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# Paraguay: First Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance and Applicability of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board discussion; and Statement by the Executive Director for Paraguay

In the context of the first review under the Stand-By Arrangement and request for waiver of nonobservance and applicability of performance criteria with Paraguay, the following documents have been released and are included in this package:

- the staff report for the first review under the Stand-By Arrangement and request for waiver of nonobservance and applicability of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **February 6, 2004,** with the officials of Paraguay. **Based on information available at the time of these discussions, the staff report was completed on March 29, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **April 12, 2004** updating information on recent developments

- a press release summarizing the **views of the Executive Board as expressed during its April 12, 2004 discussion** of the staff report that concluded the review.

- a statement by the Executive Director for Paraguay.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Paraguay*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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PARAGUAY

# First Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance and Applicability of Performance Criteria

Prepared by the Western Hemisphere Department
(In collaboration with other departments)

Approved by Markus Rodlauer and Matthew Fisher

March 29, 2004

- **Stand-by arrangement.** A 15-month SBA in an amount equivalent to SDR 50 million (40 percent of quota on an annual basis) was approved on December 15, 2003. The authorities are treating the arrangement as precautionary.
- **Program.** The program supported by the SBA aims at consolidating the stabilization initiated in 2003, and beginning a process of structural reform. A sizable fiscal effort is to reduce the deficit and end arrears; a focused and prudent monetary policy is to achieve sustained low inflation; and banking reforms are to address key vulnerabilities in that sector. An ambitious effort to initiate reform of key public institutions is to begin the structural transformation needed for sustained growth and poverty reduction.
- **Discussions.** Discussions were held in Asunción during January 28–February 6 on the first review of the arrangement. The mission met with Finance Minister Borda, Central Bank President González, and Industry and Commerce Minister Bergen, among others.
- **Staff team.** The team included Jeffrey Franks (Head), Valerie Mercer-Blackman, Randa Sab, Roberto Benelli (all WHD), and Ward Brown (PDR), and was assisted by the MFD general resident adviser in Asunción, Luis Durán-Downing. An overlapping MFD mission, led by L. Jacome, provided advice on central bank restructuring and monetary operations. Mr. D. Ayala (OED) attended most meetings.
- **Political situation.** The government of President Duarte Frutos remains popular in opinion polls and is perceived as making a significant effort to improve economic policy and governance. The authorities have shown strong ownership of the economic program, although political opposition to key reforms is rising.
- **Article VIII status and arrears.** Paraguay has accepted the obligations of Article VIII sections 2, 3, and 4 and the exchange system is free of restrictions on the making of payments and transfers for current international transactions. The country cleared all arrears to the World Bank as a prior action for the SBA, and will eliminate all other payments arrears during 2004.

Contents Page

Attachments



Annex

## I. BACKGROUND

### Economic developments under the program

1. **The economic recovery has strengthened in recent months.** Real GDP growth in 2003 is now estimated at 2.3 percent, and growth is conservatively forecast to rise further to near 3 percent in 2004. (Tables 1 and 3). The improved regional and global economic environment, a strong harvest, and increased confidence in domestic economic management underlie the improved growth prospects for 2004. Inflation has moderated further, with annual consumer price inflation falling to 3.8 percent in February 2004, from a high of 21 percent in April 2003 (Figure 1).[1] Producer price inflation has also decelerated, to 6.1 percent in January 2004.

2. **As a result, the *guaraní* has appreciated by over 15 percent against the dollar since end-2002, reflecting the strength of currencies in Brazil and Argentina, rising agricultural exports, and renewed confidence in the economic outlook.** In real effective terms, however, the appreciation has been about 10 percent in 2003, and the real effective value of the *guaraní* remains significantly below the level in recent years (Figure 2). Official reserves rose by US$340 million during 2003—to US$982 million—as the result of a current account surplus and a return of capital inflows. So far in 2004, reserves have declined slightly for seasonal reasons, but they remain well above program targets.

3. **Banking system deposits rose sharply in 2003 and have remained high so far in 2004.** Credit to the private sector, in contrast, fell by 18½ percent in 2003 as banks curtailed lending activity. This left private banks in a highly liquid position. Nonperforming loans (NPLs) have begun to decline as a share of total loans, although—at 15 percent for private banks—they remain high. Recapitalization of the National Development Bank (BNF) and a change in management have improved both the capital and liquidity position of the bank, but it continues to suffer from high administrative costs and a large stock of NPLs (56 percent of total loans). Interest rates have fallen sharply since early 2003, but lending rates remain high in real terms (Figure 3).

### Fiscal and monetary policies

4. **Fiscal performance under the program has been better than programmed.**

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[1] Inflation for end-December 2003 (9.3 percent) was slightly higher than programmed (8.8 percent) largely due to an increase in food prices (especially meat). In early 2004, a good harvest stabilized food prices and returned the country to a declining inflation path. For the remainder of 2004, some increase in inflation may be expected due to increased domestic demand and higher indirect taxation resulting from the approval of the Fiscal Adjustment Law.

- **The central government deficit was slightly lower than targeted** (Table 4). Revenues in Q4 of 2003 were sharply higher than programmed, mostly from continued improvement in VAT collections and higher nontax revenues (due to early payments from the Itaipú hydroelectric consortium). Excise tax revenues were less buoyant than expected, as cash flow problems in the oil company *Petropar* impeded the timely transfer of fuel taxes to the government (see ¶12). The higher revenues were partially offset, however, by capital spending, reflecting rising infrastructure spending in the last quarter. Current expenditure was roughly in line with projections, and wages and salaries were within the program ceiling.

- **The financial results for the rest of the public sector were also better than anticipated in 2003, mainly due to higher operating surpluses and lower capital spending in the public enterprises** (Tables 5 and 6). As a result, the consolidated public sector registered a surplus of 0.1 percent of GDP, compared with the programmed deficit of 1 percent of GDP. Public enterprises benefited from the continued strength of the *guaraní* which reduced the cost of dollar-denominated inputs.

5. **The monetary program is on track.** The end-December target for net international reserves was met with a wide margin, as capital inflows exceeded expectations and the central bank also purchased US$15 million in December. The central bank sterilized most of the additional reserve accumulations and, thus, overperformed on the net domestic assets target by a similar margin (Table 10).[2] This, together with continued accumulation of excess reserves by the banking system, left the growth of currency issue broadly in line with the program.

