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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR A PROPOSED LOAN

IN THE AMOUNT OF US$100 MILLION

TO

THE REPUBLIC OF PARAGUAY

FOR THE

ENHANCING FISCAL MANAGEMENT, SOCIAL PROTECTION
AND FINANCIAL INCLUSION DEVELOPMENT POLICY LOAN
WITH A DEFERRED DRAWDOWN OPTION

February 20, 2015

Macroeconomics and Fiscal Management Global Practice
Latin America and the Caribbean Region

PARAGUAY GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of February 20, 2015)

Currency Unit = Guaranies
Gs.4,759 = US$1

ABBREVIATIONS AND ACRONYMS

ANDE	National Electricity Administration	Administración Nacional de Electricidad
BCP	Central Bank of Paraguay	Banco Central del Paraguay
BNF	National Development Bank	Banco Nacional de Fomento
CAF	Andean Finance Corporation	Corporación Andina de Fomento
CNEP	National Council of Public Enterprises	Consejo Nacional de Empresas Públicas
CPS	Country Partnership Strategy	Estrategia de Alianza con el País
COPACO	Paraguayan Telecom Company	Compañia Paraguaya de Comunicaciones
CCT	Conditional Cash Transfer	Transferencia Monetaria Condicionada
DDO	Deferred Drawdown Option	Opción de Desembolso Diferido
DGEP	General Directorate of Public Enterprises	Dirección General de Empresas Públicas
DGGC	General Directorate of the Large Taxpayers	Dirección General de Grandes Contribuyentes
DNCP	National Directorate of Public Procurement	Dirección Nacional de Contrataciones Públicas
DSA	Debt Sustainability Analysis	Análisis de Sustentabilidad de Deuda
ESSAP	Sanitation Services Company of Paraguay	Empresa de Servicios Sanitarios del Paraguay
EMPE	Electronic Payments Entity	Entidad de Medio de Pago Electrónico
FRL	Fiscal Responsibility Law	Ley de Responsabilidad Fiscal
GoP	Government of the Republic of Paraguay	Gobierno de la República de Paraguay
IADB	Inter-American Development Bank	Banco Interamericano de Desarrollo
IMF	International Monetary Fund	Fondo Monetario Internacional
IMAGRO	Income Tax on Agricultural Activities	Impuesto a la Renta de Actividades Agrícolas
IPSAS	International Public Sector Accounting Standards	Normas Internacionales de Contabilidad para el Sector Público
IRACIS	Income Tax on Commerce, Industry and Services Activities	Impuesto a la Renta de Actividades Comerciales, Industriales y de Servicios
IRAGRO	Tax on Agriculture Income	Impuesto a la Renta Agrícola
ISC	Selective Consumption Tax	Impuesto Selectivo al Consumo
M&E	Monitoring and Evaluation	Monitoreo y Evaluación
MoF	Ministry of Finance	Ministerio de Hacienda
NDP	National Development Plan	Plan Nacional de Desarrollo
NLTA	Non-Lending Technical Assistance	Asistencia Técnica sin Financiamento
PDO	Program Development Objectives	Objetivos de Desarrollo del Programa
PFM	Public Finance Management	Gestión de Finanzas Públicas
SAS	Secretariat of Social Protection	Secretaría de Asistencia Social
SENAC	National Secretariat to Fight Corruption	Secretaría Nacional Anticorrupción

SET	Undersecretariat of Taxation	Subsecretaría de Estado de Tributación
SIAF	Integrated Financial Management System	Sistema Integrado de Administración Financiera
SOE	State-owned Enterprises	Empresas Estatales
SPIR	Public System of Information and Reporting	Sistema Público de Informes y Reportes
SSEE	Undersecretariat of Economy	Subsecretaría de Estado de Economía
TSA	Treasury Single Account	Cuenta Única del Tesoro
VAT	Value-Added Tax	Impuesto al Valor Agregado

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REPUBLIC OF PARAGUAY

ENHANCING FISCAL MANAGEMENT, SOCIAL PROTECTION AND FINANCIAL INCLUSION
DEVELOPMENT POLICY LOAN WITH A DEFERRED DRAWDOWN OPTION

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SUMMARY OF PROPOSED LOAN AND PROGRAM

REPUBLIC OF PARAGUAY
ENHANCING FISCAL MANAGEMENT, SOCIAL PROTECTION AND FINANCIAL INCLUSION DEVELOPMENT POLICY LOAN WITH A DEFERRED DRAWDOWN OPTION

Borrower:	Republic of Paraguay		
Implementing Agency:	Ministry of Finance (MH)		
Financing Data:	Terms: US$ commitment linked IBRD Flexible Loan with a fixed spread, with tailored repayments on April 15 and October 15 of each year, with a 9 year Grace Period and 29 year Final Maturity, with all conversion options selected and the Front-end Fee capitalized. Amount: US$100 million.		
Operation Type:	One-tranche stand-alone Development Policy Loan (DPL) with Deferred Drawdown Option (DDO).		
Main Policy Pillars and Program Development Objective(s):	The project has three policy pillars: (i) Public Finance Management; (ii) Social Protection; and (iii) Financial Inclusion. The Program Development Objective of this operation is to assist the Government of Paraguay's efforts to strengthen sustainability, equity and transparency in fiscal management, to improve targeting of social programs and to increase access to financial services.		
Result Indicators:		**Baseline 2013**	**Target 2017**
	VAT revenue collection from agriculture to Gross Value Added of Agriculture, Livestock and Forest ratio (%)	0.0	1.4
	VAT revenue collection from financial sector to Gross Value Added of financial intermediation ratio (%)	3.9	6.3
	Number of taxpayers whose VAT refund requests are processed through the risk-based mechanism (*canales de selectividad*)	0	31
	Tax on agriculture income (IRAGRO) revenue collection (Gs. billion)	71.8	518.4
	Interest payments of central government on intra-year borrowing operations (Gs. Billion)	41.1	20.5
	Past-due outstanding debt (arrears) of public institutions with SOEs for basic services provided (i.e., water, electricity and phone services) (US$ million)	124	47
	Available and updated information on budget execution and civil service salaries at the Ministry of Finance Portal	0 (no)	1 (yes)
	Accumulated savings generated by the new targeting mechanism applied for the *Adultos Mayores* program (Gs. million)	0	7,000
	Percentage of resources transferred from SAS to BNF for the beneficiaries of *Tekopora* that are returned to SAS (%)	2.5	2
	Percentage of adults without access to any financial sector services (%)	42	30
	Percentage of adults using financial electronic services (%)	28	40
Overall risk rating:	Moderate		
Operation ID:	P151007		

IBRD DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY LOAN TO THE REPUBLIC OF PARAGUAY

I. INTRODUCTION AND COUNTRY CONTEXT

1. **This program document proposes a single-tranche stand-alone Development Policy Loan (DPL) with Deferred Drawdown Option (DDO) in the amount of US$100 million to the Republic of Paraguay.** The Program Development Objective of this operation is to assist the Government of Paraguay (GoP) efforts to strengthen sustainability, equity and transparency in fiscal management, to improve targeting of social programs and to increase access to financial services. The DDO modality requested by the authorities reflects a precautionary risk management approach aimed at protecting essential public spending and preventing financing gaps for the government in the event of potential adverse shocks associated to a still uncertain global economic recovery, unfavorable macroeconomic developments in the neighboring countries and climate conditions that could affect Paraguay's GDP growth, exports and government revenues.

2. **Over the last decade, Paraguay has improved its economic performance.** After almost two decades of economic stagnation and instability, Paraguay's average annual GDP growth rate exceeded 4.5 percent, between 2003 and 2013, compared to 2.1 percent observed between 1990 and 2002. As a result, per capita GDP grew by 33 percent in the same period. Strong fiscal consolidation contributed to the economic turnaround observed since 2003. Overall fiscal surpluses averaged 0.5 percent of GDP between 2003 and 2013, and public debt fell from 41 percent of GDP in 2003 to 14.1 percent in 2013. Favorable terms of trade and the strong performance of exports led to current account surpluses averaging 1.1 percent of GDP in this period. The country has also enjoyed price stability**.** Favored by a consistent monetary policy, average inflation fell from the two digits levels observed in the 1990s and early 2000s to an average of 6 percent in the past decade.

3. **Economic growth has resulted in strong poverty reduction and in boosted shared prosperity.** Moderate poverty declined sharply in 2003-2013, from 44 percent to 23.8 percent. Extreme poverty was also reduced from 21.1 percent in 2003 to 10.1 percent in 2013. It is worth noting that extreme poverty was more persistent and stabilized at around 18 percent between 2003 and 2010, before declining markedly during 2011-13. Inequality followed a similar pattern: the Gini coefficient was stable at around 0.52 between 2003 and 2011, and it fell substantially to 0.48 in 2011-13. Shared prosperity has improved as well. The annual growth rate of real per capita income for those in the bottom 40 percent of the income distribution was 5.9 percent, 2.2 percentage points higher than the national average per capita income growth rate of 3.7 percent. Moreover, between 2003 and 2013, the share of the middle class (defined as those with household incomes above $10 a day per person) in Paraguay's total population grew by over 20 percentage points. By 2013, this group represented half the total population of the country.

4. **These accomplishments bring new development challenges to overcome, in addition to long-standing structural constraints.** The current overarching challenge is how to ensure the sustainability of these achievements and in particular of economic growth. Paraguay's economic growth has been highly volatile and vulnerable to exogenous shocks. In this regard, given the still uncertain global scenario, sound macro-fiscal policies are needed to further enhance the country's resilience to external adverse shocks. A second challenge is to expand the Government's fiscal

space to strengthen its ability to support poverty reduction and boost shared prosperity. While fiscal consolidation has been critical for improved growth and macroeconomic stability, low revenue mobilization and increasing recurrent expenditures resulted in limiting space for public investments and enhanced service delivery. This has hampered the government's ability to address serious infrastructure bottlenecks to improve the country's prospects for higher and sustained growth. In addition, limited fiscal resources have also constrained the expansion and quality of public services used by lower income groups. Third, higher taxation needs to be accompanied by enhancements in the efficiency of public spending. A growing middle class is drawing attention to government transparency and accountability and is demanding effective public services. Moreover, strong income volatility and still relatively high levels of poverty will require efficient social protection policies to attenuate the impact of shocks on the most vulnerable. Finally, while recent growth has been accompanied by poverty reduction, there is a perception that a vast number of people, potential entrepreneurs and small businesses are still excluded from the development process experienced by the country, and face constraints that limit their ability to prosper.

5. **Encouraged by recent socioeconomic achievements, the administration of President Cartes prepared a National Development Plan (*Plan Nacional de Desarrollo, NDP*) for the period 2014-2030 which makes the eradication of extreme poverty its paramount objective and contains an ambitious reform agenda to achieve it.** To raise growth and reduce its volatility to ensure sustainable poverty reduction, the NDP supports economic diversification strategies, management of agriculture sector risks and policies to ensure environmental sustainability. The NDP also envisages a strong public investment effort to alleviate binding infrastructure constraints. Since its inauguration in October 2013, the new administration has adopted critical reforms of the public sector. Authorities also recognize that better infrastructure and service delivery will require parallel efforts to increase revenue mobilization and more efficient government investment and social programs. In this regard, in early 2014, the government adopted a series of tax policy measures directed at broadening the tax base, reducing incentives to specific sectors and thus making the tax system more neutral. Furthermore, Government has been responding to increasing demand for transparency and accountability in public spending, including by making publicly available (through online access) information on expenditure execution and on salaries of public officials in all government agencies.

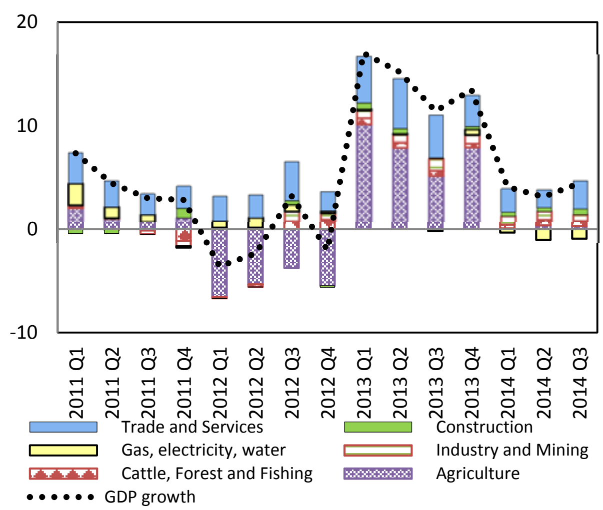
6. **Consistent with the World Bank Group Country Partnership Strategy (CPS) for FY15-FY18, this operation supports the NDP and it is expected to contribute positively to the two strategic goals of the World Bank Group of eliminating extreme poverty and boosting shared prosperity**. To support the achievement of these objectives, this operation is structured around three interrelated pillars: (i) public finance management, (ii) social protection, and (iii) financial inclusion. Sustainable gains in growth and poverty reduction are conditioned on the maintenance of macroeconomic stability which is supported by the first pillar of this operation. Fiscal sustainability will enable sustainable social protection programs. Improvements in the targeting of social protection programs will be instrumental to attaining both fiscal sustainability and the elimination of extreme poverty. Finally, through the support to financial inclusion, the proposed operation is also expected to assist the GoP in boosting shared prosperity and will favor more efficient and targeted social protection programs.

II. MACROECONOMIC POLICY FRAMEWORK

A. RECENT ECONOMIC DEVELOPMENTS IN PARAGUAY

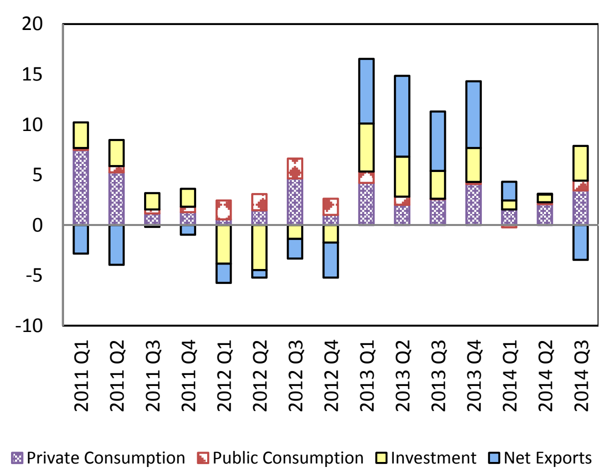
7. **GDP growth has been strong but continues to be volatile and heavily dependent on external developments and climate variations.** Following a contraction of 1.2 percent in 2012, GDP growth bounced back strongly in 2013 and reached 14.2 percent, mainly on the back of a turnaround in the agriculture and livestock sectors. Favorable climate conditions and the recovery of beef exports after a foot and mouth disease outbreak, boosted agricultural production and exports (soybean and beef), with a consequent spillover effect on private construction, transport and trade related services. Indeed, agriculture contributed about half of the GDP expansion. As of September 2014, GDP growth decelerated to 4.4 percent (in an annual basis), with trade and services being among the most dynamic sectors, together with construction and industry and mining. (see Figure II.1 below).

Figure II.1: Contributions to GDP Growth (percent) – Supply Side



Source: Central Bank of Paraguay (BCP)

Figure II.2: Contributions to GDP Growth (percent) – Demand Side



Source: Central Bank of Paraguay (BCP)

8. **On the demand side, the external sector has been the main contributor to the strong GDP growth performance in 2013.** Exports grew by 18.4 percent while imports grew by 6.8 percent. Domestic demand also had a robust expansion but at a slower pace, with a 4.6 percent increase in private consumption, a 5.3 percent increase in public consumption and an 11.9 percent increase in fixed capital formation. As of September 2014, GDP growth has been supported mainly by fixed capital formation (+14.6 percent compared to 2013.Q3), followed by public and private consumption (+10.9 percent and 5.3 percent, respectively). (see Figure II.2, above)

9. **Unemployment has remained stable at around 8 percent since 2012, but underemployment has been falling continuously**. The growth acceleration of manufacturing and agriculture did not translate into significantly higher employment growth. Though agriculture accounted for 26 percent of the employment in 2013, the sector showed limited employment growth. Similarly, while manufacturing still represents the largest sector in terms of output (around

25 percent of GDP), it continues to account for only 10 percent of total employment. The most rapid employment growth occurred in construction, where employment more than doubled in 2003-13, from 98,000 to 214,000 jobs, representing 7 percent of total employment. Underemployment[1] however, has been declining sharply from 23.9 percent in 2010.Q3 to 16.1 percent in 2013.Q3 and to 15.9 percent in 2014.Q3. The fall in underemployment could be associated with shifts from informal jobs and self-employed workers to formal employment jobs (such as construction and public and private services), the transition of farmers to employees in agribusiness enterprises, and the migration of rural populations to urban areas to work in small and medium enterprises.

10. **Following eight consecutive years of surpluses, fiscal accounts deteriorated continuously in the last three years.** Government balances shifted to moderate deficits of 1.8 percent of GDP in 2012, 2.0 percent of GDP in 2013 and 2.4 percent of GDP in 2014. The expansionary fiscal policy in 2012 designed to counteract the slowdown in economic activity, the strong increase of recurrent spending as a result of congressional decisions during the interim period in 2012-13[2], and the disappointing performance of revenues have been responsible for the fall in fiscal balances.

11. **To curb the declining trend of fiscal balances and expand the fiscal space for investments, at the end of 2013 the government adopted measures to contain the growth of recurrent spending and foster tax collection, including the approval of the Fiscal Responsibility Law (FRL) and revenue enhancement measures.** The FRL was approved by Congress in October 2013 to control public spending and avoid increased rigidity in the budget. The bill sets an upper limit for the fiscal deficit that should not exceed 1.5 percent of GDP, as well as establishing limitations on the growth of primary current expenditures that should not exceed real GDP growth rate of the previous year plus the inflation rate. In addition, the FRL establishes multi-annual budgeting and the need to attach a Debt Sustainability Analysis (among others) to budget proposals in order to provide more predictability to medium-term fiscal policy.[3]

12. **Public debt is low, although it is expected to increase as authorities have decided to take advantage of historical low interest rates and improved access to international capital markets to finance an ambitious investment program in the next few years.** Public debt increased from 14.1 percent of GDP in 2013 to 17.3 percent of estimated GDP as of November 2014, following the successful issuance of US$1 billion in sovereign bonds in August. Authorities plan to increase public investments from the current 4 percent of GDP to around 4.5 to 5 percent in the next years. Increased fiscal space and indebtedness are expected to finance this increase. The debt of the Central Administration represents about 90 percent of total public debt. Public debt is mostly external (almost 67.6 percent in November 2014) and denominated in U.S. dollars (see Table II.1).

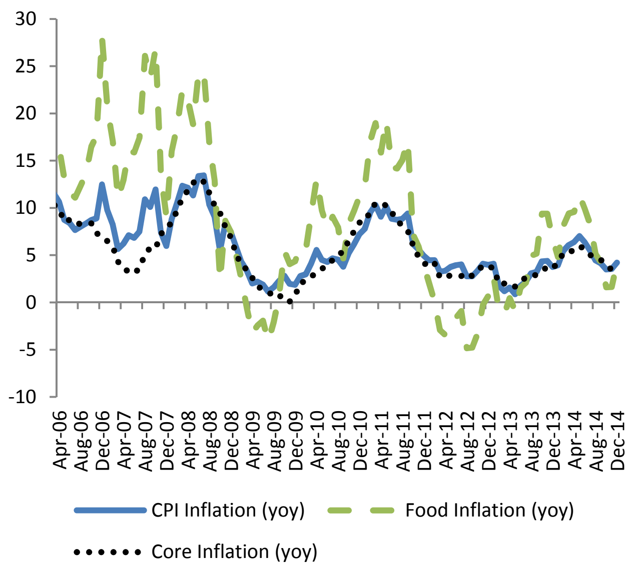
13. **Inflation remains low and within the target interval.** The inflation rate fell to 3.7 percent in 2013 (from 4 percent in 2012), and reached 4.2 percent in 2014, below the Central Bank of Paraguay's (Banco Central del Paraguay, BCP) target rate of 5 percent (see Figure II.3, below).

[1] Defined to include those who work less than 30 hours a week but are willing and available to work more, as well as those working more than 30 hours a week but earning less than the minimum wage for the hours worked.
[2] Salary increases for different categories of the civil service and strong expansion of public employment characterized the one-year interim period.
[3] As the FRL was approved in October 2013 and its regulatory decree was issued in April 2014.

Supported by the acceleration of economic activity, credit has expanded in the last two years. The sharp expansion of the economy in 2013 promoted an increase in both deposits and credits.

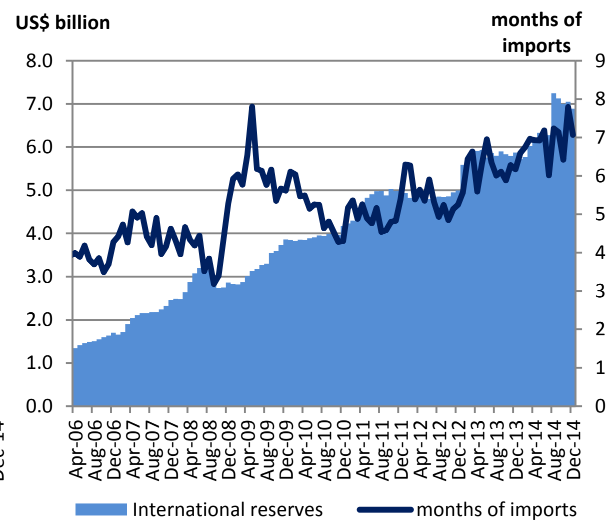
14. **The exchange rate has slightly depreciated in 2014.** The nominal effective exchange rate (NEER) appreciated by 5.5 percent and the real effective exchange rate (REER) by 3.1 percent in 2013. With the anticipated tightening of US monetary policy, the NEER reversed its trend and depreciated by 2.3 percent in 2014.

Figure II.3: Inflation (annual % rate)



Source: Central Bank of Paraguay

Figure II.4: International Reserves (bn US$ (LHS), months of imports (RHS)



Source: Central Bank of Paraguay

15. **After a period of an accommodative monetary stance in 2012-2013, the (BCP) initiated a monetary contraction in December 2013**. The BCP had reduced the policy rate from 9 percent to 5.5 percent in 2012 and had kept the rate at this level throughout the end of 2013. Consistent with the inflation-targeting regime, and as a result of inflationary pressures at the end of 2013 and beginning of 2014, the BCP increased its policy rate from 5.5 percent 2013 to 6.75 percent in February 2014, keeping the rate at this level since then.

16. **The expansion in exports during 2013 was reflected into a strong current account surplus, estimated at 2.1 percent of annual GDP.** Supported by the good performance of the main export products, including soybean, electricity and beef, the strong increase in exports led to a trade surplus of about 4.8 percent of GDP in 2013. The Mercosur trade bloc is the main destination of Paraguayan products (about 40 percent of total exports in 2013), with Brazil representing 30.0 percent of the share. The origin of imports is also heavily biased towards Mercosur (42.0 percent of the total in 2013), although China is taking a larger share with 28.5 in 2013. In 2014, merchandise exports slowed while imports remained stable, so that the trade surplus narrowed.

Table II.1: Paraguay: Selected Economic Indicators and Projections: 2011 – 2017

	Actual			Projections			
	2011	2012	2013	2014	2015	2016	2017
(annual % change, unless otherwise stated)							
Income and prices							
Real GDP	4.3	-1.2	14.2	4.0	4.5	4.5	4.5
Nominal GDP	14.6	0.0	14.7	7.8	9.2	9.5	9.5
Consumer prices (eop)	4.9	4.0	3.7	4.2	4.5	5.0	5.0
Nominal exchange rate (Guarani per US$, eop)	4439.9	4288.8	4524.0	4629.3	..	..	..
Monetary sector							
Currency issue	11.6	17.5	13.2	8.9	8.7	11.5	11.5
Credit to private sector	24.8	12.6	23.9	21.1	18.3	18.0	18.0
Private sector deposits	13.9	12.2	23.8	14.5	11.5	11.0	11.0
External sector							
Exports, percent volume change	2.0	-3.6	23.6	3.9	4.7	5.0	4.6
Imports, percent volume change	13.8	-11.0	7.2	4.5	5.6	5.3	5.0
(% of GDP, unless otherwise stated)							
Current account	**0.5**	**-1.0**	**2.1**	**0.1**	**-1.1**	**-0.6**	**-0.7**
Merchandise exports, percent of GDP	50.4	47.4	46.9	43.5	41.2	40.0	38.9
Merchandise imports, percent of GDP	47.0	45.0	41.2	40.1	38.3	37.2	36.4
Net international reserves (in millions USD)	**4983**	**4994**	**5871**	**6891**	**7280**	**7285**	**7300**
(Stock in months of imports)	4.3	4.5	6.2	7.1	6.9	6.4	6.2
Consolidated public debt	**11.5**	**14.1**	**14.2**	**19.4**	**18.0**	**17.9**	**17.8**
Memorandum items							
Nominal GDP (in billions of Guaranies)	105,203	108,832	124,853	134,530	146,843	160,793	176,068
Nominal GDP (in billions of USD)	23.3	24.9	28.1	30.1	33.3	36.1	38.7
Per capita GDP, current US$	3814	3680	4137	4358	4733	5041	5322

Sources: IMF Article IV, Central Bank of Paraguay, Ministry of Finance of Paraguay, World Bank staff estimates and projections.

