

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PARAGUAY

IDB COUNTRY STRATEGY (2014-2018)

APRIL 2014

This document was prepared under the leadership of Eduardo Almeida (CSC/CPR) and José Luis Lupo (CSC/CSC) by Pedro Garay (CSC/CPR), Fernando Montenegro (CSC/CPR), and Pablo Molina (CSC/CSC), who coordinated it, with the collaboration of Nohora Alvarado (SPH/CPR), Pablo Angelelli (CTI/CUR), Fernando Balsevich (MIF/CPR), Gustavo Beliz (ICS/CUR), Oscar Camé (ESG/CPR), Martin Chrisney (VPP/VPP), Edgar Cabañas (SCF/CFI), Roberto Camblor (FMM/CPR), Alberto De Egea (FMP/CPR), Francisco Demichelis (CMF/CPR), Christian Dunkerley (TSP/CPR), Eduardo Feliciangeli (ICS/CPR), Antonio Garcia (IFD/ICS), Pablo Garcia (INT/CUR), Alvaro Garcia (RND/CPR), Hernando Lesme (CRP/FPR), Beatriz Lopez (IFD/FMM), Raul Lozano (FMP/CPR), Carlos Ludeña (INE/CCS), Ernesto Martinez (SCL/EDU), Jorge Oyamada (WAS/CPR), Mariano Perales (FMP/CPR), Claudia Piras (SCL/GDI), Jonathan Renshaw (VPS/ESG), Marcos Robles (SCL/SCL), Emilio Sawada (ENE/CUR), Christian Schneider (OMJ/CPR), Waldo Tapia (LMK/CPR), and Carla Torrealan (CSC/CPR). Comments and guidance were provided by Geovana Acosta (PRE/PCY), Juliana Almeida (VPC/VPC), Florencia Attademo (VPC/VPC), Eduardo Borenzstein (CSC/CSC), Fazia Pusterla (SPD/SDV), and José Seligmann (CSC/CSC).

This document is being released to the public and distributed to the Bank's Board of Executive Directors simultaneously. This document has not been approved by the Board. Should the Board approve the document with amendments, a revised version will be made available to the public, thus superseding and replacing the original version.

CONTENTS

EXECUTIVE SUMMARY

I.	COUNTRY CONTEXT.....	1
II.	THE IDB IN PARAGUAY	3
III.	THE BANK’S STRATEGIC PRIORITIES FOR 2014-2018	4
	A. Priority sectors.....	5
	1. Transportation and connectivity	5
	2. Energy	7
	3. Water and sanitation.....	8
	4. Productive development.....	9
	5. Financial sector	12
	6. Public management	13
	B. Crosscutting areas of action	15
	C. Areas for dialogue	17
IV.	FINANCING FRAMEWORK.....	17
V.	STRATEGY IMPLEMENTATION	17
VI.	RISKS.....	20

ANNEXES	
Annex I	Results Matrix
Annex II	Main Economic and Social Indicators
Annex III	Lending Framework
Annex IV	Donor Coordination
Annex V	Macroeconomic Context
Annex VI	Execution Improvement Plan
Annex VII	OVE Country Program Evaluation Recommendations
Annex VIII	Summary - Development Effectiveness Matrix

ELECTRONIC LINKS	
1.	Report on the Bank's portfolio
2.	Growth diagnostic
3.	Government Plan
4.	Program for reducing extreme poverty
5.	Sector, fiduciary, and safeguard notes
	Sector technical note: Transportation and logistics
	Sector technical note: Energy
	Sector technical note: Water and sanitation
	Sector technical note: Financial sector
	Sector technical note: Public management
	Sector technical note: Productive development
	Technical note on: Labor market and social security
	Technical note on: Security
	Technical note on: Housing and Urban Development
	Technical note on: Rural development
	Technical note on: Education
	Technical note on: Health
	Technical note on: Gender
	Fiduciary technical note
	Environment and social safeguards technical note
6.	Dialogue note: Integrated Vision of the Social Sector

ABBREVIATIONS

AECID	Agencia Española de Cooperación Internacional para el Desarrollo [Spanish Agency for International Development Cooperation]
AFD	Agencia Financiera de Desarrollo [Development Finance Agency]
AMA	Asunción Metropolitan Area
ANDE	Administración Nacional de Energía [National Electricity Administration]
BCP	Central Bank of Paraguay
CAF	Andean Development Corporation
CGR	Contraloría General de la República [Office of the Comptroller General of the Republic]
DGEEC	Dirección General de Estadística, Encuestas y Censos [Bureau of Statistics, Surveys, and Censuses]
DNCP	Dirección Nacional de Contrataciones Públicas [National Directorate of Public Procurement]
EIB	European Investment Bank
ERA	Electronic reverse auction
ESSAP	Empresa de Servicios Sanitarios de Paraguay [Sanitation Services Company of Paraguay]
FDI	Foreign direct investment
FOCEM	Fondo para la Convergencia Estructural del Mercosur [MERCOSUR's structural convergence fund]
FONACIDE	Fondo Nacional de Inversión Pública y Desarrollo [National Public Investment and Development Fund]
GDP	Gross domestic product
GIZ	German Agency for International Development
ICT	Information and communication technologies
IIC	Inter-American Investment Corporation
IICA	Inter-American Institute for Cooperation on Agriculture
IMF	International Monetary Fund
ITU	International Telecommunication Union
JICA	Japan International Cooperation Agency
KFW	Kreditanstalt für Wiederaufbau [German cooperation agency]
KOICA	Korea International Cooperation Agency
LAIF	Latin America Investment Facility/European Commission
LCO	Licitación por Concurso de Ofertas [call for proposals bidding]
MAG	Ministry of Agriculture
MDG	Millennium Development Goals
MEC	Ministry of Education and Culture
MERCOSUR	Southern Common Market
MH	Ministry of Finance
MIF	Multilateral Investment Fund
MOPC	Ministry of Public Works and Communications

MSMEs	Micro, small, and medium-sized enterprises
MSPBS	Ministry of Public Health and Social Welfare
NSG	Non-sovereign guaranteed
OAS	Organization of American States
OECD	Organisation for Economic Cooperation and Development
OECD/DAC	Organisation for Economic Cooperation and Development/Development Assistance Committee
OFID	OPEC Fund for International Development
OMJ	Opportunities for the Majority Sector
OPEC	Organization of the Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation
OVE	Office of Evaluation and Oversight
PBLs	Policy-based loans
PEFA	Public Expenditure and Financial Accountability Report
PETROPAR	Petróleos Paraguayos
PPP	Public-private partnership
R&D	Research and development
RENAF	Registro Nacional de Agricultura Familiar [National Registry of Family Farms]
SCF	Structured and Corporate Financing Department
SEAM	Secretaría del Ambiente [Environment Department]
SEP	Social Entrepreneurship Program
SG	Sovereign guaranteed
SIAF	Sistema Integrado de Administración Financiera [Integrated Financial Administration System]
SIARE	Sistema Integrado de Administración de Recursos Estatales [Integrated State Resource Administration System]
SMEs	Small and medium-sized enterprises
TC	Technical cooperation operation
UMEP	Unidad de Monitoreo de Empresas Públicas [State-owned Enterprise Monitoring Unit], Ministry of Finance
UN	United Nations
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

Country context

Paraguay's economic performance has improved substantially over the last decade, with GDP growing at an average of 4.9% during the 2004-2013 period. This performance is based on a relatively undiversified export agriculture sector (soybeans, cereals, and meat), the vulnerability and volatility of which have been contained through sound macroeconomic management. Growth has not been very inclusive: employment generation has been low, and there has been little progress in reducing poverty (32%) and extreme poverty (18%).

With the country's proximity to a vast market in Brazil and, potentially, in Argentina, the availability of clean energy at competitive prices, a stable macroeconomic framework, a low tax burden, and a ready supply of labor, Paraguay's development prospects should allow it to complement its agricultural export production with *maquila* [in-bond assembly industry] and services activities that will generate employment and help sustain inclusive growth.

There are significant challenges in the social area. The authorities have resources from the sale of surplus energy to Brazil to address those challenges. The distribution of those resources, which are held in a specific-purpose fund (FONACIDE), will provide US\$153 million annually for education, US\$36 million for health, and US\$27 million for school lunches. However, the complex institutional arrangements for allocating the resources pose significant coordination and execution challenges to achieve the desired impact.

The IDB in Paraguay

The IDB is Paraguay's principal multilateral strategic partner, with a portfolio of 25 sovereign guaranteed (SG) operations in execution for a total of US\$866 million. While the Bank's intervention has historically focused on the public sector, recent years have seen considerable growth in non-sovereign guaranteed (NSG) activities. The NSG portfolio consists of eight operations for a total of US\$201.3 million, including four SCF loans for US\$183.8 million and four operations originated by OMJ for US\$17.5 million. In addition, the MIF has 15 operations totaling US\$10.2 million, and the IIC has 15 operations amounting to US\$31.1 million.

Priority sectors

The Bank will support the objectives of the Government Plan (inclusive economic growth, integration into the world economy, and reduction of extreme poverty). It will take into account the outstanding portfolio, the country's own resources, and participation by other multilateral and bilateral entities, giving priority to interventions in the following sectors: (i) transportation and

connectivity; (ii) water and sanitation; (iii) energy; (iv) productive development; (v) the financial sector; and (vi) public management. There are two crosscutting elements: support for FONACIDE, which will leverage the use of government resources in education and health; and the inclusion of gender considerations and indigenous communities in Bank programs and initiatives. The Country Strategy will be valid through December 2018.

Resources

The sovereign-guaranteed lending scenario considered by the Bank sets a tentative goal of US\$1 billion in approvals over the life of the strategy, provided significant progress can be achieved in terms of execution.

Risks

The principal risks relate to: (i) the economy's vulnerability to external shocks and climatic factors; and (ii) the execution capacity of the executing agencies, which could have an impact on the performance of the portfolio. In the first case, the country has showed that it has a macroeconomic policy that can withstand external shocks and climatic events of short duration. In the second case, the strategy calls for specific mitigation measures to increase the level of SG loan disbursements from an average of US\$94 million during the 2009-2013 period to US\$125 million for the 2014-2018 period.

I. COUNTRY CONTEXT

- 1.1 Paraguay's economic performance has improved substantially over the last decade, with GDP growing at an average rate of 4.9% during the 2004-2013 period. This growth has been driven by a relatively undiversified export agriculture sector (soybeans, cereals and meat): the sector's economic vulnerability to external shocks, climatic events, and price volatility has been contained through sound macroeconomic management. Nevertheless, the growth generated by this export agriculture model has not been very inclusive—employment generation has been low (underemployment stands at 22%)—and its continued expansion has been prompting internal migration from rural areas to cities. At the same time it has had little impact on human development indicators or levels of extreme poverty (18% in 2011) or on income distribution (with a Gini index of 0.52), among the least equitable in Latin America.¹
- 1.2 The country's traditional growth base will remain important over the medium term, with the continued availability of arable land in the eastern region for increasing soybean production and in the Chaco region for expanding cattle raising. However, the medium- and long-term outlook will require supplementing this growth with productive development of an inclusive kind that will generate sufficient employment to absorb the population that is migrating to the cities and, at the same time, sustainable development in terms of the management of natural resources such as forests, biodiversity, soil, and water. In order to reduce cyclical dependency on agricultural commodities, this growth model must be capable of adding value to traditional products (such as the soybean and meat production clusters) and incorporating diversification in the productive matrix and the export market, through nontraditional agricultural products (such as stevia and organic sugar) as well as manufacturing and services, primarily *maquila* operations geared to the Brazilian market.
- 1.3 This complementary and inclusive productive development, currently in its early stages,² is being sustained by proximity to large markets in Brazil and, potentially, in Argentina, the availability of clean energy at competitive prices, a stable macroeconomic setting, comparative tax advantages that promote investment, and the availability of labor. Consolidating this inclusive productive development will require close cooperation between the public and private sectors, the involvement of civil society, and participation by foreign investors. The Paraguayan authorities have demonstrated their determination to take advantage of these conditions and are promoting both domestic and foreign investment (in particular from Brazil and Argentina) in the country.

¹ Source of social indicators: Directorate of Statistics, Surveys, and Census.