**Performance criteria**

6. **Performance with respect to the program targets was largely positive.** Eight of ten quantitative performance criteria for end-December were observed, including the fiscal and monetary targets (Table 2). The two structural performance criteria were also observed: in December, the Congress approved legislation to reform the public employees' pension plan and, in February, the central bank and Ministry of Finance signed a memorandum of understanding to increase central bank operational autonomy. Two performance criteria on arrears were not observed, largely due to inadequate monitoring of payments (Table 8**.** While the target for reducing the total stock of external payments arrears was observed, new arrears of around US$12 million were accumulated during the program period, violating the continuous performance criterion of no new external arrears. These arrears were subsequently cleared. The target on domestic floating debt was also missed. The stock of floating debt was reduced to G/.382 billion, compared with the unadjusted target of G/.360

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[2] NDA overperformance was achieved through additional issuance of central bank notes, plus higher excess reserves held by the banking system in the central bank.

billion.[3] The authorities have requested a waiver of the missed continuous PC, given the small size of the deviations and in light of the measures they have taken to avoid future nonobservance (see ¶13).[4] The authorities have also requested waivers of applicability for all end-March PCs other than NIR and NDA, as the data to assess observance of these PCs are not expected to be available by the date of the Board meeting.

**Domestic support for the program**

7. **The government of President Duarte Frutos retains a high level of popular support, although opposition to reform is beginning to manifest itself.** Recent opinion polls have given the president approval ratings as high as 85 percent, and so far he has been able to maintain majority support in Congress for the economic reform program. There are signs, however, of increasing resistance to some elements of the reform agenda. In particular, opposition parties and powerful agricultural interests have expressed objections to the pending Fiscal Adjustment Law. The Public Banking Reform Law, sent to Congress in December, is also facing opposition from interest groups that have been beneficiaries of existing public credit.

## II. Policy Discussions

8. **After a prolonged period of economic stagnation, the authorities' reform program is laying the groundwork for sustained higher growth and poverty reduction.** While the growth rate of 2¾ percent expected in 2004 will barely keep pace with population growth, it is significantly higher than the average obtained in the recent years.[5] Moreover, more prudent fiscal and monetary policies—together with structural reforms underway—should boost growth to around 3½ percent in 2005 and beyond.[6] Continued structural reforms will be needed, however, to boost growth above that rate.

[3] Statistical revisions to the historical data on floating debt showed that the level in October 2003 was G/.108 billion higher than reported at the start of the program. The authorities reduced the stock of arrears by more than envisaged in the program in Q4, but because of the higher beginning stock, the target was missed. In addition, an adjustor was included for the December test date to move the target up (down) if program lending fell short of (exceeded) the expected level. In the event, program disbursements significantly outstripped expectations, but the funds arrived too late in the year to permit their use to pay down domestic arrears, causing the adjusted target to be missed by a larger margin.

[4] No waiver of nonobservance is need for the end-December floating debt PC, as end-March is now the applicable test date.

[5] Average growth in 1997–2002 was zero, and real per capita income was lower in 2002 than in 1980.

[6] See the medium-term outlook presented in IMF Country Report No. 04/66 for details.

## A. Fiscal Policy

9. **The authorities reaffirmed their commitment to achieving the fiscal targets under the program.** The 2004 budget, approved by Congress in December, contains spending somewhat higher than that envisaged in the program. However, the authorities assured the staff that the fiscal objectives will be met by prudent budget execution. They noted that the budget did not include the savings achieved by the passage of the Public Pension Reform Law (of around 0.3 percent of GDP), and indicated their intention to resist pressures for increased wages (provided for in the budget). The government is also engaged in a process of auditing the rosters of public pension beneficiaries to reduce fraudulent outlays, as well as an auditing of public payrolls to eliminate officials being paid for employment in more than one public agency. Finally, a reduction in expected expenditure on interest payments in 2004 should also provide a margin for meeting the program's fiscal targets.[7]

10. **Revenue gains from increased tax and customs efficiency have exceeded program projections, but there are limits to administrative improvements without further measures.** Data for January and February 2004 show continued gains in tax efficiency. The growth rate in domestic tax collections has moderated compared with the second half of 2003, but customs revenues (from VAT and import tariffs) continue to increase sharply.[8] Nonetheless, the authorities agreed with the staff that the approval of the Fiscal Adjustment Law and the new customs code will be crucial in sustaining the momentum for a higher tax effort (Box 1). The excise tax on fuel was increased by 6 percent in January as called for in the 2004 budget and anticipated under the program. This hike, together with the annualized effect the August 2002 fuel tax increase, is expected to yield around ¾ percent of GDP per year in additional revenues.[9]

11. **In February, the authorities announced a set of measures to be implemented if revenues lag or if there is a delay in the approval of the Fiscal Adjustment Law.** As a first step, the government issued a decree imposing an export tax on soy (the largest export) at an effective rate of 2 percent. The tax is expected to yield roughly 0.2 percent of GDP in 2004. The government also announced it would begin to revise the assessed base of the agricultural land tax (IMAGRO) and the transfer tax on cattle sales as further revenue

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[7] Lower interest payments are anticipated due to continued low world interest rates, savings on interest penalties from clearing payments arrears, and from rescheduled interest payments to Taiwan, Province of China.

[8] Part of the slowdown in domestic tax receipts was due to cash flow problems in Petropar, which was not passing on excise tax revenue on fuels to the central government on a timely basis.

[9] Further increases in excise taxes are also contemplated in the Fiscal Adjustment Law.

measures. In addition, the authorities are prepared to raise excise taxes and broaden the tax base by decree if revenue performance slackens or delays occur in the passage of the Fiscal Adjustment Law.[10] While welcoming the authorities' strategy of having contingency measures ready, the staff expressed concern about an export tax. The authorities explained that the measure was applied in response to growing resistance to the Fiscal Adjustment Law by some powerful groups in the agricultural sector, including soy producers. They expected that the temporary imposition of the export tax would not only raise revenue efficiently at a time of good harvest and historically high soy prices, but would also reduce resistance to the Fiscal Adjustment Law. The authorities committed to removing the export tax once the law is approved, and they reaffirmed their commitment to seeking its passage.