17. **As a result of the strong performance of the current account, international reserves have strongly increased in the last two years**. The balance of payment surpluses registered in 2013 led to an increase of US$877 million (17.6 percent) in BCP's international reserves, leading the stock to reach US$5.9 billion in December 2013. As of December 2014, boosted by the US$1 billion sovereign bond issuance, international reserves reached US$6.9 billion, exceeding 7 months of imports and now more than ten times higher than a decade ago (see Figure II.4, above).

B. PARAGUAY'S MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

18. **Paraguay's macroeconomic outlook is overall favorable as government reforms are beginning to yield returns. However some vulnerability will remain in the short run.** Having

reached a record 14.2 percent in 2013, Paraguay's economic growth will return to historical levels between 4.0 percent and 5 percent in the next few years. However, this outlook will continue to be highly influenced by external and weather-related shocks. As Paraguay is a small and increasingly open economy, it will continue to face downside risks such as fluctuations in international demand associated to a still uncertain global recovery that could affect prices for its exports. Also, the slowdown in Paraguay's main trading partners, Brazil and Argentina, could have negative impacts on growth as they account for 40 percent of the country's exports and are the main source of foreign direct investments.

19. **The Budget Law for 2015 projects a higher fiscal deficit.** The Government submitted to the Congress a 2015 budget with a 1.5 percent of GDP deficit and 9 percent growth in primary current expenditures, consistent with the limits set in the FRL.[4] Nonetheless, the Congress approved a budget including an investment package (which amounts 1.4 percent of GDP) that is already financed by the proceeds of the bonds issued in August 2014. In addition, Congress increased current expenditures (so that primary current expenditures growth increased to 11.5 percent), exceeding the 9 percent FRL ceiling defined for 2015.

20. **Authorities plan to contain the fiscal deficit for 2015 and control the increase in primary current spending through a parsimonious budget execution**. The authorities are preparing the annual financial plan for budget execution to release resources during the year by taking into account the evolution of tax revenues and the availability of cash. Based on previous outturn performance, the effective fiscal deficit is projected to fall to 2 percent of GDP.[5]

21. **Gross financing needs are expected to be covered by debt rollover, investment project financing and new issuance of bonds in international markets.** Gross financing needs are expected to fluctuate around 3 percent of GDP (or US$1 billion). In case of unlikely refinancing difficulties or higher than expected deficits, the proposed DDO is expected to cover around 10 percent of gross financing needs in the next two years.

22. **In the medium run, sustained increases in tax revenues, stronger efforts to control recurrent spending will be needed to accommodate higher investment spending and underpin sustainable fiscal balances.** Initial effects of Revenue enhancement measures including the establishment of the Tax on Agriculture Income (IRAGRO), increases in the VAT rates for the financial sector and agriculture and improvements in tax administration have already been reflected in strong growth in tax revenues (estimated at +17.7 percent). While the increases in public investment correspond to government's ambitious plans to reorient public expenditures towards investment and do not pose an immediate challenge to fiscal sustainability as they are not permanent, are already financed and are expected to have positive effects on GDP growth, the increase in primary current expenditures raises budget rigidity and thus could further reduce the already small space for investments and discretion needed to reduce deficits or adopt countercyclical policies.

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[4] The FRL regulation on primary current spending growth states that increases in this spending category should not exceed the sum of annual inflation plus 4 percent. For 2015, this regulation implies that primary current spending growth cannot exceed 9 percent.

[5] Historical execution of the budget in Paraguay has been low, with capital spending being under-executed by about 40 percent over 2008-2013 and recurrent expenditures by about 10 percent over the same period.

Table II.2. Central government fiscal accounts 2011-2017

	2011		2012		2013		2014		2015		2016	2017
	Approved budget	**Executed**	**Approved budget**	**Executed**	**Approved budget**	**Executed**	**Approved budget**	**Estimated**	**Approved budget**	**Projected**	**Projected**	**Projected**
TOTAL REVENUE	19.3	18.0	25.0	19.0	23.4	17.2	20.7	18.3	22.2	18.9	19.1	19.2
Of which: Tax Revenue	11.5	12.6	14.2	12.7	13.2	11.8	12.5	12.9	13.3	13.3	13.5	13.5
TOTAL EXPENDITURE	20.0	17.3	26.3	20.8	25.5	19.1	22.9	20.0	25.1	20.4	20.6	20.7
Of which: current expenditure	14.4	13.3	18.5	16.0	18.0	15.1	17.3	15.8	18.1	16.1	16.1	16.2
Of which: capital expenditure	5.6	4.0	7.7	4.8	7.5	4.0	5.6	4.2	7.0	4.4	4.5	4.5
NET LENDING	0.0	(0.0)	(0.0)	(0.0)	0.7	0.1	0.7	0.7	0.6	0.6	0.0	0.0
FISCAL BALANCE	-0.7	0.7	-1.2	-1.8	-2.8	-2.0	-2.9	-2.4	-3.5	-2.0	-1.5	-1.5

Sources: Central Bank of Paraguay, Ministry of Finance of Paraguay, World Bank staff estimates and projections.

23. **A Debt Sustainability Analysis (DSA) prepared by the IMF for the 2013 Article IV indicates that the trajectories of public debt and total external debts are sustainable and resilient to negative shocks.** In the baseline scenario, after having reached a peak in 2014, public debt was expected to initiate a declining trend in 2015 and reach 18.7 percent of GDP in 2017. A lower GDP growth assumption (2 percent instead of the 4.5 percent of the baseline growth in 2015-16) would bring public debt to 19 percent of GDP in 2017.[6]

24. **Inflation prospects are also favorable.** The adherence of the Central Bank to the inflation targeting regime and the low and stable inflation observed in recent years enabled inflation expectations to converge to the center of the target band at 5 percent and to reduce it to 4.5 for 2015 onwards without additional monetary tightening. A survey carried out by the Central Bank reveals that economic agents in Paraguay expect a moderate nominal appreciation of the Guarani in the next years, which suggests that inflationary pressures associated to the exchange rate will be minor.

25. **In summary, Paraguay's overall macroeconomic framework is adequate for the purposes of this operation**. Paraguay's debt-to-GDP ratio is among the lowest in Latin America, with fiscal space to increase spending in response to severe negative shocks to the economy. The Government's plan to prudently increase public debt, so as to finance infrastructure development projects, is manageable in the middle-run given the country's commitment to consolidating fiscal, monetary and financial stability. Despite the low indebtedness, authorities will need to adopt more effective controls over recurrent spending and expand fiscal space to have room to maneuver to implement counter-cyclical fiscal policies in case of GDP slowdown and mitigate risks.

C. IMF RELATIONS

26. The IMF has not had a program with Paraguay since 2008, when the country completed the sixth and final review under the Stand-By Arrangement program. The IMF carries out annual Article IV consultations with authorities through annual missions. The Executive Board concluded the latest IMF Article IV consultation with Paraguay on February 12, 2015. The Bank and IMF teams consult each other through regular meetings and bi-annual country-team level consultations.

[6] Debt numbers are being updated to take into consideration the US$1 billion issuance in August, 2014.

The IMF also has a number of technical assistance activities in Paraguay and their inputs are related to the policy program of this operation. In particular, the financial inclusion component draws main findings from the Bank-IMF joint Financial Sector Assessment Program which was published in July 2011 as well as from a financial inclusion survey carried out in 2013.

III. THE GOVERNMENT'S PROGRAM

27. **The GoP's development strategy is presented in its NDP for 2014-2030**. This multi-year plan builds upon the main goals stated by President Cartes to the Congress, shortly after his ascension to power in 2013. Based on a consultative process with the productive sector, civil society, and public institutions, the development strategy identifies eradication of extreme poverty as its main goal. In addition, the NDP highlights several challenges to overcome in the next five years: reduce growth volatility, make growth more inclusive, strengthen equality of opportunities for women and minorities, improve public sector management, and boost private sector competitiveness.

28. **The NDP is organized into strategic pillars and cross-cutting areas**. The three strategic pillars are: poverty reduction and social development, inclusive economic growth, and inserting Paraguay into the world. The cross-cutting areas include: equal opportunities, efficient and transparent government, territorial development, and environmental sustainability. These strategic pillars and cross-cutting areas resulted in twelve strategic objectives: (i) equity and social protection, (ii) quality of social services, (iii) participatory local development, (iv) sustainable habitats, (v) economic growth and competitiveness, (vi) productivity, innovation and jobs, (vii) diversification of production chains, (viii) fortifying environmental capital; (ix) participation in a globalized world; (x) export diversification and FDI; (xi) development poles for regional and global integration; and (xii) climate change mitigation.

29. **The policies supported by this DPL are directly linked to the NDP cross-cutting area *Efficient and Transparent Government*, the strategic pillar on *Poverty Reduction and Social Development*, and supports strategic objectives (v), (vi) and (vii), through the promotion of productive inclusion.** In the area of efficient and transparent government, the NDP considers that having effective public management will be instrumental to expanding fiscal space to finance needed investment projects and also for improving the efficiency of social programs. The NDP considers that deepening financial inclusion is part of the "route out of poverty" strategy.

IV. THE PROPOSED OPERATION

A. LINKS TO THE GOVERNMENT'S PROGRAM AND OPERATIONAL DESCRIPTION

30. **The Government's NDP provides the framework for the design of this operation.** The GoP's NDP contains an ambitious reform agenda which includes policies designed to: (i) promote responsible macroeconomic management by supporting the establishment of a fiscal framework for sustainable fiscal policies and enhancing tax revenue efforts; (ii) improve efficiency in social protection polices by enhancing their targeting; and (iii) reduce poverty and boost shared prosperity by fostering financial inclusion. Consistent with these objectives, this operation is structured in three pillars: (i) Public Finance Management; (ii) Social Protection; and (iii) Financial Inclusion. The Program Development Objective of this operation is to assist the GoP's efforts to

strengthen sustainability, equity and transparency in fiscal management, to improve targeting of social programs and to increase access to financial services.

31. **The pillars and objectives of this operation are complementary**. Improvements in fiscal policies support the sustainable provision of social programs. In turn, more efficient and targeted social programs reinforce expenditure rationalization and thus fiscal sustainability. The proposed operation also supports actions that enable the financial inclusion of the beneficiaries of social protection programs. Finally, financial inclusion is expected to improve productive inclusion and enable a sustainable reduction of poverty and shared prosperity which will be reflected in higher growth, more favorable fiscal conditions and more focused social programs.

32. **The design of this proposed operation is based on a number of lessons learned from Paraguay's experience with previous DPL operations.** Among these is the crucial importance of up-to-date analytical work on which to base policy dialogue and the importance of providing technical assistance to support the design and implementation of the reforms included in the policy program. In this direction, this operation is built in strong analytical underpinnings and is accompanied by two technical assistance projects.[7]

B. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Fiscal Management

33. **Paraguay fiscal policy has achieved significant progress over the past decade**. Fiscal consolidation was at the core of the economic stabilization program that contributed to the economic turnaround beginning in 2003. From 2003 to 2011, the Government was able to generate consecutive overall surpluses that resulted in public debt falling from 41 percent of GDP to 11 percent in 2011. The fiscal stabilization efforts included an increase in tax revenues through the implementation –albeit partial– of a tax reform package. Tax revenues increased from 8.7 percent of GDP in 2003 to 12.6 percent in 2011. However, fiscal consolidation has been ensured by maintaining low levels of public investment as recurrent spending experienced continuous growth, which is an issue that needs to be addressed.

34. **In the last three years, however, fiscal balances have been falling.** The combination of continuous increases in recurrent spending, higher public investments spending and the modest performance of revenues resulted in the shift of fiscal balances from a positive 0.7 percent of GDP in 2011 to a negative 2 percent of GDP in 2013. Moreover, tax revenues fell to 11.1 percent of GDP in 2013 and current spending increased from 13.3 percent in 2011 to 15.1 percent in 2013 significantly narrowing the fiscal space for investments.

35. **To improve fiscal balances, the Government has adopted a comprehensive set of tax measures**. With the objective of increasing tax revenues by 4 percent of GDP in the coming years, authorities have increased rates and expanded the tax base of the Value Added Tax (VAT), imposed corporate taxation for agricultural activities and enhanced tax administration to reduce tax avoidance and evasion. The first pillar of this operation supports the GoP's efforts to enhance fiscal sustainability through revenue enhancing measures, improve tax equity and neutrality, improvements in public financial management and transparency.

[7] See section C below for details on analytical work and technical assistance projects.

(a) Increasing Taxation

36. **A further increase in tax resources is needed to enable the GoP to support growth and poverty reduction programs.** Paraguay's overall tax effort falls short of other countries in the region. The results draw on the findings of the study conducted by Piancastelli (2001), who examined a sample a 75 countries and concluded that the most important variables in explaining differences in tax effort are the shares of the economy represented by trade and agriculture. A more recent study from Pessino and Fenochietto (2010) corroborates the low level of tax effort and tax capacity in Latin America when compared with other regions. In this study Paraguay shows a tax capacity of 25.8 percent while the average of Latin America is 34.4. Limited fiscal resources constrain GoP's ability to provide public investment and services and support poverty reduction and shared prosperity.

37. **Despite the positive effects of the tax reform of 2004, one of the reasons for the still poor revenue performance has been the partial implementation of the Tax Reform of 2004, the existence of a large number of tax exemptions and incentives, and the failure to apply uniform taxation across sectors which in turn affects the country's economic efficiency.** A tax reform in 2004 could not generate significant additional revenues as it failed to introduce taxation in the agricultural sector and other measures included in the reform such as the personal income tax, were not implemented for a long time. Also, a large number of exemptions and differentiated rates which were designed to boost the growth of priority sectors, eroded the tax base. While low taxation has played a major role in attracting investment in the agriculture sector that have fueled the country's export growth, the lack of neutrality of the existing tax system creates artificial profitability for its beneficiaries, which skews resource allocation. Moreover, the selective use of tax incentives favors certain investors over others, thus damaging the overall investment climate.

38. **Inefficiencies in tax administration have also contributed to poor tax collection performance.** The tax administration office (*Subsecretaría de Estado de Tributación,* SET) does not have an adequate organizational structure and is lacking several functions that are critical to efficient tax collection, including: coordination between tax offices, planning capacity, effective information technology, sufficient human resources, and implementation of reforms. In addition, the proliferation of tax incentives and exemptions has complicated the functioning of tax administration and favored tax evasion.

39. **Since 2013, the GoP has taken initial steps to simultaneously enhance its ability to collect tax revenues and to make the system more neutral for consumption and investment decisions.** In recent years, with Bank's support, the SET has strengthened its institutional capacity, including IT upgrading, organizational restructuring, adoption of modern HR policies, and a better oversight of the wealthiest taxpayers. Further progress is needed. A second wave of reforms should focus on establishing a comprehensive compliance risk-management model, strengthening the Large Taxpayer Office, and streamlining the VAT refund process. Also, gains in revenue collection, efficiency and income distribution could stem from reforming property taxes, to use market valuation instead of fiscal valuation. This could promote better land use, it could also increase municipal revenue, which in turn could increase accountability and reduce dependency on central government transfers.

40. **This proposed operation supports important tax policy reforms.** Authorities increased the VAT rate of 5 percent for financial sector transactions to the 10 percent which is the uniform rate applied to the VAT tax base (as envisaged during the 2004 reform) for financial sector transactions. In addition, they established a VAT rate of 5 percent for agricultural and livestock products. The two measures are expected to favor a more neutral tax incidence with the associated gains in economic efficiency. On the other side, the increase in VAT rates for agricultural product is expected to have regressive effects as bottom income groups allocate higher shares of their revenues to food. This effect can be compensated with higher and more progressive spending in education, health and social protection which is one of the main objectives pursued by the NDP.

Prior Action # 1: To increase tax revenues, the Government has: (a) increased the value-added tax (VAT) rate applied to financial sector operations from five (5) percent to the standard rate of ten (10) percent; and (b) defined the VAT collection base and established a five (5) percent rate for the agricultural sector.

41. **Expected results:** An increase of around 30 percent in total VAT collection in nominal terms by 2016 is envisaged. Initial effects have been already observed in 2014. The tax revenue to GDP ratio increased by 1.1 percentage points of GDP. In terms of the VAT on financial operations, SET expects an increase in tax revenues from financial transactions from 3.9 percent of the total value added of the financial sector to 6.3 percent by 2017. The adoption of VAT on agricultural products is expected to generate additional revenues amounting to 1.4 percent of the value added produced by the agriculture sector.

42. **To complement the strong revenue performance related to the broad tax policy reforms adopted at the end of 2013, the government' reform focus is also concentrated on tax administration improvements**. Authorities recognize that there is ample space for enhancing revenue collection through reforms in tax administration and that before initiating a second round of reforms on the tax code, their efforts need to be focused on improving the administration of the existing tax system, reduce evasion, revenue loss and fraud.

43. **In particular, fraudulent invoicing for obtaining credits on the VAT and on the Selective Consumption Tax (*Impuesto Selectivo al Consumo* - ISC)[8] claimed by large taxpayers are the most relevant sources of tax revenue loss**. The General Directorate of the Large Taxpayers (DGGC) estimates that refund claims correspond to around 30 percent of revenues collected through the VAT and ISC and that a substantial part of them are fraudulent. To date, DGGC oversees 721 large taxpayers that account for about 75 percent of the tax administration's total revenue collection. These losses appear particularly striking with regard to the devolution of VAT credits to exporters, producers of capital goods and international transport providers. In addition, the tax administration needs to devote a significant number of resources to control tax refund claims, which results in high administrative and opportunity costs.

44. **To reduce VAT and ISC revenue losses, the Undersecretariat of Taxation (SET) has approved Resolution 45 of December 2014 to introduce a risk-based process for VAT refunds of the taxpayers to control VAT claims more efficiently and effectively.** Previously a standard recovery process for all credits was used regardless of the type, size of the credit and risks of fraud.

[8] The tax base of the ISC are imports and domestic transactions on tobacco, cigarettes, alcoholic beverages, fuel and luxury goods.

The GoP is adopting a more strategic approach, discriminating the treatment of small and low risk VAT and ISCs credit refunds that can be processed through an automated system, from high value and more difficult cases, which require stronger oversight efforts. Based on a risk-management approach, VAT credits are returned to taxpayers according to the taxpayer's risk index (*Indice de Riesgo del Contribuyente*, IRC). The IRC is a numerical tax compliance behavior indicator which is obtained by analyzing the taxpayers' tax records. It will be calculated each time new tax refunds are claimed. Based on the IRC, the tax management system automatically assigns three type of procedures for the VAT refund claims (automated – green; semi-automated – yellow and tax audit – red). This, in turn, is expected to reduce the time needed for VAT refunds to low-risk taxpayers.

Prior Action # 2: To reduce tax revenue losses, the Government has established a risk-based mechanism for processing VAT and ISC credit claims refunds.

45. **Expected results:** The implementation of the risk-based mechanism is expected to improve compliance behavior, as an increasing number of taxpayers (31 expected in 2017) seek to have their refund requests processed through the risk-based mechanism (*canales de selectividad*). A reduction of VAT revenue losses is envisaged that will be reflected in the reduction of VAT refunds.

(b) Improving tax equity

46. **Paraguay's tax system is heavily reliant on indirect taxes and regressive**. Indirect taxes – primarily the VAT, excise taxes and customs duties – account for more than 75 percent of tax revenues. Indirect taxes tend to be more regressive as they are disproportionately paid by low-income consumers, who spend a higher proportion of their incomes on necessities. The income tax on commerce, industry and services activities (IRACIS) is the only significant direct tax in Paraguay, accounting for around 15 percent of total tax collection. The introduction of a personal income tax was passed only in 2012 but design problems are expected to weaken its implementation and contribution towards a more equitable tax system. Corporate income taxes have not been applied to the agriculture sector. The income tax on agricultural activities (*Impuesto a la Renta de las Actividades Agropecuarias – IMAGRO*) represented barely 0.3 percent of the government's tax revenues. Property taxes are very low as updated land prices are not used for the tax base estimation.

47. **As a result, Paraguay's tax system exacerbates income inequality.** According to the Bank's Equity Assessment (2014), taxes increase inequality by about 2 percentage points of the Gini coefficient. Indirect taxes increase the Gini coefficient by 0.03 points while direct taxes reduce the Gini coefficient by less than 0.01 percent. Including transfers, the post–fiscal income Gini coefficient is still slightly higher than the market income Gini, indicating that income inequality is increased after government takes taxes from society and redistributes part of them.

48. **In December 2013, the administration established the new agriculture sector corporate tax, the Tax on Agriculture Income (*Impuesto a la Renta Agrícola – IRAGRO*)**. This new tax replaces the previous IMAGRO. IMAGRO levied a 2.5 percent tax on farmers' income. However, the potential impact of IMAGRO on government revenues was weakened by

major tax exemptions.[9] The new IRAGRO is an attempt to address some of the existing tax loopholes. It has a broadened tax base and it is expected that the number of taxpayers will increase from the current 80,000 that were contributing to the IMAGRO to 150,000. More importantly, as the tax obligations on the IRAGRO cannot be claimed back on VAT credits, revenues are projected to increase from the US$25 million collected by the IMAGRO in 2012-13 to more than US$250 million (or 1 percent of GDP) by 2016.

Prior Action # 3: To improve tax equity the Government has established a tax on agriculture income (IRAGRO).

49. **Expected results:** The expected outcome is to increase the revenue generated by the corporate tax on the agriculture sector. This expected increase relates to improvements in tax equity and neutrality. In terms of equity, it is expected that the establishment of IRAGRO will have a heavier incidence in high income groups. In terms of neutrality, IRAGRO will make taxation more uniform across sectors as the agriculture sector starts contributing to the overall tax effort. Revenue from IRAGRO is expected to increase from about Gs.71.8 billion in 2013 to Gs.518.4 billion in 2017. Accordingly, SET expects that IRAGRO will increase the contribution of the agriculture sector to total tax revenues from the current 0.9 percent to around 4.3 percent by 2017.

(c) Financial Management

50. **The establishment of the Treasury Single Account (TSA) is one of the most important reforms on the GoP's public financial management system as it will enable effective liquidity management and strengthening controls on budget execution.** The operation of the TSA will enhance liquidity management, generate fiscal savings, exert a tighter control on budget execution and support monetary policy. As an instrument that enables the Ministry of Finance to oversight and centralize government entities' cash resources, the TSA will minimize unnecessary borrowing costs. In particular, authorities expect to substantially reduce intra-year borrowing from the Central Bank to cover a perceived cash shortage which will reduce central government interest payments. The STA is expected to reduce liquidity reserve needs, and maximize the remuneration of government cash balances. In addition, the TSA will favor regular and effective monitoring of government entities' budget execution by providing complete and timely information. No less important is that holding government cash balances at the Central Bank is expected to improve coordination with monetary policy and reduce the costs associated with open market operations.

51. **The establishment of the TSA is also instrumental to the Government's efforts to improve transparency.** In addition, the development of a new module in the Treasury IT System ensures that revenues collected by government entities through *Banco Nacional de Fomento* (BNF) are automatically registered in the TSA. This is expected to increase the coverage of the register of government other revenues (user charges, fees, etc) which are collected by decentralized entities as own revenues. The upgrading and modernization of the Integrated Financial Management System (SIAF) will be reinforced with the TSA's operation, ensuring full integration of financial, budgeting and asset control modules. Finally, the timely information to be provided

[9] For example, VAT paid on purchases of goods and services as inputs for agricultural production was credited against the IMAGRO liability of the agricultural producer.

by the TSA and the move towards adoption of the International Public Sector Accounting Standards (IPSAS) are expected to improve the quality and accuracy of fiscal information.

52. **Since its inception, the current administration has accelerated the adoption of the TSA which is now fully operational.** Following the approval of the Government Financial Modernization Act in October 2013 (which provides the legal framework of the TSA) and the Regulatory Decree No 852 that defines the operation guidelines of the TSA in December 2013, the authorities consolidated hundreds of bank accounts held by different ministries and decentralized agencies into the TSA in 2014. In parallel, implementation arrangements were completed in November 2014 and reflected in Resolution 146 of November 2014. As a result, the TSA has been fully operational since December 1st.

Prior Action # 4: To ensure effective aggregate control over cash balances and improve the efficiency of cash and borrowing management the Government has established the Treasury Single Account.

53. **Expected Results**: The operation of the TSA will allow cutting by one-half interest payments charged by the Central Bank for intra-year lending operations.

(d) Enhancing fiscal transparency

54. **Perceptions of corruption in Paraguay are higher in comparison to other countries in Latin America.** Paraguay has consistently ranked at the lower end of Transparency International's (TI) Corruption Perceptions Index, which ranks countries and territories based on how corrupt their public sector is perceived to be. In the 2013 edition of the Index, Paraguay ranks 150 out of 177, ahead only of Venezuela (160) and Haiti (163) among Latin American and Caribbean countries.[10]

55. **In response to growing demand for improved transparency and credible intensified anticorruption efforts, the GoP has made important progress on public finance management, which is expected to enable enhanced fiscal transparency and accountability.** In 2013, with World Bank support, the Ministry of Finance prepared and made publicly accessible the BOOST[11] database through its website.[12] In this regard, Paraguay was the first country in Latin America and the Caribbean, and the fourth in the world to release disaggregated budget data to the public using BOOST. The National Anti-Corruption Secretariat (*Secretaría Nacional Anticorrupción*, SENAC) recognized the implementation of the BOOST database as a good practice in terms of transparency and anti-corruption. The tool supports government efforts to improve the quality of expenditure analysis, and shows the government's commitment towards greater budget transparency. The preparation and updating of the platform has also contributed to capacity building in the Ministry of Finance as well as improved information exchange within the Ministry and with line ministries. The MoF has provided several workshops to users (media and academia) as part of its

[10] Corruption Perceptions Index 2013. *Transparency International*, 2014, http://cpi.transparency.org/cpi2013/results.
[11] BOOST is a country-specific database of disaggregated government expenditure data from a national treasury system.
[12] Ministerio de Hacienda, *Base de datos BOOST*, 2013, http://isdatabank.info/boost_paraguay/.

dissemination efforts. This was followed by the launch of the SPIR in 2014.[13] The SPIR provides financial reports, performance indicators, and budget execution data on a monthly basis.