² Non-commodity exports rose from 7.7% to 12% of nonagricultural GDP between 2003 and 2013 (IMF Country Report 14/60, 2014).

- 1.4 There are significant challenges in the social area. To address them, the authorities recently approved Law 4758/12 creating the National Public Investment and Development Fund (FONACIDE) and the Fund for Excellence in Education and Research.³ FONACIDE will be financed by the entirety of the revenues from the sale to Brazil of surplus energy generated by Itaipú Binacional. Those resources, amounting to some US\$360 million a year, will be allocated as follows: 30% to the Fund for Excellence in Education and Research (US\$108 million); 10% to the National Health Fund (US\$36 million); 25% (US\$90 million) to the departments and municipalities, of which 50% must be allocated to education infrastructure (US\$45 million) and 30% to the provision of school lunches (US\$27 million), with priority to the most vulnerable zones. In total, FONACIDE will channel US\$153 million annually to education and US\$27 million to health. These funds will not necessarily cover the needs of the respective ministries, given the competitive nature, for example, of the Education Fund and the participation of multiple actors (universities, NGOs, the private sector and the Ministry of Education and Culture), which in fact poses significant challenges of coordination and execution.
- 1.5 The country faces a number of pressing issues that will have to be addressed in order to generate inclusive growth and high-quality employment. These include: unreliable transportation infrastructure, with only 9% of roads paved; low coverage of water (85%), sewage (28%) and solid waste collection (73%) services; a power transmission and distribution network that cannot handle the abundant renewable hydroelectric energy available (it represents only 16% of the energy mix consumed); low productivity levels, according to the Global Competitiveness Index, which ranks Paraguay 109th among 144 countries; the economy's dependency on commodities (54% of exports), with a high degree of informal employment (only 18% of workers contribute to the pension system); a financial system in which the average lending term is two years; inadequate management capacity in public institutions, which prevents the effective implementation of policies; education and health systems of low coverage and quality in a context of high poverty (32% of the population), a low human development Index (Paraguay stands 20th out of 26 in Latin America and the Caribbean), and significant inequality in income distribution (Gini index 0.52). Overcoming these constraints is essential to consolidating the country's inclusive productive development and offering equal opportunities to its citizens.

³ Law 4758 of 2012 created FONACIDE, which is financed with the entirety of the funds mentioned in the fourth exchange of notes of September 2009 between Paraguay and Brazil, pursuant to which the equivalent of US\$360 million is transferred annually to Paraguay. Those funds will be distributed as follows: education 30%, health 10%, Development Finance Agency (AFD) 7%, infrastructure (National Treasury) 28%, and departmental and municipal governments 25%.

II. THE IDB IN PARAGUAY

- 2.1 The 2009-2013 Country Strategy focused on three priority areas: (i) infrastructure (transportation, energy, water and sanitation, agriculture, biofuels, and climate change); (ii) social sectors (social safety net, health, and education); and (iii) institutional strengthening (institutional capacity, financial capacity, and municipal and urban development). There were 28 loan operations approved for a total of US\$1.040 billion (US\$797 million SG and US\$243 million NSG). In addition, 64 technical cooperation operations and 14 MIF operations amounting to US\$41.3 million were approved, along with two investment grants in the amount of US\$100 million.
- 2.2 According to the OVE evaluation of the 2009-2013 Country Program, implementation of the strategy produced significant results in terms of covering the country's infrastructure and liquidity needs, although it did so to a lesser extent in the social and institutional capacity areas. Of total approvals during the period, 55% went to infrastructure, 39.8% to institutional capacity building, including two PBLs for US\$200 million, 4% to the social sector, and 1.2% to integration.^{4, 5}
- 2.3 The private sector windows also expanded their interventions in Paraguay, with the approval since 2009 of US\$322 million in investment loans and technical cooperation operations.⁶ In 2013, NSG approvals (US\$152 million) exceeded SG approvals (US\$132 million). NSG operations represent approximately 19.3% of the Bank's portfolio in Paraguay. That proportion is expected to increase, given the growth of the private sector and its importance in the country's development effort.
- 2.4 The portfolio of SG loans in execution includes 25 operations for a total of US\$866 million, with a balance of US\$541 million (62.4% of the total approved)

⁴ According to the Bank's institutional classification. However, if the social impact of the projects and their contribution to the government's poverty reduction program are taken into account, the amount available, at December 2013, is US\$206 million in the following programs: National Rural Roads Program, Phase II (US\$39 million), Water and Sanitation for Rural and Indigenous Communities (US\$8.2 million + US\$19 million in grant funding), Water and Sanitation Program for the Chaco Region (US\$19.9 million + US\$59 million in grant funding), Escuela Viva II Program (US\$27.8 million), Program for the Modernization of Agricultural Support Management (US\$10.4 million), Early Childhood Development Support Program (US\$27 million), and Program to Support Job Placement (US\$5 million).

⁵ For the most part, the private sector windows have focused on expanding access to credit for unserved communities and raising their income through investments in both the industrial and agricultural productive sectors. For example, both SCF and OMJ gave loans to SMEs at longer tenors than existing ones. SCF, OMJ, and the MIF had operations that improved access to credit for vulnerable communities, especially rural communities and women, as well as operations aimed at connecting remittances to productive investments and developing specific product value chains (milk, stevia, fruits and vegetables, and organic sugar). In addition, the MIF worked to increase the use of new technologies, develop microfranchises for women, and strengthen the regulatory framework of the cooperative sector.

⁶ The loans are concentrated in agroindustry and the financial sector, and they range from financing for a new cement factory to support for low-income female microentrepreneurs.

available for disbursement. Around 70% of the available balance is concentrated in infrastructure (53% in transportation, 12% in energy, and 5% in water and sanitation), 7% in the financial sector, 4% in public management, 9% in productive development, and 10% in health and education. The NSG portfolio consists of eight operations for US\$201.3 million, of which four are SCF loans (US\$183.8 million) and four are OMJ operations (US\$17.5 million). In addition, there are two Social Entrepreneurship Program operations for US\$1.5 million, 15 MIF operations for US\$10.2 million, and 15 IIC operations for US\$31.1 million.

- 2.5 In terms of technical support, the IDB is the most important source of technical assistance and knowledge transfer for public institutions and other actors relevant to the country's development. Currently there are 44 nonreimbursable technical-cooperation operations in execution, for a total of US\$127.2 million. These include 19 operations in the institutional area, 13 in the social area, and 12 in infrastructure. In addition, there are two investment grants.

III. THE BANK'S STRATEGIC PRIORITIES FOR 2014-2018

- 3.1 The 2013-2018 Government Plan of the President Cartes administration sets three principal strategic objectives: (i) poverty reduction (with the emphasis on creating employment opportunities for rural families in extreme poverty and providing access to social services including housing);⁷ (ii) inclusive economic growth (productive development and decent jobs); and (iii) Paraguay's integration into the world economy (broader markets and increased foreign investment).⁸
- 3.2 The objective of the 2014-2018 Country Strategy⁹ is to support the country's productive transformation, with a view to achieving sustainable and inclusive economic growth that will translate into reduced poverty and inequality, through the generation of formal employment. Using SG and NSG interventions and an extensive program of technical cooperation operations, the Bank will support the government's strategic objectives, giving priority to the following sectors: (i) transportation and connectivity, (ii) water and sanitation, (iii) energy, (iv) productive development, (v) the financial sector, and (vi) public management.

⁷ The strategy for reducing extreme poverty, "Sowing Opportunities," focuses on programs with opportunities for increasing the income of low-income people. It has four pillars: (i) technical, financial and administrative support to campesinos for improving access to markets and development of value chains; (ii) employment creation through investment in the construction and maintenance of road infrastructure, schools, health centers, and water and sanitation facilities; (iii) expansion of the conditional cash transfer program; and (iv) increased workforce training in coordination with the private sector.

⁸ The investments called for in the Government Plan amount to US\$16 billion, of which 38% (US\$6.080 billion) will go to transportation infrastructure works, 17% (US\$2.880 billion) to electricity, and 12% (US\$1.920 billion) to housing. There are also plans to use US\$1.760 billion for water and sanitation, US\$1.440 billion in assistance to the productive sector, US\$1.280 billion for health and education, and US\$640 million for telecommunications.

⁹ The Country Strategy will be valid through December 2018.

- 3.3 The Bank will support the social sector through two channels: (i) with specific interventions in each of the priority sectors,¹⁰ in support of the objective of reducing extreme poverty;¹¹ and (ii) through a crosscutting element in the form of interventions to support the investment of FONACIDE resources, primarily targeting education and health. This support, through technical cooperation operations and loans, will leverage the allocation of FONACIDE resources for these sectors.¹²

A. Priority sectors

1. Transportation and connectivity

- 3.4 Paraguay has a road network of 60,100 km, of which 16% are national roads, 11% are departmental, and 73% are local roads. Although the highways constitute the main corridor and most important mode of transportation (carrying 99% of passengers and 100% of freight, either in transit or as final destination), only 5,360 km (9%) are paved, of which 25% are severely deteriorated. Only 2,942 km of unpaved roads (4%) are improved (with stone or gravel surfacing). The remainder of the road network, or some 52,248 km, consists of poorly maintained dirt roads.¹³ In addition to this rudimentary infrastructure, Paraguay has the highest accident rate in the region, relative to its population (with 1,200 fatalities and 30,000 injuries every year).¹⁴
- 3.5 As a complement to road transport, the Paraguay-Paraná Waterway moves 77% of export tonnage and 67% of imports. Despite its importance, the Paraguay River is difficult to navigate during its low phase because of inadequate dredging, which results in cost overruns of around US\$181 million a year.¹⁵ Nearly all the river freight passes through private terminals, but there is no adequate institutional

¹⁰ The interventions in each of the priority sectors directly related to the objective of reducing extreme poverty are: in the transportation area, construction and maintenance of rural roads through cooperatives of neighbors trained for such purposes; in energy, provision of electricity in nonconventional ways that will be primarily of benefit to the indigenous population in remote areas such as the Chaco; in water and sanitation, access to these services in rural areas, plus operation by sanitation boards whose members represent the beneficiaries; in productive development, support for SMEs; in the financial sector, efforts on behalf of financial inclusion to enable micro, small, and medium-sized enterprises and female entrepreneurs to gain better access to credit; in the public management area, strengthening of citizen security agencies, with emphasis on reducing domestic violence against women and children, and implementation of a policy for the construction of housing for the poor.

¹¹ The Bank has US\$206 million available in active projects to support the government objective of reducing extreme poverty.

¹² For example, with technical assistance projects in which US\$10 million from the Bank could leverage US\$100 million in projects.

¹³ Road Planning Division, MOPC, Road Statistics. An inventory of roads is still being compiled and there are no data as yet available on the quality of infrastructure for most of the country's road network.

¹⁴ National Road Safety Plan 2013-2018.

¹⁵ World Bank, 2012. Feasibility studies for improving navigation conditions on the Paraguay River through the public-private partnership system (APA Formosa segment). Vol 2, Main Report, Washington.

framework to guarantee management of the waterway and its navigability. Apart from private investments in port terminals, there is virtually no private sector participation in public infrastructure projects, despite the contribution this could make as a supplement to public investment, which in Paraguay is less than 3% of GDP.¹⁶

- 3.6 To resolve the above-described problems in the transportation sector, the government has identified the following lines of action: (i) institutional strengthening of the Ministry of Public Works and Communications (MOPC); (ii) prioritization and execution of investments in highways, local roads, and river transportation; and (iii) increase in the provision and management of transportation infrastructure through public-private partnerships (PPPs).
- 3.7 The Bank will support critical areas for improving the country's connectivity, with financing and technical assistance for project preparation as well as for those areas that need institutional capacity building. Interventions will be designed to: (i) improve infrastructure and internal, regional, and international connectivity, supporting the construction and maintenance of major highways and departmental, local, and urban roads; (ii) formation of PPPs for improving transportation and communication services; (iii) logistics development, with priority to ensuring efficient mobility for freight and passengers, leading to a rationalization of overall transport costs; (iv) road safety measures to reduce accidents and their impact on society; (v) institutional strengthening to improve government processes and transparency, including planning, decentralization of road management, and training for technical personnel in the public and private sectors; (vi) strengthening of institutions to support implementation of the transportation master plan and the logistics plan, as well as PPP projects in Paraguay. The IDB may also finance PPP projects through its private sector windows.
- 3.8 The risks associated with the proposed interventions relate to: (i) lack of capacity of human resources for planning, programming, implementing, supervising, and auditing project execution in the sector; (ii) the impact on indigenous communities and environmental management; (iii) weak institutional capacity for structuring PPPs; and (iv) the lack of capacity of Paraguayan companies to execute large-scale projects. To mitigate these risks the Bank plans to provide technical assistance for: (i) training for road works supervisory staff; (ii) strengthening of the entities that support compliance with environmental and social safeguards (particularly with indigenous communities) and of the environmental management units within the MOPC; (iii) formation and training of teams to analyze the PPPs; and (iv) involvement of international firms to increase project execution capacity.