12. **Overall, performance in the rest of the public sector remains strong, but there are concerns in some institutions.** The strength of the *guaraní* has continued to boost the outlook of public enterprises whose cost structure has a strong dollar component (electricity, water, petroleum). Overall, the public enterprises are now forecast to run an operating surplus of 1.9 percent of GDP, compared with the programmed target of 1.7 percent of GDP. However, this overall strong performance masks serious problems in several key enterprises, including the petroleum company (Petropar), the water company (ESSAP), and the cement company (INC). Both Petropar and ESSAP lack sufficient cash flow to cover their needs at current prices, and INC has suffered from severe management problems. To address these difficulties, the authorities moved in early February to change top management at Petropar and INC. They also raised fuel prices in January by slightly more than required to offset the tax increase in order to improve Petropar's cash flow. Subsequent increases in world oil prices, however, mean that there is still a significant gap if the company is to cover its costs and eliminate its payments arrears during the program period. The authorities are aware of this risk, and indicated that the new management at Petropar would explore new financing options as well as possible cost reductions to improve its financing situation. The fiscal outlook in other public sector institutions is expected to exceed the program, led by a higher surplus for the social security institute, reflecting both a change in management and the impact on contributions of improved growth prospects.

13. **The outlook for program financing has improved.** In 2003, the better-than-expected fiscal outturn and faster disbursement of program lending from the World Bank and IDB allowed for a larger reduction in arrears than envisaged under the program as well as an accumulation of government deposits in the central bank (Table 8). For 2004, the outlook remains good because of improved fiscal prospects and additional restructuring efforts, and the authorities are confident of the early resolution of arrears (see ¶14). In particular, the

[10] The contingency measures include: (i) an increase in the VAT tax base of transport and certain imported raw materials; (ii) export taxes on other traditional exports; and (iii) an increase in the excise tax rate of regular gasoline and diesel.

government is restructuring arrears with the Fonplata and is negotiating an extended payment schedule on loans from Taiwan, Province of China.

14. **Steps have been taken to ensure future observance of the arrears targets.** In particular, the central bank granted the government a short-term loan for US$33 million which, together with Ministry of Finance funds, was used to pay off almost all of the government's bilateral arrears in February and March. A small amount of arrears remain, mostly owed by ESSAP, but the authorities expect to resolve them in April. This action substantially accelerated the reduction in arrears compared to program targets. simplifying the government's monitoring of arrears clearance. The minister of finance has designated a special team of officials to monitor compliance with the arrears targets and assure that debt payments are made on a timely basis (Table 7). Finally, the authorities have begun efforts to resolve disputed debts with certain creditors.[11]

## B. Monetary and Exchange Rate Policy

15. **The central bank's monetary program for 2004 aims at further reducing inflation, while sustaining higher reserves.** The authorities are committed to keeping NDA well below program targets so as to maintain currency issue close to its original path. However, they also noted that money demand in *guaraníes* is strengthening with the economic recovery and stabilization from the banking crisis, leaving room for higher noninflationary growth in base money, the possibility of which will be discussed at the next review. The staff welcomed the central bank's commitment to a sound anti-inflationary monetary policy, although it noted that the improved macroeconomic situation and attendant capital inflows would likely result in reserves even beyond the levels incorporated in the central bank's monetary program. The staff agreed that money growth in 2003 restored monetization of the economy to previous levels, and cautioned against complacency in accommodating base money growth beyond that foreseen in the SBA. For this reason, the staff suggested that higher NIR and lower NDA targets be locked into the program, thereby also keeping the money growth path consistent with low inflation. The authorities agreed that the targets need to be adjusted, but preferred to wait until the second review, when performance criteria are to be set for the remainder of 2004.

16. **The process of reforming and strengthening the central bank (BCP) is moving forward, with technical assistance from the Fund.** In February, the Central Bank and Ministry of Finance signed a Memorandum of Understanding (MOU) designed to give the bank greater operational autonomy (a performance criterion for the first review) (Box 3). Among the key elements of the MOU are provisions to:

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[11] Disputed debts are about US$14 million. The authorities have initiated discussions with lawyers for the Office du Ducroire in December 2003, and they expect this dispute to be resolved in the coming months. Regarding disputed arrears to certain customs verification companies, the new government has initiated a legal review of those claims, and will take a position once that review is completed.

- Phase out budgetary support from the central bank to the government;
- Clarify the BCP's authority over its monetary budget, give it more control over its administrative budget, and simplify the procurement process for spending; and
- Start a time-bound process to reconcile disputed debts between the government and the central bank, which should increase the transparency of the BCP balance sheet and clarify its capital position.

The BCP has also begun—with assistance of a recent MFD mission—to develop a restructuring plan to focus on its core responsibilities to preserve the stability of the domestic currency and of the financial system. The reforms will streamline staffing at the bank, strengthen economic analysis and bank supervision functions, improve administration, and improve its monetary and foreign exchange operations. The plan should be finalized by July 2004 and implemented during 2004–05.

17. **The authorities remain committed to the floating exchange rate policy, but expressed some concern about the possibility of excessive upward pressure on the *guaraní*.** The authorities intervened in December to meet seasonally strong demand for *guaraníes,* although the bulk of the large NIR accumulation was due to disbursements from the World Bank and IDB, and government royalty receipts. Looking forward, the magnitude of foreign exchange inflows is a key uncertainty in the macroeconomic outlook for 2004, and will require careful monitoring. The staff suggested that, while the current level of the exchange rate does not raise concerns about competitiveness, significantly higher-than-expected inflows may exercise further upward pressure on the currency. In that case, a careful balance will have to be struck between accommodating further monetization of the economy and sterilizing these inflows through monetary intervention and greater fiscal adjustment. In particular, the staff urged the Central Bank not to intervene to halt the appreciation unless it could be done without compromising the authorities' inflation objectives.

### C. Financial Sector Issues

18. **The government has submitted to Congress a Public Bank Reform Law.** The law is designed to combine the National Development Bank (BNF) with several smaller public lending institutions and create two new entities: a small second-tier investment bank to channel resources through the commercial banks, and a development bank specializing in lending to microentrepreneurs and small farmers who are not well-served by the existing financial institutions. This restructuring is to take place with the assistance of the IDB. The draft law is broadly in line with the recommendations of the IDB, although additional refinements are needed to ensure the appropriate restructuring of the public lending

institutions.[12] The authorities noted that political opposition is also likely to surface from interest groups who were beneficiaries of the existing inefficient system. Nevertheless, they assured the staff that they would continue to work to build a political coalition in support of the reform.

19. **Efforts are underway to further strengthen the banking system.** Banks are preparing adjustment plans to reach the higher provisioning requirements approved in November (a prior action for the SBA). The authorities have also prepared the enabling regulations to implement the Bank Resolution Law approved late last year. The Superintendency of Banks, with technical assistance from the Fund, is continuing efforts to improve on-site supervision and its use of financial data to monitor banking system developments. Preparations are underway for a World Bank Financial Sector loan that would support comprehensive reform of banking system legislation (including reforms of the central bank itself), an anti-money laundering law, and development of a strategic plan for the Superintendency. The authorities also reiterated their interest in an FSAP (planned for later in 2004).

