). A second line of action focused on continuing the reform of first-tier banks through diagnostic and institutional strengthening operations at Crédito Agrícola de Habilitación (CAH, PR-T1090/ PR-T1096), the Fondo Ganadero (PR-T1119), and the BNF (PR-L1048). Lastly, a third line of action had to do with support for the sector's institutional framework, in particular, regulation of the savings and loan cooperative sector, by strengthening INCOOP (PR-L1011, approved in 2006). The Bank also supported the country's efforts to improve regulations on money laundering through nonfinancial products.

In terms of execution, the AFD projects have disbursed rapidly, with no obstacles other than slight ratification delays (particularly in the case of PR-L1024) and a delay caused by the AFD's duplicating the credit assessment performed by the financial institutions. Both projects were completed in under four years, including legislative ratification.

The main result of the reform is the creation of a solid, efficient institution enjoying considerable prestige, through which the Bank has channeled resources for Paraguay's housing and productive sectors. This institution has also become a key instrument for the government to direct credit to the private sector and administer new funds from Itaipú. In and of itself, the consolidation of the AFD is an accomplishment

attributable to the Bank's timely and flexible intervention. In terms of the results of IDB funding for the AFD, the resources were placed at an average of four times the system's average (nine years), with low default rates (0.372%), in the housing (38%) and productive sectors (62%). Despite these local results, the AFD portfolio only represents a small (and shrinking) share of bank credit (5%), which limits its overall impact.

First-tier bank reform operations were executed more slowly and have yet to show any results. The operations to modernize and improve Crédito Agrícola de Habilidadación and Fondo Ganadero are still at an early stage of execution, with the diagnostic assessments and some of the preliminary activities having been completed. The BNF program is moving very slowly, having taken over two years to be approved and almost two more to be ratified by the legislature, which was achieved in June 2013. Similarly, the program to strengthen the National Institute for Cooperativism (INCOOP) and endow it with regulatory capacity has met with numerous challenges due to the lack of coordination between the beneficiary and the Ministry of Finance executing unit, which resulted in a contractual modification in 2012. Since then some consulting services have been provided but the beneficiary has yet to take ownership of the program and only 17% has been executed.

State modernization and reform programs (including PBLs and loans to strengthen statistics and the cadaster and property registry). After achieving macroeconomic stability with the 2003-2005 reforms, the Government of Paraguay requested a new program from the IMF in 2006, as the “time [was] ripe to refocus [the] policy agenda on the more ambitious goal of increasing the rate of growth of the economy on a sustainable basis.”¹⁰¹ Jointly with the World Bank and the IMF, the IDB supported the strengthening of public spending management through two programmatic loans (PR-L1043, PR-L1047), the fiscal management strengthening and modernization program (PROFOMAF II) (PR-L1035, PR-L1027) and the customs support program (PR-L1026, PR-L1052, PR-L1036). A series of more or less standalone initiatives were added to the fiscal reform and budget support portfolio. These included civil service support (PR-L1013, PR-L1016), strengthening of the National Public Investment System (SNIP) (PR-0093 reformulated), a justice support program (PR-0146, PR-L1046), several census support programs (Population PR-L1049, Economic PR-L1037 and PR L1021), a decentralization project (PR-L1033, not approved), and a second phase of the cadastre and property registry program (PR-0132 phase I, PR-L1061 phase II). This is an old portfolio: with the exception of the population census program, the cadastre and property registry program, and the programmatic loans, the rest was approved before 2009.

With the exception of the budget support programs, the portfolio faced significant challenges. First, several key reforms for the country were abandoned. The customs modernization program, which would have trained staff, streamlined processes, and strengthened controls, was canceled when it failed to obtain parliamentary ratification

and the PROPEF resources were exhausted. Similarly, the cadastre and property registry program, which would have consolidated a new institutional framework and started the titling process, was canceled in 2012 after the first phase failed to meet its objectives (see below). Lastly, the municipal development program (PR-L1033), which was intended to improve fiscal management capacity, investment, and public services at municipal level, was abandoned before being brought to the Board for approval, because of questions over the constitutionality of the royalty-based guarantee scheme it would have used.

With few exceptions, the other programs faced major execution challenges. The execution of several programs has been excessively slow (Justice, SNIP, Cadastre and Property Registry I) due to various factors, including lack of coordination (Justice, Cadastre and Property Registry I), delays resulting from an inadequate legal framework (Justice), political economy of reform (Justice), problems with calls for tender (SNIP), delays related to the lack of timely availability of census workers (Economic census, Population census), and ratification delays. All the programs were affected by ratification delays, but the population census was particularly affected because the contracting periods were shortened and coincided with the run-up to the elections. Both census projects were executed relatively rapidly, once the initial delays had been overcome.

Outcomes have been partial and piecemeal. PROFOMAF (still under way) has achieved some of its outcomes in the tax administration component, but the SIAF is still pending. The SNIP is in operation, although it is not yet universal. The cadastre and property registry program did not achieve its main objectives of unifying the cadastre and property registry system and creating a consolidated institutional framework. It was not continued because the second phase was cancelled. Both censuses achieved or are in the process achieving their final output although, in both cases, their quality was compromised. In the economic census, this was due to the low level of participation by large corporations, which account for a large share of economic activity. In the population census, it was due to problems of coverage caused by the uneven availability of census workers and the relaxation of the processes of auditing the results. In the government's opinion, achievement of the population census project's objectives is uncertain.

The small civil service program was the exception to the general picture. Not only was it executed efficiently and rapidly, but the objectives were exceeded, with over 3,000 people hired through public processes and a further 4,500 staff trained. However, its sustainability is limited unless there is progress on implementation of the national human resources system.

Social Sectors. The Bank's social portfolio shrank in relative terms to concentrate on the education sector, with the second phase of the Escuela Viva program (Phase 1 PR-0117, Phase 2 PR-L1017, PROPEF PR-0133). Other interventions

included an early childhood development program (PR-L1051, 2012), a program to support job placement (PR-L1066), and a science and technology program (PR-0126, PROCYT) to strengthen the Paraguayan innovation system. The portfolio of projects currently under way also includes the Social Investment Program II to promote investment in social investment projects in rural and vulnerable communities (PROPAIS II, PR-0125, 2002).¹⁰² Nine technical-cooperation operations were executed in this sector, including “Young Mathematicians” (PR-T1095) and “Mathematics in my School” (PR-T1128). Both adapt education models for understanding of mathematics and have generated evidence that could be used to expand the coverage of these initiatives nationwide. Similarly, the operation “Support for education sector strategic programming” (PR T1148), approved in 2013, seeks to help the government identify areas, programs, and projects that could maximize the education investments financed with FONACIDE.