¹⁶ One section of highway between the city of Coronel Oviedo and Ciudad del Este (193 Km), the corridor linking the latter with Asunción, and a concession for the power distribution system in the city of Villarica.

2. Energy

- 3.9 Paraguay has abundant hydroelectric energy from the binational power plants of Itaipú (with Brazil) and Yacyretá (with Argentina) and significant surpluses for export. Nevertheless, biomass (wood, plant waste, and coal) accounts for 46% of gross domestic energy consumption, while hydropower represents only 16%.¹⁷ While access to electric power is high (99% in urban areas, and 96% in the countryside), service quality is substandard. The transmission and distribution network is inadequate for meeting the demand for electricity, which is rising by more than 9% per year. Electricity rates are low (averaging US \$0.07/kilowatt hour, unchanged since 2003), although they have to date been sufficient to cover operating and debt amortization costs. Nevertheless, the sector's financial sustainability is being affected, among other things, by the high level of both technical and non-technical electricity losses (29%, ANDE) and the need to undertake major investments. Access to electricity service in remote areas, populated primarily by indigenous communities in the Chaco region, will not be feasible until nonconventional options such as solar energy are installed. Moreover, the country is highly dependent on hydrocarbons since, in the absence of domestic production, it imports nearly all the fuel and gas consumed.
- 3.10 The government considers it a priority to ensure power supply for the population and the productive sector, improve the quality of service (reducing the incidence of blackouts and voltage fluctuations), and at the same time minimize the need for future power rate increases. The country does not have an energy ministry (initiatives to create one never came to fruition) and there is no regulatory body, because there are in fact almost no private actors. The Office of the Deputy Minister of Energy and Mines, which is attached to the MOPC, is strapped for staff and budgetary resources, and its hierarchical level makes it difficult to carry out its role effectively. Energy policies are debated in an energy roundtable, chaired by the President of the Republic, whose participants include the main actors in the system—the representatives of Itaipú and Yacyretá, the National Electricity Administration (ANDE), and the national oil company, Petróleos Paraguayos (PETROPAR).¹⁸
- 3.11 The Bank's participation in the sector will be coordinated with the private sector windows (MIF, IIC, OMJ, SCF) and will include technical assistance and SG and NSG lending. The strategic objective will be to ensure a reliable and competitive supply of energy through support for: (i) implementation of the investment plan for the electricity system, which will help to meet demand, improve the quality of

¹⁷ Source: Balance Energético Nacional 201. MOPC, Office of the Deputy Minister for Energy and Mines.

¹⁸ Despite the institutional challenges faced by the electricity sector in Paraguay, it is possible to design projects consistent with the Bank's Public Utilities Policy (document GN-2716-6), provided they comply with the conditions established therein. Paraguay has abundant, renewable, and low-cost hydroelectric energy available. Rate subsidies are not needed to remain sustainable and efforts have been made to improve service quality and reduce electricity losses.

service, and make greater and better use of the country's abundant hydropower potential to reduce consumption from other nonrenewable, more polluting, and more costly energy sources; (ii) investments in energy efficiency, including measures to reduce electricity losses and actions to modernize the public lighting system and enhance energy efficiency in public buildings; and (iii) development of nonconventional, alternative, and renewable energy sources, including biofuels, solar energy for isolated areas, and sustainable biomass in rural zones, including indigenous communities, as in the Chaco.

- 3.12 The principal risks and challenges relate to: (i) the need for multiparty political support for a government policy to modernize the energy sector and make it sustainable over the medium and long terms; and (ii) the difficulties faced by ANDE in executing its budget and in obtaining environmental licenses, problems that are holding up the pace of works. These challenges can be mitigated by fostering public policy dialogue and promoting an institutional and rate-setting framework that will guarantee ANDE's financial sustainability.

3. Water and sanitation

- 3.13 Sewage service coverage is quite low in Paraguay (10% nationwide, 30% in the Asunción Metropolitan Area (AMA)), compared with most Latin American countries. Although water service coverage in urban areas is relatively high (85.5%), there are persistent problems with the quality, quantity, and continuity of service. The gaps in water and sanitation coverage between the urban and rural sectors are still significant (85.5% versus 59.1% for piped water and 92.5% versus 47.7% for basic sanitation¹⁹), and are even greater in the case of indigenous communities. In addition, small rural providers (sanitation boards) face technical and operational challenges and their technical assistance and support arrangements are weak.
- 3.14 The low coverage of sewage service is compounded by the virtual nonexistence of sewage treatment, the lack of effective solid waste disposal (garbage collection service coverage is 40.6% nationwide), and the low coverage of storm drainage systems (19% in Asunción). These factors have generated a critical degree of pollution in the AMA's urban watercourses, especially Lake Ypacaraí and the Bay of Asunción. In addition, the Patiño aquifer, one of the main sources of water for the AMA and cities in the department of Central, is overexploited, and the water table is declining as extraction outstrips replenishment.²⁰ There is an obvious lack of integrated urban water management.

¹⁹ Includes sewage service, flush toilets, septic tanks, and pit latrines.

²⁰ In 2005, around 85% of the population settled on the aquifer was receiving safe water, of which 40% came from that source. For the 2005-2035 period, projections indicate a gradual decline in the underground water reservoir, until overexploitation of 305,100,000 m³ per year in 2035 is reached, which would lower the water table by an estimated 40 meters (Consorcio CKC/JNS – SENASA, 2005).

- 3.15 The main thrusts of government policy are to: (i) increase the levels of service coverage, particularly for sanitary sewers in the AMA and cities in the department of Central and safe water and basic sanitation in rural areas; (ii) modernize and strengthen the operational and financial management of operators; (iii) undertake environmental cleanup of receiving bodies of water, in particular the Bay of Asunción and Lake Ypacaraí; (iv) reinforce the institutional and regulatory framework; and (v) develop a financial policy for the sector, including rate schedules.
- 3.16 The Bank will provide support through NSG and SG financing and technical assistance for: (i) expansion and improvement of urban sanitary sewer services, sewage treatment, safe water, storm drainage, garbage collection and disposal (these investments will be focused in particular on cleanup of the Bay of Asunción, urban watercourses in the AMA, and Lake Ypacaraí). The Bank will also support: (ii) the sector institutional reform process and the technical, managerial, and financial strengthening of service operators in order to boost their efficiency and improve service quality (particularly the Sanitation Services Company of Paraguay (ESSAP)). Continued support will be provided for: (iii) efforts to expand access to safe water and sanitation services in indigenous communities, rural areas, and the country's medium-sized cities. The Bank will support the structuring of unconventional PPPs with community entities to deliver basic services.
- 3.17 The main risks are associated with the lack of preinvestment studies, including comprehensive feasibility analyses, and limited technical capacity for program design and management. To mitigate these risks, technical cooperation operations will be processed to prepare or update preinvestment studies and to strengthen the capacity of the institutions involved in and responsible for project design, execution, and supervision.

4. Productive development

- 3.18 In recent years, the Paraguayan economy has performed poorly in terms of productivity, with a growing concentration on production and exports of such items as soybeans and meat, which are exposed to exogenous factors (e.g. climatic variability) and generate volatility. A 2002 study by Fernandez-Monge found that productivity had stagnated during the 1950-2000 period. More recent data show a major gap vis-à-vis the other countries of the region. Between 1999 and 2008, productivity grew by only 0.3% a year, well below the 1% average for Latin America and the Caribbean.²¹ The concentration of exports is higher in Paraguay than in Uruguay, Argentina, or Brazil, and is exceeded only by Bolivia and Chile, countries in which mining output is a significant component of the export structure.

²¹ Productivity in Paraguay's agriculture sector between 2001 and 2007 was at 7.4%, well above regional productivity (1.8%); the country had the highest growth in the region for that period (see Ludena, C. 2010. Agricultural Productivity Growth, Efficiency Change and Technical Progress in Latin America and the Caribbean. IDB Working Paper Series No. 186).

The sector basket is dominated by agricultural commodities (54% of total exports). Low productivity and the lack of diversification are associated with meager investment in research and development (R&D) and innovation, in human capital, in information and communication technology (ICT), and in policies to promote productive development.

- 3.19 R&D investment represented only 0.06% of GDP in 2011, the lowest rate in the region (where the average is 0.7%). Countries at the same per capita income level as Paraguay are investing 0.3% of GDP. The low level of firms' investment in innovation is related to financial market shortcomings that limit access to credit, as well as problems with strategic public inputs. It is noteworthy, for example, that agencies such as the National Technology and Metrology Institute and the Paraguayan Institute of Agricultural Technology have very little involvement in research activities and in the transfer of technology to the productive sector. The lack of innovation also reflects the shortage of human capital. Only 32% of students complete intermediate education within the theoretical timeframe (12 years of study), and only 5% finish upper secondary education. Moreover, very few young people enroll in technical and vocational education, which is so important to the productive sector. When it comes to job training, supply is fragmented from the institutional viewpoint, and there is no coordination or regulation of the system to ensure its quality. The level of informality in the economy is high, and only 18% of workers contribute to social security.
- 3.20 Apart from the soybean complex, farming activity faces some significant obstacles to its development. The property cadaster and registry system does not provide legal certainty for land holdings. According to the 2008 CGA, 53% of existing farms lack a formal property title (66% in the case of farms of less than 5 hectares), and overlapping titles affect 70% of properties. The government provides almost no agricultural goods and services: budgetary expenditure on the sector is low (1% versus 17% for the region), in relation to the gross incomes of Paraguayan farmers, and only 16% of expenditure is earmarked for general services (versus 50% for the region). Public phytosanitary management is deficient, and this has had an impact on Paraguay's exports to markets in developed countries. In addition, as an agricultural country, Paraguay is quite exposed to climatic variability, and its capacity to manage natural resources (through the Environment Department) is weak, resulting in little capacity to adapt to the increasingly more recurrent extreme events, high deforestation rates (one of Latin America's highest), and threatened biodiversity from the expansion of the agricultural frontier, thus raising questions about the environmental sustainability of its agricultural development.
- 3.21 Paraguay is not taking advantage of the potential benefits of foreign direct investment (FDI) and the ICT-enabling possibilities inherent in broadband to boost productivity and productive diversification. Inflows of FDI in recent years have been low. The FDI/GDP ratio in 2011 was 1.72%, below the South American

average of 3.26%. With respect to broadband development as an ICT enabler, Paraguay has not kept pace with international trends. It is characterized by:²² (i) a low level of broadband penetration, with 5.43 lines for every 100 inhabitants, versus averages of 27.62 for countries of the Southern Cone, 18.38 for Latin America and the Caribbean, and 75.56 for OECD countries; (ii) poor service quality, with an average fixed broadband speed of 0.64 Mbps compared with 1.37 Mbps for the Southern Cone, 2.18 for Latin America and the Caribbean, and 7.34 for OECD countries; and (iii) service prices above the average for the region, with an average plan price of US\$60 per Mbps (at purchasing power parity), higher than the average cost for the region (US\$53.17 per Mbps).