## D. Other Issues

### Pension reform

20. **The law to reform the public employees pension fund (*Caja Fiscal),* a March 8, 2004 performance criterion, was approved by Congress in December** (Box 3). In response to a teachers' strike in October–November over the law, the proposed reduction in benefits was somewhat diluted. Nevertheless, the law still represents a major overhaul of the deficit-plagued system. The immediate net fiscal savings from the law are expected to be around 0.3 percent of GDP, with savings expected to build over the long-term to over 2 percent of GDP per year. The law, together with steps to purge the roster of beneficiaries of false claims and increased budgetary funding for noncontributory pensions of Chaco War veterans, will substantially reduce the actuarial deficit. Additional action will eventually be needed, however, to deal with the longer-term challenges of the system.

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[12] The main refinements needed in the law are: (i) limiting public financial intermediation to the two entities created in the law; (ii) emphasizing the objective of channeling funds to the rural sector; (iii) specifying stricter rules for the use of public sector deposits; and (iv) requiring renegotiation of lending agreements with international lenders to assure that only the new banks will accept such funds.

## Public enterprises

21. **The government has accelerated the restructuring of public enterprises.** As noted, management was recently changed at the state oil company Petropar and at the National Cement Company (INC), both seriously affected by scandals and suffering from financial difficulties. Reform plans for Petropar are being developed with assistance from the World Bank. The authorities have indicated their intention to open both companies to private capital.

22. **Progress in conducting external audits of key public enterprises and institutions (a performance criterion for end-September 2004) has been uneven.** Some institutions (the electricity, water, and telecommunications companies, and the central bank) already undertake regular external audits and are proceeding satisfactorily. In Petropar and INC, audits are being pursued by the ministry of industry and commerce as part of the reform process, but other institutions (the social security institute, airport authority, and telecommunications commission) have yet to begin the auditing process. The staff urged the authorities to accelerate audits to ensure that the end-September target will be met.

## Governance

23. **The authorities have strengthened their efforts to improve governance and transparency.** The changes in management in the social security institute and several public enterprises reflect the commitment to improve management of these institutions, while public sector audits will improve transparency. The application of the new procurement law is reducing the scope for corruption in public expenditure, as are audits of the registries of public employment and of the beneficiaries of public pensions. The tax authorities have initiated legal action against several alleged tax evaders, and officials have been removed from office for corrupt activities in the tax administration and Ministry of Finance. President Duarte Frutos is also pursuing the reconstitution of the supreme court and other legal institutions.

## Trade

24. **In December 2003, Mercosur approved several measures to give Paraguay special treatment within the trading bloc.** The measures include an extension of the deadline to harmonize tariffs with the Common External Tariff (CET) to 2010, which will prolong exemptions for a number of products,[13] an extension of the exemptions for Paraguay's duty-free zones until 2014, beneficial "rules of origin" treatment for Paraguay's imports of intermediate goods used in exports, and the establishment by Mercosur of structural funds to channel development assistance to less developed regions. Also in March,

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[13] These exemptions cover three areas: (i) 549 goods chosen by the Paraguayan government, (ii) capital goods, computers and telecommunications; and (iii) intermediate goods.

all of Paraguay's temporary import surcharges on imports from Mercosur partners are due to expire.

**Statistical issues**

25. **The timeliness and coverage of economic statistics have improved notably, but more progress is needed to overcome a history of weak data and reporting standards.** The authorities issued a decree in November requiring stricter monthly reporting standards of all public sector entities, but some lags from various decentralized agencies, public enterprises, and local governments remain. Moreover, weak public debt service management and reporting standards contributed to the authorities' inability to comply with the end-December arrears performance criteria. The staff also urged the authorities to step up efforts to secure financial data on financial cooperatives.

### E. Program Risks

26. **Near-term economic risks have abated, though maintaining the domestic consensus for structural reform will remain challenging**. The improved economic outlook for the region—along with stronger domestic economic activity and the good start made by the authorities with their economic reform agenda—has substantially reduced the risk of a near-term downturn and contagion from neighboring countries. However, the stronger economy and the possibility of higher-than-projected capital inflows, may increase inflationary or upward exchange rate pressures. Although the government remains popular, there is the risk that broad support for reforms could be undermined by political opposition and interest groups that benefit from the status quo. A failure to sustain structural reforms would significantly reduce prospects for boosting growth, and would leave the country more vulnerable to future shocks.

## III. Staff Appraisal

27. **Paraguay has made significant progress in the first months of the program.** Economic activity has strengthened, inflation prospects have improved, and renewed confidence in economic policy management has helped boost banking system deposits and central bank reserves. These improvements—together with the better regional economic environment—present Paraguay with a historic opportunity to implement far-reaching economic reforms and lay the groundwork for sustained economic growth and poverty reduction in the medium term.

28. **Fiscal performance has been favorable, but continued reforms are needed to keep the program on track.** Improved tax collections due to better tax administration provided a cushion for compliance with the end-December deficit targets. However, there are signs that this improvement in tax efficiency is reaching its limit, unless momentum is maintained through structural reforms. Key items on the reform agenda include the approval of the pending Fiscal Adjustment Law, a new customs code, and further restructuring of the tax and customs administrations. The staff commends the authorities' willingness to

implement contingency measures to assure that its revenue objectives are met, although it regrets the recourse to the taxation of selected exports, which should be replaced by less distortionary measures as soon as possible.

29. **The authorities need to remain vigilant in their efforts to control spending overruns.** Capital investment was significantly above the program in Q4 of 2003, and care should be taken to assure this spending does not imperil fiscal compliance in 2004. The early approval of the public pension reform law will provide some expenditure relief, but its benefits are mainly long term, leaving the authorities with the challenge of controlling costs through improved monitoring and through their ongoing efforts to audit the rosters of public pensioners and the payroll of public employees. Although the public pension reform generates important savings in net present-value terms, the staff urges the authorities to monitor closely the evolution of the *caja fiscal* and to adopt further reforms if the savings prove insufficient to achieve long-term financial sustainability.

30. **The staff welcomes the authorities' efforts to address Paraguay's payments arrears difficulties.** The initiative to pay off all bilateral arrears ahead of schedule reaffirms the government's commitment to responsible economic management. It will also ease the authorities' burden in monitoring payments going forward. Nevertheless, the difficulties in complying with two debt-related performance criteria emphasize the need for improved control and oversight of the payments process. The staff urges the authorities to address the cash flow difficulties in two highly indebted public enterprises—ESSAP and Petropar—which could jeopardize compliance with future targets.