56. **It is worth to mention that the implementation of the Treasury Single Account (TSA) is instrumental to the GoP's fiscal transparency efforts.** The TSA will broaden the comprehensiveness of public accounting as it will incorporate the accounts of spending units in the ministries and decentralized agencies. In addition, the ongoing development of a new module in the Treasury IT System that will ensure revenue collection through *Banco Nacional de Fomento* (BNF) is automatically registered in the TSA. This is expected to increase the coverage of the register of government other revenues (user charges, fees, etc.) which are collected by decentralized entities as own revenues. Finally, the decision to move towards adoption of the International Public Sector Accounting Standards (IPSAS) is also a good example of ongoing PFM reforms that will improve the quality and accuracy of fiscal information.

57. **The GoP has also introduced a new public procurement system to streamline government purchases, increase efficiency and improve transparency in government contracting.** The system, called *e-jogua*, is a virtual store with all the products offered by suppliers selected through a tender for a framework agreement. This information technology platform processes reverse auctions electronically. Following an open bidding or reverse auction tender process, the National Directorate of Public Contracting (*Dirección Nacional de Contrataciones Públicas*, DNCP), registers winning prices in the price registration system. The prices in the system are valid for a defined period and any government entity from any government level can purchase the required goods or services at these prices. The products are offered through the portal of the DNCP and can be procured by government agencies using a purchase order, instead of conducting separate tenders. All the information about the tender is available through the DNCP portal, allowing for public verification throughout the entire contracting process. The Decree 1315 of February, 2014 regulates the use of the reverse auction by government entities and the public access to the system.

58. **Transparency efforts have culminated in the adoption of the Public Information Law (Law 5184 of May 2014) which makes mandatory the publication of salaries, subsidies and other allowances paid to public officials**. This law requires all state entities and agencies, as well as private institutions that receive transfers or manage government funds to make this information available on a monthly basis. The introduction of the law provides an unprecedented level of detail regarding the allocation of public resources, in particular wages and allowances to civil servants in the executive, managers and staffs of the SOEs, binational enterprises, legislative and judiciary branches.

59. **To follow up the initiatives taken so far, the GoP has adopted the Open Government Action Plan 2014-2016, which confirms its commitment to transparency, access to information, and participation.** Prepared in close consultation with representatives from civil society organizations in the framework of the Open Government Partnership, this plan encompasses nine commitments in the areas of transparency, participation, and accountability, to be implemented starting July 1, 2014.[14] The commitments include the design and implementation

[13] Ministerio de Hacienda, *Portal de Reportes Financieros*, 2014, http://www.hacienda.gov.py/portalspir/.
[14] "Plan de Acción de Gobierno Abierto 2014-2016 República del Paraguay" *Secretaría Técnica de Planificación del Desarrollo Económico y Social*, 2014, http://www.gobiernoabierto.gov.py/documents/10179/18004/Plan+de+Acci%C3%B3n+2014-2016.pdf/4e5a9a44-c903-4928-b138-269dfb36ecbd.

of an open data policy, and capacity building among civil society regarding the use of open data and public expenditure management, among others. As part of these measures, the GoP plans to publish open budget data through the SPIR, promote activities to make the budget more accessible to the public and to adopt the Open Contracting Data Standard currently being developed.

> **Prior Action # 5:** To increase transparency and accountability of its public financial management systems, the Government has: (a) prepared, updated and made accessible budget execution information on a monthly basis through the internet; (b) enabled public access to the bidding process and subsequent phases that are part of the *Convenio Marco* through the DNCP; and (c) made mandatory the publication on the internet, on a monthly basis, of salaries and allowances received by civil servants.

60. **Expected results:** The measures supported in this area are expected to improve transparency and accountability of the GoP's public financial management systems, which will contribute towards a more efficient delivery of public services as well as increased participation of civil society actors in the fight against corruption.

(e) Improving SOE's financial performance

61. **In Paraguay, State-Owned Enterprises (SOEs) are responsible for providing basic services that are essential to the country's competitiveness and its population's welfare, such as the provision of electricity, water and sanitation or petroleum products.** The SOE sector encompasses nine companies, with an aggregate budget equivalent to 10 percent of GDP and total investments equivalent to 3.2 percent of GDP (or around 40 percent of total public sector investments). The operation of SOEs has substantial implications on the government's fiscal accounts. Consequently, strengthening the operational and financial performance of Paraguay's SOEs is a key element in the government fiscal reform agenda.

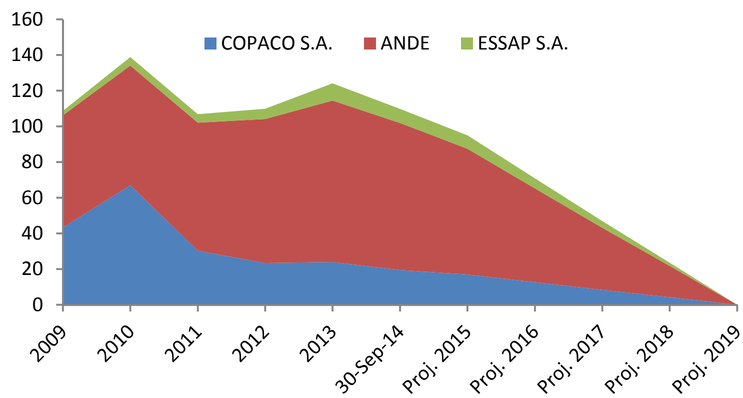
62. **Previous reform efforts were focused on the enhancement of the institutional framework, financial transparency, and performance monitoring**. The Paraguayan SOE sector moved from a completely decentralized model managed by line ministries, with virtually no transparency and accountability mechanisms, to a coordinated and more accountable model in which the Ministry of Finance and sector line ministries have well defined roles. The GoP has established an institutional framework for SOE oversight and ownership based on international good practices, which was institutionalized through the approval of a law creating the National Council of Public Enterprises (*Consejo Nacional de Empresas Públicas – CNEP)* in September 2013, giving a stronger legal backing than the decrees they had in place. The CNEP was established with the status of a vice-ministry, putting it in a strong position within the Government. Together, those actions give institutional support for CNEP and the General Directorate of Public Enterprises (*Dirección General de Empresas Públicas, DGEP*), its technical arm, to perform their strategic roles of monitoring and oversight.

63. **Transparency has been increased by strengthening audit and financial management of SOEs**. SOEs have implemented an internal control system and all annual financial statements and audit reports are now published online, increasing accountability and transparency. With a view to improving service delivery, the introduction of management contracts started with the five biggest SOEs representing 80 percent of total SOE-consolidated expenditures and is now being implemented by all SOEs. These management contracts, agreed between the SOE management

and the Government, include targets linked to financial performance and service delivery efficiency.

64. **This proposed operation aims at supporting the GoP in the second round of reforms to further increase SOE efficiency and improve service delivery**. Supported by a Bank NLTA, the CNEP has prepared a Strategic Plan for 2014-18, which encompasses critical steps towards the enhancement of the operational, commercial and financial performance of SOEs through nine policies that will be implemented over the mandated period, namely: (i) Adoption of a prices and fees policy; (ii) Adoption of a subsidy policy for end users: (iii) Elimination of the consolidated arrears between SOEs and between Government and SOEs; (iv) Prohibition of debt between SOEs as a financing mechanism; (v) Establishment of a rule-based transfer mechanism; (vi) Coordination of functions among policy making, regulation and delivery of services; (vii) Establishment of regulations and incentives to improve SOEs' investment and management policies; (viii) Adoption of a uniform model of principles of corporate governance for SOEs; and (ix) Strengthening the oversight capacity of DGEP. This plan is complemented by an Action Plan which proposes specific activities under each policy for 2014-2015, some of which have already been showing very significant results that in some cases go far beyond what was initially envisaged.

Figure IV.1: General Government Debt to SOEs (in millions of US$), 2009-16



Source: DGEP and World Bank staff calculations

65. **Efforts to reduce the consolidated arrears between SOEs and between Government and SOEs have been reflected in the establishment of trajectories towards total debt build-down.** Ensuring the financial sustainability of SOEs has been one of the major challenges as it affects the quality of service delivery and has impacts on the financial position of the overall public sector. In this regard, a pending issue is the non-timely payment of basic services provided to central government institutions by public utility SOEs. Government institutions have significant outstanding debt for non-payment of utility bills (i.e., water, electricity and phone services)[15] with SOEs. While some institutions started to pay-off arrears the total outstanding debt has been oscillating in the recent years, it decreased by 23.1 percent from a peak of US$139 million in 2010 to US$107 million in 2011 but increased back to US$124 million by 2013 and recently has come down to US$110 million by end September 2014. This amount represents 0.4 percent of GDP and 2 percent of the consolidated public sector debt.

66. **This proposed operation, supports efforts aimed at improving the commercial performance of SOEs and ensuring their financial sustainability.** In particular, the proposed

[15] These companies are: ANDE for electricity services, ESSAP for water services and COPACO for telecommunication services.

operation would support the Government's commitment to change the debt trajectory in two ways. First, through the allocation of funds in each central government institution's budget earmarked for the timely payment of utility bills to avoid further accumulation of debt and enabling SOEs to interrupt service provision in case of no payment of current bills. Second, issuing a law that requires the Ministry of Finance to define a payment plan for the full repayment of debt in arrears of general government entities to SOEs over a five years period. The implementation of this law is evidenced by the inclusion in the Budget Law of 2015, of a five-year repayment plan with annual repayments ranging between 18.5 percent and 21.5 percent of the outstanding debt and therefore establishing the schedule towards the total build-down by the end of the period. In the case of non-payment of current utility bills, the service-providing SOEs can opt to discontinue the provision of their basic services to the respective defaulted institutions of the central administration and decentralized public entities (except schools and hospitals) as provided for in Law No. 5.060, approved by the National Congress in May 2014. Finally, to discipline commercial and financial transactions related to service provision between SOEs, the CNEP has issued a regulation aimed at preventing the accumulation of arrears between SOEs. This regulation prohibits continued delivery and financial transactions if services are not paid on time.

Prior Action # 6: To further improve state-owned enterprises' (SOEs) financial and operational performance, the Government has: (a) defined a payment plan to repay in a five-year period the central government entities' outstanding debt to SOEs for utility services provided; (b) enabled SOEs to interrupt service provision to central government entities and decentralized public entities in case of no payment of services; (c) required mandatory external audits for SOEs that should be submitted to the Government's executive branch; and (d) created regulations that prevent the generation of debts for unpaid services between SOEs.

67. **Expected results:** According to DGEP, during the first two years, these measures would lead to a reduction of the past-due debt from US$124 million at the end of 2013 to US$47 million by 2017. The timely payment of utility services and the partial re-payment of the outstanding arrears would allow the SOEs more financial flexibility and planning stability to enhance their efficiency through investments and other measures and ultimately increase the quality of the delivery of basic services.

Pillar 2: Social Protection

(f) Improving Targeting

68. **Consistent with the NDP, the overall government objective in Social Protection (SP) is to reduce poverty focusing in a first stage on extreme poverty**. Both urban and rural areas benefited from the decade's reduction in extreme poverty, although recently the decline was higher in rural than in urban areas. However, by 2013, rural areas were home to 68 percent of the extreme poor and the incidence of extreme poverty was three times as high in rural areas than in urban areas.

69. **In the last years, SP policies have expanded and their poverty reduction impact has been enhanced with the establishment and expansion of two key government transfer programs**. The non-contributive pension program *Adultos Mayores* and the conditional-cash transfer program (CCT) *Tekopora*. Still, their contribution to poverty reduction is limited given their relatively low coverage and substantial targeting weaknesses and the fact that these transfers

accounted for less than 5 percent of the total household income in 2013, although this share is higher for rural households.

70. **An important obstacle to reach the objectives mentioned above is the institutional capacity of the agencies responsible to run these programs**. *Adultos Mayores*, the largest Non-Contributory Pensions Program has been selecting beneficiaries using an outdated targeting instrument designed for CCTs using 2002 data, an obstacle to efficient SP spending. The use of this targeting instrument implies a targeting error of 34 percent, composed of 28 percent inclusion error (non-poor elders included in the program), and 6 percent exclusion error (non-included poor elders)[16]. While *Tekopora* has a much lower targeting error of 20 percent, composed of 15 percent inclusion error and 6 percent exclusion error, there is space for improvements in targeting that are expected to release resources for a larger coverage or to finance other social protection programs.

71. **Authorities recognize the need for improving targeting mechanism for the selection of beneficiaries of *Adultos Mayores* and *Tekopora*.** In the first case, the government strategy is committed to complete the geographical coverage expansion of the NCP *Adultos Mayores* with an updated targeting instrument, aiming to reach 185 thousand beneficiaries. *Tekopora* is re-certifying 95 thousand program beneficiaries, using an updated version of the *Indice de Calidad de Vida*. Both actions are aimed at improving the efficiency of SP spending to target poor and extreme poor households. Reduction of inclusion errors could have some distributional implications as while not eligible some existing beneficiaries are part of bottom income groups and their exclusion from these programs might have negative effects on poverty reduction. However, authorities do not plan to exclude existing beneficiaries but to use the new targeting instruments in the selection of new beneficiaries.

Prior Action # 7: To improve targeting mechanisms for the selection of beneficiaries of the *Adultos Mayores* Program, the Government has introduced specific criteria that more accurately select new beneficiaries according to the poverty line measurement.

72. **Expected results:** Improvements in the targeting of the *Adultos Mayores* program managed by the Directorate of Non-Contributory Pensions (*Dirección de Pensiones No-Contributivas, DPNC*) are expected to increase the contribution of this program to poverty reduction. The implementation of an updated program-specific targeting instrument can generate savings of around Gs. 7 billion as a result of the improved targeting of the program.

(g) Increasing Efficiency of Delivery

73. **Authorities are also investing efforts in enhancing the functioning of social protection programs.** *Tekopora* has been paying benefits in cash, by lining up beneficiaries in public places once every two months, an obstacle to effective program delivery. Currently 2/3 of the 95 thousand *Tekopora* beneficiaries are paid in cash every two months which involves a series of difficulties for the beneficiary and high transaction costs for Secretary of Social protection (*Secretaría de Acción Social, SAS*), the agency responsible for the implementation of the program. In absence of small denomination bank notes, beneficiaries are paid round figures, normally lower than the corresponding benefit. In addition, beneficiaries are allowed to cash their benefits in a determined

[16] Targeting errors for population aged 65 and above, are 15 percent and would decrease down to 10 percent with the implementation of the new ICVAM.

lapse of time, after which funds are returned to SAS and no retroactive mechanism is in place. Finally, while beneficiaries are allowed to cash their benefits using a debit card (*Tarjeta Monedero*) this is not associated to an individual bank account but to a single common SAS account, which prevents the provision of other financial services to them.

74. **Authorities are addressing this issue by agreeing with the *Banco Nacional de Fomento – BNF* on the opening of basic savings account by beneficiaries**. This will not only facilitate the functioning of the program and will reduce transaction costs for both beneficiaries and SAS, but will allow beneficiaries to receive financial services associated to basic savings account, thus fostering financial inclusion.

Prior Action # 8: To ensure that beneficiaries of the *Tekopora* Program receive the cash transfers in a timely manner and to reduce transactions costs, the Government has taken steps to use individual basic bank accounts in the *Banco Nacional de Fomento* to pay cash transfers to beneficiaries of the *Tekopora* Program.

75. **Expected results**: Paying benefits of *Tekopora* directly to beneficiaries' bank accounts will: a) improve program's governance and transparency, b) avoid income losses to program beneficiaries, c) foster financial inclusion, and d) reduce transactions costs to SAS. In particular, it is expected that the amounts of benefits that are not received by the beneficiaries and return to SAS will be reduced from 2.5 percent of total *Tekopora* benefits to less than 2 percent.

Pillar 3: Financial Inclusion

(h) Deepening Financial Inclusion

76. **In recent years, Paraguay has made some strides in financial inclusion but the country still lags behind regional averages**. The 2013 financial inclusion survey[17] shows that the percentage of adults that had an account with a formal institution was 29 percent, up from 22 percent in 2011, but lower than the 39 percent for the Latin American region in 2011. The 2013 survey shows that the main barriers for not having an account with formal institutions include: lack of money (51 percent), lack of documentation (24 percent), excessive bureaucracy (19 percent), and high costs (19 percent). In terms of getting credit in 2013, 34 percent of adults requested loans, mainly from formal institutions (21 percent). Regional disparities exist with 40 percent of adults in the Center region getting loans, almost twice than those in the Northeast. The lack of access to banking is especially felt among the rural population, among whom only 10 percent reported they had accounts. Though data on access to formal financial institutions are unavailable on the bottom 40 percent in rural areas, it is clear that formal banking is rare among the rural poor. Additionally, the savings rate (formal and otherwise) is exceptionally low among the rural population: only 7.4 percent reported they had any savings during 2010-11. This combination of low savings and poor access to formal financial institutions poses a challenge in the event of household shocks.

[17] The Central Bank of Paraguay carried out a financial inclusion survey to understand the demand for financial services. The survey used an expanded version of the Findex questionnaire that was used worldwide to analyze financial inclusion issues by the World Bank.

77. **Reasons to request loans include health expenditures, purchases of consumption goods, business development and education spending**. The use of credit cards decreased slightly from 9 to 8 percent of adults, while the use of debit cards increased from 11 to 15 percent of adults between 2011 and 2013. Paraguay stands out in terms of using mobile phone for payments. In 2011, 5.7 percent of adults use mobile phones to receive money and 4.3 percent to send money, 3 to 5 times higher than the regional average.

78. **The proportion of adults who save has almost doubled in the past two years**, **suggesting untapped opportunities for savings mobilization.** About 39 percent of adults in Paraguay reported saving some part of their incomes in 2013, well above 18 percent in 2011 and also the regional average of 26 percent. Most adults reported saving at home (24 percent) and only 14 percent did so in formal institutions. Individuals with a bank account are more likely to report saving (63 percent), but almost 3 out of 10 adults without a bank account reported savings. Even adults in the bottom 40 percent of income reported savings (26 percent) in the past year, but in a smaller proportion than those in the top 40 percent of income (51 percent). Most adults are saving for possible emergencies (29 percent), future expenditures (7 percent), or to start a business (7 percent).

79. **With most adults owning a cell phone in Paraguay, mobile money could be used to promote mobile banking and mobile payments.** About 28 percent of adults reported using a mobile money product, compared to 21 percent who have either a bank account or a loan with a cooperative and 15 percent who have either an account or a loan with a bank. While cellular companies (*Tigo* and *Personal*) have also captured unbanked adults (23 percent) and 27 percent of adults in rural areas, mobile money is used mainly for domestic transfers instead of electronic wallet. With a low population density (16.25 inhabitants per km^2), cellular companies could be a cost-effective distribution channel to reach out to financially excluded adults. The data shows that there is scope for future growth of mobile money, with 10 percent of adults planning to use such service in the next six months. Mobile money usage could expand beyond domestic remittances to other market segments, such as payments to waged workers, who are mainly paid in cash (76 percent) and payments of government transfers for poverty reduction. Mobile money is a payment alternative that could reduce costs and establish mechanisms with better control and audit capabilities.

80. **Due to the high volatility of income, households in Paraguay are exposed to income fluctuations and financial markets could play a role to mitigate the effects of systemic or idiosyncratic negative shocks.** In Paraguay, only 24 percent of adults could get a loan in case of an emergency, mainly from friends and families (70 percent), savings (26 percent) and financial institutions (14 percent). As a result, three-quarters of the adult population could not self-insure themselves, and can be forced to reduce consumption to cope with shocks. Financial literacy could encourage adults to rely more on financial savings as means to deal with negative shocks or emergencies.

81. **Promoting financial inclusion is one of the channels envisaged by the NDP to ensure sustainable poverty reduction and to boost shared prosperity and the Central Bank of Paraguay (BCP) has taken the leading role in moving this agenda.** Financial services can assist households to attenuate the impact of adverse shocks, especially for lower income families. Empirical evidence shows that having a bank account could have positive effects on savings and investment behavior. At the end of 2013, the BCP created a special unit, the Financial Inclusion

Office responsible for promoting banking services, financial education, and consumer protection. In July 2014, the GoP passed a decree to legally establish the National Committee for Financial Inclusion (*Comité Nacional de Inclusión Financiera - CNIF*) – which is composed by the MoF, BCP, the Technical Secretariat of Planning (STP) and the National institute of Cooperatives (INCOOP). In August 2014, an Executive Secretariat and a Technical Team were appointed to prepare and implement the National Strategy for Financial Inclusion (*Estrategia Nacional de Inclusión Financiera – SNIF*). With Bank's technical support, a first step was the demand-side survey on financial inclusion carried out in 2013. This demand-side analysis will be complemented by a supply-side assessment, a legal and regulatory analysis, and a consumer and financial literacy diagnostic to inform the SNIF.

82. **In the meantime, the BCP has also taken important actions to create new products and provide better regulation and protection for financial inclusion.** The BCP issued a regulation on basic savings accounts with the objective of allowing unbanked adults to manage their savings through bank accounts. The main differences with a regular bank account are a simplified process to open it and low costs. The individual only needs to present his/her identity card and provide basic information. There are no monthly maintenance fees, no minimum opening amount or balance, and clients are allowed to have 3 balance inquiries and four withdrawals through ATMs, mobile phones or internet without any charge. These basic accounts can be opened at banks, through cellphone operators, or through bank correspondents. Another advantage of the basic accounts is that they could use debit cards.

Prior Action # 9: To facilitate access to financial services for lower income groups, the Government has established simplified processes to open and manage basic savings accounts which do not have minimum opening and balance amount requirements, and do not charge monthly maintenance fees.

83. **Expected results:** The BCP regulations for basic accounts and electronic payments are expected to remove barriers for using financial services. The basic accounts provide a low cost option for saving with financial institutions, instead of keeping savings at home. This is expected to reduce the number of adults without access to any financial service from 42 percent to 30 percent in the next three years.

(i) Regulating electronic transactions

84. **Electronic payments**. Given the strong growth of mobile money in Paraguay, the BCP issued a regulation to authorize the creation of electronic payment companies (*Entidad de Medio de Pago Electrónico, EMPE*) and regulate electronic payment products. The EMPEs will process and manage services related to electronic payments through mobile operators and are not allowed to do financial intermediation. The regulation defines what is considered as electronic money, limits users to one account per EMPE, establishes that the balance in such accounts cannot exceed 40 minimum salaries, and that partial withdrawals of electronic transfers are not allowed. EMPEs will need to create a trust fund to guarantee the funds of each user, agent, and point of sale.[18]

[18] The Bank is providing technical support for the strengthening of EMPE's regulatory framework.

Prior Action # 10: To strengthen the legal framework for the provision of financial services, the Government has regulated the use of electronic payment services.

85. **Expected results**: Tapping into the widespread availability of mobile users, the regulation of electronic operations by the BCP will enable the provision of further electronic payment services to extend financial services to the currently under-served segments of the population. It is expected that the proportion of adults using financial electronic services will increase from the current 28 percent to 40 percent by 2017.

86. **The proposed operation is based on a number of analytical studies and technical assistance activities produced by the Bank over the last years**. In particular the recently published Public Expenditure Review (PER) "The Quest for Optimal Tax and Expenditure Policies for Shared Prosperity" (Report No. 78194-PY), the study on "Growth Volatility in Paraguay Sources, Effects, & Options" (Report No. 78198-PY) and the forthcoming "Volatility and Inequality as Constraints to Shared Prosperity: Paraguay Equity Assessment", provide a solid analytical foundation for prior actions supported by this DPL. The Non-lending Technical projects Strengthening Tax Administration & SOE Corporate Governance (P148234) and Paraguay Finance and Private Sector Development Programmatic Approach (P147386) are providing support to the authorities for the implementation of the prior actions on tax policy, SOE governance and financial inclusion. Table IV.1 below, describes the relevant economic and sector work and its contribution to the proposed prior actions supported by this operation.

Table IV.1: Analytical Underpinnings and Prior Actions and Triggers

ESW, NLTA, Policy Notes	Contribution to the Program
PY Volatility Analysis (2014)	Overall policy program, Pillar 1 Prior Action # 1
PY Public Expenditure Review (2014)	Pillar 1, Prior Actions # 1, 2, 3 and 5
PY Strengthening Tax Admin & SOE Corp. Gov. (P148234) Role and Organization of the State in the Ownership and Supervision of Public Enterprises in Latin America (P126779).	Pillar 1, Prior Action # 2 and 3 Pillar 1, Prior Action 4
PY Equity Assessment (2014)	Overall policy program, Pillar 2, Prior Action # 3 and 6
Más alla de las pensiones contributivas; Catorce experiencias en América Latina – Capitulo 12 Paraguay (2012)	Pillar 2, Prior Action # 6
PY Volatility and PER (including BOOST) - Dissemination, Capacity Building and Policy Dialogue (P147079)	Pillar 1, Prior Action # 4
Gobierno Corporativo de Las Empresas Publicas en América Latina (2014)	Pillar 1 Prior Action # 5
PY Finance and Private Sector Development Programmatic Approach (P147386)	Pillar 3, prior Actions # 8 and 9

C. LINKS TO THE CPS AND OTHER BANK OPERATIONS

87. **The proposed operation is consistent with the WBG's CPS for Paraguay for 2015-18.** The new WBG program (presented to the Board in December 2014) is anchored in the Government's NDP. The CPS is built around three results areas: (a) boosting pro-poor delivery of public goods and services, (b) fostering inclusive markets, and (c) strengthening resilience to risks

and volatility. This operation directly covers result area (a) through the Fiscal Management and Social protection pillars and result area (b) through the financial inclusion pillar.