The social sector projects were among those facing the biggest execution challenges. The main program in the portfolio (Escuela Viva II) took almost three years to obtain its first disbursement and has only executed 30% of its resources. The program has faced difficulties with the performance-driven loan, recently resulting in a contract modification and high turnover among staff of both the ministry and the executing unit. The social investment program experienced a two-year delay for approval and successive contractual amendments, which changed the intervention strategy by incorporating a US\$9 million cash transfer subcomponent.¹⁰³ A further difficulty was related to the coordination of weak executing units. Although these changes accelerated program implementation, they deviated from the original design, which focused on financing community social investment projects.¹⁰⁴ The early childhood development (1.15 years) and employment (1.2 years) programs were ratified recently and have not yet been disbursed.

The science and technology program financed projects at universities and in businesses. The program also supported postgraduate training in the country and abroad. In 2013 the program was almost fully executed, after almost three years of delays in ratification and difficulties arising from problems of governance in the sector and the institutional weakness of CONACYT. Although the academic project components and grants achieved their targets, this was not the case for the business innovation projects component.¹⁰⁵ A second phase of the science and technology program, which would look for more streamlined and flexible financing modalities to create incentives for business projects, began to be prepared by Management, although it is unclear whether this operation will be given priority by the new government.

Agriculture, competitiveness, and private sector. In this sector, the Bank’s action focused on three areas: (i) support for the modernization of agricultural support management (PR-L1001 and PR-L1020 PROPEF) by creating incentives for technology adoption; (ii) promotion of investments and exports (PR-L1018),



including tourism (PR-L1050); and (iii) a series of MIF operations, small projects, and OMJ operations that sought to support value chain development for specific products (milk, PR-M1018; *ka'a he'e* or Stevia, PR-M1013; fruits and vegetables, PR-M1025; organic sugar, PR-L1068).

The Bank's program in agriculture was focused on changing the agricultural support policy from a seed and production-input distribution model, to support that is not tied to specific crops or inputs. As part of the transition, a program component included "compensatory support" for beneficiaries of the preceding project that focused on cotton (PR-0082). During execution the program experienced significant delays associated with ratification (2.07 years), errors in instrument design (performance-driven loan) and contractual amendments,¹⁰⁶ lack of experience of beneficiaries in the use of magnetic cards (the program's means of payment), political instability, local counterpart problems, and administrative delays associated with verification of beneficiaries. Although the program has benefited 6,913 producers with direct support and 89,960 producers with compensatory support, there is no evidence that the Ministry of Agriculture has given up production input distribution programs.

The latest data available from 2011 indicated that in Paraguay 32% of the population is poor and 18% is extremely poor, while in rural areas, the figures climb to 45% and 30%.

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The economic vulnerability of the country became evident during the droughts of 2009 and 2012, which caused a drop in the soybean harvest of 39% and 48%, resulting in a 4% and 1% drop in the GDP, respectively.

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The exports and investments program (PR-L1018), executed through Paraguay's investment and export promotion agency, financed small-scale initiatives and project proposals in eight sector export boards (meat and leather, stevia, textiles and apparel, etc.), which were also organized under the program. Execution was delayed by almost two years due to legislative ratification, in addition to which there was counterpart fund underexecution and a design problem relating to approval processes and the financing of subprojects. As a result of the latter, some of the subprojects were cancelled. There are currently 144 projects under way in eight sector export boards, which are producing some interesting results (e.g. Kokoré children's clothing project).

Both the SCF and IIC portfolios increased significantly in the period, among other things because of the economic situation and greater impetus on the part of the Bank (e.g. increase in IIC operational staff in Paraguay). The SCF placed its first three loans in Paraguay, divided between the financial sector (US\$71.2 million), a cement manufacturer (US\$52 million), and a soybean agroindustrial complex (US\$92 million). The IIC approved 10 operations for US\$42 million, 75% of which

was earmarked to fund financial institutions (Banco Regional, Sudameris, BBVA).¹⁰⁷ Lastly, OMJ and MIF projects continued supporting microfinance and financial inclusion. Trade finance credit lines (TFFP) were also continued, through which 138 transactions were guaranteed, for a total of about US\$81 million between 2008 and 2012 through six Paraguayan financial institutions.¹⁰⁸

In general, the IDB's private sector in Paraguay has been dynamic and there have been specific cases of innovation (e.g. the recent operation to provide long-term productive financing in local currency in association with the pension institute and a financial institution, PR-L1078). However, generally speaking the additionality of the private sector operations is not always clear since the majority of the resources targeted financial institutions that are solvent, sound, and profitable.



Use of the abundant hydro power to promote the country's industrialization, either through the maquila industry, agroindustry, or a park of electro-intensive industries is one of the options of the country to improve the development agenda.

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4 Conclusions and Recommendations

Paraguay is a landlocked country, whose main source of wealth is connected to the exploitation of natural resources. The return to democracy in 1989 was accompanied by a decade of sluggish growth and a persistent banking crisis lasting from 1995 until 2003. The 2003-2004 economic reforms, in conjunction with a favorable economic context, enabled a resumption of economic growth under an agricultural export model based on a few commodities (soybeans, meat). This model was well established in the review period, but new challenges were being taken up. First, the economy's dependence on agricultural exports made it more vulnerable to the climatic shocks in 2009 and 2012. Second, this model exhibited limited capacity to reduce poverty and inequality. Apart from the progress made during the recovery (2003-2008), and even despite the social safety net initiated in 2005 (*Tekoporã*), there are no signs that poverty and inequality are waning. Thus, the country's main challenge continues to be sustained economic growth with job creation, poverty reduction, and greater equity.

The new Government of Paraguay will face an outlook of challenges and opportunities. In the short term, the economic situation is favorable (12% GDP growth for 2013)¹⁰⁹. On the political front, a strategy of integration and relations with MERCOSUR still needs to be defined. In the medium term, the country needs to advance in the expansion of its development strategy in order to make the growth model more stable in the face of the vulnerabilities of the agricultural export model. Use of the abundant hydro power to promote the country's industrialization, either through the maquila industry, agroindustry, or a park of electro-intensive industries is one of the options. However, any decision in this regard must be based on a

careful study of the long-term costs and benefits. The pressure that the agricultural export model has placed on the environment and natural resources (deforestation, pollution) will also demand effective responses.