- 3.22 In the face of these challenges, the Government of Paraguay plans to take the following actions to generate employment and improve income levels: (i) generate a hospitable business climate in order to attract investment for agriculture development in particular, with a special focus on productive chains that generate value added; (ii) increase the number of productive chains based on the development of new products at the primary or industrial level, and diversify export markets; (iii) coordinate with the private sector, local governments, and municipalities for the installation and development of industrial zones, particularly in cities with high demographic density and infrastructure concentration (logistics and energy); (iv) upgrade the National University to become a center of excellence in higher education; (v) reform technical and vocational training, particularly for 15- to 18-year-olds; and (vi) promote broadband in terms of both access (connectivity) and adoption and use.
- 3.23 In light of the foregoing, the IDB will provide loans and technical assistance in coordination with the private sector windows (MIF, IIC, OMJ, and SCF) to support initiatives that will foster the conditions necessary to enhance the productivity and competitiveness of firms, generate employment (especially in the productive chains mentioned in paragraph 1.2), and promote the economic participation of women. These are: (i) consolidation of public policies for development of the private sector; (ii) organizational and technological innovation in firms, with emphasis on SMEs and on small-scale farmers' associations; (iii) consolidation of the cadaster and registry system to promote the legal certainty of landholdings; (iv) provision of public agricultural goods and services; (v) institutional strengthening of the Department of the Environment for sustainable management of natural resources (forests, biodiversity, and water) and preparation of the National Plan for Adaptation to Climate Change; (vi) the increase and diversification of exports; (vii) promotion of foreign investment; (viii) formalization of the workforce and job training in the skills and competencies required by the productive sector; and (ix) promotion of access, adoption, and use of broadband by companies, to make innovation and adoption of more sophisticated technologies possible.

²² The following broadband indicators are taken from the IDB's broadband development index and the study Prices and quality of broadband in Latin America: Benchmarking and trends (Galperin, 2012).

- 3.24 The main risk relates to the weakness of government institutions involved in the design and execution of productive development and competitiveness policies, as such weaknesses can limit the interagency coordination needed for the interventions. To mitigate this risk, the Bank's programs will include an institutional capacity assessment of the agencies involved and the plans for strengthening them. An additional risk lies in the weakness of information for making decisions in the sector. To address this, Bank interventions will incorporate measures to enhance the availability of information about business activity, so as to produce more accurate diagnostics and facilitate monitoring and evaluation.

5. Financial sector

- 3.25 Paraguay's financial sector has been gaining strength in recent years in terms of profitability, liquidity, and capitalization. It comprises a banking and financial sector regulated by the Central Bank of Paraguay (BCP) and a cooperative sector regulated by the National Institute of Cooperativism. Its depth, in terms of private savings (deposits/GDP), is 46%, while the rate of banking penetration, as the proportion of debtors within the economically active population, is 30%, and 26.73% as the proportion of depositors. In terms of financial intermediation, the rate is 38% (loans/GDP), and the average placement term is two years: both these figures are among the lowest in the region, itself characterized by a financial sector below its level of economic development. Banks hold excess reserves, which distorts market incentives and undermines the BCP's capacity to promote financial stability and to conduct monetary policy. The banks keep abundant liquid reserves as a precautionary measure, due especially to the high proportion of short-term deposits (70.5%) and the lack of any efficient instrument to enable the BCP to manage liquidity. The cooperatives present some important vulnerabilities in supervision and in their operation, as they pay higher interest rates on deposits than the banks, thus putting at risk their capacity to generate profits and to keep themselves capitalized.
- 3.26 Microfinance institutions are becoming more important, but serve only 17% of the sector even though they cover 71% of clients. When it comes to small-scale producers, women are at a disadvantage, and only 16% have access to credit (versus 26% of men). The capital market in Paraguay is shallow, with trading volumes on the BVPASA [Asunción stock exchange] amounting to only US\$400 million per year: trading in shares is equivalent to 0.1% of GDP and market capitalization is 4.0% of GDP. Institutional investors such as pension funds, insurance companies, and the government itself have virtually no presence in the capital market. The pension and retirement funds lack a regulatory framework with a global and systemic vision that would serve to integrate them into a national pension system, and the system is highly fragmented, with asymmetries in its benefits and permanent financial deficits that represent a major financial burden for the State.
- 3.27 The government's objective is to improve access to long-term financing and to foster financial inclusion for a significant portion of the population, particularly in the rural areas, and for micro, small, and medium-sized enterprises (MSMEs) that

- so far have been excluded. The government hopes to implement a series of reforms to the rules governing the system, including the Central Bank, the capital market, and the pension system. It also wants to strengthen first- and second-tier public banks to supplement private banks and to promote the development of financial products that will encourage financial inclusion for individuals and MSMEs, as well as access to the housing market.
- 3.28 Through SG and NSG lending and technical assistance, the Bank will support projects designed to: (i) promote financial inclusion and access to long-term financing for local firms, especially MSMEs and small-scale farmers' associations; (ii) focus on access to credit for women entrepreneurs, in particular rural women; (iii) strengthen the public development banking system's capacity to implement public policies in terms of access and financial inclusion, by establishing a government guarantee fund for MSMEs; (iv) deepen local capital market development; (v) channel housing subsidies for upgrading and constructing dwellings for low-income groups, as a supplement to the financing provided by qualified financial institutions; (vi) support the establishment of a regulatory framework governing investments by pension fund managers, together with a pensions superintendency; and (vii) create instruments to enable the BCP to regulate financial market liquidity.
- 3.29 The main risks involved in amending existing legislation covering the Central Bank of Paraguay, the public banking system, the capital market, and, in particular, the pension system, have to do with the very credibility of the system, which collapsed in the late 1990s. To mitigate this risk, alternative proposals will be examined in light of successful experience in other, similar countries, so as to be able to choose among possible solutions.

6. Public management

- 3.30 The management of public affairs faces substantive problems that have to do with: (i) the low level of tax revenues, which prevents greater public investment and limits efforts to fight poverty and inequality; (ii) the lack of efficiency and effectiveness in crosscutting areas such as financial management, the procurement system, e-government, the civil service, and public security, which makes it more difficult to capitalize on sector efforts; (iii) the lacking or weak institutional capacity in areas where coordination is key for taking advantage of sector investments in infrastructure, both in the case of the AMA, where it is essential to ensure a sustainable city, and in the case of policies to promote housing for low-income groups.
- 3.31 The tax ratio in Paraguay, at 12.3% of GDP, is well below the average for Latin America (27.6%). The rigidity of public expenditure is high: current spending accounts for 78% of total expenditure and is crowding out capital expenditure, which over the last decade averaged less than 3% of GDP; execution is very weak, with an implementation rate of 40%. The present value of contingent liabilities in government coffers is between 40% and 50% of GDP, not including the implicit

- debt associated with low coverage, which at some point will result in budgetary pressure.²³
- 3.32 Paraguay has made progress with its financial management and with its procurement system. However, coverage in many of the initiatives is still low: only seven entities have results-based budgeting, there is external control over only 28.7% of expenditure, and the Integrated State Resources Management System is not yet operational. As to the procurement system, much has been done to enhance the transparency of procurement but this has not extended to market practices, where there is little quality or pricing control and SMEs receive very little support. According to the United Nations e-government index, Paraguay ranks ninth among 12 countries of South America, and 104th out of 190 countries around the world. The professional level of the civil service is low: only 26% of vacancies during the 2008-2012 period were filled through competition by the Public Service Ministry, and the civil service development index (IDB, 2013) places Paraguay below the average for Latin America (26 versus 38). The public perception of citizen security is negative (24%, compared with the regional average of 33%, Latinobarómetro 2012), despite the relatively high ratio of law enforcement personnel (355 per 100,000 inhabitants, versus a Western Hemisphere average of 246). Gender violence accounts for 20% of complaints: 63.6% of women who reported injuries and threats suffered them in their own home, 89.3% were acquainted with the attacker, and 43% were attacked by partners or former partners (National Survey of Victimization and Citizen Security, 2011).
- 3.33 The sustainability of the AMA, which is home to 45% of the population, is in question, since it lacks an organization to administer it and the delivery of basic services (water, sewage, transportation, waste removal, etc.) is fragmented. Some 18% of the population lives in makeshift housing, both within the AMA and the rest of the country. The housing deficit amounts to one million units and there are no policies in place to resolve the problem of access to housing for low-income families.
- 3.34 In the face of these challenges, the government plans to: (i) bring more transparency to the cost structure for services and goods provided by the State; (ii) legitimize public demands in a framework of consultation, dialogue, and consensus seeking; (iii) initiate a comprehensive process for restructuring the public administration and streamlining procedures; (iv) improve the efficiency and effectiveness of the police forces, in particular through a new system of recruitment, training, and incentives; (v) extend the principles and mechanisms of merit-based selection for senior public administration positions to the departmental and municipal levels; (vi) reorganize State-owned enterprises to facilitate management by results through management contracts; and (vii) make internal control procedures and practices more effective.

²³ Larraín, Viteri, Zucal, 2013, “Análisis Actuarial y de Gobernanza de la Caja Fiscal y Apoyo a Propuestas de Ley Régimen de Inversiones”.

- 3.35 The IDB will support the strengthening of institutional capacity in public entities through investment loans and technical assistance that will promote citizen satisfaction through reduced costs and shorter times for transactions with the State: (i) economic and fiscal stability (countercyclical policy, tax revenues, budgetary discipline, better social spending, contingent liabilities in the social security system), which is vital to the sustainability of the ambitious public investment program that includes the Bank's interventions; (ii) greater transparency, effectiveness, and integrity in the management of public institutions and their investment programs (Government Center/access to information/electronic government and access to broadband/citizen participation); (iii) civil service professionalization; (iv) strengthening of public investment and the public procurement system; (v) improvement of State financial administration, adoption of management by results, multiyear budgeting, and government control at the different levels of government; (vi) efficient and comprehensive management of citizen security agencies, with priority to reducing domestic violence against women and children; (vii) efficiency in the management of housing programs, which will require, among other things, coordinated management in terms of land use, efficient and sustainable delivery of public services such as water and energy, and housing access policies with a view to reducing the housing deficits; and (viii) improved urban management of metropolitan areas and medium-sized cities, so as to strengthen the coordination of infrastructure interventions (transportation, water and sanitation, and energy).
- 3.36 The primary risk in the area of public management has to do with the complex political process involved in making institutional changes. There is also a risk of fragmentation, i.e. carrying out isolated changes in institutional capacity without sufficient coordination to generate opportunities for efficiency within the public administration. With a view to mitigating these risks, the Bank will encourage interventions that are based on a solid consensus among the different stakeholders so that political support will be guaranteed. The Bank's institutional capacity specialists will be encouraged to participate in sector projects, in order to promote a unified vision of changes in institutional capacity.

B. Crosscutting areas of action

- 3.37 The country strategy will have two crosscutting areas of action: (i) support for the use of FONACIDE resources, and (ii) the Bank will promote the inclusion of gender considerations and indigenous communities in the Bank's programs and initiatives through mechanisms to be determined in each project during implementation of the strategy.²⁴
- 3.38 FONACIDE (see paragraph 1.4) is an account through which resources generated by the power transfers from Itaipú are channeled. These resources will be

²⁴ The strategy envisages interventions in energy, water and sanitation, productive development, financial sector, and public management, for which there are indicators in the results matrix.

earmarked exclusively to finance public investment and development projects as follows: 20% to infrastructure programs and projects, 30% to the Fund for Excellence in Education and Research,²⁵ 25% to departmental (20%) and municipal (80%) governments,²⁶ 7% to capitalize the Development Finance Agency, and 10% to the National Health Fund.²⁷ There are some significant challenges to be addressed for these resources to be used effectively: complex and fragmented allocations, divergent objectives of the ministries, and difficulties in formulating, evaluating, and implementing projects. It is especially significant that the line ministries, in particular education and health, must compete for the funds allocated to health and education (US\$108 million for education and US\$27 million for health). The strategic objective is to provide support at the project evaluation level as well as for their formulation. Improvements must translate into support for sectors for which the resources are earmarked, in particular education and health.

- 3.39 The Bank will support implementation of a framework of effective rules and procedures for allocating the funds, such as project design, implementation, monitoring, and evaluation in the areas of infrastructure, education, and health. To this end, the Bank will provide technical assistance in the form of technical cooperation operations and loans to leverage existing resources handled through the education and health funds. It will also support the structuring and financing of PPPs. It is particularly important to note the impact that this could have in the areas of education and health care, where substantial increases in the coverage and quality of services are anticipated. The goal is to boost the performance of students on national tests, improve the supply of education, and reduce maternal and neonatal mortality in areas where those rates are now the highest.