88. **This operation builds on the enhancements on public sector management supported by previous development policy loan operations prepared in 2009 and 2011.** Through the continuous support to the SOEs reform agenda, this operation aims at consolidating the improvements in the governance associated with the oversight and management of SOEs. The SOEs' component of this operation complements ongoing investment-financing operations such as the Water and Sanitation Sector Modernization Project (P095235) which promotes institutional-based and social accountability activities, improving corporate governance of the water company ESSAP, and the Energy Sector Strengthening Project (P114971), which supports improvements in transparency, planning, execution, and evaluation processes at the public electricity utility ANDE.

D. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

(i) Consultations

89. **The actions of this DPL emerged from the GoP's multi-year plan (NDP)**. As part of the preparation of the NDP, the government staged a consultative process among several stakeholders within the Paraguayan society. Within the public sector, the MoF organized a discussion table with 25 public agencies identifying action plans, programs, and indicators associated with the country's development objectives (e.g., financial inclusion, poverty reduction and equality promotion). Some of the policy reforms supported by this DPL involve an increased level of transparency and accountability of public management by making accessible data on budget planning and execution and setting up a Public Procurement Portal (Prior action # 5). The Government has worked together with civil society, the media and relevant actors which welcomed the initiatives regarding transparency. Taxation measures have been carefully discussed with different segments of the society and negotiated with the agricultural sector. The priorities defined as a result of these inter-ministerial consultations are consistent with current reforms related to SOEs' strengthening.

90. **In addition to these initial consultations, current reforms targeted by this program benefitted from specific consultations.** With regard to SOE oversight, workshops and conferences were held with members of Congress and the media in order to disseminate and explain the objectives and scope of the reform. Constant communication and consultation were also established with representatives from SOEs. In the area of internal control, a continuous process of consultation and setting-up of committees was developed in parallel to the design and implementation of the new internal control framework.

(ii) Collaboration with Development Partners

91. **Besides the World Bank, the Inter-American Development Bank (IADB) and the Development Bank of Latin America (CAF) are the major financial institutions operating in Paraguay**. The role of the Bank is more focused on the GoP's poverty reduction agenda, while IADB and CAF provide finance to infrastructure sectors. The IADB has a portfolio of more than US$865 million, covering infrastructure (mainly road rehabilitation and maintenance), modernization and strengthening of public institutions, and social and human development. Recently, the IADB has also committed more than US$200 million to support the private sector, wrapping diverse sectors that include soybean industrialization, financial inclusion and cement

production. With a portfolio of US$400 million, CAF finances the implementation of national and departmental infrastructure projects.

V. OTHER DESIGN AND APPRAISAL ISSUES

A. POVERTY AND SOCIAL IMPACTS

92. **Overall, the reform program supported by this operation is expected to have positive impacts on poverty and shared prosperity**. Policy measures on tax policy are expected to have ambiguous effects on poverty and income distribution. Assuming that the VAT will lead to a one-time increase in food prices, the expansion of the VAT base to the agriculture sector is expected to be regressive. This finding is not surprising given that the poor spend a significantly larger proportion of their income on consumption goods, in particular food. Of course, the effect will be smaller the higher the elasticity of the demand for food, and the higher the degree of substitution with other goods. However, irrespective of the welfare measure used (income or consumption) and even after accounting for the fact that the poor are both more likely to purchase goods from informal markets and to consume home-grown products, the poor will likely pay a larger part of their income on agriculture products due to the inclusion of the agricultural sector on the VAT base.

93. **The incidence assessment of the impact of changes to the VAT applied to the financial sector is difficult due to the lack of available data on the household level demand for loans.** Nevertheless, the VAT applied to the financial sector, which essentially is expected to increase the cost of financial transactions and interest rates, will affect users of financial services and borrowers. In 2011, only 3.4 percent of the bottom 40 percent and 20 percent of the top 60 percent of the population obtained a loan from a financial institution, which suggest that the change to the VAT applied to the financial sector is likely to have a greater on the middle class and to further reduce access to formal credit for low income households.

94. **Indirect evidence, suggest that the establishment of IRAGRO is expected to have progressive effects on tax incidence**. Due to the lack of available data on income from agriculture activities, directly assessing the expected impact of the new tax on agricultural income is not possible. However, the distribution of land ownership, land size and output in Paraguay is highly regressive; this along with the fact that the average monthly per-capita income (from all income sources) of the bottom 40 percent is below three minimum wage salaries suggests that IRAGRO is unlikely to represent a burden on low-income households.

95. **Measures supporting improvements in the targeting of social programs are expected to contribute significantly to both moderate and extreme poverty reduction**. In particular, the strengthening of the targeting of the *Adultos Mayores* and *Tekopora*, which directly benefits the elderly and poor or extreme poor, will likely generate efficiency gains and savings that will enable a cost effective expansion of the program. As mentioned above, new targeting criteria will be applied to new beneficiaries and should not represent exclusion of existing beneficiaries.

96. **Finally, the measures to promote financial inclusion have a strong positive impact on poverty reduction and shared prosperity**. Paraguay shows a low level of financial inclusion relative to its regional peers; account ownership at a formal financial institution is 10 times lower among the poorest 40 percent relative to the top 60 percent of the adult population. Moreover, the rate of electronic and mobile payment usage in Paraguay is low, particularly among the less

educated and the poor. Improving access to financial services by removing price or non-price barriers to their use is likely to benefit the poor and other disadvantaged groups who are disproportionately more likely to lack access to these services. The recent adoption of mobile money technologies at the same time that capable mobile phones become cheaper and widely accessible will help Paraguay to accelerate financial inclusion and to improve economic opportunities to enable a sustainable boost in shared prosperity.[19]

B. ENVIRONMENTAL ASPECTS

97. **The specific actions supported under the proposed operation are not likely to have significant positive or negative effects on the state or country's environment, forests, fisheries or other natural resources.** The first pillar, Strengthening Public Sector Management, has a primarily fiscal nature, therefore policy actions under the first pillar are unlikely to either exacerbate environmental problems or contribute to their remediation. While the establishment of the corporate tax on income from agriculture activities could have some impact on land use, this impact will be of second or third order and if any will have positive effects as it will promote a more rational use of land. The second and third pillars on Social Protection and Financial Inclusion encompass policy actions that are not expected to have implications on environmental sustainability**.**

C. PFM, DISBURSEMENT AND AUDITING ASPECTS

98. **PFM and procurement systems in Paraguay have been at the center of government reforms for several years**. As a result, PFM shows improvement in several areas. The annual budget is timely prepared and published, in-year fiscal reporting is regular and available in a monthly basis and the coverage of the budget is reasonable, and annual financial statements include complete information on revenue, expenditure and financial assets and liabilities. Despite progress achieved, Paraguay PFM system is still challenged by the need to address the existing bottlenecks that are hindering the quality and timely delivery of its public spending programs. Progress in public procurement has been steady. The *DNCP* regulatory authority exerts a close control of government contracts and the introduction of new procurement procedures such as reversal auction has been successful.

99. **The latest IMF safeguards assessment of foreign exchange control environment of the Central Bank of Paraguay** (BCP) **was performed in October 2006.** The report states that while the Central Bank has made some progress in strengthening the safeguard framework since the 2003 safeguard assessment, vulnerabilities remain in areas such as financial and program data reporting to the Fund. However, according to the assessment, the current foreign exchange control environment within the Central Bank is satisfactory. The BCP financial statements for the year 2013 have been audited by KPMG Uruguay following international auditing standards. An unmodified audit opinion was given by the auditors on BCP financial statements. Based on the review of the audited financial statements and previous DPL operation, nothing came to the attention of the Bank that would indicate that the BCP control environment into which the loan proceeds will flow is other than adequate under the proposed arrangements.

[19] Annex 4 presents a detailed Poverty and Social Impact Assessment (PSIA) which assesses the effects of the tax and financial inclusion.

100. **Disbursement.** The Bank would make the single loan disbursement to a dedicated account that forms part of the country's official foreign exchange reserves at the Central Bank of Paraguay. As the operation is a DPL DDO, the disbursement when requested by authorities, would be made upon the Bank's assessment on satisfactory compliance of implementation of the policy program and the observance of the legal instruments supported by the operation and compliance with the adequacy of the Borrower's macroeconomic policy framework at the time of disbursement. Disbursement will not be linked to any specific purchases and no procurement requirements would be needed. Once the Loan is approved by the Board of Executive Directors, the Borrower would open and maintain a dedicated deposit account. The Bank will disburse the proceeds of the Loan into the foreign currency deposit account. Upon the deposit into the foreign currency account, the Borrower would deposit an equivalent amount into the local currency deposit account. If the proceeds of the Loan or any part thereof are used for ineligible purposes, as defined in the Loan Agreement, the Bank will require the Borrower to either return the amount to the deposit account for use for eligible purposes or refund the amount directly to the Bank. The deposit account in US$ Dollars would be maintained in the Central Bank and its transactions and balances fully incorporated into the Borrower's accounting records and financial statements, *via* the SIAF.

101. **Legal agreement clauses.** Through the MoF the Borrower will: (i) report, within one week from the date of receipt, the exact sum received into the account; (ii) ensure that all withdrawals from the dedicated account are for budgeted public expenditures, excepting military expenditures or other items on the Bank's excluded expenditure list; and (iii) provide the Bank with evidence that the Paraguayan currency (Gs.) equivalent of the Loan proceeds were credited to the STA and that disbursements from that account were for budgeted public expenditures.

D. IMPLEMENTATION, MONITORING AND EVALUATION

102. **The preparation of this operation is led by the MoF.** The Undersecretariat of Economy (SSEE) at the MoF is coordinating the implementation of the policy program. Most of the implementation entities are within the Ministry of Finance structure. The Central Bank is also responsible for the implementation of prior actions under the financial inclusion pillar. The Bank will vet the prior conditions for effectiveness and disbursement. The SSEE should present this information in a timely manner and in a format satisfactory to the Bank.

103. **The Government Financial Management System and the M&E system that supports the implementation of the NDP will provide the information for the results framework to assessing progress on the reforms included in this proposed operation.** Public sector budget monitoring and execution reports from the Ministry of Finance, including reports on revenue collection will be regularly provided to assess progress on the fiscal management pillar. The Central Bank of Paraguay will provide reports on financial inclusion. With support from the World Bank team, the SSEE will ensure adequate monitoring and evaluation.

104. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, and/or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could

occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. Information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS) can be found at http://www.worldbankorg/GRS. Information on how to submit complaints to the World Bank Inspection Panel can be found at visit www.inspectionpanel.org.

VI. SUMMARY OF RISKS

105. **This operation entails an overall moderate level of risk.** The most relevant risks that can affect achievement of the PDOs defined for this operation are: macroeconomic risks and risks related to Paraguay's institutional capacity for implementation.

106. **Macroeconomic risks are considered moderate as the recovery of the global economy seems to be underway, despite some uncertainties**. However, there are downside risks associated with the effects of monetary tightening in developed economies and international prices for Paraguay's main exports, which could reduce GDP growth and government revenues, and thus jeopardize fiscal sustainability. Despite economic growth of 14.2 percent in 2013, Paraguay remains highly vulnerable to regional and global economic fluctuations and to weather-related shocks. In particular, the slowdown in Paraguay's main trade partners, Argentina and Brazil, may negatively affect demand for Paraguayan exports. However, as the country's exports are mainly commodities, reductions in the demand of regional partners can be compensated in other international markets. While adverse shocks to the Paraguayan economy are likely and are bound to have adverse impacts on government revenues, solid macroeconomic fundamentals strengthen Paraguay's ability to deal with such shocks. In particular, the GoP's comfortable fiscal position enables the adoption of policies to mitigate adverse external shocks in the short run. Moreover, the increased fiscal space expected to be achieved going forward through the full implementation of the FRL limits on recurrent spending and the tax revenue measures recently adopted enhances the ability of GoP to implement countercyclical policies in global downturn episodes. Finally, the contingent financing provided by this DPL DDO, is expected to further strengthen the country's resilience to adverse shocks.

107. **Risks related to institutional capacity for implementation are deemed as moderate**. Public sector capacity constraints are considerable in Paraguay and constitute a major challenge to successful implementation of the reform program. The limited number of technical staff in core ministries poses some implementation risks. In addition weak inter-institutional cooperation could put the success of the Government's reform program at risk. The proposed operation seeks to mitigate these risks in several ways. First, the operation has a small coverage in terms of policy areas and implementation responsibilities rely on a small number of government entities. In fact, the operation covers the core public sector (area led by the Ministry of Finance), non-contributory pension programs (also managed by the Ministry of Finance) and financial inclusion (reform area led by the Central Bank of Paraguay). Both, the MoF and BCP are the most capable public sector entities in the country. The Secretary of Social Assistance (SAS) that manages the *Tekopora* program has been progressively investing in technical capacity and improving the targeting mechanisms behind the program. Second, the operation builds on ongoing initiatives as opposed

to introducing new ones; and third, the operation is complemented by Bank technical assistance for alleviating capacity constraints, including the Non-lending Technical projects Strengthening Tax Administration & SOE Corporate Governance (P148234) and Paraguay Finance and Private Sector Development Programmatic Approach (P147386).

Table VI.1: Systematic Operations Risk- Rating Tool (SORT)

Risk Category	**Rating**
1. Political and Governance	Low
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Low
4. Technical Design of Project or Program	Low
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Low
7. Environment and Social	Low
8. Stakeholders	Low
9. Other	N.A
OVERALL	Moderate

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions	Expected Outcomes	Results Framework	2013 Baseline	2017 Target
Pillar 1: Public Finance Management				
Prior Action # 1: To increase tax revenues, the Government has: (a) increased the value added tax (VAT) rate applied to financial sector operations from five (5) percent to the standard rate of ten (10) percent; and (b) defined the VAT collection base and established a five (5) percent rate for the agricultural sector.	Increases in tax revenue	VAT revenue collection from agriculture to Gross Value Added of Agriculture, Livestock and Forest ratio (%)	0.0	1.4
		VAT revenue collection from Financial sector to Gross Value Added of Financial Intermediation ratio (%)	3.9	6.3
Prior Action # 2: To reduce tax revenue losses, the Government has established a risk-based mechanism for processing VAT and ISC credit claims refunds.	Improve compliance behavior and reduce VAT refunds	Number of taxpayers whose VAT refund requests are processed through the risk-based mechanism (*canales de selectividad*)	0	31
Prior Action # 3: To improve tax equity the Government has established a tax on agriculture income (IRAGRO).	Improvements in tax equity	tax on agriculture income (Gs. billion)	71.8	518.4
Prior Action # 4: To ensure effective aggregate control over cash balances and improve the efficiency of cash and borrowing management the Government has established the Treasury Single Account.	Reduction in interest payments for intra-annual borrowing	Interest payments of central government on intra-year borrowing operations (Gs. billion)	41.1	20.5
Prior Action # 5: To increase transparency and accountability of its public financial management systems, the Government has: (a) prepared, updated and made accessible budget execution information on a monthly	Increase transparency	Available and updated information on budget execution and civil service	0 (no)	1 (yes)

Prior Actions	Expected Outcomes	Results Framework	2013 Baseline	2017 Target
basis through the internet; (b) enabled public access to the bidding process and subsequent phases that are part of the *Convenio Marco* through the DNCP; and (c) made mandatory the publication on the internet, on a monthly basis, of salaries and allowances received by civil servants.	and accountability	salaries at the Ministry of Finance Portal		
Prior Action # 6: To further improve state-owned enterprises' (SOEs) financial and operational performance, the Government has: (a) defined a payment plan to repay in a five year period the central government entities' outstanding debt to SOEs for utility services provided; (b) enabled SOEs to interrupt service provision to central government entities and decentralized public entities in case of no payment of services; (c) required mandatory external audits for SOEs which reports will be submitted to the Government's executive branch; and (d) created regulations that prevent the generation of debts for unpaid services between SOEs.	Improve financial performance of SOEs	Past-due outstanding debt (arrears) of public institutions to SOEs for basic services (US$ million)	124	47
Pillar 2: Social Protection				
Prior Action # 7: To improve targeting mechanisms for the selection of beneficiaries of the *Adultos Mayores* Program, the Government has introduced specific criteria that more accurately select new beneficiaries according to the poverty line measurement.	Reduction in the targeting errors of the non-contributory pensions program *Adultos Mayores*.	Accumulated savings generated by the new targeting mechanism applied for the *Adultos Mayores* program (Gs. million)	0	7,000

Prior Actions	Expected Outcomes	Results Framework	2013 Baseline	2017 Target
Prior Action # 8: To ensure that beneficiaries of the *Tekopora* Program receive the cash transfers in a timely manner and to reduce transactions costs, the Government has taken steps to use individual basic bank accounts in the *Banco Nacional de Fomento* to pay cash transfers to beneficiaries of the *Tekopora* Program.	Improve governance and transparency of *Tekopora* Reduction of transactions costs for SAS and beneficiaries	Percentage of resources transferred from SAS to BNF for the beneficiaries of *Tekopora* that are returned to SAS (%)	2.5	2.0
Pillar 3: Financial Inclusion				
Prior Action # 9: To facilitate access to financial services for lower income groups, the Government has established simplified processes to open and manage basic savings accounts which do not have minimum opening and balance amount requirements, and do not charge monthly maintenance fees.	Increase access and usage of financial services	Percentage of adults without access to any financial sector services (%)	42	30
Prior Action # 10: To strengthen the legal framework for the provision of financial services, the Government has regulated the use of electronic payment services.		Percentage of adults using financial electronic services (%)	28	40

ANNEX 2: LETTER OF DEVELOPMENT POLICY

MINISTERIO DE **HACIENDA**

Asunción, 26 de enero de 2015

M.H. N° 170.-

SEÑOR
JIM YONG KIM, PRESIDENTE
BANCO MUNDIAL
WASHINGTON, D.C. 20433, USA

Tengo el agrado de dirigirme a usted para elevar a su conocimiento que el Gobierno del presidente Horacio Cartes, que ha iniciado su mandato el pasado 15 de agosto de 2013, concentrará las políticas públicas para lograr una efectiva igualdad de oportunidades, buscando eliminar la pobreza extrema, la discriminación y la exclusión, para construir progresivamente una sociedad más justa y equitativa, donde todos los ciudadanos, en particular los niños, tengan igualdad de oportunidades para su desarrollo integral, en el marco de la construcción participativa de una sociedad próspera, cohesionada y equitativa de transformación productiva y aceleración del desarrollo integral con una economía diversificada y competitiva, basada tanto en el aprovechamiento sustentable y sostenible de la riqueza natural del Paraguay y en la creciente incorporación de conocimiento a través del desarrollo del capital humano y la utilización progresiva de tecnologías de última generación, para el logro de un Paraguay integrado a la región y al mundo, aprovechando la diversidad y oportunidad que ofrece el mercado global, en donde no solo importa el grado de desarrollo sino la interacción de los agentes en todos los sentidos (Exp. M.H. N° 4206/2015).

La presente carta tiene el propósito de presentar los objetivos y acciones relacionados con el Préstamo de Apoyo a Políticas de Desarrollo, con opción de Desembolso Diferido (DPL-DDO) que tiene como base el Plan Nacional de Desarrollo (PND) 2014-2030 y el Programa Nacional de Reducción de la Pobreza, "*Sembrando Oportunidades*".

I. Plan Nacional de Desarrollo del Gobierno

El Gobierno del Paraguay definió los ejes y objetivos estratégicos, las prioridades de políticas y las líneas de acción para el desarrollo inclusivo y sostenido en el Paraguay. El Plan Nacional de Desarrollo (PND) constituye un instrumento de orientación de la actividad privada, a la vez que determina el alcance de las políticas y programas prioritarios para la Administración Pública.

En el corto plazo, el PND sirve de referencia para la definición de programas y asignación de recursos públicos, al tiempo que establece indicadores para el seguimiento a las acciones y para la verificación del cumplimiento de las metas trazadas por el Gobierno. A mediano plazo, la implementación del PND implica la alineación de los objetivos estratégicos con las prioridades impulsadas en cada quinquenio, con mecanismos políticos e institucionales que permitan tomar en cuenta y plasmar la orientación estratégica del PND para el desarrollo al 2030.

El PND está organizado en tres "ejes estratégicos", que permiten ordenar conjuntos de Políticas y Programas en función de Resultados esperados, i) Reducción de pobreza y desarrollo social, relacionado a la capacidad de la sociedad paraguaya para cubrir las necesidades humanas básicas de sus ciudadanos y sus comunidades; ii) Crecimiento económico inclusivo, buscando acelerar el ritmo de crecimiento y la diversificación productiva, promoviendo la participación de todos los agentes económicos y compartiendo los resultados del crecimiento, principalmente con el 40% de la población de menores ingresos; e iii) Inserción del Paraguay en el mundo en forma adecuada, buscando posicionar y mejorar la imagen país, fortalecer la participación nacional en los procesos de integración y en los foros internacionales y mejorar la asignación de recursos e incorporación de conocimientos.

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II. Programa Nacional de Reducción de la Pobreza Extrema

El Programa Nacional de Reducción de Pobreza Extrema tiene como objetivo primordial aumentar los ingresos y el acceso a los servicios sociales de las familias en condición de pobreza extrema. Estas familias se encuentran en los departamentos y distritos con mayor vulnerabilidad social, donde existen asentamientos y comunidades que tienen múltiples precariedades en infraestructura, servicios sociales, escasez de empleo y baja productividad en las fincas campesinas.

Para cumplir con su objetivo, el Programa Sembrando Oportunidades desarrolla un enfoque de precisión mediante la aplicación de una Ficha Social. Con esta herramienta se registra la situación socioeconómica de las familias, especificando los derechos vulnerados de cada uno de sus miembros: hombres, mujeres, niños y niñas, adultos y personas de la tercera edad. Esto permite que el programa direccione de manera más efectiva las respuestas de las instituciones que ejecutan políticas públicas sociales.

El Programa busca por un lado generar ingresos agropecuarios a través de: i) el fortalecimiento de la capacidad productiva de las familias con vocación agropecuaria para que diversifiquen sus rubros de autoconsumo y renta; ii) la capacitación laboral a jóvenes para actividades agropecuarias; iii) las alianzas productivas ente los diferentes actores de la cadena de valor y los agricultores familiares campesinos, trabajando en la preproducción, producción, transformación y comercialización; y iv) la implementación del Decreto N° 1056/2013, un marco legal que permite a los pequeños agricultores vender sus productos directamente a las instituciones públicas como escuelas, hospitales, fuerzas armadas y penitenciarias. Asimismo, busca generar ingresos no agropecuarios a través de: i) la capacitación laboral a jóvenes para actividades comerciales y de servicios; ii) la capacitación laboral a jóvenes para actividades industriales; y iii) de incentivos en la generación de empleo e ingresos a través de obras públicas pequeñas y medianas de gran impacto local, infraestructura comunitaria, como la construcción y mantenimiento de caminos vecinales, puentes y viviendas en 120 asentamientos priorizados.

Por otro lado, el Programa busca el acceso de las familias a servicios sociales básicos a través de: i) el fortalecimiento y expansión del Programa Tekoporã para que 100 mil familias puedan participar del programa en el 2014. Tekoporã está dirigido a las familias más vulnerables y las transferencias monetarias están condicionadas al cuidado de la salud y vacunación de los niños y niñas del hogar, a la matriculación y permanencia en el sistema educativo y al desarrollo de iniciativas productivas; ii) la expansión de la cobertura de la Pensión de Adultos Mayores para llegar a 130 mil personas en el 2014. Las personas adultas mayores de 65 años reciben una pensión alimentaria equivalente al 25% del salario mínimo vigente; iii) el trabajo en 12 mil soluciones habitacionales, construcción y mejoramiento de viviendas; iv) la instalación y fortalecimiento de las Unidades de Salud Familiar en los asentamientos y distritos identificados como prioritarios por su población vulnerable; y v) la búsqueda de la matriculación del 100% de niños y adolescentes en el sistema educativo, así como la distribución de kits de útiles escolares e implementación de almuerzos escolares.

III. Programas de Gestión Pública relacionados con el Préstamo de Apoyo a Políticas de Desarrollo, con opción de Desembolso Diferido (DPL-DDO)

El Gobierno ha optado por la modalidad de Desembolso Diferido en su afán de gestionar los riesgos, mediante la disposición de una línea de crédito contingente que permita: i) incrementar la capacidad de respuesta financiera inmediata del Gobierno ante desastres naturales y, al mismo tiempo, proteger su posición fiscal a largo plazo; ii) reducir la vulnerabilidad financiera del país y, por lo tanto, de riesgo macroeconómico; iii) proveer liquidez inmediata ante eventuales shocks internos y externos; y iv) asegurar el logro de los objetivos estratégicos de Gobierno en caso de una crisis o evento natural.