The country has infrastructure investment needs of at least US\$6 billion over the next 10 years (see infrastructure notes). These include investment in ports, airports, power transmission and distribution, as well as roads. On top of the investments in infrastructure are the challenges of investing in the social and education sector. The possibility of strengthening public investment through cofinancing from various donor agencies and the leveraging of public investment with private sector investments will be crucial going forward. The approval of the public-private partnerships law in late October 2013 is the first step towards building an effective institutional framework for securing these investments¹¹⁰, without forgetting that this must be coupled with the generation of reliable information and the strengthening of an institutional framework that guarantees transparency and efficiency in the application of resources.¹¹¹

The country is also in a situation in which it has more public resources available for investment in the medium term, both from the sovereign bonds issued (US\$500 million) and the new resources from Itaipú (US\$240 million per year), which will be channeled through FONACIDE. Given this greater availability of resources, the country faces challenges to design investment programs and strategies that effectively address the country's priority problems and to improve execution by national and local agencies in order to apply them more efficiently.

During the review period, the Bank's program was significant for covering the country's infrastructure and liquidity needs. In the context of the international financial crisis, the government channeled part of the Bank's programming towards fast-disbursing loans in the first part of the period (2009-2010). The rest of the program was characterized by a considerable degree of inertia and a strong focus on infrastructure. These biases were explained by the nature of the parliamentary ratification process. With the 2012 change in government, the Bank rapidly responded to the programming priorities of the incoming government. However, the delays in appointing a new representative made the dialogue difficult and, given the regional context and the Bank's importance in the country, had a negative impact on relations.

Conversely, the Bank's program was of little significance in terms of attacking the country's enormous social challenges (poverty, equity) and supporting the development of institutions in general. The Bank only partially used its concessional instruments (only grants) to boost social investments and make progress in that direction. Even when reform projects were approved for key sectors (customs, cadastre and property registry, environment), they were cancelled. The construction of sector institutions was very limited despite the fact that resources were included in

most of the operations approved. Lastly, the Bank's participation in the institutional development necessary to manage and protect natural resources was incipient despite the fact that it is the major focus of the country's development.

The Bank's Country Office in Paraguay successfully managed to address the challenges inherent in having one of the oldest portfolios in execution and the image problems that arose during the previous period. To improve its image, it ran an effective communication strategy and strengthened its ties with civil society. With regard to execution, the Bank's Country Office in Paraguay adopted what turned out to be an innovative operational support model based on "service units." Although its impact on portfolio efficiency is not yet apparent, this model has achieved significantly shorter response times to client requests, which could improve the program's low efficiency.

The outcomes of the program currently being executed show a mixed picture. The reform and funding of second-tier banks (AFD) remains one of Bank's main accomplishments in Paraguay. In the infrastructure sector execution was slow, but most of the proposed objectives were eventually achieved, though the road sector's performance was the least favorable. Lastly, the achievements in the modernization and social sector were limited and piecemeal, basically concentrated in small, isolated interventions. The sustainability of the results achieved is threatened in most of the sectors, however, because of the weak institutional framework in place and the limited progress achieved in this regard.

Against this backdrop, and with the aim of contributing, through an independent perspective, to improving the relevance, efficiency, and effectiveness of the Bank's program in Paraguay, OVE recommends the following:

- **Recommendation 1: Support the country to enable it to leverage its investments in infrastructure with the private sector and bilateral and multilateral actors.** To achieve this, the following is proposed: (i) increase coordination between the Bank's private sector windows; (ii) use the Bank's leadership to generate a forum for dialogue with the private sector as a way of facilitating the generation of projects and articulating a private sector action strategy (similar to the experience with the ConSOCS); (iii) support the country in the development of an appropriate legal framework to attract private investment in infrastructure areas; and (iv) use the Bank's leadership to leverage its own projects with cofinancing from bilateral and multilateral actors.
- **Recommendation 2: Strategically use concessional instruments (technical cooperation, FSO) as a way to deepen the dialogue in those agendas that tend to be relegated because of the dynamics of programming in Paraguay.** In particular, it is important to help generate a forum for broader collaboration in the social sectors, the building of institutional frameworks, and the expansion of the data and statistical base necessary for better



Farming accounts directly for 25% of Paraguay's GDP and, together with indirect activities (agroindustry, services), it is estimated to represent 41%.
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programming and evaluation of the country's development strategies. It is also necessary to continue supporting the reforms initiated in the country (e.g. reform of first-tier banks and institutional structures of the AFD).

- **Recommendation 3: Support the country in the effective use of FONACIDE, tapping into cofinancing opportunities.** The Bank could become a strategic partner for the country in the selection, implementation, and evaluation of projects to be financed by FONACIDE, thereby increasing the opportunities for cofinancing. If necessary, the Bank can also support the country in legal reform to ensure greater effectiveness. To this end, the following is suggested: (i) support the process of selection and prioritizing investment projects; (ii) continue to promote the development of local capacity for the preparation, management, monitoring, and evaluation of investment projects; (iii) cofinance social investments with FONACIDE, providing not only resources but value added at the sector level and in execution and fiduciary areas.
- **Recommendation 4: Strengthen natural resource management capacity** Given the crucial role that natural resources play in Paraguay's development, the Bank can add value by maintaining a line of action and forums for dialogue with the government for the implementation of effective environmental policies

and a strategy to manage natural resources. Such a dialogue should encourage the strengthening of the various competent authorities' (e.g. Department of the Environment, MOPC) natural resource management and planning capacity.

- **Recommendation 5: Use the experience of other countries with legislative ratification to mitigate the impact that such ratification has on the Bank's portfolio in Paraguay.** Paraguay is only one of eight Bank member countries that require legislative ratification.¹¹² The Bank could consolidate the lessons learned in these countries with a view to developing mitigation strategies that would apply in Paraguay. Insofar as possible, within the limits imposed by the Agreement Establishing the Bank, the Bank could also promote forums for dialogue with the Congress of Paraguay, providing information on operations in order to streamline the ratification process.