31. **The central bank's monetary program for 2004 provides for a significant reduction in the growth rate of monetary aggregates.** The staff commends the authorities for the prudent stance of monetary policy, although it notes that monetary developments need to be kept under close review, particularly in light of possible continued sizable foreign exchange inflows. The authorities should also monitor closely the evolution of banking system excess reserve deposits in the Central Bank, since a rapid drawdown could prove inflationary. While in the staff's view, the strength of the *guaraní* does not present a competitiveness problem at this time, the appreciation of the real effective exchange rate should be closely monitored. In the meantime, the BCP should maintain its policy of limiting intervention in the foreign exchange market to that needed to smooth out seasonal fluctuations in foreign currency demand. The staff considers the short-term loan from the central bank to the Ministry of Finance for arrears reduction appropriate under the circumstances, but it is important that future central bank credit to the government be avoided.

32. **The banking system is stabilizing, but continued vigilance is required.** The improving financial condition of commercial banks should allow them to resist future shocks, but many banks continue to make losses and lending has yet to pick up. Improved management and recapitalization of the BNF have averted an imminent crisis, but comprehensive public banking reform cannot be delayed or the crisis will re-emerge.

33. **The authorities have made a good start in their structural reform agenda.** The early approval of the public pension reform law is a major step in improving the medium-term fiscal prospects. The authorities have also been actively pursuing their Fiscal Adjustment Law and the new Customs Code. Serious reform efforts are beginning in some key public enterprises (Petropar and INC), although controls and auditing initiatives have been unevenly implemented thus far. The authorities should increase their auditing efforts if future program targets are to be met. The staff welcomes the strong emphasis in the program on strengthening governance and urges the authorities to persevere in their efforts in this area, by continuing to improve transparency and initiate legal reforms.

34. **The government will need to continue working to build and sustain a broad domestic consensus on reforms.** The staff encourages the authorities to vigorously pursue their efforts at mobilizing support for their reform agenda in Congress as well as with the public and civil society. This will be critical in the months ahead in order to sustain program implementation and achieve early results in the face of renewed risks of opposition to reforms from special interests.

35. **In light of the strong performance under the program, the staff recommends completion of the first review and approval of the requested waivers.**

**Box 1. Recent Developments in the Fiscal Law**

**The Administrative Reorganization and Fiscal Adjustment Law is scheduled to be considered and approved by the Chamber of Deputies by end-March and then go to the Senate.** The current version of the Law will:

- Eliminate all exemptions to the profit tax (with a gradual phase-out of tax holidays), while reducing the tax rate from 30 percent to 10 percent;
- Eliminate exemptions and standardize the small business tax (*tributo único*) and land rent tax (*Imagro*) to be uniform with profit tax so as to reduce distortions across the tax base.
- Introduce a personal income tax. Initially it is expected to yield very little, as those with income below 10 minimum salaries, (about 95 percent of households), are exempt. However, this ceiling will gradually be lowered over time.
- Eliminate all exemptions to the VAT (more gradually for agricultural products);
- Introduce a tax on the value of automobiles (*patente fiscal*).
- Widen the base of the excise tax and raise tax rates from 12 percent to up to 20 percent for alcohol and tobacco products.
- Increase the operational transfer to the tax authority to 3.5 percent of tax revenues

**The timely passage of the law is a priority of the current administration, despite vocal opposition by some groups and recent postponement of legislative action.** Before the two-month Congressional recess began in December 2003, the Chamber of Deputies had approved most of the important articles of the Law but, in a concession to the opposition, decided to revisit it upon reconvening in March. It is still possible to obtain approval of the Law within the program deadline of end-May. The authorities are working closely with the congressional finance committee members to ensure that the most important elements of the law are preserved, namely, the widening of the VAT base, the elimination of exemptions and the introduction of the personal income tax.

**Box 2. Reform of the Caja Fiscal**

**Congress approved a new law regulating the various public employees' pension plans on December 22, 2003.** The new law, with regulations issued on January 30, 2004, aims at improving the actuarial balance of the system and at reducing the heterogeneity across old-age pension plans. The main changes are as follows:

- An increase in the **contribution rate** from 14 to 16 percent for all workers.
- An increase in the **retirement age** to 62, making retirement mandatory at this age, except for police and army officers—for whom the old rules continue to apply—and teachers (see below). **Early retirement** is allowed at 50 with at least 20 years of service.
- Broadening the **base wage** used to compute the pension benefit by defining it as the average wage in the last five years of service rather than the last year.
- Lowering the **replacement rate** at 20 percent of the base wage plus 2.7 percent for each year of service (previously 93 percent of the base wage).
- Eliminating the **thirteen-month bonus** (*aguinaldo*).
- Linking **pension indexation** to CPI inflation rather than public wage increases.

**The new law retains some special provisions for the teachers' pension plan,** most importantly by allowing ordinary retirement after 25 years of service at a replacement rate of 83 percent. These exceptions were negotiated with the teachers' unions following protests from the teachers. The law also allows teachers with at least 20 years of service to opt for the old regime until December 31, 2004 (about 6,000 teachers are eligible). The new provisions for teachers are nonetheless a clear improvement over the existing situation. First, the new minimum retirement age for teachers is still higher than the age at which many teachers now retire. Second, the broader definition of the base wage is particularly important for teachers, given the common current practice of teachers working more hours and shifts just prior to retirement. Finally, the law essentially eliminates early retirement for teachers, which remains only as a disability pension.

**In the short-run, the reform is likely to generate savings of around 0.3 percent of GDP in 2004.** The increase in the contribution rate and the elimination of the thirteen-month bonus will generate savings of around 0.25 of GDP; further savings will arise mainly from increasing the retirement age for the nonteacher plans.

**Preliminary actuarial calculations show that the reform generates major long-term savings (Table).** The Caja Fiscal was on an explosive path in the prereform scenario, with the net present value of deficits in 2003–2050 approaching 80 percent of GDP. The reform addresses these dynamics by cutting the net present value of deficits by more than half, but—by itself—it still leaves unfunded liabilities worth about 37 percent of GDP. The main findings of these calculations can be summarized as follows:

- The reform generates savings in net present value terms worth about 20 percent of GDP from the teachers' pension plan, which accounts for almost half of the prereform net present value of deficits. Two-thirds of these savings arise from the lower pension benefits in the new law.
- Raising the retirement age has an effect that diminishes over time, because mandatory retirement introduced by the law is likely to raise over time the number of retirees in those sectors—such as the public and judicial administration—where many employees tend to retire late in life.
- The reform achieves financial balance in net present values for judges and university professors. However, these plans are too small to generate a large impact on the overall deficit of the Caja Fiscal.
- The reform has a relatively small impact on the deficits of the pension plans for police and army officers. The reform reduces the combined net present value of deficits in these plans from over 30 percent in the prereform scenario to about 20 percent of GDP.