²⁵ The Fund for Excellence in Education and Research is to be applied, according to the regulations, as follows: (i) ICTs: 30% to 40%; (ii) teacher training, no less than 10%; (iii) school infrastructure, up to 15%; (iv) early childhood education, up to 10%; (v) parents' cooperative networks, between 3% and 5%; (vi) higher education scholarships (10% to 20%); (vii) Accreditation Agency (up to 5%); and (viii) science and technology, between 20% and 30%. This is a competitive funding facility, open to universities, NGOs, the private sector, and the Ministry of Education and Culture (MEC). It is therefore likely to cover only a portion of the investment needs in the education plan designed by the MEC for the 2014-2018 period.

²⁶ Funding is to be distributed among the departmental and municipal governments in accordance with the following criteria: (i) at least 50% for education infrastructure; (ii) 30% for school lunches; and (iii) the remainder for other infrastructure. In turn, distribution of the local government share (80%) will depend on how many localities have been impacted by the Itaipú Dam, as 30% is earmarked for municipios affected by the reservoir and 50% for those not affected. With respect to the departmental government share (20%), one half will go to those affected, and the other half to those not affected.

²⁷ The National Health Fund is to be applied to: (i) the plan for strengthening and upgrading hospital technology; (ii) purchase of high-cost drugs and complex medicines; (iii) strengthening of services in hospitals and intensive care units; (iv) strengthening of hospital laboratories; (v) strengthening of comprehensive care programs for pregnant women, children under five, and seniors; and (vi) support for human resource development, with emphasis on public health and health-related research.

C. Areas for dialogue

- 3.40 The Bank will foster dialogue with the country on those social areas in which it believes Paraguay faces challenges, including: universal access to health care and early education services; improvement in the quality of education; labor market formalization and expanded social security coverage; and consolidation of a social safety net, including the design and delivery of comprehensive services for women. To this end, technical cooperation operations will be used to help the government design public policies and develop instruments that will address these challenges (e.g. strategic programming for the education sector, support for the integration of health service networks, development of integrated social policies for youth).

IV. FINANCING FRAMEWORK

- 4.1 The central government's financial needs for 2014 represent approximately 3% of GDP and will decline gradually to 1% of GDP as the fiscal deficit shrinks, again gradually, from an estimated 1.9% of GDP in 2014 to near-balance, at 0.5% of GDP in 2018 (see Annex III). These needs are expected to be met by issuing new bonds on the international market, as well as support from the IDB and greater participation by other multilateral entities, in particular CAF.
- 4.2 The indicative lending program proposed for the five-year period is US\$1.0 billion in SG loans, which would materialize as the proposed improvements in project execution come into effect (see paragraphs 5.1 to 5.3). Approvals would average US\$200 million per year, compared with the average of US\$159.4 million approved during the 2009-2013 period. In addition, the program would be supplemented through the private sector windows (NSG) to maintain the momentum observed during the last period.
- 4.3 The objective is to generate net positive capital flows over the 2014-2018 period sufficient to stabilize the country's debt to the IDB at around 3.1% of GDP. To achieve this, the objective proposed is to raise the disbursement target from a 2009-2013 average of US\$94 million (excluding PBLs) to US\$125 million during 2014-2018. Paraguay's debt to the IDB in 2013 stood at 43.2% of the external public debt and 27.7% of total public debt. The Bank's exposure would drop to 32.7% of the external public debt and 17.9% of the total public debt.

V. STRATEGY IMPLEMENTATION

- 5.1 **Measures to improve execution.** The weaknesses in Paraguay's State institutions affect the planning, execution, and evaluation of public investment. The rigidity of the budgetary structure and administration, the inadequate government control system, and the shortage of qualified human resources make it difficult to execute public investment projects—including IDB-financed loans—as planned. The Bank has been working with the government to streamline execution of public investment by strengthening the country systems and the National Public Investment System.

- 5.2 Successful implementation of the country strategy is associated with improving the efficiency and effectiveness of the execution of Bank projects. First, because this will allow successful execution of the existing portfolio, which is aligned with the government's program and has more than US\$500 million awaiting disbursement. Second, because effective execution will enable the programs approved by the Bank during the current period to produce results that support the government's strategy. The Bank has agreed with the current administration to establish a task force with the specific objective of implementing the measures needed to improve execution. This task force comprises staff of the Ministry of Finance, the Ministry of Public Works and Communications, and the Bank (see Annex VI).
- 5.3 Improvements are needed in the following areas: (i) speed up the government's submission of projects to Congress for ratification and reduce the time needed to fulfill project eligibility conditions after congressional ratification; (ii) improve budgetary processes with respect to the availability of the local counterpart contribution, the predictability of cash flow constraints, and the processing of budget reprogramming; (iii) make execution more efficient through training, assistance, and process simplification and automation; (iv) try out alternative execution arrangements, such as the use of management firms; (v) implement the "Government Center" as an effective instrument for monitoring investments.
- 5.4 **Use of country systems.** Budget and treasury systems are being used in 100% of IDB-financed operations. The Ministry of Finance prepared a 2012-2015 action plan for improving the management of public finances in Paraguay and the financial fiduciary sector has been working with the multidonor committee to implement the recommendations from the Public Expenditure and Financial Accountability Report (PEFA). The government will receive further support for optimizing the Integrated Financial Administration System (SIAF) through the Fiscal Management Strengthening and Modernization Program II (2014/BL-PR), together with the Public Management Modernization Program II (2727/OC-PR, 2728/BL-PR). The SIAF will be upgraded to enable financial reports on IDB projects to be issued.

Table 1. Country Systems

Systems	Current level of use	Expected level of use	Planned actions
	Share of projects (%)	Number of projects (%)	
	2013	2018	
Financial management:			
Budget	100%	100%	Work with the government to identify and implement SIAF system improvements.
Treasury	100%	100%	Work with the government to identify and implement SIAF system improvements.
Accounting and Reporting	100%	100%	Support for improving accounting records and reports.
Internal Audit	0%	0%	Support for improving supervision
External Audit	0%	10%	Support for Pilot II (2163/OC-PR, 2164/BL-PR) of the MOPC and 1776/OC-PR of the Ministry of Finance, in IDB audits, additional strengthening for AT/OC-13604-PR for strengthening the control system. ²⁸
Procurement:			
Information System	100%	100%	Support for and monitoring of advances
Individual Consultants	0%	0%	Support for the DNCP to launch the use of electronic reverse auctions (ERA).
Shopping (standard goods and services)	0%	50%	Support for reviewing and improving legislation.
Partial NCB	0%	50%	Support for DNCP to launch the use of call for proposals bidding (LCO)
Advanced NCB	0%	0%	Support for DNCP to launch the use of LCO

- 5.5 Further technical support will be given to the Office of the Comptroller General (CGR) so that it can take advantage of existing opportunities to improve government control. These two assessments suggest that Paraguay's country systems are at an intermediate stage of development.
- 5.6 For procurement, the country information subsystem is being used to publicize public sector procurement notices. The Electronic Reverse Auction (ERA) subsystem was approved during 2013 and will come into use in 2014 for IDB operations, within the limits and conditions established by the Board of Executive Directors. The IDB will support the government in formulating an action plan based on an updated diagnostic assessment of the public procurement system using

²⁸ In 2013 an initial training program in IDB audits was conducted for the CGR, under loans 2163/OC-PR, 2164/BL-PR, 1822/OC-PR, executed by the MOPC, and loan 2150/OC-PR for the AFD.

the OECD/DAC methodology. Table 1 summarizes the status of country systems in Paraguay, and the actions and progress expected over the life of the strategy.

- 5.7 **Environmental and social safeguards.** The Bank will pursue efforts to comply with environmental and social safeguards in the projects it finances in Paraguay. The Bank will also seek opportunities to give the government technical and financial support for implementing the national environmental system, including measures to strengthen the system, with a focus on environmental licensing, institutional capacities, and adjustment of environmental legislation through nonreimbursable technical cooperation and other mechanisms.
- 5.8 **Coordination with other donors.** The Bank has been a catalyst (channeling Spanish cooperation grants in the amount of US\$100 million for water and sanitation), leveraging projects through cofinancing (rural roads: JICA, OPIC; power transmission: CAF, EIB, LAIF), and working in coordination to maximize the efficient allocation of resources (education: IDB in early and basic education, World Bank in secondary education). The Bank will continue to seize opportunities to act as a catalyst in the water and sanitation area, where the European Community has shown interest; in transportation and energy, where the volume of projects requires intervention by more than one multilateral agency (World Bank, CAF, OPIC, JICA); and in public management, where it is working jointly with the European Union, the World Bank, and USAID on diagnostic assessments. The social sector will be primarily the preserve of the World Bank.

VI. RISKS

- 6.1 **Macroeconomic risks.**²⁹ As a small and open economy, Paraguay is highly vulnerable to external and climatic shocks that could increase its financing needs. Paraguay is exposed to the uncertainties of the global economic setting and the volatility of international commodity prices. A setback in China, the main customer for soybeans, or in its neighbors would have an adverse impact on the pace of economic growth. In addition, the region is experiencing a slower pace of economic growth, accompanied by exchange rate shifts that are having a significant impact on relative price determination. With respect to climatic shocks, whether in the form of a drought or an event such as El Niño, there is a high probability of occurrence during the period of the strategy, with effects similar to those experienced during 2009 and 2012, which led to an economic contraction of 4% and 1.5% respectively. In terms of mitigation, the country has a macroeconomic policy framework that should allow it to withstand external shocks and climatic events of short duration. As a complement, the Bank will work with the authorities to make available

²⁹ Pursuant to the mandate contained in the Report on the Ninth General Capital Increase of the Inter-American Development Bank, the macroeconomic sustainability of borrowing countries is analyzed every year.

financial instruments (local currency loans,³⁰ PBLs, and contingencies) and technical assistance (technical cooperation operations in the environment and climate change area) in order to boost risk coverage and mitigate the negative impact of such events. Through the Macroeconomic Sustainability Assessment, the Bank will conduct annual monitoring of the macroeconomic situation.

- 6.2 **Implementation risks.** The main risk has to do with the local counterparts' execution capacity, which is limited in many government entities and could result in a lower level of project execution. To mitigate this risk, the Bank has established a joint working group with the government, and through technical cooperation funding and (if necessary) loans, will support efforts at institutional strengthening that will involve identifying new program design and execution approaches, adapted to local capacities. In addition, the Bank will continue to work directly, and through technical cooperation operations, to strengthen financial administration and public procurement country systems, with a view to bringing greater transparency to programs and maximizing the impact of assistance. The Bank will track execution continuously through its supervision and monitoring systems and it will continue to monitor country systems jointly with the government, the World Bank, and the European Union.

³⁰ The Bank has taken the lead in seeking solutions to expand the availability of long-term financing in local currency, thereby reducing the banking system's and the productive sector's exposure to the exchange risk.