- ¹ Both because of the agriculture sector's share of the economy (approximately 25% of GDP) and the number of agricultural jobs (between a quarter and a third of the population), Paraguay is one of the countries most dependent on agriculture among the Bank's borrowing member countries. See WDI, Series: Employment in agriculture (% of total employment) and Agriculture (% of total value added).
- ² After Haiti, Honduras, Nicaragua, and Guyana. Nevertheless, as explained below, per capita GDP has recently grown rapidly. In 2011 (the last year for which data are available in the series) Paraguay became the seventh poorest country, overtaking Bolivia and Guatemala, although it is likely that this result is related to an accounting issue since, beginning in 2011, the output of the Itaipú and Yacretá binational companies—hydroelectric power plants shared with Brazil and Argentina, respectively—was incorporated into the calculation of GDP. Previously the companies were treated as “nonresident” units by Paraguay's National Accounts System.
- ³ There is a high level of uncertainty as to the precise extent of the population loss caused by the war, due to the fact that a significant portion of Paraguay's archives were destroyed during the hostilities. However, it is estimated that the pre-war population was between 800,000 and 1.3 million, and the 1886 census recorded a population of 237,000. See Francisco Doratioto, *“Maldita Guerra, Nova História da Guerra do Paraguai”* São Paulo: Companhia das Letras, 2002, p. 456 or *Historia de las Relaciones Exteriores de la República Argentina* ([Link](#)) for an analysis of the various estimates.
- ⁴ Except for the period immediately preceding the Chaco War (1923-1932), the 80 years between the end of the War of the Triple Alliance and the rise of General Stroessner were marked by considerable instability. From 1940 onward, the country was in a constant state of siege. See Fernando Masi and Dionisio Borda (eds.), *“Estado y Economía en Paraguay: 1870-2010,”* CADEP: Asunción, 2011, p. 151.
- ⁵ For an analysis of the Paraguayan economy under General Stroessner's government, see Fernando Masi and Dionisio Borda (eds.), *“Estado y Economía en Paraguay: 1870-2010,”* CADEP: Asunción, 2011. In particular, the article by Melissa Birch, *“Financiamiento Externo, Institucionalidad Autoritaria y Lento Crecimiento. Los primeros años de Alfredo Stroessner, 1954-1972.”* After the War of the Triple Alliance (1865-1870), the Paraguayan economy underwent a series of specific booms linked to agricultural exports: yerba mate (in the late 1880s), harvesting of quebracho and meat production (1910-1920) through the only exit to the Atlantic then available (Argentina). After a period of stagnation related to an internal conflict, the economy recovered between the end of the 1960s and 1981. By settling the border with Brazil, Paraguay not only gained an exit route to the Atlantic but also embarked on cooperation projects with its neighbor. In particular, the building of Itaipú Binacional, the biggest hydroelectric facility in the world, drove Paraguay's rapid economic growth in the second half of the 1970s.
- ⁶ The dangers of liberalization in a context of deep financial repression (as prevailed in Paraguay in the 1990s) have already been mentioned by Carlos Diaz-Alejandro in a famous article on the Latin American experience in the 1970s. See Carlos Diaz-Alejandro, 1985, “Goodbye Financial Repression, Hello Financial Crash,” *Journal of Development Economics* 19, pp. 1-24.
- ⁷ There are a number of relevant sources regarding Paraguay's financial crisis of the 1990s-2000s. Borda, Dionisio, *“Paraguay: resultados de sus reformas (2003-2005) y sus perspectivas,”* ECLAC: Santiago, Chile, November 2006; Aníbal Insfrán Pelozo, *“El Sector Financiero Paraguayo. Evaluando 10 Años de Transición,”* Central Bank of Paraguay, 2000; and Alejandro Santos (eds.), *“Paraguay: Addressing the Stagnation and Instability Trap,”* International Monetary Fund, Washington, D.C., 2009. The data on closures of financial institutions comes from Alejandro Santos, *Op. Cit.*, p. 50 and p. 51 for the drop in the number of financial institutions from 97 in 1995 to 27 in 2007. See *Ibid.* p. 59 for an analysis of the cost of Paraguay's crisis. At a direct cost of 16% of GDP, it compares favorably with other recent Latin American financial crises (Uruguay 2001-2002, 20%; Mexico 1995-1997, 19.3%; Argentina 2002, 11.4%; Ecuador 1998-2001, 20%; Brazil 1994-1996, 8.6%).

- ⁸ On the fiscal side, the agreement sought to reform the tax system, social security, and the customs code, in order to eliminate the primary deficit. On the financial side, it aimed to reorganize the public development banking sector and strengthen bank supervision. See Borda, *Op. Cit.* and economy note for more details. See Borda, *Op. Cit.* p. 39.
- ⁹ See IICA, Observatory, Soybean trade, [Link](#). After falling at a rate of 3.2% per year between 1996 and 2002, exports grew by 7.7% between 2003 and 2008. World Bank, WDI, Series NE.EXP.GNFS.KD.ZG.
- ¹⁰ In fact, President Lugo appointed the same minister in the Ministry of Finance who spearheaded Paraguay's exit in 2003-2005.
- ¹¹ UNASUR, Special Meeting of the Council of Heads of State and Government of UNASUR, Mendoza, Argentina, 29 June, [Link](#).
- ¹² Argentine Republic, Ministry of Foreign Affairs and Worship, Press release 208/12, 23 June 2012, [Link](#).
- ¹³ In Venezuela's case, President Chávez publicly announced the withdrawal of the ambassador and the end of oil shipments to Paraguay.
- ¹⁴ Federative Republic of Brazil, Ministry of Foreign Affairs, Note 155, "Situação no Paraguai," 23 June 2012, [Link](#).
- ¹⁵ Republic of Colombia, Ministry of Foreign Affairs, press release, 24 June 2012, [Link](#).
- ¹⁶ Republic of Chile, Ministry of Foreign Affairs, statement by President Piñera, 29 June, [Link](#).
- ¹⁷ United Mexican States, Department of Foreign Affairs, communiqué, 24 June, [Link](#).
- ¹⁸ Eastern Republic of Uruguay, Ministry of Foreign Affairs, communiqué, 26 June 2012, [Link](#).
- ¹⁹ The communiqué refers to Venezuela's entry into MERCOSUR, which was announced at the same meeting at which the suspension of Paraguay was decided. Republic of Paraguay, Ministry of Foreign Affairs, "Comunicado sobre la decisión del MERCOSUR sobre Paraguay," [Link](#).
- ²⁰ Republic of Paraguay, Ministry of Foreign Affairs, 27 September 2012, [Link](#).
- ²¹ Organization of American States, Minutes of the Special Session held on 10 July 2012, [Link](#).
- ²² Paraguay, Ministry of Foreign Affairs, 12 November 2012, [Link](#).
- ²³ See UNASUR, Paramaribo Declaration, 30 August 2013, [Link](#).
- ²⁴ See MERCOSUR, Decision to end Paraguay's suspension from MERCOSUR in application of the Ushuaia Protocol on democratic commitment, 12 July 2013. [Link](#).
- ²⁵ Ministry of Foreign Affairs, Note 345, "Construindo uma nova etapa na relação bilateral." 25 July 2009.
- ²⁶ See IMF, Paraguay, Article IV Consultation, 2011, paragraph 28 and footnote 4.
- ²⁷ Average for 2009-2013. See IMF, Article IV Consultation, Paraguay 2012, [Link](#). For a detailed analysis of the Paraguayan tax system see IMF, Selected Issues, Paraguay, 2010.
- ²⁸ See IMF, Selected Issues, Paraguay, 2010, paragraph 9.
- ²⁹ VSee IMF, Article IV Consultation, Paraguay 2012, [Link](#) and Selected Issues, Paraguay, 2010.
- ³⁰ A 2006 Bank study identified Paraguay's public spending efficiency as the lowest among the 19 Latin American countries studied. See Roberto Machado, "Gastar más o mejor? La eficiencia del Gasto Público en América Central y República Dominicana."
- ³¹ WB-IDB-EU, Integrated Fiduciary Evaluation, 2008, page 12. The law referred to here is the Financial Administration Law. Between 2000 and 2010, only 83% of the budget was executed and only 58% of the physical investment budget.