**Box 2. Reform of the Caja Fiscal (concluded)**

Paraguay: Estimated Savings from Reforming the Caja Fiscal 1/

| | 2003 | 2004 | 2005 | 2010 | 2020 | 2030 | 2040 | 2050 | **NPV 2/** |
|---|---|---|---|---|---|---|---|---|---|
| Overall balance | | | | | *Percent of GDP* | | | | |
| Before reform | -0.8 | -0.9 | -0.9 | -1.2 | -2.0 | -2.9 | -3.6 | -4.2 | **-77.8** |
| After reform | -0.8 | -0.5 | -0.5 | -0.6 | -0.9 | -1.4 | -1.7 | -1.9 | **-37.2** |
| Savings | - | 0.4 | 0.4 | 0.6 | 1.1 | 1.5 | 1.9 | 2.3 | **40.6** |
| Source of savings: 3/ | | | | | *Percent of Savings* | | | | |
| Raising retirement age | - | 18.8 | 19.0 | 16.3 | 7.1 | 1.7 | -1.7 | -3.7 | **3.3** |
| Lowering pension benefits | - | 6.3 | 12.7 | 34.9 | 59.4 | 71.9 | 79.3 | 84.2 | **67.0** |
| Abolishing aguinaldo | - | 30.4 | 27.3 | 19.2 | 14.3 | 12.2 | 10.8 | 9.5 | **13.1** |
| Raising contribution rate | - | 36.6 | 33.0 | 22.2 | 13.7 | 9.8 | 8.2 | 7.2 | **11.9** |
| More employees contribute | - | 2.8 | 3.2 | 3.7 | 3.0 | 2.2 | 1.5 | 0.9 | **2.2** |
| Survivors pensions | - | 5.1 | 5.0 | 3.7 | 2.6 | 2.1 | 2.0 | 1.9 | **2.4** |

Sources: Minister of Finance; and Fund staff estimates.

1/ Actuarial computations on the contributing regimes of the Caja Fiscal (excluding Chaco War pensions).
2/ NPV represents the net present value of operational balances between 2003 and 2050 at an annual real interest rate of 5 percent.
3/ Savings computed without taking into account the transitory regime for teachers.

**The government has also started reorganizing the public pension administration and reviewing the roll of beneficiaries.** With assistance from the IDB, the government hired *Price Waterhouse Cooper* to help reorganize the pension administration and computerize its databases. The work has already provided a preliminary diagnosis and a detailed agenda for reform. On a related front, the government is completing a questionnaire-based census of public employees that will provide a detailed database of the contributors to the pension system. In a second stage, the government plans to extend this census to the pension recipients, further deepening the clean-up of the registry of beneficiaries.

**Finally, the law generates savings from the Chaco war pensions, which generated a deficit of 0.7 percent of GDP in 2003**. In particular, the law reduces the survivor pensions to 75 percent of the original pension, tightens somewhat the eligibility criteria, and abolishes the *aguinaldo*. According to staff's calculations, these measures should generate savings of 0.1 percent of GDP in 2004 and of about 2 percent of GDP in net present value terms. Furthermore, by separating the administration of Chaco War pensions from the other contributing plans and by requesting that the former be fully financed in the annual budget law, the reform will make explicit the cost to society of Chaco War pensions.

**Box 3. Safeguards Assessment Status**

**A safeguards assessment of the adequacy of the Central Bank of Paraguay (BCP) was undertaken in late 2002 by the Finance Department.** The safeguards assessment found that the BCP had improved its audit safeguards since the late 1990s but continues to suffer from deficiencies. Among the key findings, the assessment found that: (i) the BCP lacks sufficient operational autonomy from the Ministry of Finance (MOF); (ii) full application of international accounting standards is needed to fully reflect the BCP's financial weaknesses; and (iii) procedural controls over the compilation of program monetary data require strengthening.

**Among the main recommendations of the safeguard assessment included in the SBA are the following:**

- Signature of a Memorandum of Understanding (MOU) with the MOF designed to regularize their relationship and to give the bank greater operational autonomy (completed, see below).
- Application of international accounting standards and annual external audits of the BCP by June 2004.
- Preparation of structural reforms of the Central Bank to improve its management and operations.
- Improve provision of monetary data to be used for program monitoring purposes.

**In February 2004, the BCP and the MOF signed the MOU.** The key provisions of the MOU are to:

- Phase out the annual contribution from the BCP to the MOF, eliminating it fully by 2007. The annual contribution will be reduced by 50 percent in 2005 and by 75 percent in 2006 (relative to the 2004-budgeted contribution).
- Prevent adjustments made by the MOF to the BCP proposed annual budget.
- Grant full autonomy to the BCP in determining its monetary budget to enable it to conduct monetary policy objectives more efficiently.
- Simplify the procurement process of the BCP for its nonmonetary spending by allowing it to issue procurement certificates, provided the spending is budgeted for in the annual fiscal budget.
- Start a process to reconcile disputed debts between the MOF and the BCP, which should increase the transparency of the BCP balance sheet and clarify its capital position. The reconciliation of most debts (those contracted after the BCP's Charter Law went into effect) will be concluded by December 2004. The remainder will be reconciled by December 2005.