RESULTS MATRIX

Government Objective	Sector	Strategic Objective	Expected Outcomes	Indicators	Baseline
Improve the country's connectivity and rural access to basic services	Transportation and logistics	Improve transportation infrastructure	Increased number of kilometers of all-year roads	Kilometers of interurban roads constructed, maintained, or improved (annual)	5.360 (MOPC-Road Planning Division, 2013)
			Improved conditions on the national road network, the departmental road network, and local roads	% of the national road network in good condition (International Roughness Index, $0 < IRI \leq 2.8$) (biannual)	66% (MOPC-Road Planning Division, 2013)
				% of the local roads network in good condition (International Roughness Index, $IRI \leq 12$) (biannual)	76.6% (MOPC-Road Planning Division, 2013)
		Improve the level of road safety	Reduction in the number of traffic accident victims	Number of traffic accident victims/ 100,000 inhabitants (biannual)	18.46/100,000 inhabitants (MSPBS, 2013)
Ensure power supply with quality service	Energy	Ensure the sustainability of power supply for the public and for the productive sector	Expanded electricity transmission and distribution network	Kilometers of electricity transmission and distribution lines installed or improved (annual)	5,070 (ANDE, 2013)
			Reduced technical and non-technical losses	% of electricity losses/ total energy fed into the system (annual)	29.1% (ANDE, 2013)
			Increase in the indigenous population with access to electricity	Number of indigenous households with new electricity service from renewable/non-polluting sources	0 (IDB, 2014)
		Boost domestic production of biofuels	Increased production and blending of biodiesel in conventional diesel fuel	% of biodiesel blend in conventional diesel (annual)	Less than 1% (B1) (PETROPAR, 2013)

Government Objective	Sector	Strategic Objective	Expected Outcomes	Indicators	Baseline
Increase the coverage of water and sanitation services	Water and sanitation	Increase the coverage of water and sewage (including wastewater treatment) services in the AMA and in rural areas	Increased proportion of AMA residents with connections to the sewer network	% of AMA population connected to the urban sewer network (annual)	28% (DGEEC, 2011)
			Increased proportion of AMA residents with connections to the sewer network with wastewater treatment	% of AMA population with connection to the sewer network with wastewater treatment (annual)	4% (DGEEC, 2011)
			Greater operating efficiency for the ESSAP	% of unaccounted-for water (volume invoiced/volume produced) (annual)	46.5% (UMEP, 2011)
			Increase in the rural population connected to safe water systems	% of the rural population connected to the safe water system (annual)	59.1% (DGEEC, 2011)
				# of indigenous households with new connections to the safe water system	0 (IDB, 2014)
			Increased rural population with basic sanitation	% of the rural population with basic sanitation solutions (annual)	47.7% (DGEEC, 2011)
				# of indigenous households with new basic sanitation solutions	0 (IDB, 2014)
Generate a business climate conducive to productive development and improved competitiveness	Productive development	Enhance the productivity and competitiveness of firms	Greater investment in R&D	% total R&D spending/GDP	0.06% (RICYT, 2011)
			Workforce formalization	% of workers contributing to social security	18% (DGCEE, 2010)
			Greater broadband penetration	Lines per 100 inhabitants (fixed and mobile broadband)	5.43 (ITU, 2012)
			Increase in FDI	% FDI/GDP	1.72% (BCP, 2011)

Government Objective	Sector	Strategic Objective	Expected Outcomes	Indicators	Baseline
			Greater diversification of exports (products)	Herfindahl-Hirschman index (6d-hs) ¹	18 (Intrade, IDB and Customs-PY, 2010)
			Improved participation by women in the economy	Subindex of economic participation and opportunity in the gender gap index (ranking among 136 countries) ² (annual)	83/136 World Economic Forum
		Guarantee the legal certainty of land ownership	Lower index of overlapping properties in districts surveyed	Cadastral area/total geographic area	2.22 (SNC & DGRP, 2012)
		Increase the supply of agricultural public goods and services	Higher sector spending (SENASA, SENACSA, MAG, etc.) on the provision of agricultural public goods	% of the agriculture sector spending on provision of agricultural public goods (annual)	16% (MAG, 2013)
Improve access to financing and foster financial inclusion	Financial sector	Promote investment financing through the financial system	Improved access to financing for long-term investments	Access to financing is one of the five key most problematic factors for doing business (ranking among 189 countries) (annual)	112/189 World Economic Forum, 2012-2013
			A regulatory framework is in place for pension system investments	% of pension fund assets invested under the new regulatory framework	0 (BCP, 2013)
		Foster greater financial inclusion	People have greater access to financial services	% of the economically active population that has a bank account (annual)	26% (BCP, 2012)

¹ The Herfindahl-Hirschman concentration index weighs the importance of each product in total exports. It is calculated as $\sum_{i=1}^N (P_i)^2$ with $P_i = X_i/X_T$, where X_i is the share of the product (market) i in the country's total exports, X_T is the country's total exports, and N is the number of products (countries) considered. The greatest possible value is 100. The sectors were identified using six digits of the harmonized system.

² The subindex takes three gaps into account: participation, pay, and achievement. The participation gap is captured using the difference in the rate of participation of women in the labor force compared with men (19.9%). The pay gap is captured by the ratio between the estimated income of women and men (22.1%) and a qualitative variable from the World Economic Forum's Executive Opinion Survey, equal pay for equal work (31%). The achievement gap for men and women is captured through two indicators: the ratio of female to male legislators, senior officials, and managers (14.9%) and the ratio of women to men in technical and professional jobs (12.1%).

Government Objective	Sector	Strategic Objective	Expected Outcomes	Indicators	Baseline
			The financial system is lending in greater volumes	% of financial system lending to the private sector as a proportion of GDP (annual)	35% (BCP, 2012)
			Greater access to credit for rural women	% of rural women with access to credit	16% (RENAF, 2011)

Government Objective	Sector	Strategic Objective	Expected Outcomes	Indicators	Baseline
Improve the impact, efficiency and effectiveness of government action	Public management	Consolidate fiscal sustainability	Growth in tax receipts during the period	Tax burden as % of GDP, average 2014/2018	11.8% (MH, average 2008/2013)
			Increased public investment	Capital spending as % of GDP, average 2014/2018	4.3% (MH, average 2010/2013)
			Better control over personnel costs	% degree of integration and reconciliation between personnel records and payroll data	D rating (PEFA, 2011)
		Reduce levels of violence and crime	Reduction in robberies and assaults and improved public perceptions as to security	Robberies per 100,000 inhabitants	205.9/100,000 inhabitants (Standardized Regional System of Citizen Security Indicators, BPR IDB, 2011)
			Reduction in domestic violence	% of people 18 years and over who experienced domestic violence in the last 12 months in Asunción	22.3% (Min. Mujer, 2013)
		Improve the effectiveness, transparency, and integrity of public entities	Increased coverage of the SIAF in the central administration	% of central government institutions integrated into the SIAF's integrated cash management system	45% (PEFA, 2011)
			Increase in the scope, nature, and monitoring of external auditing by the CGR	Quality of the annual audit of central government entities	C rating (PEFA 2011)

Government Objective	Sector	Strategic Objective	Expected Outcomes	Indicators	Baseline
			Greater efficiency in public management based on the new Management Model	Government Online Service Index ³ (biannual)	0,4575 (UN E-Government Survey, 2012)
	Crosscutting areas	Improve students' performance in language and communication	Better student scores on national tests in language and communication	% of students earning medium or high scores (levels III and IV) in National Education Evaluation System tests	3rd grade: 27%; 6th grade: 21% (MEC, 2010)
		Expand the coverage of upper secondary education	Improvement in the physical, human, technological, and pedagogical resources devoted to education	Net enrollment rate in upper secondary education (annual)	60% (MEC, 2011)
		Reduce maternal and neonatal mortality	Reduced maternal and neonatal mortality rates in areas with the highest maternal mortality indices	% of pregnant women receiving at least 4 prenatal checkups in the 5 regions with the lowest coverage currently	59% (MSPBS, 2013)

³ This index measures the scope and quality of government online services in comparison with other countries. The range is from 0 to 1, where 1 is the highest-ranking country. According to the indicator, Paraguay ranks 85 out of 190 countries for online service quality.

MATRIX OF COUNTRY SYSTEMS

Strategic Objectives	Results expected during the Country Strategy period	Indicator	Baseline	Indicative targets	Timing
Strengthen country systems or subsystems	National Public Bidding Subsystem strengthened	Indicator 1(d), 2(c), and 2(e) of Pillar I and Indicator 9(a) and 9(e) of Pillar IV MAPS diagnostic	Indicator outcomes: Indicator: 0 in 1(d), 1 in 2(c), and 0 in 2(e) of Pillar I / 1 in 9(a) and 0 in 9(e) of Pillar IV	Indicator outcomes: Indicator: 1 on 1(d), 3 in 2(c), and 2 in 2(e) of Pillar I / 2 in 9(a) and 2 in 9(e) of Pillar IV	At the end of the Country Strategy period
	CGR strengthened for purposes of auditing IDB-financed projects	% of IDB projects audited by the CGR.	10%	10%	At the end of the Country Strategy period
Use of country fiduciary systems	Electronic Reverse Auction (ERA) and Call for Proposals Bidding (LCO) introduced and in use in the DNCP for operations with the IDB	% of portfolio using Electronic Reverse Auction (ERA) and Competitive Bidding (LCO)	0% use of ERA and 0% use of LCO in Q1 of 2014	50% of the SG portfolio uses the ERA subsystem for shopping and 50% of the SG portfolio uses LCO for Partial National Competitive Bidding	At the end of the Country Strategy period
	Increased use of financial reports	Number of loans submitting reports directly from the country system	0	10%	At the end of the Country Strategy period

MAIN ECONOMIC AND SOCIAL INDICATORS

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Social indicators									
Population	5,911,418	6,041,531	6,171,643	6,301,754	6,431,866	6,561,979	6,710,102	6,858,227	7,006,351
Poverty rate	38.6	43.7	41.2	37.9	35.1	34.7	32.4	n/a*	n/a*
Extreme poverty rate	16.5	23.7	23.2	19.0	18.8	19.4	18.0	n/a*	n/a*
Unemployment rate	5.8	6.5	5.5	5.7	6.4	5.7	6.0	7.9	8.1
GDP per capita (US\$)	1,487	1,774	2,261	2,970	2,516	3,105	3,833	3,700	4,368
Real sector indicators									
Real GDP (growth %)	2.1	4.8	5.4	6.4	-4.0	13.1	4.3	-1.2	13.6
Nominal GDP (US\$ millions)	8,772	10,662	13,838	18,505	15,955	20,028	25,149	24,691	29,631
Fiscal indicators (% of GDP)									
Fiscal revenues	15.7	16.0	15.6	15.8	17.5	17.1	18.0	19.0	16.6
Tax revenues	10.1	10.5	10.1	10.7	11.6	12.0	12.6	12.7	11.4
Total expenditure	15.0	15.6	14.8	13.6	17.5	15.9	17.3	20.8	18.5
Capital expenditure	3.5	3.7	3.3	2.5	4.1	3.4	4.0	4.8	3.9
Primary balance	1.7	1.3	1.6	2.8	0.6	1.6	1.0	-1.6	-1.7
Overall balance	0.7	0.4	0.9	2.3	0.1	1.2	0.7	-1.7	-1.9
Public debt	27.9	23.1	18.1	14.1	17.0	14.1	10.7	14.5	14.1
External debt	25.9	21.0	15.9	12.1	14.0	11.7	9.1	9.1	9.0
External indicators (% of GDP unless otherwise indicated)									
Current account balance	-0.8	1.6	5.6	1.0	3.0	-0.3	0.4	-1.0	1.2
Family remittances	0.9	0.9	1.4	1.1	1.3	1.4	1.8	2.1	1.5
Net international reserves	14.7	16.0	17.8	15.5	24.2	20.8	19.8	20.2	19.8
Net international reserves (US\$ millions)	1,293	1,703	2,462	2,864	3,861	4,168	4,984	4,994	5,876
(In months of imports, monthly average)	4.1	3.5	4.2	3.9	6.8	5.2	8.6	8.8	8.5
Monetary and exchange rate indicators									
Inflation rate (end of period)	9.9	12.5	6.0	7.5	1.9	7.2	4.9	4.0	3.7
Growth in monetary aggregates (M2)	16.3	15.9	39.4	19.1	28.8	15.7	17.5	12.6	17.5
Nominal exchange rate (average, GS/US\$)	6,178	5,636	5,033	4,363	4,967	4,739	4,196	4,422	4,304
Real exchange rate index US\$ (close of each year)	149.4	116.9	101.7	96.5	94.0	89.6	87.3	82.0	84.6

Source: Central Bank of Paraguay, Ministry of finance, General Directorate of Statistics, Surveys, and Census.

n/a = not available

LENDING FRAMEWORK

The last two years have seen a certain deterioration in the public finances, despite a fiscal policy that has been characterized by solid revenue performance and prudent management of expenditures, thus making it possible to consolidate the debt. In fact, the government ran constant fiscal surpluses from 2003 until 2011, followed by successive deficits in 2012 and 2013 (of 1.6% and 1.9% of GDP respectively). This reversal in fiscal outcomes was due to a sharp increase in expenditures, and particularly in current expenditures. The increase in such expenditures began in 2009, and persisted over the two following years, with a significant leap in 2012 and 2013.