- ³² See Masi and Borda, *Op. Cit.*, pp. 291-293, for a description of the budget process. Also, the 2008 Integrated Fiduciary Assessment (IFA). The two main problems identified by the IFA are the inefficiency and lack of credibility of the budget process and the lack of fiscal transparency, mainly as a result of transfers to subnational governments without a unified and transparent system. Lastly, the IFA highlights the weaknesses of internal control as the main challenge. The internal audit office lacks trained staff and harmonized rules and processes. External audits have limited impact as there is little follow-up of their recommendations.
- ³³ The area most suited to soybean production is located in three departments in the eastern region of Paraguay on the coast of the Paraná River (Canindeyú, Upper Paraná, and Itapúa), which account for 80% of Paraguay's soybean production ([Link](#)). Using the FAO estimate (24 million of Paraguay's 40 million hectares are arable, 60% of the total) and taking into account the size of the departments and the soy-planted area in 2007/8 ([Link](#)) 62% of the arable land of these three departments is devoted to soybean production. Because the estimates of arable land are relatively old (2007/08) and there are other crops in these departments, this number should be considered the lower limit of the real value. These calculations would confirm that the frontier of soybean expansion in the eastern region is being reached.
- ³⁴ The concentration of the planted area in Paraguay increased steadily over the period. The Herfindahl index (a standard measure of concentration) went from 0.25 to 0.35 during the period. Concentration indexes of more than 0.35 are considered very high. Moreover, with 3 million hectares planted in 2012, soybeans represented 60% of the total planted area. In comparison, in 2003, 1.5 million hectares (46% of the total) were planted. The figures are the author's own, from FAO data (FAOSTAT).
- ³⁵ Chistensen, J.H. 2010. "Summaries of Likely Climate Change Impacts, by Country", in *Reducing Poverty, Protecting Livelihoods, and Building Assets in a Changing Climate*, ed. Dorte Verner (Washington: The World Bank. Directions in Development - Environment and Sustainable Development, 2010), 395-397.
- ³⁶ Berry, Albert (ed.), 2010, "Losing Ground in the Employment Challenge: The Case of Paraguay", Transaction Publishers: New Brunswick. See, in particular, chapter 3 "The Role of Agriculture", 4 "Farm Size-Productivity Relationships in Paraguay" and 5 "Potential and Future of Paraguayan Family Farming", pp. 61-121.
- ³⁷ Refers to farms of over 1,000 hectares. FAO, "*Dinámicas del Mercado de Tierras en América Latina y el Caribe: Concentración y Extranjerización*," Rome, p.415.
- ³⁸ See, for example, Albert Berry (ed.), "Losing Ground in the Employment Challenge: The Case of Paraguay," New Brunswick: Transaction Publishers: Chapter 3 "The Role of Agriculture".
- ³⁹ See 2008 farming census, and IDB loan proposal PR-L1061. For a complete analysis of the political economy of land tenure in Paraguay, see Gregg Hetherington, "Guerrilla Auditors: The Politics of Transparency in Neoliberal Paraguay." Durham, NC: Duke University Press, 2011, in particular chapters 2 and 3
- ⁴⁰ On the threat to biodiversity in the Chaco, see Fred Pearce, "Battle of the Chaco: Who will win the wilderness?" *The New Scientist*, Vol. 211, Issue 2820, 9 Julio 2011, pp. 43-47. The deforestation figure comes from Berry, *Op. Cit.*, p. 77. See also Marcellus Caldas (et al.), "Land-Cover Change in the Paraguayan Chaco: 2000-2011", *Journal of Land Use Science*, 2013, who attribute most of deforestation to livestock raising.
- ⁴¹ For an econometric analysis of the weak connections between the agriculture sector and the economy, see IMF, "Paraguay: Selected Issues, 2010", chapter 1, "Potential Output Growth and Spillovers from Agriculture", pp. 3-15. The conclusion is that there are only a few ties with the construction sector.
- ⁴² On the topic of inequality in land distribution, see: Luis Galeano, "*Dinámica del mercado de la tierra en América Latina y el Caribe: El caso de Paraguay*." Santiago: FAO. [Link](#).
- ⁴³ According to UNDP (Human Development Index) and ECLAC based on CELADE data (infant mortality). Paraguay, with 32 live births per thousand, has the fourth highest infant mortality rate in the region, after Haiti (48.8), Bolivia (45.6), and Guyana (42.4).

⁴⁴ The poverty/extreme poverty headcount in Paraguay fell from 49.7%/24.4% in 2002 to 37.9%/19.0% in 2008. Between 2008 and 2011, extreme poverty decreased by only one point (to 18), while moderate poverty decreased another five points to 32.4. For this last year, 45% of people living in rural areas were moderately poor, while 24% were so in urban areas. Even in comparison with the southern cone and with Latin America in general, the decrease in poverty in Paraguay was the lowest in the region (Note: these poverty measures are equivalent to US\$2.50 per day while those mentioned above are the country's official headcount based on its poverty line. This is why the two measures do not necessarily agree. The source in all cases is CEDLAS-SEDLAC/World Bank, [Link](#)).