Table 1. Paraguay: Selected Economic Indicators, 1999–2004

| | 1999 | 2000 | 2001 | 2002 | 2003 Prog. | 2003 Est. | 2004 Prog. | 2004 Proj. |
|---|---|---|---|---|---|---|---|---|
| (Annual percent change) | | | | | | | | |
| **National accounts and prices** | | | | | | | | |
| GDP at current prices | 3.0 | 11.5 | 4.4 | 13.7 | 16.7 | 16.8 | 9.3 | 9.2 |
| GDP at constant prices | 0.5 | -0.4 | 2.7 | -2.3 | 2.0 | 2.3 | 2.4 | 2.7 |
| Consumption | -3.6 | 0.8 | 6.2 | -5.1 | 2.6 | 2.7 | 2.4 | 2.6 |
| Investment | -3.8 | -0.7 | -17.5 | -11.0 | -4.6 | -3.6 | 7.6 | 8.4 |
| Net exports (contribution to growth) | 4.8 | -0.9 | 0.4 | 4.4 | 0.3 | 0.3 | -0.8 | -0.9 |
| Exports | -27.0 | -15.1 | -0.4 | 14.3 | 3.6 | 12.3 | 0.2 | 2.0 |
| Imports | -27.1 | -6.7 | -1.6 | -6.3 | 1.5 | 7.8 | 3.0 | 4.3 |
| GDP deflator | 2.5 | 11.9 | 1.7 | 16.4 | 14.3 | 14.7 | 6.7 | 6.3 |
| Consumer prices (average) | 6.8 | 9.0 | 7.3 | 10.5 | 14.1 | 14.2 | 7.5 | 8.0 |
| Consumer prices (end-of-period) | 5.4 | 8.6 | 8.4 | 14.6 | 8.8 | 9.3 | 8.0 | 8.0 |
| Real effective exchange rate | | | | | | | | |
| Average (depreciation -) | 6.4 | -3.1 | -1.5 | -3.9 | ... | -6.0 | ... | ... |
| End-of-period (depreciation -) | 2.4 | 4.3 | -12.5 | -6.6 | ... | 9.7 | ... | ... |
| (In millions of U.S. dollars) | | | | | | | | |
| **External sector** | | | | | | | | |
| Exports, f.o.b. | 2,307 | 2,322 | 1,876 | 1,878 | 2,102 | 2,114 | 2,111 | 2,205 |
| Imports, c.i.f. | 2,750 | 2,864 | 2,495 | 2,159 | 2,339 | 2,396 | 2,398 | 2,510 |
| Current account | -165 | -163 | -278 | 92 | 83 | 118 | 26 | 66 |
| (In percent of GDP) | -2.1 | -2.1 | -4.0 | 1.7 | 1.4 | 2.0 | 0.4 | 1.0 |
| Capital account | 509 | 157 | 152 | 51 | -308 | 186 | 116 | 27 |
| Overall balance | 87 | -254 | -45 | -83 | 75 | 234 | 141 | 93 |
| Terms of trade (deterioration -) | 2.3 | -4.6 | 0.0 | 7.4 | 6.4 | 6.4 | -4.8 | 0.9 |
| (In percent of GDP) | | | | | | | | |
| **Public sector** | | | | | | | | |
| Central government primary balance | -2.8 | -3.1 | 0.2 | -1.7 | 1.0 | 0.9 | 1.6 | 1.8 |
| Central government overall balance | -3.6 | -2.9 | -4.4 | -2.3 | -0.3 | -0.3 | 0.2 | 0.6 |
| Consolidated public sector primary balance 1/ | -1.8 | -2.6 | 1.0 | -1.3 | 1.2 | 1.9 | 2.2 | 2.9 |
| Consolidated public sector overall balance 1/ | -5.3 | -1.0 | -3.3 | -3.1 | -0.5 | 0.1 | 0.3 | 1.2 |
| Public sector external debt (end-of-year) | 28.9 | 30.6 | 33.5 | 44.5 | 44.3 | 44.7 | 42.6 | 41.4 |
| Domestic public sector debt | 3.1 | 3.4 | 4.9 | 6.8 | 4.8 | 4.7 | 5.3 | 5.1 |
| (Annual percent change) | | | | | | | | |
| **Money and credit** | | | | | | | | |
| Monetary base | 9.5 | -1.3 | 5.8 | -1.0 | 49.9 | 57.7 | 3.2 | 15.6 |
| M2 | 10.7 | 2.2 | 4.9 | -2.2 | 19.0 | 24.9 | 17.0 | 18.3 |
| M5 2/ | 6.4 | -0.1 | 1.5 | -18.5 | 18.4 | 17.7 | 14.4 | 11.1 |
| Net foreign assets 3/ | 13.1 | -5.4 | -5.5 | -12.8 | 25.2 | 32.3 | 4.8 | 5.2 |
| Net domestic assets 3/ | -6.7 | 5.3 | 7.0 | -5.6 | -6.8 | -14.6 | 9.6 | 5.9 |
| Credit to the public sector 3/ | -9.0 | 2.3 | 3.5 | 5.2 | 2.5 | -4.0 | 0.7 | -1.9 |
| Credit to the private sector 3/ | 1.3 | -0.8 | -0.7 | -14.9 | -10.7 | -12.8 | 6.3 | 7.4 |
| Velocity of M2 | 6.6 | 7.2 | 7.2 | 8.3 | 8.2 | 7.8 | 7.6 | 7.2 |
| **Memorandum items:** | | | | | | | | |
| International reserves (in millions of U.S. dollars) | 988 | 772 | 723 | 641 | 818 | 982 | 855 | 982 |
| (In months of imports) | 3.6 | 3.2 | 3.5 | 2.8 | 3.7 | 4.1 | 3.5 | 3.9 |
| GDP (in billions of guaranies) | 24,144 | 26,921 | 28,119 | 31,977 | 37,302 | 37,333 | 40,779 | 40,771 |

Sources: Paraguayan authorities; and Fund staff estimates.

1/ Consolidated public sector, including the quasi-fiscal operations of the BCP.
2/ Foreign currency items are valued at a constant exchange rate.
3/ Contribution to M5 growth.

Table 2. Paraguay: Quantitative Performance Criteria

| | December 31, 2003 | | | 2004 | | | |
|---|---|---|---|---|---|---|---|
| | | | | Performance Criteria | Indicative Target | | |
| | Actual | Target (unadjusted) | Target (adjusted) | Mar. 31 | Jun. 30 | Sep. 30 | Dec. 31 |
| **Monetary targets** | | | | | | | |
| Net international reserves (floor, in millions of U.S. dollars) 1/ | 982 | 818 | 812 | 762 | 836 | 822 | 855 |
| Net domestic assets (ceiling, in billions of guaranies) 1/ | -3,961 | -2,890 | -2,852 | -2,770 | -3,085 | -3,055 | -2,761 |
| **Fiscal targets** | | | | | | | |
| Overall balance of the central administration (floor, in billions of guaranies) | -100 | -125 | -125 | 240 | 320 | 440 | 55 |
| Wage bill of the central administration (ceiling, in billions of guaranies) | 2,724 | 2,750 | 2,750 | 650 | 1,310 | 1,990 | 2,900 |
| Overall balance of the public sector (floor, in billions of guaranies) | 33 | -321 | -321 | 250 | 350 | 495 | 130 |
| **Public debt and arrears targets** | | | | | | | |
| Contracting or guaranteeing of nonconcessional debt by the NFPS (ceiling, in millions of US$) | 0 | 50 | 50 | 100 | 150 | 200 | 200 |
| External payments arrears of NFPS (ceiling, in millions of US$) | 91 | 102 | 102 | 75 | 23 | 5 | 0 |
| *Of which:* bilateral arrears 2/ | 43 | 51 | 51 | 38 | ... | ... | ... |
| Central government floating debt (ceiling, in billions of guaranies) 3/ | 400 | 360 | 147 | 350 | 320 | 285 | 250 |
| **Continuous PCs** | | | | | | | |
| Contract or guarantee short-term external debt by the NFPS | observed | | | | | | |
| No new external debt arrears | not observed | | | | | | |

Sources: IMF Country Report No. 04/66; TMU; and staff estimates.