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A continuación se presentan las áreas de implementación del Préstamo de Apoyo a Políticas de Desarrollo, con opción de Desembolso Diferido (DPL-DDO) del Banco Mundial, por un monto de US$ 100 millones. En particular, el Gobierno del Paraguay desea consolidar los recientes avances alcanzados en tres temas mayores: Gestión de las Finanzas Públicas; Protección Social, e Inclusión Financiera.

III.1 Gestión de las Finanzas Públicas

El Gobierno, a fin de asegurar una sostenibilidad fiscal, ha promulgado la Ley N° 5098/2013, "*De Responsabilidad Fiscal*", que tiene por objeto establecer reglas generales de comportamiento fiscal orientadas a la estabilidad y sostenibilidad de las finanzas públicas, bajo el principio general de asegurar la sostenibilidad de las finanzas públicas en el mediano plazo, teniendo como meta resultados fiscales que no causen efectos negativos sobre la estabilidad macroeconómica, preservando el equilibrio entre los ingresos y los gastos públicos. Las leyes anuales del Presupuesto General de la Nación se sujetan a un déficit fiscal anual de la Administración Central, incluidas las transferencias no mayor que el 1,5% del Producto Interno Bruto estimado para dicho año fiscal; el incremento anual del gasto corriente primario del Sector Público no podrá exceder a la tasa de inflación interanual más el 4% y no se podrán incorporar incrementos salariales, excepto cuando se produzca un aumento en el salario vital mínimo y móvil vigente. El aumento será como máximo en la misma proporción y se incorporará en el Presupuesto del siguiente Ejercicio Fiscal. En ese sentido, el Decreto N° 1559/2014, por el cual se reglamenta la Ley N° 5098/2013, establece que las reglas macro-fiscales previstas en dicha ley deberán ser observadas en cada etapa del proceso presupuestario.

El escenario 2015 prevé ajuste fiscal con contención del gasto corriente, aumento de la recaudación tributaria y mayor volumen de ejecución de proyectos de inversión. El artículo 34°, del anexo "A", del Decreto N° 2929/2015, por el cual se reglamenta la Ley N° 5386 del 6 de enero de 2015, "*Que aprueba el Presupuesto General de la Nación para el Ejercicio Fiscal 2015*", dispone que el Plan Financiero aprobado podrá ser evaluado por el Ministerio de Hacienda al finalizar cada cuatrimestre, a efectos de actualizar los montos, conforme a las disponibilidades de recursos financieros de la Tesorería General, al resultado de la ejecución presupuestaria, al mejoramiento de las metas de recaudaciones durante el Ejercicio Fiscal o en base a las previsiones de desembolsos de los organismos financieros destinados al financiamiento de programas y proyectos ejecutados por más de un OE, operantes con una cuenta especial administrada por el Ministerio de Hacienda.

El Gobierno ha promulgado la Ley N° 5061/2013, a fin de incrementar los ingresos tributarios, mejorar la neutralidad y equidad del sistema tributario, a través del aumento del Impuesto al Valor Agregado (IVA) aplicado al sector financiero del 5% a la tasa general del impuesto de 10%, así como la expansión de la base tributaria del IVA al sector agrícola y estableciendo una tasa del 5%. Además, dicha reglamentación regula el Impuesto a la Renta Agropecuaria (IRAGRO). Por otro lado, la mencionada ley dispone que la Subsecretaría de Estado de Tributación deberá instaurar canales de selectividad para conceder la devolución de los créditos fiscales.

La Resolución General SET N° 15/2014 reglamenta la devolución del Impuesto al Valor Agregado y del Impuesto Selectivo al Consumo, dispuesta en la Ley N° 125/91, "*Que establece el Nuevo Régimen Tributario*", y sus modificaciones. Además, la Resolución General SET N° 45/2014 implementa canales de selectividad para los procesos de devolución de impuestos. Los canales de selectividad se clasifican en Canal Verde, que corresponde a aquellos contribuyentes que tengan un Índice de Riesgo del Contribuyente (IRC)

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inferior a 6, y permite la devolución del 90% del crédito solicitado dentro de las veinticuatro (24) horas de haberse presentado la solicitud; el Canal Amarillo, que corresponde a aquellos contribuyentes que tengan un IRC igual o mayor a 6 e inferior a 20, y permite la devolución del 80% del crédito solicitado dentro de las veinticuatro (24) horas de haberse presentado la solicitud; y el Canal Rojo, que corresponde a aquellos contribuyentes que tengan un IRC igual o superior a 20, por lo que la devolución se tramita por el Régimen General. El IRC es el valor numérico atribuido al comportamiento tributario del mismo, que se obtiene mediante el análisis de sus antecedentes impositivos y se calcula aplicando las Reglas de Validación descritas en el artículo 3° de la mencionada Resolución.

En el primer semestre del año 2014, los ingresos tributarios han mostrado el importante crecimiento del 19,2% con respecto al primer semestre del año 2013. Se espera que la tendencia para este segundo semestre se mantenga y se traslade a un cierre de ejercicio con nivel destacable en materia de recaudación. El comportamiento favorable de los ingresos tributarios se explica en gran medida por el dinamismo observado en los impuestos que gravan la actividad económica interna, que al mes de junio se han incrementado en 27,1%.

Para incrementar la transparencia y responsabilidad fiscal, la Ley N° 5189/2014 establece la obligatoriedad de la provisión de informaciones en el uso de los recursos públicos sobre remuneraciones y otras retribuciones asignadas al servidor público de la República del Paraguay. Todos los organismos o entidades públicas, entidades binacionales y aquellos en los que el Estado paraguayo tenga participación accionaria, y organismos privados que administre recursos del mismo, deberán difundir a través de portales electrónicos en internet todas las informaciones de fuente pública, relativas al organismo o la entidad y a los recursos administrativos y humanos de los mismos.

Con el objetivo de mejorar la eficiencia en la gestión de la liquidez, la Ley N° 5097/2013 dispone medidas de modernización de la Administración Financiera del Estado y establece el régimen de cuenta única y de los títulos de deuda del tesoro público. El Decreto N° 852/2013 reglamenta los artículos 5°, 6°, 7°, 8° y 9° del Capítulo II de la Ley N° 5097/2013 y el artículo 32° de la Ley N° 1535/99. La Resolución MH N° 337/2014 reglamenta la implementación del Sistema de Cuenta Única del Tesoro en el Sistema de Tesorería (SITE), integrante del Sistema Integrado de Administración Financiera (SIAF). El Tesoro Público operará sobre la base de recaudaciones y transferencias de recursos financieros, las que se efectuarán a través de la Cuenta Única del Tesoro. El Ministerio de Hacienda podrá utilizar los recursos institucionales no requeridos por las Entidades comprendidas en la Cuenta Única del Tesoro, con el objetivo de realizar un manejo eficiente de los fondos que la conforman. Para este efecto, la Tesorería General garantizará la disponibilidad de los recursos requeridos por los organismos y entidades del Estado.

Por último, el Consejo Nacional de Empresas Públicas (CNEP) ha emitido la Resolución N° 10/2014, por la cual se aprueba el Plan Estratégico del CNEP, correspondiente al periodo 2014-2018. La decisión adoptada por los poderes Legislativo y Ejecutivo del Paraguay de hacer más eficiente el sistema de empresas públicas se concreta en un escenario afortunado para el país por la coincidencia de tres elementos: (i) La expedición reciente de la Ley N° 5058/2013 que crea el CNEP y ordena la gestión eficiente y transparente de las empresas públicas; (ii) El Plan de Gobierno del presidente Cartes que define entre sus estrategias "*servicios públicos eficientes y estabilidad económica con el fin de reducir la pobreza y buscar un ciudadano satisfecho*", y finalmente (iii) La decisión del CNEP de iniciar sus tareas formales adoptando la decisión de desarrollar un Plan Estratégico para el presente período de Gobierno. El Plan Estratégico tiene como objetivo principal crear las condiciones para garantizar la gestión eficiente y transparente de las empresas públicas, mediante la definición de lineamientos de políticas públicas para modernizar el sistema de empresas públicas.

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Al mismo tiempo, el CNEP, por Resolución N° 11/2014, ha establecido un procedimiento especial para contraer obligaciones financieras en concepto de prestación de bienes y servicios entre empresas públicas y sociedades anónimas con participación accionaria mayoritaria del Estado. La normativa dispone que las empresas públicas y sociedades anónimas con participación mayoritaria del Estado no podrán asumir obligaciones financieras en concepto de prestación de bienes y servicios, entre estas, sin expresa autorización por Resolución del CNEP, a partir de que las mismas comprometan el treinta por ciento (30%) restante de la disponibilidad presupuestaria asignada al rubro respectivo y cuando las mismas se establezcan en el marco del artículo 2°, inc. d), primera parte, de la Ley N° 2051/2003, *"De Contrataciones Públicas"*.

Además, el Ministerio de Hacienda ha presentado en el Proyecto de Ley que aprueba el Presupuesto General de la Nación para el Ejercicio Fiscal 2015 un articulado en el cual las empresas públicas y las sociedades anónimas con participación mayoritaria del Estado podrán realizar descuentos totales o parciales de intereses por mora o quitas de las deudas por prestación de bienes y servicios que posean los organismos y entidades del Estado con las mismas.

III. 2 Protección Social

La Secretaría de la Acción Social (SAS) y el Banco Central del Paraguay (BCP) suscribieron un Convenio Marco de Cooperación Interinstitucional que tiene por objeto el desarrollo de programas y proyectos adecuadamente convenidos, mediante la organización y coordinación en el diseño, planificación e implementación de actividades diversas, así como la asistencia técnica, el asesoramiento e intercambio de información educacional, científica, tecnológica, administrativa y de servicios a las comunidades, siempre que dicha información no esté protegida por el régimen de secreto bancario previsto en la legislación nacional. La cooperación consiste, entre otros, en acompañar la implementación del proyecto piloto de inclusión financiera del Programa Tekoporã.

El Programa Tekoporã consiste en romper la transmisión intergeneracional de la pobreza, posibilitando que las niñas y niños de estas familias ejerzan sus derechos para mejorar sus oportunidades futuras. El Programa contempla las Transferencias Monetarias con Corresponsabilidad (TMC) y actualmente llega a cerca de 85.000 familias y tiene previsto ampliar su cobertura a 100.000 familias para este año. Es el Programa Social de mayor cobertura territorial y forma parte del Programa Nacional de Reducción de la Pobreza, *"Sembrando Oportunidades"*.

La inclusión financiera del Programa Tekoporã busca que la población tradicionalmente excluida del sistema financiero acceda a su amplia gama de servicios, en tanto sean instrumentos que ayudan a los hogares a una mejor administración de sus recursos y enfrentar mejor los riesgos a los que se encuentran expuestos. El componente de inclusión financiera denominado "Kakuaa" tiene por objetivo la inserción al sistema financiero formal de las familias beneficiarias del Programa Tekoporã a través de la apertura y uso de las cuentas de ahorro y de otros servicios financieros, generando en sus hogares capacidades básicas para iniciar y consolidar actividades productivas mediante la movilización del ahorro formal y el manejo eficiente de liquidez.

Un nuevo Programa del Gobierno Nacional, Tenonderã, implementado por la Secretaría de Acción Social, busca que las familias que van a egresar de Tekoporã puedan generar sus propios ingresos, sean estables económica y socialmente con alternativas de producción, a fin de que puedan salir y mantenerse fuera de la situación de pobreza. El programa cuenta principalmente con dos componentes: capacitación y asistencia financiera. En una primera etapa, Tenonderã beneficiará a unas 1.000 a 1.500 familias de los departamentos de Concepción, Caazapá, Caaguazú y Misiones que se encuentran preferentemente en el tercer nivel en adelante del Programa Tekoporã, las madres cabeza de familia del Departamento Central y eventualmente otras familias en condición de vulnerabilidad según criterios de intervención prioritarios definidos por la SAS. Este programa complementa el trabajo con las familias para una salida estructural y sostenida de su situación de pobreza.

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Por otro lado, el Programa de Adultos Mayores es una política de Estado que consiste en una asistencia monetaria mensual, equivalente al 25% del salario mínimo vigente. La Resolución MH N° 236/13 establecía en 65 el punto de corte del Índice de Calidad de Vida (ICV) para la identificación y selección de los potenciales beneficiarios de la Ley 3728/2009, "*Que establece el derecho a la pensión alimentaria para las personas Adultas Mayores en situación de pobreza*", iniciando la inclusión de los adultos mayores cuyo ICV se encuentre dentro del rango de cero (0) a cuarenta (40) puntos para el Sector Rural y de cero (0) a sesenta (60) puntos para el Sector Urbano. Si surge un número inferior de potenciales beneficiarios dentro de las franjas del ICV establecidas, se continua la inclusión de los adultos mayores cuyo rango del ICV se encuentren entre cuarenta coma uno (40,1) a sesenta y cinco (65) puntos para el Sector Rural y sesenta coma uno (60,1) a sesenta y cinco (65) puntos para el Sector Urbano, de acuerdo con la disponibilidad presupuestaria, y sin perjuicio de aquellos adultos mayores seleccionados bajo el régimen de proporcionalidad de ejercicios anteriores, previa verificación por parte de la Dirección de Pensiones No Contributivas (DPNC), dependiente de la Subsecretaría de Estado de Administración Financiera del Ministerio de Hacienda.

Por Resolución M.H. N° 130/2013 se dan por concluidas las funciones de la Unidad de Economía Social (UES), dependiente del Gabinete del Ministro, creada por Resolución M.H. N° 50/2008. Además, se dispone que toda la documentación, informe de gestión, análisis y documentos vinculados al objeto para el cual fuera creada la UES sean remitidos a la DPNC y se instruye a la Dirección Administrativa del Ministerio de Hacienda a realizar todas las acciones administrativas necesarias tendientes al cierre de la Unidad en cuestión, incluyendo la eventual reubicación de los funcionarios que hubieran conformado la UES.

Luego, la Resolución DPNC N° 2/2014 crea el Área de Identificación y Selección de Potenciales Beneficiarios, dependiente de la DPNC, en su carácter de Institución responsable de la aplicación de la Ley N° 3728/2009.

La Resolución M.H. N° 166/2014 autoriza la implementación del Sistema de Pensión Alimentaria para Adultos Mayores (SPAAM), en el marco de la Ley N° 3728/2009. El SPAAM se constituye en una solución informática y tecnológica para el registro de beneficiarios. La implementación de este Sistema optimiza las gestiones de sistematización a cargo de la DPNC, aportando transparencia y eficiencia en los procesos vinculados a la citada norma.

Finalmente, se procedió a una actualización del instrumento de focalización del Programa, y por Resolución M.H. N° 237/2014 se aprueba el formato de "Ficha de Hogar" a ser utilizado en la identificación y selección de los adultos mayores en situación de pobreza, cuyo mecanismo de información utiliza la técnica multivariada para calcular un ponderador a cada una de las dimensiones seleccionadas según se traten de los dominios territoriales donde residan, de cuyo resultado es el Índice de Calidad de Vida –Adultos Mayores (ICV-AM), que lo califique en situación de pobreza y lo habilite a ser beneficiario del subsidio establecido, dejándose con ello sin efecto la Resolución M.H. N° 236/2013.

III.3 Inclusión Financiera

El Gobierno ha lanzado la preparación de la Estrategia Nacional de Inclusión Financiera (ENIF). El Decreto N° 1971/2014 aprueba la elaboración y la creación de la ENIF, a fin de contribuir con la meta de "*Reducción de Pobreza*", declarada de prioridad nacional. La ENIF busca aunar y organizar las acciones y los esfuerzos de las instituciones que directa e indirectamente trabajen y contribuyan a mejorar la inclusión financiera en el país, para lograr un mayor impacto y alcance de los trabajos realizados que apuntan al bienestar de las personas. Asimismo, se establece el Comité Nacional de Inclusión Financiera, cuyas funciones están claramente establecidas en relación con el objetivo propuesto.

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El Banco Central del Paraguay, a través de la Resolución N° 25/2013, aprueba el reglamento para la regulación de las cuentas básicas de ahorro. Estas cuentas podrán ser abiertas con la sola presentación del documento de identidad y recabando datos básicos del solicitante. Las entidades bancarias y financieras podrán habilitar cuentas básicas de ahorro sin presencia física del solicitante. Al respecto, se admitirá la apertura de estas cuentas a través de teléfonos móviles u otros medios tecnológicos que podrían ser autorizados por el BCP, a solicitud de las entidades financieras.

El Banco Central del Paraguay, a través de la Resolución N° 6/2014, aprueba el reglamento de medios de pagos electrónicos. El reglamento tiene por objeto regular la provisión de dinero electrónico, las transferencias no bancarias y los requisitos a los que deben adecuarse las entidades que prestan, dentro del territorio nacional, los servicios establecidos en la Resolución a través de telecomunicaciones.

El Gobierno ha promulgado el decreto N° 1056/2013 por el cual se establece la modalidad complementaria de contratación denominada proceso simplificado para la adquisición de productos agropecuarios de la agricultura familiar y se fijan criterios para la realización de los procesos de contratación y selección aplicadas para estas adquisiciones. En este contexto, la inserción de la agricultura familiar en el ámbito de las adquisiciones públicas debe ser comprendido en el marco de un concepto superior, cual es el derecho a la alimentación y, a partir de ello, diseñar herramientas que busquen la reducción de la pobreza y políticas que garanticen la alimentación a través de la consolidación de las familias rurales. Con el ingreso de los productos de la agricultura familiar en las contrataciones públicas se pretende fortalecer la capacidad de gestión y organización económica de los pequeños productores en función de las demandas en el mercado.

En tal sentido, me permito señalar que el apoyo del Banco Mundial resultará imprescindible para llevar adelante las acciones antes señaladas e impulsar los logros de los ambiciosos objetivos estratégicos de desarrollo que el Gobierno se ha trazado.

Hago propicia esta oportunidad para saludarle con mi distinguida consideración.

MINISTERIO DE HACIENDA
REPÚBLICA DEL PARAGUAY
PAZ Y JUSTICIA
MINISTRO

SANTIAGO PEÑA PALACIOS
MINISTRO DE HACIENDA
GOBERNADOR TITULAR POR PARAGUAY

Translated Version- Project note to the WB

Asunción, January 26, 2014

M.H. N° 170

JIM YONG KIM
PRESIDENT
WORLD BANK
WASHINGTON, D.C. 20433

Dear Dr. Kim:

The Government of President Horacio Cartes, who began his term in office on August 15, 2013, will concentrate on public policies to achieve real equality of opportunities, eradicating extreme poverty, discrimination, and exclusion, to progressively build a more just and equitable society, where all citizens, especially boys and girls, have equal opportunities for their full development, in the framework of the participatory construction of a prosperous, cohesive, and equitable society; productive transformation and accelerated economic growth, with a diversified and competitive economy, based on the sustainable use of Paraguay's natural riches and on the increasing incorporation of knowledge through the development of human capital and the progressive use of cutting-edge technologies; and a Paraguay that is integrated with the region and the world, taking advantage of the diversity and opportunity offered by the global market, where it is not only the level of development that counts but also the engagement of the agents in all respects.

The purpose of this letter is to present the objectives and actions related to the Development Policy Loan (DPL) with Deferred Drawdown Option (DDO) that is based on the National Development Plan 2014-2030 and the National Poverty Reduction Program *Sembrando Oportunidades* [Sowing Opportunity].

I. National Development Plan of the Government

The Government of Paraguay has identified the strategic pillars and objectives, the policy priorities, and the lines of action for inclusive and sustainable development in Paraguay. The National Development Plan (NDP) is an instrument that is intended to guide private activity while establishing the scope of the government's priority policies and programs.

In the short term, the NDP serves as the reference for defining programs and allocating public resources, while establishing indicators to monitor actions and verify fulfillment of the targets set out by the Government. In the medium term, implementation of the NDP entails aligning the strategic objectives with the priorities established in each five-year period, with political and institutional mechanisms that take into account and help chart the strategic course of the NDP for development to 2030.

The NDP is built around three "strategic pillars," which group together sets of policies and programs according to expected results: (i) poverty reduction and social development, related to the capacity of Paraguayan society to meet the basic human needs of all its citizens and communities; (ii) inclusive economic growth, to accelerate the pace of growth and productive diversification, promote the participation of all economic agents, and share the results of growth especially with the bottom 40 percent; and (iii) effective global integration of Paraguay, to position and improve the image of the country, strengthen national participation in integration processes and international forums, and improve the allocation of resources and the incorporation of knowledge.

National Poverty Reduction Program

The basic objective of the National Extreme Poverty Reduction Program is to increase income and access to social services for families in situations of extreme poverty. These families live in departments and districts with high levels of social vulnerability, where settlements and communities face a multitude of challenges, including weak infrastructure and social services, scarce employment, and low productivity on campesino farms.

In order to meet its objective, *Sembrando Oportunidades* is taking a precision approach, using a tool known as a Social Card, which records the socioeconomic situation of the families, specifying the rights that are being violated for each one of their members, male and female alike: children, adults, and the elderly. This allows the program to more effectively target the responses of the institutions responsible for social policy.

The program aims to generate income from agricultural sources through: (i) strengthening of the productive capacity of family farms so they are able to diversify their subsistence and cash crops; (ii) youth job training for the agricultural sector; (iii) productive partnerships between the various actors in the value chain and campesino family farms, working on pre-production, production, transformation, and marketing; and (iv) implementation of Decree No. 1056/13, a legal framework that enables small farmers to sell their products directly to public institutions such as schools, hospitals, the Armed Forces, and prisons. It will also generate income from non-agricultural sources through: (i) youth job training for the commercial and services sector; (ii) youth job training for the industrial sector; and (iii) incentives for job creation and income generation through small and medium-sized public works with strong local impact, community infrastructure, such as construction and maintenance of local roads, bridges, and housing in 120 priority settlements.

In addition, the program aims to improve family access to basic social services through: (i) strengthening and expansion of the Tekoporã Program to serve 100,000 families in 2014. Tekoporã targets the most vulnerable families, providing conditional cash transfers that are tied to health care and immunization of children in the recipient households, school enrollment and attendance, and the development of productive initiatives; (ii) expanded coverage of the pension system for 130,000 senior adults in 2014. People 65 years and older receive a food allowance equivalent to 25 percent of the minimum wage; (iii) work on 12,000 housing solutions, including construction and improvements; (iv) establishment and strengthening of family health clinics in the settlements and districts identified as priorities by their vulnerable population; and (v) work towards the goal of universal school enrollment of children and adolescents, including the distribution of school supply kits and implementation of school lunches.

II. Public Management Programs related to the Development Policy Loan (DPL) with Deferred Drawdown Option (DDO)

The Government has opted for the deferred drawdown modality in its desire to manage risks, through the provision of a contingent credit line that will make it possible to: (i) increase the Government's capacity to provide an immediate financial response during natural disasters while protecting its long-term fiscal position; (ii) reduce the country's financial vulnerability and thus macroeconomic risk; (iii) provide immediate liquidity in the event of internal or external shocks; and (iv) ensure fulfillment of the Government's strategic objectives in case of a crisis or natural event.

Following are the areas of implementation of the World Bank's Development Policy Loan (DPL) with Deferred Drawdown Option (DDO) for US$100 million. In particular, the Government of Paraguay wishes to lock in progress made in three major areas: public finance management, social protection, and financial inclusion.

III.1 Public Finance Management

In order to ensure fiscal sustainability, the Government has enacted Law No. 5098/13 on Fiscal Responsibility, which establishes general rules on fiscal behavior geared towards the stability and sustainability of public finances, under the general principle of ensuring the medium-term sustainability of public finances, with fiscal targets that do not have negative effects on macroeconomic stability, while preserving the balance between public revenue and expenditure. The annual laws of the General Budget of the Nation are subject to an annual central government fiscal deficit, including transfers, of no more than 1.5 percent of the estimated gross domestic product for the fiscal year in question; an annual increase in public primary current expenditure not to exceed the year-on-year inflation rate plus 4 percent; and no increase in wages, except when there is an increase in the adjustable minimum living wage, in which case the increase, at most, will be the same percentage and will be incorporated into the budget for the subsequent fiscal year. In this regard, Decree No. 1559/14, which regulates implementation of Law No. 5098/13 on Fiscal Responsibility, establishes that the macro-fiscal rules provided in that law will be observed in each stage of the budget process.

The scenario for 2015 envisages a fiscal path with containment of recurrent spending, increases in tax collection and a higher execution of investment projects. The Article 34 of Annex "A" of the Decree 2929/15 regulating the 2015 Budget Law No. 5386 of January 6, 2015, “which approves the General Budget of the Nation for the 2015 fiscal year”, stipulates that the approved Financial Plan may be evaluated by the Ministry of Finance at the end of each quarter, in order to update allocations according to the availability of financial resources from the Treasury, the result of budget execution, improvements in the revenue collection targets during the fiscal year Fiscal or based on forecasts of disbursements of Financial Institutions for financing programs and projects executed by more than one spending unit, operating with a special account administered by the Ministry of Finance.

The Government has enacted Law No. 5061/13 in order to boost tax revenue and improve the neutrality and equity of the tax system, by increasing the value-added tax (VAT) applied to the financial sector from 5 percent to the general tax rate of 10 percent and expanding the VAT base to the agricultural sector and setting a rate of 5 percent. In addition, the law regulates the tax on agriculture income (IRAGRO). In addition, the above-referenced law also establishes that the Undersecretariat of Taxation (SET) should establish the selection mechanisms for processing tax credit refunds.