POVERTY HEADCOUNT: US\$2.50 PER DAY. PARAGUAY VERSUS LATIN AMERICA

	1998	2003	2011	%03-11
Paraguay	26.7	27.4	18.2	-33.4%
Southern Cone	22.3	24.7	10.7	-56.6%
Latin America	24.4	24.8	12.6	-49.1%

Source: Authors, based on CEDLAS-World Bank data

⁴⁵ Between 2005 and 2008 social spending increased rapidly from 41% to 52% of total spending. Even so, in Paraguay public spending on education accounts for 10.6% of the budget (4.1% of GDP) against 17.1% in Latin America (5% of GDP) (World Bank, World Development Indicators (WDI), 2010). As to social public spending, ECLAC estimated that Paraguay spent 8.9% of GDP in 2008-2009, the fourth lowest percentage in the region (above Guatemala, 7.6%, Peru, 7.8%, and Panama, 8.9%) and well below the regional average of 18.4% (See [Table III.A-1](#) on page 156).

⁴⁶ See CEDLAS-SEDLAC/World Bank, *Op. Cit.* The most recent data available from the Statistics, Surveys, and Censuses Bureau (DGEEC) is from 2010. The publications available since then do not include poverty estimates.

⁴⁷ See Latinobarómetro, Annual Report 2011, [Link](#), p. 72

⁴⁸ On informality in Paraguay see Guillermo Cruces and Leonardo Gasparini. “*Políticas Sociales para la Reducción de la Desigualdad y la Pobreza en América Latina y el Caribe. Diagnóstico, Propuesta y Proyecciones en Base a la Experiencia Reciente.*” CEDLAS, Working paper 142. March 2013. For the most recent data on underemployment, see DGEEC, “Principales Resultados de la EPH 2012,” Online publication, [Link](#).

⁴⁹ See Sector Note on Education, IDB, 2013.

⁵⁰ According to the World Economic Forum's Global Competitiveness Report 2012-2013. Only Venezuela ranks below Paraguay and the Paraguayan economy is 116 out of 144 in terms of competitiveness. [Link](#). In terms of investment, with 14.3% of GDP, Paraguay has one of the lowest levels in the region, well below the regional average of 23.2% (World Bank, WDI, 2012).

⁵¹ See Mesquita Moreira *et al.*, 2008, Unclogging Arteries, The Impact of Transport Costs on Latin American and Caribbean Trade, p. 10. Shipping charges as a percentage of the value of goods refer to extraregional shipping, primarily affecting Paraguay's agricultural production.

⁵² World Bank, Enterprise Survey, 2010.

⁵³ In essence, the Paraguayan financial sector is excessively liquid, with reserves above the regulator's requirements (7% to 15% of deposits). There are several reasons for this. Precautionary ones include the country's high vulnerability to macroeconomic cycles, the high volatility of monetary aggregates, the high proportion of demand deposits in the system, the lack of a fast liquidity instrument for banks, payment system deficiencies, low opportunity costs for maintaining reserves. Excessive reserves in the financial system not only mean high intermediation costs (the *spread* between lending and borrowing rates in guaraníes is on the order of 2,000 to 3,000 basis points), but also limit the ability to transmit monetary policy through the interest rate. See IMF, Paraguay: Selected Issues, 2011, pp.16-34, [Link](#). It is also significant that Paraguay has the lowest ratio of banking sector interest income to gross income (8.5%, compared with 59% for Latin America and 57% for developed countries. Source: IMF, Financial Soundness Indicators, 2011). The lack

of significance of interest income would indicate that most of the business of banks in Paraguay is not related to financial intermediation but to transactional aspects. In the 2011 update of the FSAP, most recommendations in fact referred to the key weaknesses of the system, such as liquidity management (including recapitalization of the BCP) and the payment system update. See IMF, *Financial System Sustainability Assessment—Update*, July 2011, [Link](#). See, in particular, the table with priority recommendations.

- ⁵⁴ According to BCP data, 50% of exports between January and July 2013 were going to MERCOSUR countries, a figure slightly higher than in 2009-2012 (46%). Trade with Brazil accounted for 30% of exports over this period. See IDB, Intrade database for data from 2009 to 2012 and BCP for the more recent period. From January to July 2013, the maquila sector accounted for US\$154 million, of which 34% was intended for the Brazilian market and 9% for Argentina and Uruguay.
- ⁵⁵ Since the first version of this report was written, the new government has indicated that the electricity-intensive industry proposal is no longer a priority.
- ⁵⁶ Electric power accounted for 49.4% of exports in 2003, but only 30% of exports in 2008, due to soybean export growth.
- ⁵⁷ See ECLAC, 2008. *Transformaciones Demográficas y su Influencia en el Desarrollo de América Latina y el Caribe*. [Link](#).
- ⁵⁸ See the Minister of Finance's presentation on the fiscal situation on 27 May 2013. In fact, almost all of the increase in public spending between 2007 and 2012 (5% of GDP, from 16.6% to 21.6%) is explained by salary increases (2.8% of GDP), transfers (2% of GDP), and, to a lesser extent, spending on goods and services (1% of GDP), all offset by the reduction in interest payments (-0.7% of GDP).
- ⁵⁹ Between 2010 and 2013, Management also produced annual programming documents (CPDs) either as standalone documents (GN-2541-3 in 2010) or as an annex to the Bank's operational program in other years (GN-2617, GN-2661-4, GN-2696 for 2011, 2012 and 2013, respectively).
- ⁶⁰ See Republic of Paraguay, *Plan Estratégico Económico y Social 2008-2013*, p. 12.
- ⁶¹ For example, one of the specific objectives of the macroeconomic stability pillar is to increase the tax burden and one of the associated actions is to develop compulsory withholding mechanisms for the tax on income from agricultural activities (IMAGRO) to reduce evasion and bolster collection. The associated indicators are that the tax burden from IMAGRO rises to 0.9% of GDP and the designation of 114 large taxpayers with an impact of 0.15% of GDP.
- ⁶² The 11 pages of the country strategy document include two initial pages containing an introduction and a brief analysis of the Bank's operations in Paraguay, seven pages of sector analyses, and three pages for the rest (financial program, use of country systems, risks, etc.).
- ⁶³ PGA/09/17. The revised version was document GN-2541-1, which was ultimately approved.
- ⁶⁴ GN-2541-1, p.21.
- ⁶⁵ Although Management commissioned a growth diagnostic from the Ricardo Hausmann group, the diagnostic was not incorporated into the strategy document or used in the priority-setting exercise contained therein. The diagnostic was attached as an annex to the country strategy.
- ⁶⁶ See Portfolio Annex (XI), which contains a table with the alignment of the Bank's strategy and its program, and another table with the country's strategy (PEES) and the Bank program.
- ⁶⁷ The technical guidelines for CPDs (GN-2551) indicate that "[t]he purpose of the CPD is to complement the information provided in the country strategy (CS) in two fundamental areas: (i) provide project-based targets that relate to concrete indicators and baselines, and monitor the progress towards those targets, making the combined CS-CPD fully evaluable; and (ii) provide the list of interventions to be undertaken, including loans, guarantees, and grants across all business units of the Bank." In other words, the purpose of the CPDs is not only to present the new program but also to provide monitoring and present the outcomes of the program being executed.