In this context, and in order to contain rising expenditure, the government recently promulgated the “Fiscal Responsibility Law” (Law 5098/13), the main objective of which is to promote responsible fiscal management and thereby contribute to the stability and sustainability of the public finances. Accordingly, the general government budget for 2014 makes no provision for increased current expenditures, which remain at their 2013 level. Moreover, given the risk that the current tax system is reaching its revenue-producing potential, the government is working on a revenue adjustment plan. That plan calls for tax reforms that will help to increase revenues: these include an adjustment to the Value Added Tax (VAT) in various sectors, such as finance, pharmaceuticals, and real estate, an adjustment to the selective consumption tax (ISC), in addition to a broadening of the scope of the Personal Income Tax (IRP). With these adjustments, the government expects to increase the tax burden from the current 12% to 17% in 2018.

Medium-term financing needs. Based on estimates of the different variables, financing needs are projected to decline in keeping with a gradual reduction in the fiscal deficit over the medium term. For the 2014-2018 period, financing needs would amount to US\$3,211,500,000.¹ Nevertheless, the advent of external shocks or natural disasters could spark an increase in financing needs (especially, greater demand for external resources), given the Paraguayan economy’s vulnerability to such events.

**Medium-term financing needs
Paraguay: Central Government**

Variables	2014	2015	2016	2017	2018
Nominal GDP (US\$ millions)	31,535	33,829	36,579	39,318	42,262
Deficit/Surplus % of GDP	0.019	0.017	0.015	0.01	0.005
Deficit/Surplus (US\$ millions)	599.2	575.1	548.7	393.2	211.3
Amortization	320.9	311.5	347.8	296.7	207.1
Financing needs	920.1	886.6	896.5	689.9	418.4

¹ Not including new bond issues and/or a new investment plan.

The scenario for sovereign guaranteed lending has been designed on the basis of the government's financing needs. This scenario is tentative, and is subject to the availability of Bank funding and to the annual programming exercises. It also assumes that an appropriate macroeconomic policy framework remains in place, according to the Bank's evaluation criteria. The scenario calls for average annual approvals of US\$200 million, resulting in a total of US\$1.0 billion for the 2014-2018 period. Under this scenario, the IDB's share of the external public debt would average 38.8% during this time, while IDB debt as a percentage of GDP would remain, on average, at around 3.3%.

Sovereign Debt Financing Scenario 2014-2018
(US\$ millions)

(US\$ Millions)		2014	2015	2016	2017	2018	Average
Approvals		250	200	200	200	150	200
Disbursements		85.0	110.0	140.0	160.0	130.0	125.0
Repayments		98.1	95.0	93.0	88.5	89.2	92.7
Net flow of loans		-13.1	15.0	47.0	71.5	40.8	32.256
Interest and fees		29.4	26.9	23.9	21.0	18.4	23.9
Net cash flow		-42.5	-11.9	23.1	50.5	22.4	8.336

Debt indicators	2013	2014	2015	2016	2017	2018	Average
IDB debt	1,156.0	1,142.9	1,157.9	1,204.9	1,276.4	1,317.3	1,219.9
IDB debt/GDP	3.9%	3.6%	3.4%	3.3%	3.2%	3.1%	3.3%
IDB debt/total public debt	27.7%	23.7%	19.2%	16.6%	15.6%	14.2%	17.9%
IDB debt/external public debt	43.2%	43.1%	41.5%	39.8%	37.0%	32.7%	38.8%
External public debt/total public debt	64.1%	55.0%	46.3%	41.8%	42.1%	43.3%	45.7%
Total public debt/GDP	14.1%	15.3%	17.8%	19.8%	20.8%	22.0%	19.1%

Note: The data exclude NSG loans. Annual approval amounts are indicative and are subject to the availability of Bank funds.

DONOR COORDINATION

The Ministry of Finance of Paraguay, through the Office of the Deputy Minister of Economy and Integration, coordinates the bilateral, regional, and multilateral entities that are active in Paraguay. To this end, it defines the agencies' sector participation as well as the distribution of functions within each sector. Table 1 of this annex maps the principal areas of intervention by economic sector. The following paragraphs describe the level of involvement of the cooperation agencies in the priority sectors of the Country Strategy.

In the transportation sector, JICA and OFID are important sources of cofinancing with the IDB of loans relating to highways and urban transportation and, consequently, they cooperate at the operational level. Institutions such as the World Bank and the Andean Development Corporation (CAF) are working independently in similar aspects of the transportation sector (e.g. paving, rehabilitation, and maintenance) but in geographic areas different from those where the IDB is involved. In all cases, these institutions cooperate with the IDB through ongoing dialogue with and between the Ministry of Finance and the MOPC.

In the energy sector, the Bank is cofinancing the ANDE Multiphase Power Transmission Program, Phase II (PR-L1058), with the CAF, the European Investment Bank (EIB), and the European Community's Latin America Investment Facility (LAIF). In addition, ANDE receives support from other agencies such as the World Bank, JICA, and OFID for investments in subtransmission, distribution, and generation.

In water and sanitation, the Bank will continue working in close coordination with AECID, especially in rural areas and medium-sized cities, where programs cofinanced by the Spanish Fund (US\$100 million in two operations) are being executed, as well as projects in the Lake Ypacaraí basin, with funding from LAIF. Interventions in the Asunción Metropolitan Area will be coordinated primarily with the World Bank and with other cooperation agencies such as the CAF.

In the financial sector, the Bank has been working jointly with the International Monetary Fund since 2010 on money laundering issues. In this respect, the Central Bank of Paraguay, in particular the Department for the Prevention of Money Laundering (SEPRELAD), has been strengthened as a means of addressing the structural shortcomings in the anti-money laundering (AML) system. A national strategy for AML and combating the financing of terrorism prepared jointly with the IMF was recently approved by the government, and the Bank expects to continue working jointly on its implementation.

Actions designed to strengthen public management in Paraguay have positioned the IDB as an important actor in multilateral and bilateral coordination. For example, in the area of public finances the Bank is working with the European Union and the World Bank, at the multilateral level, and with AECID, at the bilateral level, to conduct periodic updates of the Public Expenditure and Financial Accountability Report. In the area of external control, the Bank is coordinating support from the World Bank, the German Agency for International Development (GIZ), and the United States Agency for International Development (USAID) to strengthen the Office of the Comptroller General of the Republic (CGR). In the procurement area, the Bank has been coordinating participation by the World Bank, UNDP,

the European Union, and USAID to update the diagnostic assessment and expansion of the Public Procurement System (MAPS) using the OECD/DAC methodology. With respect to the civil service, the Bank is the lead/coordinator of efforts with USAID, UNDP, AECID, and GIZ, while the World Bank has recently been enlisted in support of the public investment sector.

TABLE 1. PRINCIPAL AREAS OF INTERVENTION BY DONORS

Country	Agency	Areas of support																	
		Public administration	Participatory democracy	Security and peaceful coexistence	Education	Health and social security	Equal rights, social protection	Territorial cohesion	Decent housing, healthy environment	Culture and identity	Articulated, innovative, and environmentally sustainable economy	Energy	Competitiveness and innovation	Employment	Sectoral productive structure	Environment	Risk management	Water and sanitation	Roads and transportation
BILATERAL																			
Spain	AECID																		
Taiwan																			
Japan	JICA																		
USA	USAID																		
Germany	KFW																		
Korea	KOICA																		
Morocco																			
MULTILATERAL																			
EU																			
UN*																			
IBRD																			
OAS																			
IICA																			
CAF																			
OFID																			
REGIONAL																			
FOCEM																			
PROGRAMAS IBERO-AMERICANOS																			

 Area of support

* UN: UNDP, UNICEF, FAO, UNFPA, UN-WOMEN, PAHO/WHO, UNAIDS, UNIDO, ILO, UNESCO, WMO, UNOPS, UNHRC

MACROECONOMIC CONTEXT

Paraguay's economic performance has improved significantly over the past decade. GDP growth during the 2004-2013 period averaged 4.9%, slightly above the average for the countries of MERCOSUR over the same period (4.3%). This growth was based on a relatively undiversified agricultural production model, which generates 25% of GDP and more than 60% of exports. Following a 1.2% contraction in output in 2012 (reflecting primarily the drought that hit the 2011-12 crop), the latest estimates of real GDP growth for 2013 point to economic growth of around 13.6%, the highest in Latin America and the Caribbean. Despite this and because the economy is so dependent on agriculture, which in turn is hostage to climatic shocks and international price fluctuations, the country's growth is subject to a high degree of vulnerability and volatility.

Notwithstanding a certain deterioration in the public finances over the last two years, the country's debt sustainability indicators are adequate and its financing needs are manageable. The output volatility caused by climatic shocks was to a great extent mitigated through sound macroeconomic management. Fiscal policy has been characterized by solid revenue performance and prudent management of expenditures, thus making it possible to consolidate the debt, which declined steadily from 50.5% of GDP in 2003 to only 11.5% of GDP in 2013. Moreover, the government ran constant fiscal surpluses from 2003 until 2011, followed by successive deficits in 2012 and 2013 (of 1.6% and 1.9% of GDP, respectively). This reversal in fiscal outcomes was due to a sharp increase in expenditures, and particularly in current expenditures. The increase in such expenditures began in 2009 and persisted over the two following years, with a significant leap in 2012 and 2013. In this context, and in order to contain rising expenditure, the government recently promulgated the "Fiscal Responsibility Law", the main objective of which is to promote responsible fiscal management and thereby contribute to the stability and sustainability of the public finances. Moreover, given the risk that the current tax system is reaching its revenue-producing potential, revenue adjustments will be required that will allow the government to increase the tax burden, which is now around 12% of GDP, one of the lowest in the region.

The Paraguayan financial system has expanded significantly in recent years, with its assets rising from 61% of GDP in 2005 to more than 86% in 2013. Historically, the financial system has been dominated by the commercial banks, with total assets equivalent to 54% of GDP and a loan portfolio representing 34% of GDP. Finance companies are relatively smaller, with assets and portfolio equivalent to 3% and 2% of GDP, respectively. The remainder of the financial system comprises the savings and loan cooperatives and producer cooperatives: there are currently around 372 such cooperatives and they hold 17% of the financial system's total assets. Lending to the private sector represents 60% of the commercial banking system's assets, 95% of its total portfolio, and 32% of GDP. In 2013, stricter provisioning measures were imposed and capital requirements were increased: this helped to strengthen the financial institutions' headroom. It will be important to defend this stability by keeping credit growth under control, reinforcing regulation and supervision even further, and addressing the sector's information gaps.

Total inflation during 2013 was below the midpoint of the Central Bank's target range, closing the year at 3.7%, similar to the 4% observed in 2012. Monetary policy focused on avoiding excessive volatility in the inflation rate, using as a benchmark a target rate of 5% plus or minus 2 percentage points. Upward pressure on consumer prices in recent years has been relatively weak: since 2007, total inflation has remained at single-digit levels and indeed, in the last three years, it has been slightly below the inflation target set by the monetary authorities. Given current economic circumstances, in an attempt to forestall inflationary pressures in 2014, the BCP has raised the benchmark interest rate successively (50 basis points as of December 2013 and another 50 basis points in January 2014), bringing it to 6.5%.

In its relationship with the international economy, Paraguay is characterized by a high degree of openness to trade and the free movement of capital. From 2002 until 2013, the balance of payments performed well, and international reserves rose by a factor of nine over that time, rising from US\$641 million to an estimated US\$5.820 billion. Both the current account and the capital account were in surplus for most of that time. The high level of international reserves should cushion any financial or real shocks to the economy. Reserves are ample to cover short-term debt obligations and, at the end of 2013, represented 20% of GDP, providing backing for approximately 85% of total banking system liquidity (total deposits in local currency). In 2013, the terms of trade evolved favorably, with a year-on-year increase of 12%, primarily as a result of the growing importance of exports of soy-based processed goods, such as flour and oil. Exports and imports alike are expected to show stronger growth in 2014, given that the trends in both the global and regional economies could make room for growth in the volume of exports by the region, as well as higher service exports and inflows of remittances. Nevertheless, growth in domestic demand, associated with buoyant consumption and a potential increase in investment, could have the effect of boosting imports of goods and services. At the same time, with less liquidity available internationally because of the cutback in bond purchases by the U.S. Federal Reserve in 2014, portfolio investment inflows could decline and the offshoring of funds by local investors could increase.