SET’s General Resolution No. 15/2014 regulates the refund of credits corresponding to the Value Added Tax (IVA) and the Selective Consumption Tax (ISC) defined in the Law No 125/91 “that establishes the new tax regime,” and its amendments. In addition, SET’s General Resolution No. 45/2014 puts in place selectivity mechanisms for tax refund processes. The selectivity mechanisms are classified as follows: the Green Channel, corresponding to taxpayers with a taxpayer risk index (IRC) below 6, and allowing refund of 90 percent of claimed credits within twenty-four (24) hours; the Yellow Channel, corresponding to taxpayers with an IRC greater or equal to 6 and lower than 20, and allowing refund of 80 percent of claimed credits within twenty-four (24) hours; and the Red Channel for taxpayers with an IRC greater than or equal to 20, for whom the refund will be governed by the General Regime. The IRC is the numerical value for tax behavior which is based on the analysis of historical tax compliance and is calculated according to the Validation Rules described in Article 3 of the above-mentioned Resolution.

In the first half of 2014, tax revenue rose sharply, by 19.2 percent over the first half of 2013. The trend is expected to continue in the second half of the year, pointing to strong year-end revenues. This revenue growth is largely explained by the robust growth in taxes on domestic economic activity, which were up by 27.1 percent as of June.

To enhance transparency and fiscal responsibility, Law No. 5189/14 establishes the obligation to provide information on the use of public resources for pay and other compensation made to public employees of the Republic of Paraguay. All public agencies or entities, binational and other entities in which the Paraguayan

State has an ownership share, and private entities that administer public funds are under the obligation to disseminate, via electronic portals on the Internet, all public information related to the agency or entity and their administrative and human resources.

To improve the efficiency of cash management, the Law No 5097/13 defines measures for the Modernization of the State Financial Management System and establishes the regime of the single account and of the debt instruments of the Treasury. The Decree No 852/13 regulates Articles 5th, 6th, 7th, 8th and 9th of Chapter II of the Law No 5097/2013 and Article 32 of the Law No 1535/99. The Ministry of Finance Resolution No 337/14 regulates the implementation of the Treasury Single Account (TSA) system within the Treasury System (SITE), which is part of the Integrated System of Financial Management (SIAF). The Treasury will function based on collections and transfers of financial resources, which will be effected through the Treasury Single Account. The Ministry of Finance will be able to use the available institutional resources of all entities registered in the Treasury Single Account, in order to manage efficiently the cash flows that are centralized in the TSA. To this end, the General Treasury will guarantee the availability of resources requested by public organizations and entities.

Lastly, the National Council of Public Enterprises (CNEP) has issued Resolution No. 10/14 approving the CNEP Strategic Plan for the period 2014-2018. The resolve of Paraguay's legislative and executive branches to make the public enterprise system more efficient is materializing in a fortunate scenario for the country due to the convergence of three elements: (i) the recent enactment of Law No. 5058/13 creating the CNEP and mandating the efficient and transparent management of public enterprises; (ii) the Government Plan of President Cartes, which identifies among its strategies "efficient public services and economic stability in order to reduce poverty and achieve a satisfied citizenry"; and lastly (iii) the CNEP decision to launch its formal activities by adopting a resolution to develop a strategic plan for the current term of government. The main objective of the Strategic Plan is to create the right conditions to guarantee the efficient and transparent management of public enterprises, by setting public policy guidelines to modernize the public enterprise system.

At the same time, the CNEP, through Resolution No. 11/14, has established a special procedure for contracting financial obligations for the provision of goods and services among public enterprises and corporations in which the State has a majority ownership share. The law establishes that public enterprises and corporations in which the State has a majority ownership share may not assume financial obligations for the provision of goods and services without express authorization by resolution of the CNEP, when such obligations would commit the remaining 30 percent (thirty percent) of the available budget allocated to the respective budget category and when they are established in the framework of the first part of Article 2(d) of Law No. 2051/03, "Public Procurement."

In addition, the Ministry of Finance has introduced an article in the draft law to approve the General Budget of the Nation for Fiscal Year 2015 that would allow public enterprises and corporations in which the State has a majority ownership share to totally or partially deduct penalty interest or write-downs of debt for the provision of goods and services that State agencies or entities have with them.

III.2 Social Protection

The Social Action Secretariat (SAS) and the Central Bank of Paraguay (BCP) have signed a framework agreement for interagency cooperation that is intended to develop suitably agreed upon programs and projects, through organization and coordination in the design, planning, and implementation of a range of activities, as well as technical assistance, advisory services, and sharing of information on education, science, technology, administration, and community services, provided that such information is not protected by national banking secrecy laws. This cooperation consists of, among other activities, support for the implementation of the financial inclusion pilot project under the Tekoporã Program.

The Tekoporã Program seeks to break the intergenerational transmission of poverty by making it possible for boys and girls from poor families to exercise their rights to improve their future opportunities. The program makes available conditional cash transfers to close to 85,000 families at present, and there are plans to expand coverage to reach 100,000 families this year. This is the largest social program in the country, and it is part of the National Poverty Reduction Program *Sembrando Oportunidades*.

The financial inclusion component of the Tekoporã Program seeks to provide groups traditionally excluded from the financial system with access to a wide variety of services, as these are instruments that help households better manage their resources and better handle the risks to which they are exposed. The objective of this financial inclusion component, known as "Kakuaa," is to bring Tekoporã beneficiary families into the formal financial system by helping them open and use savings accounts and other financial services, building the basic skills that will allow these households to initiate and consolidate income-generating activities through the mobilization of formal savings and the efficient management of cash.

A new national government program, Tenonderã, implemented by the Social Action Secretariat, helps families that are graduating out of Tekoporã to generate their own income and achieve social and economic stability through production alternatives, so they can rise out of poverty and remain out. The program basically has two components: training and financial assistance. In a first stage, Tenonderã will benefit some 1,000 to 1,500 families in the departments of Concepción, Caazapá, Caaguazú, and Misiones preferably at the third level or beyond in Tekoporã, female heads of household in the Central Department, and eventually other families in situations of vulnerability based on the priority intervention criteria set by the SAS. This program complements the work being done with the families to find a structural and sustainable exit from poverty.

The *Adultos Mayores* [Senior Adults] Program is a State policy consisting in monthly cash assistance equivalent to 25 percent of the minimum wage. Ministry of Finance Resolution No. 236/13 set 65 as the cutoff score on the quality-of-life index for identifying and selecting potential beneficiaries of Law No. 3728/09 "establishing the right to a food allowance for senior adults living in poverty," starting off by selecting senior adults whose quality-of-life score is between zero (0) and forty (40) points for the rural sector and between zero (0) and sixty (60) points for the urban sector. If a small number of potential beneficiaries emerges at the edges of these parameters, senior adults with scores between forty point one (40.1) and sixty five (65) for the rural sector and between sixty point one (60.1) and sixty five (65) for the urban sector will also be selected, based on the availability of budget resources, and without prejudice to senior adults selected under the proportional regimes of previous years, subject to verification by the Non-Contributory Pension Office (DPNC) in the Ministry of Finance's Undersecretariat for Financial Administration.

Ministry of Finance Resolution No. 130/13 terminates the functions of the Social Economics Unit (UES), which was created by Ministry of Finance Resolution No. 50/08 within the Minister's Cabinet, and provides that all documentation, management reports, analyses, and documents related to the purpose for which the UES was created should be forwarded to the DPNC and instructs the Ministry of Finance's Administrative Division to conduct any administrative actions necessary to close the UES, including the eventual reassignment of the officials who would have comprised the Unit.

In turn, DPNC Resolution No. 2/14 creates the Area for the Identification and Selection of Potential Beneficiaries, which reports to the DPNC in its capacity as the institution responsible for the implementation of Law No. 3728/09.

Ministry of Finance Resolution No. 166/14 authorizes the implementation of the Food Allowance System for Senior Adults (SPAAM), in the framework of Law No. 3728/09. The SPAAM offers an information and technology solution for registering beneficiaries. Implementation of this system optimizes the systematization activities for which the DPNC is responsible, bringing transparency and efficiency to the processes related to this cited law.

Lastly, the program targeting instrument has been updated, with Ministry of Finance Resolution No. 237/14 approving the format of the "household card" to be used for the identification and selection of senior adults living in poverty. This instrument's information mechanism uses a multivariate technique for assigning a weight to each one of the dimensions selected according to how they are handled in the territorial areas where the senior adults reside, and the result is the quality-of-life index for senior adults (ICV-AM), which yields a score indicating a situation of poverty and thus eligibility to receive the established subsidy. This resolution supersedes Ministry of Finance Resolution No. 236/13.

III.3 Financial Inclusion

The Government has launched preparation of the National Financial Inclusion Strategy (ENIF). Decree No. 1971/14 approves the development and creation of the ENIF, for the purpose of contributing to the "poverty reduction" goal identified as a national priority. The ENIF seeks to unite and organize the actions and efforts of the institutions directly and indirectly working and helping to improve financial inclusion in the country, in order to achieve a greater impact and expand the reach of work to improve the well-being of the people. In addition, the National Committee on Financial Inclusion has been created with functions that are clearly related to the proposed objective.

The Central Bank of Paraguay (BCP), through Resolution No. 25/13, has approved rules and regulations governing basic savings accounts. These accounts may be opened upon simple presentation of identification and the collection of basic information from the applicant. Bank and financial institutions may authorize basic savings accounts without the physical presence of the applicant. Applications to open such accounts may be processed by cellular phone or other technologies as may be approved by the BCP at the request of the financial institutions.

Through Resolution No. 6/14, the BCP has approved rules and regulations governing electronic payments, for the purpose of regulating the provision of electronic money, nonbank transfers, and the requirements that must be met by the institutions providing, within the national territory, the services established in the resolution through telecommunications.

The Government has issued Decree No. 1056/13 establishing the complementary modality of contracting known as the simplified process for the procurement of agricultural products from family farms, and criteria have been set for the contracting and selection processes to be used for such procurements. In this context, the integration of family farming into the area of public procurements should be understood in the framework of a higher ideal, which the right to food, based on which tools should be designed that seek to reduce poverty and policies should be formulated that guarantee access to food through the strengthening of rural families. By incorporating family farm products into the public procurement system, the idea is to strengthen the economic organization and management capacity of small farmers in line with market demand.

The World Bank's support will be instrumental in carrying out the actions described above and achieving the ambitious strategic objectives set out by the Government.

Please accept assurances of my highest consideration.

SANTIAGO PEÑA PALACIOS
MINISTER OF FINANCE
GOVERNOR FOR PARAGUAY

ANNEX 3: FUND RELATIONS

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 15/63
FOR IMMEDIATE RELEASE
February 20, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Paraguay

On February 12, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Paraguay, and considered and endorsed the staff appraisal without a meeting.[2]

Economic activity in Paraguay has slowed from the record-high growth in 2013, but remains buoyant. Construction, manufacturing, and services led the expansion in 2014, whereas electricity production declined, and re-exports suffered from weak growth in Brazil. Full-year growth is estimated to have slightly exceeded 4 percent. Inflation spiked in early 2014 on account of higher food and regulated prices, but subsequently eased, ending the year at 4.2 percent, slightly below the authorities' midpoint target. Credit growth has moderated from earlier peak rates but still hovers around 20 percent, while banks continue to report strong capitalization and profitability.

Macroeconomic policies have been tightened somewhat since late 2013. Tax revenue grew at a brisk pace in 2014, linked to better enforcement and new taxes. Due to lower revenue from electricity royalties and faster execution of spending in the latter part of the year, the headline deficit increased slightly relative to 2013. Still, estimates point to a modest contractionary impulse. Monetary policy has been on hold since the central bank (BCP) raised the official policy rate by 125 basis points, to 6.75 percent, between December 2013 and February 2014.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Real GDP is projected to remain close to 4 percent in 2015. Weak trading partner growth and lower export prices cloud the outlook, and agricultural production is projected to rise only marginally above the high level of 2014. However, positive impulses should come from the projected rebound in electricity generation, the lower oil price, and the launch of new infrastructure projects. The external current account is projected to switch from a small surplus in 2014 to a moderate deficit in 2015, reflecting weaker terms of trade.

Risks around the outlook are broadly balanced. On the one hand, worsening terms of trade could affect domestic spending more than anticipated, while further ruble depreciation might hurt exports to Russia. On the other hand, looser-than-expected macroeconomic policies and efforts to exploit a recently discovered hydrocarbon resource could create upside surprises. Inflation is expected to hover around the 4.5 percent target in 2015, as recent guaraní depreciation and a small positive output gap offset the impact of lower commodity prices.

Executive Board Assessment

In concluding the 2014 Article IV consultation with Paraguay, Executive Directors endorsed the staff's appraisal as follows:

The government has started to tackle some of the long-standing structural weaknesses holding back development. Tax collection has improved significantly, creating space for higher public investment; preparations are underway to launch several large infrastructure projects; and the recently adopted "freedom-of-information" law will foster government transparency. These efforts are commendable, and should be extended to achieve lasting improvements in public services, institutional quality, and the rule of law. Such improvements, in turn, are critical to attract investment, boost productivity, and underpin medium-term growth and poverty reduction.

Paraguay's macroeconomic fundamentals remain sound, though the 2015 budget has dimmed hopes that the Fiscal Responsibility Law (FRL) would provide a firm institutional anchor for fiscal prudence. Paraguay boasts moderate public debt, low inflation, and strong external balances. To consolidate macroeconomic stability, the authorities have adopted new policy frameworks in recent years, notably an inflation targeting regime and the FRL. These frameworks provide appropriate anchors for policy. It is thus unfortunate that the approved 2015 budget envisages spending and a deficit above the mandated limits. With due restraint in the execution of the budget and continued efforts to improve tax enforcement, it remains possible to achieve the original FRL targets and thereby bolster the credibility of the fiscal rules. Over time, a stronger budget process will be essential to support fiscal discipline.

More broadly, it will be crucial to integrate the planned improvement of public services into a prudent fiscal plan for the medium term. The authorities' reform strategy holds great promise, but should not come at the expense of weakening Paraguay's solid macroeconomic position. This puts a premium on generating sufficient revenue to accommodate spending plans and preserve favorable debt dynamics. To ensure public support, it is important that additional revenue effectively translates into better public services. Civil service reform would assist this endeavor, by rationalizing public employment and raising efficiency. A prudent medium-term fiscal plan should also incorporate some buffer against adverse shocks, given the high volatility of Paraguay's economic environment.

In the same vein, it will be important to contain fiscal risks related to infrastructure projects, State Owned Entreprises (SOEs), and public pension funds. Private sector participation in infrastructure is welcome but must be managed carefully to contain risks to the public finances. Particular caution is warranted with respect to deferred financing schemes that could create government liabilities without the scrutiny of the regular budget process. Fiscal risks could also arise from the missing oversight of Paraguay's pension funds and their actuarial imbalances. It is encouraging that the authorities plan to address these risks proactively, starting with the planned creation of a regulator. Similar resolve is required to address the financial and operational challenges in the SOE sector.

Monetary policy is currently well calibrated, and efforts should focus on further enhancing the effectiveness of the inflation targeting regime. To strengthen the transmission of monetary policy, it will be instrumental to develop a more active money market and encourage gradual de-dollarization. Meanwhile, the central bank's plan to make its sales of government foreign-currency receipts more predictable will help to distinguish these transactions clearly from occasional discretionary intervention within the flexible exchange rate regime.

In light of continued strong credit growth, the authorities should closely monitor potential risks and consider targeted macroprudential tightening. Paraguay's banking system remains sound, but the long-running credit expansion calls for vigilance. To contain the risks from rising consumer indebtedness, lenders should be formally required to observe prudent limits on households' debt servicing capacity. Other areas for stepped-up oversight include foreign-currency lending; and the proper recognition of credit risk in renegotiated loans. In this context, the proposed revision of the central bank and banking laws is essential to put risk-based regulation and supervision on a robust legal basis. Another priority is to strengthen the governance, resources, and enforcement powers of Instituto Nacional de Cooperativismo (INCOOP).

Paraguay: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2013 (millions)	6.8	Gini index (2013)	48.0
Unemployment rate (2013)	5.0	Life expectancy at birth (2010)	72.3
Percentage of population below the poverty line (2013)	23.8	Adult illiteracy rate (2013)	5.3
Rank in UNDP development index (2013)	111 of 186	GDP per capita (US$, 2013)	4,193

II. Economic Indicators

	2009	2010	2011	2012	2013	Est. 2014	Proj. 2015
(Annual percent change, unless otherwise indicated)							
Income and prices							
Real GDP	-4.0	13.1	4.3	-1.2	14.2	4.3	4.0
Nominal GDP	-2.0	20.0	10.8	3.4	14.7	8.8	7.1
Consumer prices (end of period)	1.9	7.2	4.9	4.0	3.7	4.2	4.5
Nominal exchange rate (Guarani per U.S. dollar, eop)	4,600	4,558	4,478	4,224	4,585	4,629	...
Monetary sector							
Currency issue	11.3	18.5	11.6	17.5	13.2	8.9	8.7
Bank credit to private sector	22.4	42.5	24.8	12.6	23.9	21.1	18.3
Liabilities to private sector	25.0	19.9	19.3	14.0	20.0	19.4	11.8
External sector							
Exports (fob, values)	-20.3	35.1	20.7	-7.8	16.8	-3.4	-1.4
Imports (cif, values)	-23.6	44.7	22.9	-6.0	7.8	1.1	-1.3
Terms of trade	-3.0	8.2	14.3	-10.2	11.4	9.8	-3.2
Real effective exchange rate 1/	-5.1	3.8	2.2	9.3	-3.0	11.6	...
(In percent of GDP, unless otherwise indicated)							
Current account	**3.0**	**-0.3**	**0.5**	**-0.9**	**2.2**	**0.1**	**-1.2**
Trade balance	7.1	4.3	3.7	2.3	5.9	3.6	3.4
Exports	48.6	50.6	54.1	46.7	48.0	44.3	42.1
Electricity	11.9	9.5	9.7	9.2	8.1	7.4	7.6
Other registered	19.9	21.9	23.6	20.3	25.4	25.2	21.6
Unregistered	16.8	19.2	20.9	17.3	14.5	11.7	12.8
Imports	-41.6	-46.4	-50.5	-44.4	-42.1	-40.7	-38.7
Of which: Oil imports	-5.7	-5.2	-6.5	-6.6	-6.1	-5.7	-3.3
Capital account and financial account	**0.4**	**0.9**	**2.0**	**2.1**	**1.2**	**3.4**	**1.2**
General government	0.1	0.3	-0.3	-0.1	1.8	4.2	0.7
Private sector	0.2	0.6	2.3	2.2	-0.6	-0.8	0.6
Of which: Direct investment	0.6	1.0	2.4	1.9	1.3	1.2	1.3
Errors and omissions	2.3	0.9	0.9	-1.2	0.3	0.1	0.0
Gross international reserves (in millions of U.S. dollars)	**3,861**	**4,168**	**4,984**	**4,994**	**5,871**	**6,914**	**6,922**
In months of next-year imports of goods and services	4.5	3.9	5.0	4.6	5.3	6.3	6.0
Ratio to short-term external debt	2.0	2.3	2.7	2.8	3.2	3.7	3.7
Gross domestic investment	**13.8**	**16.2**	**17.1**	**15.1**	**15.4**	**15.3**	**16.1**
Gross national saving	**16.8**	**15.9**	**17.5**	**14.2**	**17.6**	**15.3**	**14.9**
External saving (+) or dissaving (-)	**3.0**	**-0.3**	**0.5**	**-0.9**	**2.2**	**0.1**	**-1.2**
Central government revenues 2/	**17.5**	**17.1**	**18.0**	**19.0**	**17.2**	**18.2**	**18.7**
Of which: Tax revenues	11.6	12.0	12.6	12.7	11.8	12.9	13.3
Central government expenditures 2/	**17.5**	**15.9**	**17.3**	**20.8**	**19.2**	**20.5**	**20.8**
Of which: Wages and salaries	7.7	7.3	7.6	9.6	9.4	9.1	9.3
Of which: Transfers	3.7	3.4	3.7	4.4	4.2	4.6	4.3
Of which: Capital expenditure	4.1	3.4	4.0	4.8	4.1	4.9	4.9
Central government primary balance 2/	**0.6**	**1.6**	**1.0**	**-1.6**	**-1.6**	**-1.9**	**-1.4**
Central government overall balance 2/	**0.1**	**1.2**	**0.7**	**-1.8**	**-2.0**	**-2.3**	**-2.1**
Public sector debt (excl. central bank bills)	**18.2**	**15.4**	**12.8**	**16.0**	**16.8**	**21.5**	**22.7**
Of which: Foreign currency	15.4	13.2	11.1	10.9	11.4	15.0	15.5
Of which: Domestic currency	2.9	2.2	1.7	5.1	5.4	6.4	7.2
Memorandum items:							
GDP (billions of Guaranies)	79,117	94,934	105,203	108,832	124,853	135,780	145,393
GDP (US$ billions)	15.9	20.7	23.3	24.9	28.3	29.6	...

Sources: Central Bank of Paraguay; Ministry of Finance; and IMF staff estimates and projections.

1/ Average annual change; a positive change indicates an appreciation.

2/ According to the GFSM 1986 presentation.

ANNEX 4: POVERTY AND SOCIAL IMPACTS ASSESSMENT

A. *Expected Impacts*

Pillar 1: Public Finance Management

Prior Action 2 — The government has increased tax revenues by: (i) increasing the value added tax (VAT) rate applied to the financial sector from 5 percent to the standard rate of 10 percent; and (ii) defining the VAT collection base for the agriculture sector and establishing a 5 percent rate to this tax base.

Main findings:

Due to the lack of available data on the household level demand for loans it is difficult to assess the precise impact of the changes to the VAT applied to the financial sector on households or fiscal revenue. Nevertheless, both the fact that the VAT applied to the financial sector is expected to increase interest rates and that, in 2011, 3.4 (19.5) percent of the bottom 40 (top 60) percent of the population obtained a loan from a financial institution in the past year (Global Findex 2011) suggest that the change to the VAT applied to the financial sector is likely to have a greater impact on the middle class and may further reduce access to formal credit for low income households.

The expansion of the VAT base to the agriculture sector is expected to increase government revenues by more than 175,000 million Guaraní. In terms of its relative incidence, the change to the VAT code is expected to be regressive. In particular, irrespectively of the welfare measure used (income or consumption) and even after accounting for the fact that the poor are both more likely to purchase goods from informal markets and to consume home-grown products, the poor will bear a relatively larger burden of the tax (i.e. the ratio of the tax liability resulting from the VAT code reform to the welfare measure used is higher for the less well-off relative to the better-off). This finding is not surprising given that the poor spend a significantly larger proportion of their income on consumption goods. In terms of its absolute incidence, the change to the VAT code is expected to be progressive; that is, the better-off are expected to bear the brunt of the tax in absolute terms.

Context

In the last two decades (1990-2010), the tax collection in Paraguay represented on average 71 percent of public sector income[20] and being equivalent to about 13 percent of the GDP on average. About three-quarters of tax revenues come from indirect taxes, in particular from the Value Added Tax (VAT) levied on the consumption of goods and services.[21] The general VAT tax rate in Paraguay is 10 percent, being the lowest in South America; however, prior to the 2014 tax reform many goods and services were VAT-exempted, particularly those from the agricultural sector.

[20] The remaining third is explained by non-tax income (royalties, capital revenues, external grants).
[21] Paraguay Public Expenditure Review, World Bank. 2014.

In 2014, the Government of Paraguay (GoP) implemented a set of tax reforms designed to improve the tax collection. Among the key reforms is the application of a 5 percent VAT rate to selected agricultural products. The goal of this reform is to increase the tax collection in this sector relative to the total VAT collection.[22] Another key reform introduced by the government with the goal of both increasing the tax collection and the wealth distribution of the land is the new Tax on Agriculture Income (IRAGRO).

The Government of Paraguay has established an expansion of the VAT in order to include agriculture sector related products. Specifically, the Law N° 5061, approved by the Parliament on October 3rd 2013, and the Decree N° 1440, dated April 2nd 2014, state the new tax regime that introduces changes within the agricultural activities. According to these legal instruments, agricultural activities involve those that farmers do through the utilization of land, capital and work, in order to obtain primary products, vegetables or animals. Among other things, the new regime imposes a 5 percent tax on the sale of agricultural, fruit and horticultural products.[23] The analysis presented in this section aims to assess the distributional impact of the new VAT on agricultural activities implemented by the GoP in 2014.

Methodology

The methodological approach used is a static, partial equilibrium tax assessment which assumes that neither changes in prices nor changes in wages caused by other reforms impact households' and individuals' purchasing behaviors. In particular, the distributional impact of the VAT tax reform is evaluated by analyzing the total or relative changes in expenditures/incomes accrued to different groups of households. The analysis evaluates the progressivity of both the relative incidence and the absolute incidence of the VAT tax reform. In the former case, it considers the amount of tax paid (or saved) by a household expressed as a proportion of either the expenditure or income per household; in the latter case, it considers the amount of tax paid (or saved) by a household expressed as a proportion of the change in the government's tax revenues resulting from the VAT tax reform.