- ⁶⁸ For example, the strategy's first indicator is to increase the number of kilometers of paved roads from 4,512 to 4,652. However, the CPDs associate this indicator with four operations between 2010 and 2013: three technical cooperation operations (PR-T1046, PR-T1088, PR-T1100) and a private sector loan to a cement manufacturer.
- ⁶⁹ See CPD, Paraguay, 2012, paragraph 1.16.
- ⁷⁰ See the Annex on the Bank's Portfolio in Paraguay. The percentages are similar when the whole portfolio under review is considered.
- ⁷¹ It should be noted that this is how long the project was in the Congress according to the legislative information system. This time is additional to the period between project approval by the IDB and its being submitted to the legislature by the Executive Branch. These periods tend to be longer on average (8.6 months) than the average legislative processing period (8.3 months). The Executive Branch tends to send rapid availability projects sooner (5.7 months for PBLs, 5.06 months for funding for second-tier banks). See annex on legislative processing and the section on efficiency below.
- ⁷² Republic of Paraguay, Chamber of Senators, Official Journal, 25 September 2008, p. 22. Available at <http://www.senado.gov.py/>
- ⁷³ During the evaluation period, 65 grants were approved for a total of US\$36 million. Of this amount, 59% was used for the agriculture and competitiveness sector and the education and social investment sector (28% in each case), 14% for projects related to public administration, 12% for roads and urban development, 6% for water, sanitation, and environment, 6% for public development banks and statistics and registry, 4% for operational technical cooperation, and 2% for energy.
- ⁷⁴ These FSO resources (US\$15 million biannually) are blended with OC resources in a fixed 80% OC/20% FSO ratio. The resulting blended product has a higher level of concessionality than Ordinary Capital (36% compared with 23%). As to the references to the FSO, there are many Bank documents governing the use of the FSO, beginning with the Agreement Establishing the Bank, which is not specific in that it only mentions that it should be used for special operations. Subsequent FSO documents (e.g. AB-300-3, AB-1704 (IDB-8)) are clear as to the use of the FSO for social projects. Later rules (GN-2442) focus more on how FSO resources should be distributed among D countries than on how the funds should be used.
- ⁷⁵ See Portfolio Review Document 2004-2008, note 10. Between 2000 and 2003, 54% of technical cooperation operations were with the government, while between 2008 and 2012 the figure was just 24%. Over the same period the IDB went from executing just 11% to executing 54%. Although there has been a trend towards increased execution by the IDB in general in recent years, this was particularly noticeable in Paraguay's case. (See Portfolio Annex)
- ⁷⁶ A second, more practical, issue concerns the effective limitations that the US\$20 million limit on the revolving line might introduce if the 2008-2010 approvals scenario is repeated.
- ⁷⁷ Paraguay ranks fourth at the Bank in terms of paying the most fees as a percentage of disbursements (1.25%), only behind Trinidad and Tobago (1.8%), Barbados (1.75%), and Venezuela (1.4%).
- ⁷⁸ See RE-446-3, Table 4.
- ⁷⁹ IDB, Annual Meeting of the Board of Governors, Address by the Governor for Paraguay, Dionisio Borda, AB-2862, para. 13.
- ⁸⁰ The expected approvals scenario in the CSD was around US\$1 billion, slightly frontloaded (46% in 2009 2010).
- ⁸¹ With Executive Order 9286/2013 ([Link](#)) of 16 July 2012, the President of the Republic authorized the Minister for Industry and Trade to start negotiations with Rio Tinto-ALCAN (RTA) to install an aluminum processing plant on the Paraná River. In December (Executive Order 10341/2013), the signing of a Memorandum of Understanding with RTA was authorized ([Link](#)). The Minister for Industry publicly announced the suspension of negotiations on 14 May 2013.
- ⁸² See 2013 Programming Agreement Aide-mémoire ([Link](#))

- ⁸³ The Bank's public image had deteriorated in the past as a result of various accusations related to the alleged improper use of Bank project resources, coupled with the sudden departure of the IDB's Representative in May 2008. For example, from 2004 to 2009, a number of articles appeared questioning the misuse of funds from Bank programs, such as the Municipal Strengthening Program (PR-0024) in 1993 ([Link](#)), the IDB program with the National Housing Council ([Link](#)) or a project in the Province of Formosa, Argentina ([Link](#)). The Bank was also questioned regarding a sanction imposed by the Office of Institutional Integrity on the nongovernmental organization "Transparencia Paraguay" for fraudulent practices.
- ⁸⁴ The strategy was presented at the Paraguay Team Workshop 27-29 October ([Link](#))
- ⁸⁵ Financed with technical cooperation funding under the C and D Action Plan (PR-T1133)
- ⁸⁶ For fuller details of the CONSOC thematic discussion forums in Paraguay, see the Paraguay Country Office's intranet site ([Link](#)). See also *Informe Final de Actividades*, CONSOC-BID Paraguay, 2012.
- ⁸⁷ The age of the investment loan portfolio currently being executed in Paraguay exceeds five years, the Bank's second oldest after Guyana, and well above the average of 3.75 years. The age of the portfolio under review (including closed projects) is 6.75 years.
- ⁸⁸ For the full menu see the intranet site of the Bank's Country Office in Paraguay ([Link](#)).
- ⁸⁹ One of the criticisms of the Bank's project monitoring mentioned in the 2012 public sector survey concerned the lack of uniformity in the criteria the Bank applies to executing units, which vary according to the specialist. See the public sector survey on the IDB-CPR website.
- ⁹⁰ IDB, Office of the Executive Auditor (AUG), Audit Report, Paraguay, 2010, Audit of the basic internal controls and operational activities of the Bank, 29 March 2010. As regards audited financial statements and fiduciary oversight, see Recommendations 7 and 9. AUG also recommended starting to use the Public Procurement Department (DNCP) for IDB project review in order to avoid duplications and strengthen country systems (Recommendation 8). The work with the Comptroller's Office is a historical Bank action line (TC0002087 of 2001, PR-T1043 of 2007, and PR-T1130 approved in December 2012) as well as a good example of coordination between the different Bank divisions.
- ⁹¹ According to the draft Fiduciary Technical Note, 2013.
- ⁹² Paraguay's disbursements in the period totaled around US\$260 million, of which US\$200 million were in the form of PBLs. The IDB's portfolio is around 3.5 times bigger than the World Bank's, and its disbursements are 10 times higher.
- ⁹³ Various criteria were used to arrive at the valuations in each cell. In the case of execution, the average performance of each sector was compared with respect to the programmed execution period. In other words, the prevalence and intensity of the delays were observed. In the case of results, the evaluation considered whether proposed outputs and outcomes were generally achieved (for a breakdown of the project indicators, see Portfolio Annex). Lastly, the dimension of institutional frameworks was evaluated in terms of the extent to which project outcomes contributed to consolidating and forming sector institutions. Based on these criteria, each dimension was assigned the category of high, medium, or low.
- ⁹⁴ These programs were accompanied by two preinvestment loans (PR-L1046 for rural roads and PR-L1056 for urban improvements in Asunción.)
- ⁹⁵ Since this report was written, the Senate ratified approval of the *electric metrobus* project on 31 October 2013 with loans and local counterpart totaling US\$212 million (US\$160 million from the IDB, US\$19 million from OFID, and US\$68 million in local counterpart). Having been approved by the Senate, the proposal was sent to the lower chamber for discussion, where it is expected to be approved in the coming weeks.
- ⁹⁶ WHO / UNICEF Joint Monitoring Programme (JMP) for Water Supply and Sanitation. 2010.