EXECUTION IMPROVEMENT PLAN

The Paraguayan government has limited institutional capacity, which affects the planning, execution, and evaluation of public investment. The rigidity of the budgetary structure and administration, the weak system of government control, and the shortage of qualified human resources make it difficult to execute public investment projects—including IDB-financed loans—as planned. The Bank has been working with the government to streamline execution of public investment by strengthening country systems, in particular the National Public Investment System.

Projects take longer to execute in Paraguay than in most of the Bank's member countries. This is due primarily to the additional period, averaging 600 days after approval, that elapses between signature and legislative ratification of loan and technical cooperation operations. Excluding this period needed for operations to enter into force, loans in Paraguay are executed in an average of 6.5 years between their effective date and the close of operations, which is close to the Bank's average. Loan disbursement rates have historically been slightly higher than the Bank average: during the 2010-2012 period, 31% of the eligible undisbursed loan balance (EULB) was released to the country at the beginning of each year.

Since the end of 2012, however, Paraguay has been experiencing a period of fiscal deficit and constraints. As a result, investment projects did not have the budgeted counterpart funds needed to maintain execution at historical rates. Moreover, the government's cash management was such that this counterpart, already reduced in the budget, was not allocated to Bank-financed projects at the appropriate time to permit execution. In addition, budget reprogramming was not approved in time to allow execution. As a result of this situation and of delays in the decision-making process related to the administration changeover, the pace of project execution in Paraguay suffered significantly, dropping to 24% of EULB at the beginning of 2013.

A substantial portion of the Country Strategy is devoted to making the execution of Bank projects more effective and efficient. Such is the case, first, to allow successful execution of the current portfolio, of which approximately US\$540 million remains to be disbursed, and second, to ensure that programs approved by the Bank within the lifespan of the strategy can produce outcomes that will support the current government's program.

The Bank and the current administration have agreed to establish a task force with the specific objective of taking the measures necessary to improve execution. This task force comprises staff of the Ministry of Finance, the Ministry of Public Works and Communications, and the Bank.

The task force has already identified areas of action to address the most important bottlenecks in the execution process: (i) speed up the government's submission of projects to Congress for ratification, coordinate with the Legislative Branch to ensure that it has a clear understanding of the loans and technical cooperation operations submitted for ratification, and reduce the time needed to fulfill project eligibility conditions after congressional ratification; (ii) improve budgetary processes with respect to the availability of local counterpart funding, the predictability of cash flow constraints, and the processing

of budget reprogramming; (iii) make execution more efficient through training, assistance, and process simplification and automation; (iv) try out alternative execution arrangements, such as the use of management firms; (v) revise the participation requirements, conditions for awarding contracts, and reference prices established by the executing agencies in the Bank-issued standard bidding documents, which must be used in Paraguay, in order to further encourage participation by international firms in bidding for works and consulting services, given certain limitations in some sectors' capacity to submit bids; and (vi) implement the "Government Center" as an effective instrument for monitoring key investments.

The task force has established a plan of action, comprising the following activities:

Reduce the time needed for legislative ratification. The Bank will conduct a study of the legislative ratification process in the eight member countries that have such a process, in order to draw lessons that could be applicable in Paraguay. The study will be delivered to the Paraguayan Executive Branch for consideration, on the understanding that the Legislature is an independent branch of government with full decision-making autonomy. The government also intends to submit projects to Congress for consideration in batches, so as to facilitate processing and debate. The government hopes to use its parliamentary majority to secure ratification of all pending loan operations in 2014.

Reduce the time elapsing between legislative ratification and project eligibility. During the recent portfolio review, it was agreed to pursue the work of fulfilling the conditions precedent to the first disbursement of loans in parallel with the legislative ratification process (and to proceed immediately with those conditions that can be fulfilled even prior to the effective date of the loan). The project specialists will support the executing agencies in this task.

Improve budgetary processes. Consultants will be hired in 2014 to analyze, propose improvements, seek consensus on, and support the implementation of changes in budget processes, as they relate to availability of local counterpart funding, the predictability of cash flow constraints, and the processing of budget reprogramming. An opportune time for making the operational changes and simplifications in the budget reprogramming process will be the upcoming development and implementation of the government's new financial administration system.

Automate processes and make them more efficient. The Bank is supporting the government in the simplification of internal procurement, financial, and planning processes, especially within the Ministry of Public Works and Communications, which is responsible for 70% of the Bank's portfolio in Paraguay. Moreover, to facilitate the management of operations, the Bank's Country Office is developing a set of interactive tools to enable users to access standardized reports and standard documents, including examples, forms that can be downloaded or completed online, and good practices.

Pilot test alternative execution arrangements. The Bank is analyzing and will support the design, selection, and financing of alternative execution arrangements for critical projects in the Bank's portfolio in Paraguay, including the creation of executing units that will have budgetary and procurement autonomy, the use of management firms, and special-purpose vehicles.

Review bidding requirements. There will be a review of requirements for participation and the conditions for awarding bids established by executing units for Bank operations in Paraguay in the “Bidding Data” section of the Bank’s bidding documents, as well as the criteria for establishing benchmark costs.

Create the Government Center. The Bank is helping the authorities to create a Government Center, which will monitor progress with flagship projects and will coordinate public policies. The government recently approved the creation of the Government Center by decree. The Bank is now preparing a technical cooperation project to support the strengthening of that Center.

Resources. The Bank is processing a technical cooperation project with resources from the Fund for Special Operations to support the activities described above: approval is expected in April 2014.

OVE COUNTRY PROGRAM EVALUATION RECOMMENDATIONS¹

Recommendation	Management's response
<p>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.</p>	<p>Agree. The Bank supported the drafting of the public-private partnerships bill (through a MIF operation), which was approved by Congress in December 2013 and provides an effective legal framework for attracting private investments in infrastructure, making it possible for the government to negotiate such investments directly with the private sector. This was done in regular consultation with the Private Sector Consulting Group, which will be empowered, as OVE suggests, to create a forum for dialogue for the purpose of facilitating the generation of projects. Coordination between the private sector windows is increasing, as is coordination with the public sector windows. The Bank is therefore well positioned to promote public-private partnerships in a coordinated manner. As to financing by bilateral and multilateral actors, the Bank will continue to leverage projects, as it has done in the past with CAF, EIB, JICA, OPIC, and others, and in turn will try to channel grants, as it did in the past with Spanish Cooperation.</p>
<p>2. Strategically use concessional instruments (technical cooperation, Fund for Special Operations) 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 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).</p>	<p>Agree. As this strategy becomes more focused, concessional resources may be concentrated, to the extent possible, on relevant areas according to the government's priorities. It is worth noting that a problem of scale often arises, given that the blend covers resources that may be equivalent to half the annual program. Thus, for example, if an infrastructure program is presented that absorbs a large proportion of the entire lending program, the concessional resources are then allocated to that area. As to the need to continue supporting reforms and the AFD, we fully agree with the suggestion, as reflected in the objectives of the strategy.</p>

¹ These recommendations and Management's response are included in document RE-452-1, "Country Program Evaluation: Paraguay 2009-2013" and in document RE-452-2, "Country Program Evaluation: Paraguay 2009-2013. Management's comments".

Recommendation	Management's response
<p>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.</p>	<p>Agree. One of the Bank's objectives is to act as a catalyst, especially in the social sector through technical support it can provide to FONACIDE. The management, targeting, and efficient operation of FONACIDE will first be supported through a technical cooperation operation, after which support for its investments is also expected to be provided through cofinancing. Management is in full agreement with the items mentioned.</p>
<p>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.</p>	<p>Agree. The Bank has maintained a consistent line of action regarding the importance of strengthening natural resource management. Both for the reasons given by OVE and in relation to the implementation of safeguards in Bank projects, we agree with the spirit of OVE's suggestion. Accordingly, the topic will be dealt with as a cross-cutting element in the strategy, in order to support—through projects and technical cooperation operations—competent authorities that associate themselves with the Bank's initiatives. It is worth recalling that, under the programming cycle that is ending, the Bank approved a loan operation to finance the institutional strengthening of SEAM, which was then not signed by the government.</p>
<p>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. 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.</p>	<p>Agree. The Bank will review the experiences of these countries with a view to developing a mitigation policy that applies to Paraguay.</p>

SUMMARY - DEVELOPMENT EFFECTIVENESS MATRIX

COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX	
<p>In August 2008, the Board of Executive Directors approved the Development Effectiveness Framework (GN-2489) to increase the evaluability of all Bank development products.</p> <p>The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the "Good Practice Standards for Country Strategy and Program Evaluation."</p>	

COUNTRY STRATEGY: PARAGUAY (2014-2018)

STRATEGIC ALIGNMENT: (measures two dimensions: (i) the extent to which the strategy's objectives are consistent with the country's development challenges and the government's priorities and plans; and (ii) the use of a mix of products (financial, knowledge, technical assistance) to attain the objectives, and identification of other cooperation agencies and their areas of action.)

Consistency of strategic objectives: The strategy focuses on the following sectors: (i) transportation and connectivity; (ii) water and sanitation; (iii) energy; (iv) productive development; (v) financial sector; and (vi) public management. The strategy also has two crosscutting elements: (i) support for FONACIDE, which will leverage government resources in education and health; (ii) promotion of the inclusion of gender considerations and indigenous communities. All the areas selected address development challenges and are consistent with the priorities set by the Government of Paraguay. Moreover, the selected work areas are the outcome of the dialogue between the country and the Bank.

Product mix and participation of other cooperation agencies: The strategy proposes to use various Bank instruments such as sovereign guaranteed operations, non-sovereign guaranteed operations, and technical cooperation. The strategy takes into account the interventions of other multilateral cooperation agencies, such as the World Bank, AECID, the CAF, and JICA, among others.

EFFECTIVENESS: Measures whether the country strategy is likely to achieve its intended objectives, through an examination of four dimensions of effectiveness: (i) quality of the diagnostic assessments on which the Bank's action rests in each area of work; (ii) the quality of the strategy results matrix; (iii) the use and strengthening of country systems; and (iv) the analysis of the lending framework:

Dimensions of effectiveness	%
I. Sector diagnostics	
- Identifies the main problems based on empirical evidence	100
- Identifies the main beneficiaries	100
- Identifies and dimensions the factors that contribute to the problems identified	100
- Presents the policy framework and a sequence for Bank intervention	100
- The diagnostic corresponds to the objectives presented in the strategy	100
II. Results Matrix	
- The expected outcomes are clearly defined	100
- The indicators measure outcomes and are SMART	100
- The indicators have baselines	100

Thirteen sector notes were submitted as part of the strategy

All the notes have been validated.

- 100% of the notes clearly identify the main sector problems based on empirical evidence.
- 100% of the notes identify the potential beneficiaries in each area of intervention.
- 100% of the notes raise or dimension the factors contributing to the problems identified.
- 100% of the notes identify the policy framework and sequence for Bank actions.
- In 100% of the notes, there is consistency between the issues raised in the note and the Bank's strategic objectives.

Results matrix:

- 100% of the strategic objectives have a clear definition of the expected outcomes.
- 100% of the indicators used are outcome indicators and are SMART.
- 100% of the indicators have baselines.

Country systems: There are diagnostic assessments for the financial management and procurement subsystems and for environmental safeguards. Some of the financial management (external control) and procurement (shopping methods and use of country bidding systems) are expected to be strengthened along with the environmental safeguards systems. Some country systems will be used during the period of the strategy.

Lending framework: The strategy contains an analysis of the country's financing requirements, and provides an estimated scenario for the amount of sovereign guaranteed lending. The financial framework is consistent with the macroeconomic projections and the country's financing strategy.

RISKS (measures three dimensions: (i) identification of factors that affect or might affect the attainment of the proposed objectives; (ii) definition of mitigation measures, and (iii) monitoring mechanisms):

The strategy identifies risks associated with the Bank's involvement in each of the strategic sectors and identifies mitigation measures. Risks associated with the country's macroeconomic situation and implementation risks are also raised.