The simulation of the tax scenario requires identifying each of the components of the household expenditure, in general, but in particular the ones that will be affected by the tax reform. In this sense, the DGEEC facilitated the codes to construct the aggregates in order analyze the incidence. There are two different aggregates that the NSO generated considering total expenditure. One of the aggregates includes all the items while the other excludes some items; for instance some lumpy and non-frequent expenditures like funeral drawers or expenditures on festivals and events.[24]

In order to generate the analysis this work proposes several tax scenarios that may help to find either lower or upper bounds of the effects of the tax reform over the welfare of households. One

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[22] In 2012, the relative tax collection from the agricultural sector stood at 5.7 percent of the total tax collection. *Source: Departamento de Estadísticas - Coord. de Inteligencia e Investigación Tributaria – SET.*

[23] Article 91 of the Law N° 5061 list the agricultural products taxed at the new 5 percent tax rate. See Table 1 in Annex 1.

[24] The excluded items are the following: some taxes and fees, house and car insurance, funeral drawer, expenditure on festivals and events (like rental of chairs, tables, tablecloths, cutlery, among others), charges for life insurance, insurance provision for death and contributions to social clubs and sports.

commonly used approach to measure tax evasion is the "tax gap" methodology, which estimates the difference between the true tax liability for a given tax year and the amount that is paid on time; this is done by comparing two sources of income information: tax return data and the National Accounts.[25] However, given that VAT data is not readily accessible, in order to account for tax evasion the current analysis distinguishes between purchases from the formal and informal markets by taking into account the place of purchase.[26]

In particular, the data allow for estimates in three different scenarios: (1) The first tax scenario (Tax I) assumes that all households purchase unprocessed foods (agricultural, fruit and horticultural goods) in the formal market and thus pay taxes, without taking into account if they were bought in the market or self-produced (corresponding an upper bound on incidence). For instance, this scenario considers that products generated within the households or given in charity are subject to taxation. Although quite unreal, this would help to estimate a source of upper bound of the effect of the tax reform.[27] (2) The second scenario (Tax II), excludes all the possible different ways to acquire a product but keep only bought items. Finally, the last scenario, (3) Tax III includes bought items but in a formal framework or basis (corresponding to a pseudo-lower bound on incidence). This paper considers that, although many people buy their products, they do so not within a formal channel but through an informal way, thus evading the possibility to pay the VAT. Consequently, Tax III excludes purchases done in *Ambulante*, *Comedor Popular*, *Puesto Fijo*, *Vivienda Particular*, and *Mercado*. In other words, this "lower bound" scenario assumes that these places are overall informal markets in which taxes are generally evaded.

It is important to note the caveats of the analysis presented in this section. First, the analysis assumes no behavioral changes either as a result of the VAT tax reform or other reforms or events. Second, focusing only on the VAT tax reform affecting agricultural products and services, the analysis fails to capture the total tax effect of the various changes to the Paraguayan tax code taking place in 2014. Lastly, the analysis is based on household survey data which does not fully capture the high end of the income distribution.[28]

Data

Besides the set of legal instruments that were already introduced, the main source of information is the Income, Expenditure and Living Conditions Survey (EIGyCV) carried out between August 2011 and July 2012. The EIGyCV is collected by the National Statistical Office (NSO) of Paraguay (Dirección General de Estadística, Encuesta y Censos - DGEEC). The survey covers almost all the country with the exception of the departaments of Alto Paraguay and Boquerón whose populations represent less than 2 percent of the total population of the country. The survey is also representative

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[25] Cruz 2009.

[26] For instance, a good is assumed to be purchased in the formal market when it is purchased in a supermarket or small store and in the informal market when it is purchased from peddlers or informal stores.

[27] The question includes the following categories: bought, produced by the household, got from the business, as part of payment to a household member, given or paid by any member of another household, given away or donated by any public social program or another institution like NGO or church.

[28] The wealthier segments of the population are often underrepresented in household surveys due to underreporting, missing responses, or sampling reasons. While there is no simple solution to address this issue, several authors adjust expenditures items by fixed factors from National Accounts. The method chosen for this study is to assume zero underreporting, given that the adjustment may introduce bias.

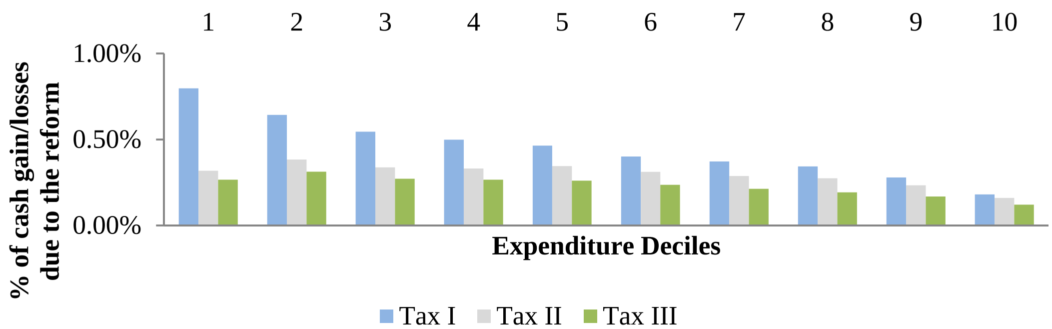
at departmental level for the following departments: Asunción, San Pedro, Caaguazú, Itapúa, Alto Paraná, Central and then “the rest”. It allows measuring both the consumption (food and non-food items) and income levels of households. Hence, it provides a unique opportunity to analyze the fiscal incidence of the VAT reform.

Results

Figure 1 shows the results of the relative incidence analysis. The figure illustrates the relative incidence at each decile of the per capita expenditure. The deciles were generated in terms of per capita consumption including “excluded” goods (see footnote 23). For each decile the relative incidence is calculated as the ratio of the average per capita expenditure of and the average per capita tax paid by the given decile. Under the first scenario (Tax I), the relative incidence of the tax is inversely related to per capita consumption; that is, the higher the per capita expenditure the lower the tax paid relative to the total household expenditure suggesting that the tax reform is regressive in relative terms. The results for the second (Tax II) and the third (Tax III) scenarios follow an inverted U-shape pattern with cash gains decreasing at either end of the expenditure distribution relative to the middle deciles; overall, however, both scenarios are regressive.

At each decile of the expenditure distribution, tax losses are higher under the Tax I scenario than under either the Tax II and Tax III scenarios. The expected impact of the tax reform under the Tax II scenario is similar to that of the Tax III scenario, although the magnitude of the impact is slightly lower under the latter. The results suggest the relative importance of consumed but not purchased items for lower deciles of per capita consumption and especially for the two lowest ones. In term of the average cash losses incurred by the bottom 40 percent of the expenditure distribution, these range from 0.34 percent under the Tax II scenario to 0.62 percent under the Tax I scenario.

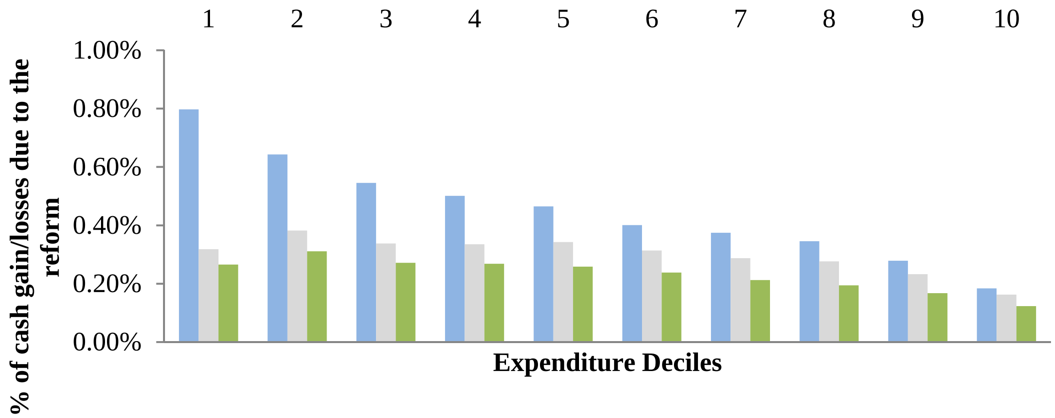
Figure 1: Relative Incidence of VAT on Agriculture Sector Related Products by Expenditure Decile



Source: Own estimations using EIGyCV 2011/2012.

Figure 2 shows the results for the same analysis, but this time excluding from the consumption aggregate lumpy consumption and non-frequent expenditures. Overall, the results presented in this figure are nearly identical to those presented in Figure 1. The three scenarios have a generally regressive distributional impact.

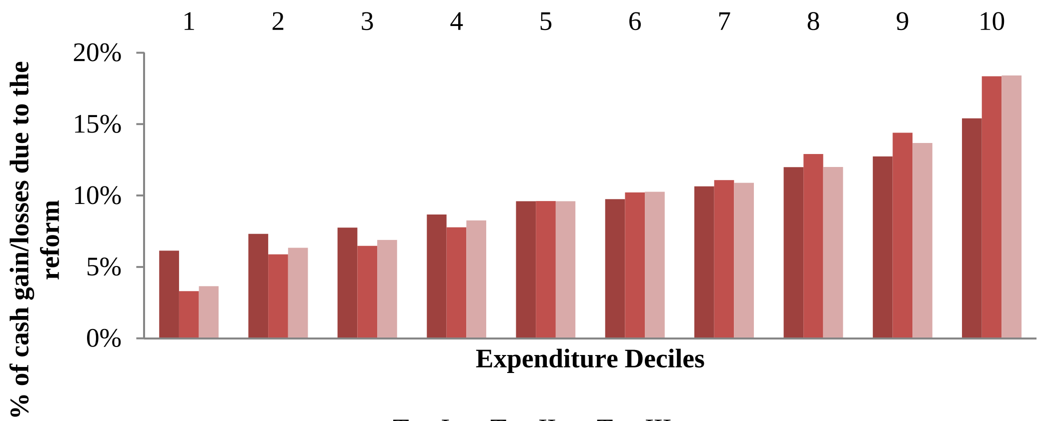
Figure 2: Relative Incidence of VAT on Agriculture Sector Related Products by Expenditure Decile Excluding Lumpy Consumption and Non-frequent Expenditures.



Source: Own estimations using EIGyCV 2011/2012.

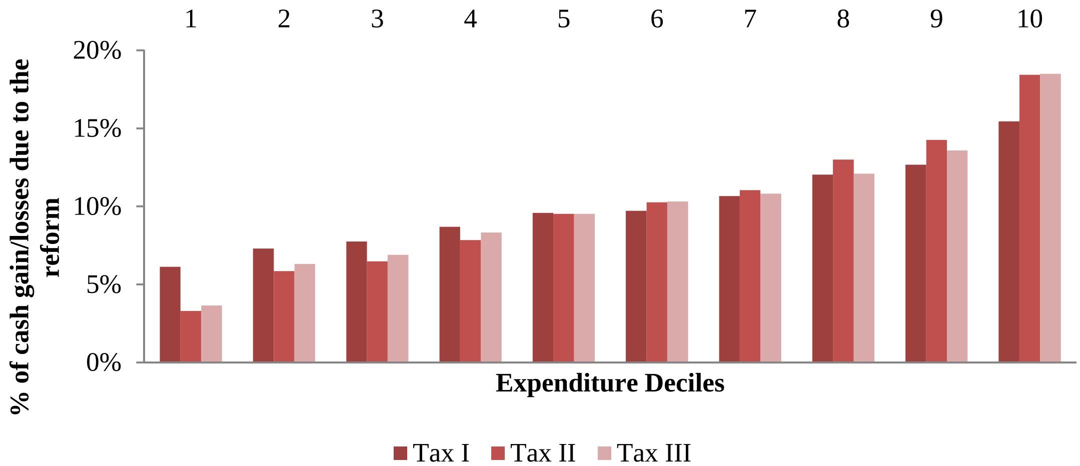
Figures 3 and 4 present the results of the absolute incidence analysis for the two different expenditure aggregates considered in the previous paragraphs (i.e. including and excluding lumpy expenditure items). As it is evident from the figures, the absolute incidence of the VAT reform is clearly progressive; that is, higher expenditure deciles make higher contributions to the change in the government's tax revenues resulting from the VAT tax reform.

Figure 3: Absolute Incidence of VAT on Agriculture Sector Related Products by Expenditure Decile.



Source: Own estimations using EIGyCV 2011/2012.

Figure 4: Absolute Incidence of VAT on Agriculture Sector Related Products by Expenditure Decile Excluding Lumpy Consumption and Non-frequent Expenditures.



Source: Own estimations using EIGyCV 2011/2012.

In order to corroborate the finding that the VAT tax reform is regressive, the analysis makes use of concentration curves, concentration coefficients, and the Kakwani index. Concentration curves and coefficients are used to evaluate the distribution of basic goods or services (e.g. access to running water) considering the whole income distribution. Concentration curves are constructed similarly to Lorenz curves, the difference being that the vertical axis measures the proportion of the tax (transfer) paid (received) at each quantile of the welfare measure.[29] As a result, concentration curves for a transfer targeted to the poor, for example, can be above the diagonal (something that, by definition, could never happen with a Lorenz curve).

The concentration coefficient is calculated in the same manner as the Gini coefficient; for cases in which the concentration coefficient is above the diagonal, the difference between the triangle of perfect equality and the area under the curve is negative, which cannot occur with the Gini for the income distribution by definition. For the case of taxes, the progressivity is given when the proportion paid in relation to the welfare measure used increases as the welfare measure increases. Therefore, the concentration curve lies below the expenditure Lorenz curve. In a regressive scenario, the proportion paid relative to the welfare measure decreases and the concentration curve lies above the Lorenz curve.

Table 1: Gini Coefficients of Per Capita Expenditure and Concentration Coefficients of Taxes

		Gini	Concentration Coefficient		
Welfare Variable			Tax I	Tax II	Tax III
Expenditure per capita	Including excluded goods	0.381	0.152	0.243	0.223
	Excluding excluded goods	0.379	0.153	0.243	0.223

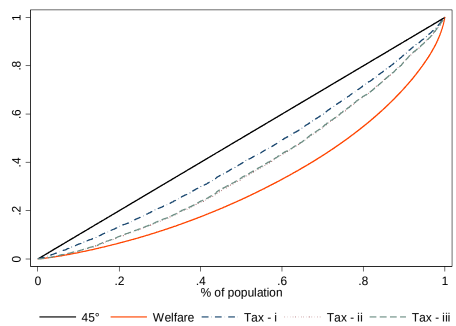
Source: Own estimations using EIGyCV 2011/2012.

[29] For an in-depth discussion see Lustig and Higgins (2012).

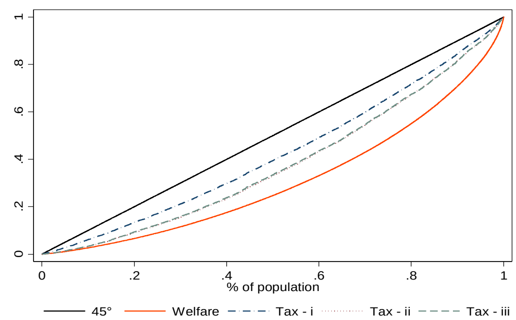
Table 1 and Figure 5 present the results from this analysis. The results confirm that, under all three scenarios considered, the impact of the VAT reform is regressive. In particular, irrespectively of the welfare measured considered, the concentration curves lie above the Lorenz curve and the corresponding concentration coefficients are smaller than the Gini coefficients, implying in turn negative Kakwani indices (or regressivity) for all scenarios. Moreover, undertaking the same analysis at the urban/rural/departmental levels show that the impact of the reform is also regressive (see Annex 2).

Figure 5: Concentration Curves of the VAT Tax Reform and Gini Coefficients of Expenditure Per Capita

Expenditure per capita



Expenditure per capita (excluding lumpy consumption and non-frequent expenditures)



Source: Own estimations using EIGyCV 2011/2012.

With regard to the annual change in total government revenue resulting from the change in the VAT, the estimates presented in Table 2 suggest that it is expected to range between 175,000 million Guaraní and 275,000 million Guarani.

Table 2: Estimated Change in Government Revenues Resulting from the VAT Reform

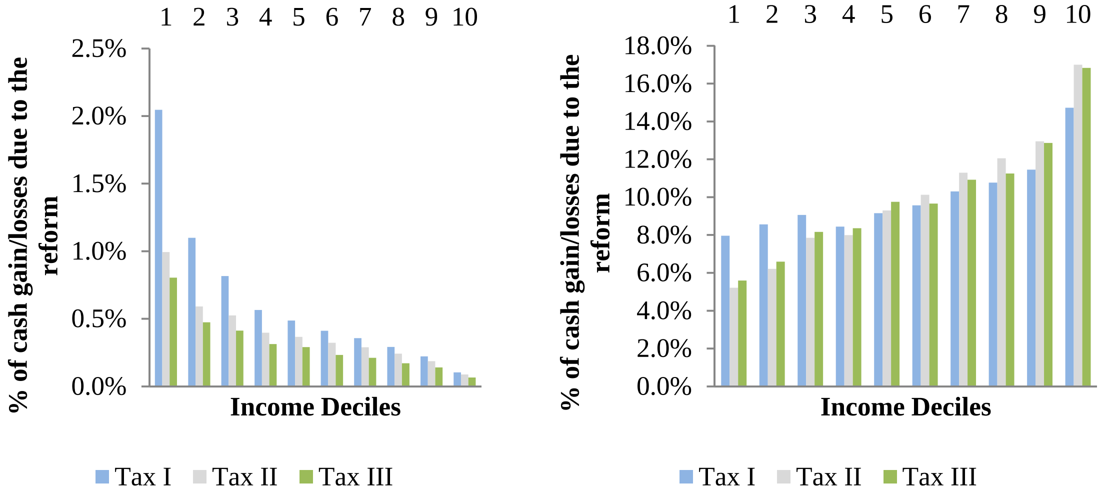
Scenario	Change in the annual tax collection in millions of Guarani	Change in tax collection as a proportion of total VAT collection
Tax_I	273,676	6.38%
Tax_II	202,906	4.73%
Tax_III	153,262	3.57%

Source: Own estimations using EIGyCV 2011/2012.

Box 1. Income Analysis

In Paraguay, an income aggregate is used as the welfare variable to measure poverty. It is therefore worthwhile to analyze the incidence of the tax reform in terms of income. Figures B1.1 and B1.2 below present the tax incidence analysis considering per capita income as the welfare variable. The figure on the left shows the results for the relative incidence analysis, while the figure on the right shows the results for the absolute incidence analysis. The results for the incidence analysis based on per capita income are similar to those obtained using per capita consumption. The relative incidence of the VAT tax reform is regressive meaning that lower deciles pay more in terms of their total income while its absolute incidence is progressive suggesting that higher per capita income deciles make higher contributions to the change in the government's tax revenues resulting from the VAT tax reform.

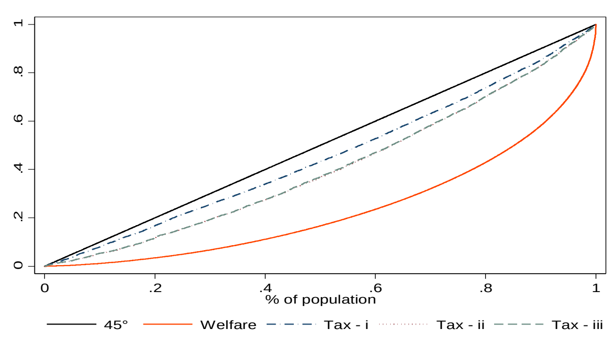
Figure B1.1: Relative and Absolute Incidence Considering Per Capita Income



Source: Own estimations using EIGyCV 2011/2012.

Figure B1.2 presents the Gini and the concentration coefficients. The Gini coefficient of per capita income (0.527) is substantially higher than the Gini coefficients of per capita consumption (0.379-0.381). The concentration coefficients of the tax burden based on per capita income are similar to the ones obtained using per capita consumption ranging from 0.096 (Tax I scenario) to 0.170 (Tax III scenario). Moreover, similarly to the analysis based on per capita consumption, the tax reform is regressive under all the scenarios considered.

Figure B1.2: Concentration Curves and Lorenz Curve



Source: Own estimations using EIGyCV 2011/2012.

Prior Action 3— To improve tax equity the Government has established a tax on agriculture income (IRAGRO).

Main findings: Due to the lack of available data on income from agriculture activities, directly assessing the expected impact of the new tax on agricultural income is not possible. However, the distribution of land ownership and land size in Paraguay are regressive; this along with the fact that the average monthly per-capita income (from all income sources) of the four lower income deciles is below three minimum wage salaries suggests that IRAGRO is unlikely to represent a significant burden on low-income households.

Context

Low income households are both more likely to be involved in agriculture activities and, when involved in agriculture activities, less likely to own land. Table 2 below presents the share of households in which at least one member works in agriculture by income quintile.[30] According to the table, 73 percent of households in the lowest quintile have at least one member involved in agriculture, whereas the same statistic is only 17 percent for households in the top quintile. In addition, while more than 93 percent of households in the top quintile that inform they have at least one member working in agriculture activities are also land owners, the same statistic is 81 percent for households in the lowest quintile.

Table 2: Share of Households with at Least One Member Working in Agriculture Related Activities and Land Ownership by Quintile, 2013

	Quintile				
	1	2	3	4	5
At least one member working in Agriculture	73.4	53.2	37.9	26.7	17.4
Land Ownership	81.1	87.9	88.7	87.5	93.2

Note: Numbers were calculated at household level.
Source: Own calculations using EPH 2013.

As with land possession, land dimension varies significantly across income quintiles. Table 3 present the average and median land size by income quintile. The first three quintiles have an average land size of around 3 hectares, whereas the fourth and the fifth quintiles have an average land size 3 and 50 times as large, respectively. Analyzing the median land size, however, reveals the existence of a great deal of dispersion within deciles and across the distribution; in particular, not only is the median land size significantly smaller at all the deciles, but the median land size of the top quintile is 6 hectares, suggesting that those at the higher end of the top decile own grand land extensions.

Table 3: Mean and Median of Land Hectares by Income Quintile, 2013

	Quintile				
	1	2	3	4	5
Average of Land Hectares	3.1	3.0	3.3	10.2	148.2
Median of Land Hectares	1.0	0.2	0.2	0.1	6.0

Note: Numbers were calculated at household level.
Source: Own calculations using EPH 2013.

[30] Section 8 of 2013 survey, *Encuesta Permanente de Hogares*, allows identifying those households. However, it is not possible to disentangle the labor relation whether if they are employer, employee, self-account workers or just non-paid workers.

The distribution of land ownership and land size are regressive; this along with the fact that the average monthly per-capita income (from all income sources) of the four lower income deciles is below three minimum wage salaries suggest that IRAGRO is unlikely to represent a significant burden on low-income households.[31]

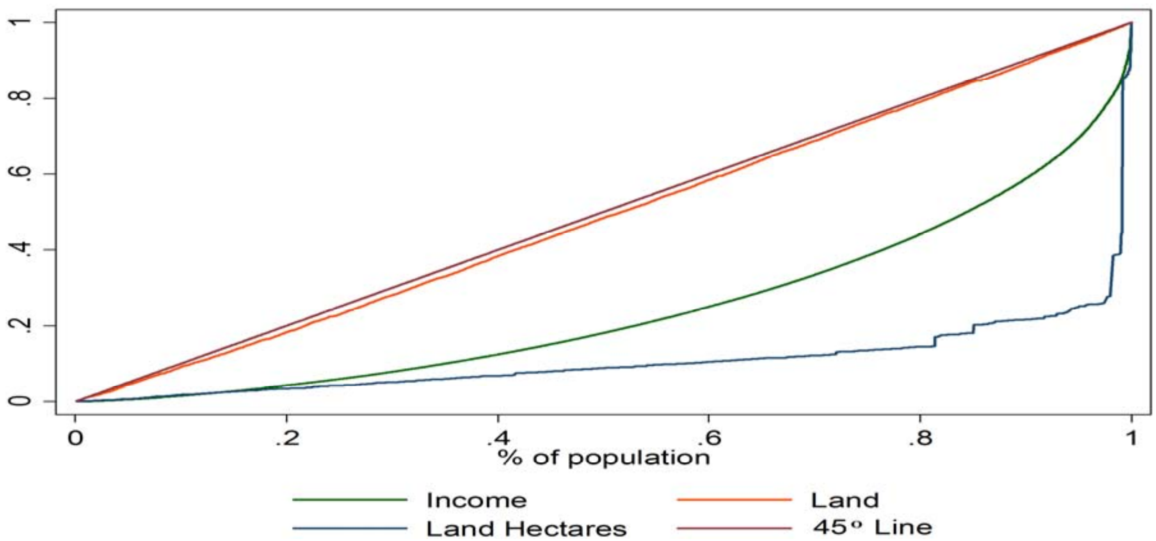
Table 4: Concentration Coefficients Land, Land Hectares and Official Income, 2013

Land Possession	0.026
Land Hectares	0.789
Official income	0.508

Source: Own calculations using EPH 2013.

Table 3 presents the concentration coefficient of land possession, hectares and official per capita income (thus is analogous to the Gini index). While land distribution is only marginally regressive, land dimension, measured by hectares, is highly regressive, more so than the distribution of income.

Figure 6: Concentration Coefficients for Land, Land Hectares and Per Capita Income, 2013



Note: Numbers were calculated at household level.
Source: Own calculations using EPH 2013.

B.2. Pillar 2: Social Inclusion
Prior Action 6
Prior Action 7

Main findings: The expansion of the coverage of the AM program is expected to contribute significantly to both moderate and extreme poverty reduction, particularly among the elderly. However, the fine-tuning of AM's targeting instrument is recommended as a means for improving the efficiency of public expenditure.