- ⁹⁷ Lake Ypacaraí was immortalized in Demetrio Ortiz's Guaranía "Recuerdos de Ypacaraí" [Memories of Ypacaraí] which begins: "Una noche tibia nos conocimos/ junto al lago azul de Ypacaraí/Tú cantabas triste por el camino/viejas melodías en guaraní" [One warm night we met / by the blue waters of lake Ypacaraí / On the way, you sadly sang / old songs in Guaraní.]
- ⁹⁸ The principles of the Bank's public utilities policy (PUP) included: (i) separation of the policy formulation, service delivery, and regulation roles; (ii) the vertical and horizontal separation of the sector, and promotion of competition where possible given the market's structure. For the power sector, it was proposed that generation and distribution (where competition could be fostered) be separated from transmission (a natural monopoly); (iii) a regulatory and pricing scheme to stimulate new investments and ensure the financial sustainability of existing investments. In Paraguay's case, given the small size of its market and its ample supply from the Itaipú and Yacyretá facilities, applying the PUP rigidly does not seem to have been appropriate. See OP-708 (GN-1869-3).
- ⁹⁹ See project document PR-L1058, p. 8. This program was cofinanced by CAF and the EIB.
- ¹⁰⁰ At the country's explicit request, the Bank hired Jeffrey Sachs and his Earth Institute team to conduct a study of the strategic potential of the use of hydroelectric power for Paraguay's development. This study ([Link](#)), reached the conclusion that the direct jobs created by the aluminum plant would be minimal (2,000 jobs), so the industrial park would only make sense if it could be linked to the wider economy. Even so, the study concluded that "unless there are truly significant spillovers from the RTA project, the proposed project should not pay less in tariffs and taxes than Paraguay would receive from selling the electricity directly to Brazil [...]" and it went on to say that such revenue losses were unlikely to be made up by non-monetary benefits from the RTA project. The study also suggested the need for the new government to re-examine Paraguay's debt for Itaipú.
- ¹⁰¹ Letter of intent by the Government of Paraguay to the IMF, 8 May 2006. [Link](#).
- ¹⁰² See the "Social Sector" Annex for an exhaustive and comprehensive review of Paraguay's social subsectors and the country program.
- ¹⁰³ See Executive Auditor's Report, *Op. Cit.*
- ¹⁰⁴ The program was approved in 2002 and passed by the Congress in 2005. In 2006 the government requested that an investment component be redirected to conditional cash transfers, which was authorized in October 2006 (amendatory contract #3, [Link](#)). Since 2002, the program has executed 63% of its funds, although more than 50% was in the 2009-2013 period.
- ¹⁰⁵ Of the US\$1.2 million originally earmarked for the business projects, only *US\$950,000* were disbursed. Of the 22 companies financed, 10 projects have been completed, nine are under way, and three were canceled.
- ¹⁰⁶ See the Executive Auditor's Report mentioned above.
- ¹⁰⁷ For additional details on the operations approved in the 2009-2013 period, consult the website of the Inter American Investment Corporation (IIC). [Link](#).
- ¹⁰⁸ The guarantees covered transactions for industrial goods (30.4%), fertilizers (27.3%), electrical machinery (11.4%), and vehicles (9.4%). It should be noted, however, that this type of intervention entails significant risks, particularly in the context of solvent, sound banks such as Paraguay's. See, for example, Jean Pierre Chauffour and Thomas Farole, "Trade Finance in Crisis: Market Adjustment or Market Failure?", World Bank Policy Research Working Paper, July 1, 2009.
- ¹⁰⁹ According to estimates of the IMF's *World Economic Outlook*, most recently updated in October 2013. [Link](#).
- ¹¹⁰ The Bank supported the promotion of these partnerships through a guarantee from the Multilateral Investment Fund to fund the "Project to promote public-private partnerships in Paraguay," approved in 2010 for US\$700,000. The main objective of the program was to establish the legal, operational, and functional frameworks to implement public-private partnerships in Paraguay to deliver infrastructure, equipment, and basic services. It is still being executed at this time, with 40% of its resources disbursed. It is expected to be completed in 2014.

- ¹¹¹ The law to promote investment in public infrastructure and the expansion and improvement of goods and services under State responsibility, also known as Public-Private Partnership, was approved on 31 October 2013 by the Congress of Paraguay. By means of this law, the Legislative Branch authorizes the Executive Branch to structure, select, award, and conclude works contracts with public-private participation for investments in public infrastructure, service delivery, and the production of goods. In recent months, the Fiscal Responsibility Law was also approved, which will enter into force in 2015 (the 2014 budgets already exceed the deficit established under the new law).
- ¹¹² According to information from the Legal Department, as of 2013 The Bahamas, Belize, Brazil, Honduras, El Salvador, Guatemala, and Venezuela require prior authorization. Legislative ratification is required by Bolivia, Costa Rica, the Dominican Republic, El Salvador, Haiti, Honduras, Nicaragua, and Paraguay. Chile and Panama need ratification by the Comptroller General but not by the Legislature, which is why they were excluded from the comparison group.

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