[31] The average monthly per capita income by decile is presented in Table 2 of Annex 1.

Context

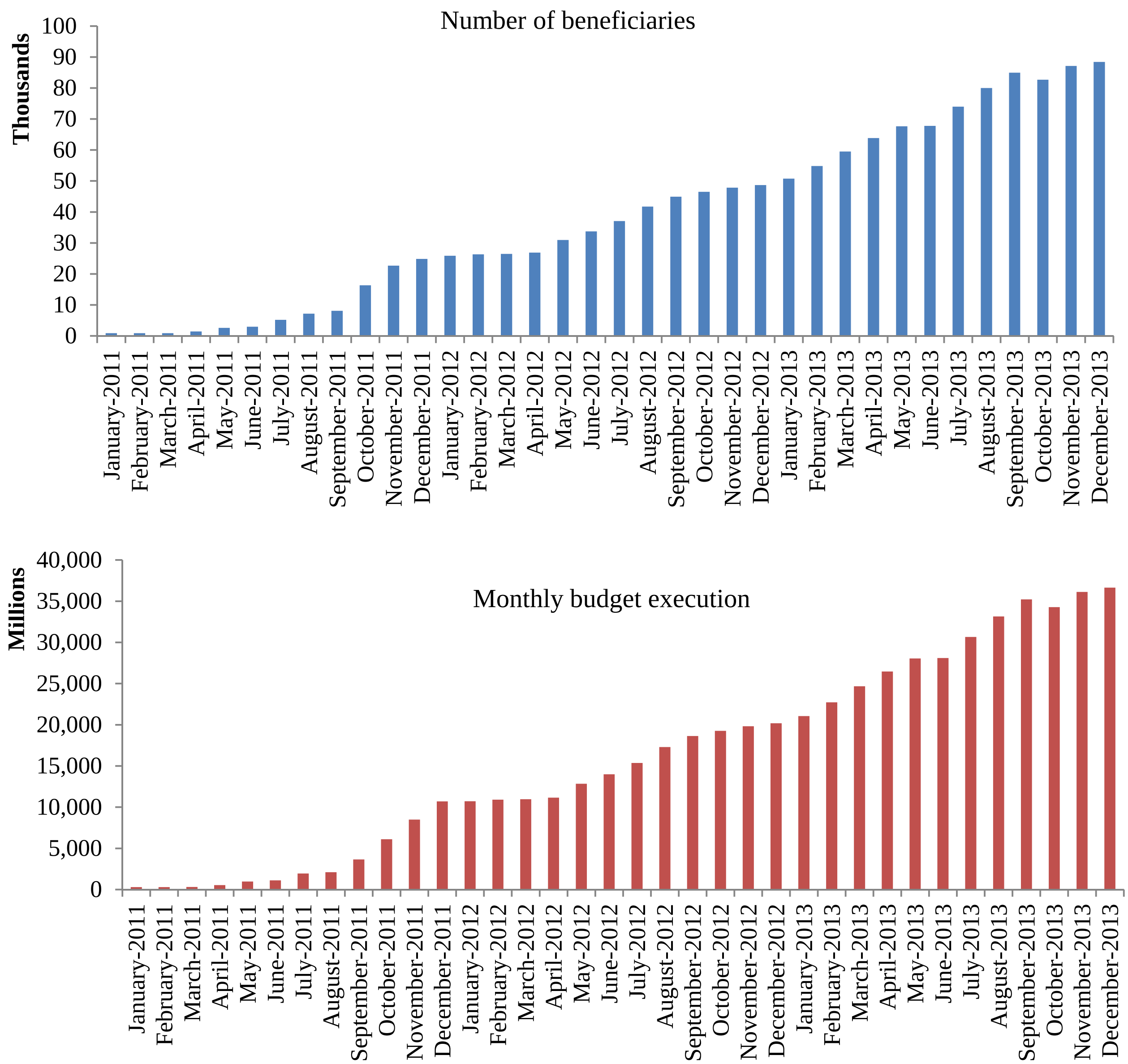
Through the Law N° 3729/09, the Paraguayan State established that adults living under poverty have the right to access a non-contributory pension plan, currently known as “Adultos Mayores” (AM). The proposed plan contemplates a monthly monetary transfer equivalent to one quarter of the current minimum wage. To be eligible to receive the transfer, individuals must:
Hold the Paraguayan citizenship;
Be older than 65 years of age;
Be considered poor, by the official national definition of poverty.
Receive neither public nor private wage, pension, or retirement;
Have no debts with the state (Ande, Essap, Copaco, Subsecretaria de Estado de Tributación);
Have no pending actions with the Justice

The program is administered by the Dirección de Pensiones No Contributivas within the Ministry of Finance. Beneficiaries receive their monetary transfers through debit cards issued by Banco de Fomento. Several entities take part in the registration process; among them, Secretaría de Acción Social (SAS), Dirección General de Estadística, Encuestas y Censos (DGEEC) and Unidad de Economía Social. Currently, AM uses the same targeting instrument as the Tekopora program, a conditional cash transfer established in Paraguay in 2005.

With regard to its implementation strategy, AM is similar to Tekopora (Rofman, Apella and Mezza 2013). In particular, municipalities are ordered using a geographic prioritization index that is mainly a combination of monetary poverty and unsatisfied basic needs. Municipalities presenting the highest values in the prioritization index are given priority to receive the program. Within the selected municipalities, a targeting instrument is used to approximate the poverty status of the household following an algorithm that uses household characteristics and possession of goods, among other variables.

Both administrative records and household survey data suggest that, since being introduced in 2011, the number of AM beneficiaries increased considerably. Figure 1 shows the evolution of administrative enrolments rates and budgetary executions of Adultos Mayores by month and year. According to administrative records, the program experience the largest average month-to-month growth in 2011 (40 percent) and continued to grow at an average month-to-month rate of 14 percent in 2012 and 12 percent on 2013.

Figure 7: Adultos Mayores Administrative Records, 2011-2013



Source: Sistema de Contabilidad (SICO) and Área de Estadísticas de la DPNC.

According to household survey data, the number of AM beneficiaries jumped from approximately 11,000 in 2011 to nearly 78,000 in 2013 (Table 2). Except for 2011, the household survey estimates are qualitatively similar to those presented in Table 1.

Table 5: Coverage of "Adultos Mayores", 2011-2013

Year	Number of Individuals Receiving Adultos Mayores Benefit (a)	Number of Individuals 65 or above (b)	Ratio (a)/(b)
2011	11,067	441,202	2.5
2012	43,011	437,786	9.8
2013	77,662	480,654	16.2

Source: Own calculations using Encuesta Permanente de Hogares 2011-2013.

A quick assessment suggests that AM provides its beneficiaries with an opportunity to escape extreme poverty. Table 1 below presents the evolution of the minimum wage, the evolution of the extreme poverty line, and the evolution of the ratio of these two indicators for the period 2010-2013. The latter is a relative measure of the purchasing capacity that the transfer gives to beneficiaries of the program. As can be seen from the table, this ratio is lower than the 25 percent received by beneficiaries of AM suggesting that, at the very least, the target is expected to lift beneficiaries out of extreme poverty.

Table 6: Evolution of Minimum Wage and the Extreme Poverty line in Paraguay, 2010-2013

Period	Minimum legal wage	Extreme Poverty line	Ratio (%)
2010			
January/June	1,408,864	317,510	22.5
July/December	1,507,484	317,510	21.1
2011			
January/March	1,507,484	343,212	22.8
April/December	1,658,232	343,212	20.7
2012			
January/December	1,658,232	336,202	20.3
2013			
January/December	1,658,232	364,241	22.0

Note: The minimum wage and the poverty line figures are expressed in current Guaranies. The extreme poverty line values correspond to the Area Metropolitana.

Source: Sub Gerencia General de Política Monetaria, Departamento de Cuentas Nacionales y Mercado Interno and Dirección General de Estadística, Encuesta y Censo (2013).

Table 7 shows self-reported benefits received by AM beneficiaries. The right side of the table reports the ratio of the transfer received to the prevailing minimum wage. The average and median values of this ratio vary from 21.1 to 24.3 percent.

Table 7: AM's Transfer Relative to the Minimum Wage, 2011-2013

Year	Nominal Minimum Wage (a)	Adultos Mayores Benefit Amount (b)		Ratio (a)/(b)	
		Average	Median	Average	Median
2011 April/December	1,658,232	357,875	350,000	21.6	21.1
2012 January/December	1,658,232	394,240	400,000	23.8	24.1
2013 January/December	1,658,232	402,210	400,000	24.3	24.1

Source: Encuesta Permanente de Hogares 2011-2013.

Table 4 presents the evolution of extreme and moderate poverty (left side of the table), and the proportion of the poor who are either elderly or non-elderly (right side of the table). Extreme and moderate poverty felt dramatically from 2011 to 2013. According to official figures, during the same period, extreme poverty fell 8 percentage points (from 18.0 percent to 10.2 percent) and moderate poverty fell 8 percentage points (from 32.4 to 24). At the same time, the proportion of the elderly among the poor remained nearly constant (about 5.5 percent) suggesting that poverty fell at approximately the same rate for both the elderly and the non-elderly. The household survey estimates suggest that by 2013 approximately 85,000 elderly individuals still lived in poverty.

Table 8: Share of Adults among the Poor, 2011-2013

2011	Number of Individuals	Percentage of Total Population	Among the Poor	Number of Individuals	Percentage of Poor
Extreme Poor	1,165,745	18.0	Less than 65 Years	1,973,160	94.12
Moderate Poor	930,728	14.4	Elderly (65 or above)	123,313	5.88
Total Poor	2,096,473	32.4		2,096,473	
Total Non-Poor	4,368,175	67.6			
2012					
Extreme Poor	903,349	13.8	Less than 65 Years	1,671,745	94.77
Moderate Poor	860,730	13.1	Elderly (65 or above)	92,334	5.23
Total Poor	1,764,079	26.9		1,764,079	
Total Non-Poor	4,802,331	73.1			
2013					

Extreme Poor	678,880	10.2	Less than 65 Years	1,514,088	94.65
Moderate Poor	920,865	13.8	Old (65 or above)	85,657	5.35
Total Poor	1,599,745	24.0		1,599,745	
Total Non-Poor	5,072,772	76.0			

2011	Elderly # of people	percentage	Non Elderley # of people	percentage
Extreme Poor	63,332	14.4	1,102,413	18.3
Moderate Poor	59,981	13.6	870,747	14.5
Total Poor	123,313	27.9	1,973,160	32.8
Non Poor	317,889	72.1	4,050,286	67.2
2012				
Extreme Poor	40,922	9.4	862,427	14.1
Moderate Poor	51,412	11.7	809,318	13.2
Total Poor	92,334	21.1	1,671,745	27.3
Non Poor	345,452	78.9	4,456,879	72.7
2013				
Extreme Poor	24,369	5.1	652,720	10.5
Moderate Poor	61,385	12.8	850,353	13.7
Total Poor	85,754	17.8	1,503,073	24.3
Non Poor	394,900	82.2	4,688,790	75.7

Source: Encuesta Permanente de Hogares 2011-2013.

The AM transfer represents one-third of beneficiaries' total household income. Table 5 shows that the share of AM transfer in total household income has an average value that varies from 26 percent to 30 percent and a mean value of approximately 32 percent.[32]

Table 9: Share of AM in Total Household Income, 2011-2013

	Median	Mean
2011	30.5	32.5
2012	27.7	32.5
2013	26.8	33.0

Note: Estimates calculated at the household level.
Source: Encuesta Permanente de Hogares 2011-2013.

The impact of AM on poverty reduction has increased over time and is estimated to be significant. Using cross-sectional data at individual level and a static simulation, Zavattiero (2010) estimates that AM generates a reduction in poverty of around 1.3 percent. Table 6 presents rough estimates

[32] Although it is worth to analyze the composition effect within a household, there aren't enough observations to focus only in households where all their members are 65 or above.

based on household survey data of the effect of the program on poverty. In particular, the estimates presented correspond to extreme and moderate poverty excluding and including the value of the AM transfer from household income. The information below suggests that the program has a negligible effect on eradicating extreme poverty, but has increasingly contributed to moderate poverty reduction, reaching a nearly 1 percentage point contribution to moderate poverty reduction by 2013.

Table 10: Poverty Rates with and without Adultos Mayores, 2011-2013

			Mean	Std. Err.	[95% Conf. Interval]	
2011	Extreme	Official Income Aggregate	0.180	(0.003)	0.175	0.186
		Without Adultos Mayores	0.182	(0.003)	0.177	0.188
	Moderate	Official Income Aggregate	0.324	(0.003)	0.318	0.331
		Without Adultos Mayores	0.325	(0.003)	0.318	0.332
2012	Extreme	Official Income Aggregate	0.138	(0.002)	0.133	0.142
		Without Adultos Mayores	0.140	(0.002)	0.135	0.145
	Moderate	Official Income Aggregate	0.269	(0.003)	0.263	0.275
		Without Adultos Mayores	0.274	(0.003)	0.268	0.280
2013	Extreme	Official Income Aggregate	0.102	(0.002)	0.098	0.106
		Without Adultos Mayores	0.108	(0.002)	0.103	0.112
	Moderate	Official Income Aggregate	0.240	(0.003)	0.234	0.246
		Without Adultos Mayores	0.249	(0.003)	0.243	0.255

Source: Encuesta Permanente de Hogares 2011-2013.

As expected, the estimated impacts of the program on both moderate and extreme poverty are larger and economically significant when focusing on the elderly. Table 7 repeats the exercise explained in the previous paragraph but it focuses on the elderly. As before, the contribution of the program to poverty reduction grew over time. The estimates for 2013 show that in the absence of the program, extreme (moderate) poverty would have been 4 (7) percentage points higher.

Table 11: Adult (65 or above) poverty rates with and without Adultos Mayores, 2011-2013

			Mean	Std. Err.	[95% Conf.	
2011	Extreme	Official Income Aggregate	0.144	(0.010)	0.125	0.162
		Without Adultos Mayores	0.157	(0.010)	0.137	0.176
	Moderate	Official Income Aggregate	0.279	(0.012)	0.256	0.303
		Without Adultos Mayores	0.286	(0.012)	0.262	0.310
2012	Extreme	Official Income Aggregate	0.093	(0.008)	0.079	0.108
		Without Adultos Mayores	0.117	(0.008)	0.101	0.134
	Moderate	Official Income Aggregate	0.211	(0.011)	0.190	0.232
		Without Adultos Mayores	0.252	(0.011)	0.229	0.274
2013	Extreme	Official Income Aggregate	0.051	(0.006)	0.040	0.062
		Without Adultos Mayores	0.090	(0.007)	0.075	0.104
	Moderate	Official Income Aggregate	0.178	(0.010)	0.159	0.197
		Without Adultos Mayores	0.246	(0.011)	0.225	0.268

Source: Encuesta Permanente de Hogares 2011-2013.

However, AM's targeting instrument can be improved to increase the efficiency of public expenditure. Moreno et al. (2013) suggest that the fact that AM uses Tekopora's targeting instrument, an instrument not specifically designed to target the poor and elderly, leads to inefficiencies in the implementation of the program. The authors note that AM's current targeting instrument also needs to be updated to reflect current lifestyles of beneficiaries. They propose an alternative targeting instrument which would reduce the total targeting error, the sum of the inclusion and exclusion errors, from 34 percent to 15 percent and suggest its adoption as a way to improve the efficiency of the use of public resources allocated to the program.[33]

B.3. Pillar 3: Financial Inclusion

Prior Action 8— To facilitate access to financial services for lower income groups, the Government has established simplified processes to open and manage basic savings accounts which do not have minimum opening and balance amount requirements, and do not charge monthly maintenance fees.

Prior Action 9— To strengthen the legal framework for the provision of financial services, the Government has regulated the use of electronic payment services.

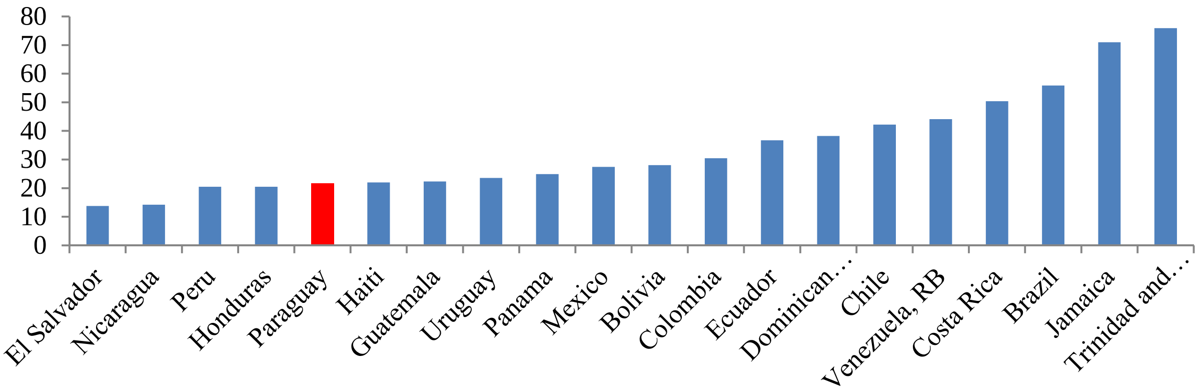
Main findings: Paraguay shows a low level of financial inclusion relative to its regional peers; account ownership at a formal financial institution is 10 times lower among the poorest 40 percent relative to the top 60 percent of the adult population. Moreover, the rate of electronic and mobile payment usage in Paraguay is low, particularly among the less educated and the poor. Improving access to financial services by removing price or non-price barriers to their use is likely to benefit the poor and other disadvantaged groups who are disproportionately more likely to lack access to these services. The recent adoption of mobile money technologies at the same time that capable mobile phones become cheaper and widely accessible will help Paraguay to accelerate financial inclusion.

[33] The first error type refers to individuals who receive benefits from the program but are not eligible to the program; the second error type highlights the fact that people that are eligible to receive the AM's benefits are not currently receiving them.

Context

Paraguay shows a low level of financial inclusion relative to its regional peers. Well-functioning financial systems play a key role in society, channeling financial resources from and to households, firms and the public sector. In general, the lack of access to credit constrains individuals' ability to invest in their education, health, and future; similarly, small enterprises and entrepreneurs with limited access to financial markets must rely on their limited earning capacity to pursue promising business opportunities. A good and simple indicator of financial inclusion is rate of account ownership at a formal financial institution. Figure 1 presents the percentage of population aged 15 or above that owns an account at a formal financial institution for a selected group of Latin American and Caribbean countries. In particular, the indicator measures the percentage of respondents with an individual or joint account at a bank, credit union, other financial institution (e.g. cooperative, microfinance institution), or the post office (if applicable) including respondents who reported having a debit card. As it is evident from the figure, Paraguay is among the worst performers in this indicator relative to the countries included in the figure, suggesting that the potential marginal benefits from increasing financial inclusion are likely to be large.

Figure 8: Ownership of an Account at a Formal Financial Institution, International Comparison, 2011



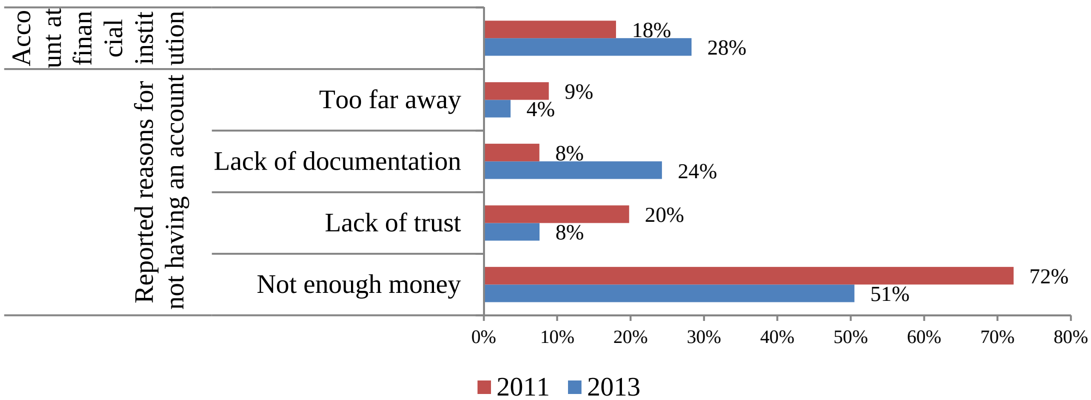
Source: Global Findex (Global Financial Inclusion Database).[1]

[1]The majority of the indicators presented in this section come from the Global Financial Inclusion (Global Findex) Database, a project funded by the Bill & Melinda Gates Foundation. The main objective of this project is to measure and compare how individuals from 148 economies save, borrow, make payments and manage risk. The Global Findex indicators are drawn from survey data collected by Gallup, Inc. The target population is the civilian, non-institutionalized population 15 years and above and the sample is nationally representative. For more information refer to Demirguc-Kunt (2012).

Account ownership increased significantly between 2011 and 2013, from about one in five individuals having an account in 2011 to nearly one in three individuals having an account by 2013. Figure 2 presents the main reasons for an individual not having an account at a formal financial institution according to the 2011 and 2013 rounds of the Findex Global Financial Indicators Survey.[34] The table shows that, as of 2013, the number one reason for not having an account at a formal financial institution was "not having enough money" (51 percent) followed by "lack of documents essential to open account" (24 percent).

[34] Differences for each indicator are statistically significant.

Figure 9: Account at Financial Institution and Reasons for Not Having an Account, 2011 vs. 2013



Source: Global Findex (Global Financial Inclusion Database).

Improving access to financial services by removing price or non-price barriers to their use is likely to benefit the poor and other disadvantaged groups who are disproportionately more likely to lack access to these services. Table 1 presents the rate of account ownership at formal financial institutions by age group, gender, income group, education and location. As expected, the poorest 40 percent of the Paraguayan population are ten times less likely to own an account than the top 60 percent. Similarly, young adults in Paraguay are 10 percentage points less likely to have an account relative to older adults, whereas individuals with "primary education or less" are more than 3 times less likely to hold an account than individuals with secondary education or more. Considering this, the efforts of the Paraguayan Government to improve the inclusiveness of the financial system by establishing the basic savings account with no minimum requirement could contribute significantly to the promotion of shared prosperity and the eradication of extreme poverty in the country.[35]

Table 12: Account at a Formal Financial Institution by Categories, 2011

Category	Dimension	2011
	Total	21.7
Age group	Young adults (% ages 15-24)	14.6
	Older adults (% age 25+)	24.7
Gender	Female (% age 15+)	22.7
	Male (% age 15+)	20.7
Income	Income, bottom 40% (% age 15+)	3.4
	Income, top 60% (% age 15+)	34.5
Education	Primary education or less (% age 15+)	8.3
	Secondary education or more (% age 15+)	29.8
Location	Rural (% age 15+)	10.2
	Urban (% age 15+)	29.3

Source: Global Findex (Global Financial Inclusion Database).

The rate of electronic and mobile payment usage in Paraguay is low, particularly among the less educated and the poor. Table 2 presents the rates of use of electronic and mobile payments. The

[35] Resolution number 25, by the Central Bank of Paraguay (BCP) dated July 18, 2013.

former rate refers to the percentage of adults who have made at least one electronic payment in the past 12 months. The latter denotes the percentage of adults who have used a mobile phone to pay bills at least once in the past 12 months. At the national level, in the last year, 4.2 percent of adults have made an electronic payment, whereas only 1.3 percent of adults have used a mobile phone to pay a bill. The estimates are even lower when focusing on the poorest 40 percent of the population and on those with primary education or less.

Table 13: Rate of Electronic and Mobile Payments, 2011

Category	Dimension	Electronic	Mobile
	Total	4.2	1.3
Age group	Young adults (% ages 15-24)	2.8	0.0
	Older adults (% age 25+)	4.8	1.9
Gender	Female (% age 15+)	3.9	1.2
	Male (% age 15+)	4.4	1.5
Income	Income, bottom 40% (% age 15+)	0.3	0.2
	Income, top 60% (% age 15+)	6.8	2.1
Education	Primary education or less (% age 15+)	0.3	0.2
	Secondary education or more (% age	6.5	2.0
Location	Rural (% age 15+)	2.8	1.6
	Urban (% age 15+)	5.3	1.1

Source: Global Findex (Global Financial Inclusion Database).

The recent adoption of mobile money technologies at the same time that capable mobile phones become cheaper and widely accessible will help Paraguay to accelerate financial inclusion. Besides the changes in the requirements to open a saving account, the Central Bank of Paraguay also adopted a resolution to regulate the electronic payments to support the supply and usage of mobile money services.[36] While regulated by a financial institution, this instrument allows making payments performed from or via a mobile device. Instead of paying with traditional instruments like cash, debit or credit card, or checks, users of this financial product can use a mobile phone to schedule payments. In this sense, Paraguay follows the suit of more than 70 other countries that have introduced mobile payment as a way to expand financial services to the people without access to the financial system and to accelerate financial inclusion (Ernst and Young 2013).[37]

[36] Resolution number 6, by the Central Bank of Paraguay (BCP) dated March 13, 2014.
[37] See Pénicaud, Claire. 2013. State of the Industry – Results from the 2012 Global Mobile Money Adoption Survey [PowerPoint presentation], GSMA (Feb. 2013), available at http://www.gsma.com/mobilefordevelopment/wp-content/uploads/2013/03/MMU_Results-from-the-2012-Global-Mobile-Money-Adoption-Survey.pdf.