1/ NIR is adjusted upward (downward) for any increase (decrease) in reserve requirement deposits. Similarly, the NDA target will be adjusted upward (downward) following the adjustment in the NIR.

2/ The end-September 2003 stock of bilaterals arrears erroneously included US$7 million of disputed arrears. This did not affect compliance with the target. Targets for end-June 2004 and thereafter have been set to zero, reflecting the authorities clearance of arrears in advance of the original program schedule.

3/ The ceiling is adjusted downward by any excess in program lending above US$15 million (expressed in Guaranies). The stock of floating debt in September has been revised, due to a mistake in reporting, from G277 billion to G384 billion.

Table 3. Paraguay: GDP and Prices

| | 1999 | 2000 | 2001 | 2002 | 2003 Prog. | 2003 Est. | 2004 Prog. | 2004 Proj. |
|---|---|---|---|---|---|---|---|---|
| I. National Accounts | | | | | | | | |
| (In annual percentage change) | | | | | | | | |
| Real GDP | 0.5 | -0.4 | 2.7 | -2.3 | 2.0 | 2.3 | 2.4 | 2.7 |
| Contribution to growth: | | | | | | | | |
| Consumption | -3.5 | 0.7 | 5.8 | -5.0 | 2.4 | 2.5 | 2.2 | 2.5 |
| Investment | -0.8 | -0.1 | -3.5 | -1.8 | -0.7 | -0.5 | 1.0 | 1.2 |
| Exports | -7.9 | -3.2 | -0.1 | 2.5 | 0.7 | 2.5 | 0.0 | 0.4 |
| Imports | 12.7 | 2.3 | 0.5 | 1.9 | -0.4 | -2.3 | -0.9 | -1.3 |
| (In percent of GDP) | | | | | | | | |
| Gross domestic investment | 23.0 | 21.8 | 19.8 | 19.1 | 18.3 | 17.2 | 18.7 | 18.3 |
| Private | 11.8 | 14.9 | 14.7 | 13.2 | 13.4 | 12.3 | 13.1 | 13.3 |
| Public | 11.2 | 7.0 | 5.1 | 5.9 | 4.9 | 4.9 | 5.6 | 5.0 |
| Gross national savings | 20.9 | 19.7 | 15.8 | 20.7 | 19.7 | 19.3 | 19.1 | 19.3 |
| Private | 18.9 | 20.7 | 14.6 | 19.8 | 15.9 | 14.8 | 13.8 | 13.7 |
| Public | 2.0 | -1.0 | 1.2 | 0.9 | 3.8 | 4.4 | 5.3 | 5.6 |
| II. Prices | | | | | | | | |
| (In annual percentage change) | | | | | | | | |
| GDP deflator | 2.5 | 11.9 | 1.7 | 16.4 | 14.3 | 14.7 | 6.7 | 6.3 |
| Consumer prices: | | | | | | | | |
| End-of-period | 5.4 | 8.6 | 8.4 | 14.6 | 8.8 | 9.3 | 8.0 | 8.0 |
| Period average | 6.8 | 9.0 | 7.3 | 10.5 | 14.1 | 14.2 | 7.5 | 8.0 |
| Guarani/US$ exchange rate | | | | | | | | |
| End-of-period | 16.7 | 6.9 | 30.7 | 51.0 | ... | ... | ... | ... |
| Period average | 15.0 | 11.8 | 17.8 | 38.4 | ... | ... | ... | ... |
| **Memorandum items:** | | | | | | | | |
| Real GDP per capita (percentage change) | -2.0 | -2.8 | 0.3 | -4.6 | -0.7 | -0.4 | -0.3 | 0.0 |
| Population (percentage change) | 2.7 | 2.6 | 2.5 | 2.5 | 2.7 | 2.7 | 2.7 | 2.7 |
| GDP (in billions of guaranies) | 24,144 | 26,921 | 28,119 | 31,977 | 37,302 | 37,333 | 40,779 | 40,778 |
| GDP (in millions of U.S. dollars) | 7.756 | 7.734 | 6.858 | 5.633 | 5.731 | 5.782 | 6.117 | 6.410 |

Sources: Central Bank of Paraguay; and Fund staff estimates.

Table 4. Paraguay: Central Government Operations

| | 2000 | 2001 | 2002 | 2003 Prog. | 2003 Est. | 2004 Prog. | 2004 Proj. |
|---|---|---|---|---|---|---|---|
| | (In billion of guaraníes) | | | | | | |
| **Total revenues 1/** | **4,214** | **4,892** | **5,048** | **5,877** | **6,001** | **6,809** | **6,894** |
| Tax revenues | 2,677 | 2,851 | 2,923 | 3,683 | 3,676 | 4,395 | 4,555 |
| Value added tax | 1,150 | 1,204 | 1,235 | 1,462 | 1,570 | 1,809 | 1,957 |
| Nontax revenues 2/ | 1,453 | 1,983 | 2,118 | 2,190 | 2,318 | 2,412 | 2,337 |
| Capital revenues | 84 | 57 | 7 | 4 | 7 | 3 | 3 |
| **Current expenditures**: | **4,369** | **4,378** | **4,766** | **4,998** | **4,981** | **5,335** | **5,317** |
| Wages and salaries | 2,401 | 2,400 | 2,582 | 2,728 | 2,724 | 2,882 | 2,881 |
| Goods and services | 420 | 295 | 373 | 426 | 408 | 505 | 496 |
| Interest payments | 312 | 378 | 456 | 478 | 489 | 562 | 508 |
| Transfers | 1,196 | 1,270 | 1,326 | 1,341 | 1,334 | 1,304 | 1,348 |
| *Of which* : pensions and benefits | 797 | 879 | 913 | 937 | 943 | 899 | 918 |
| Other | 39 | 35 | 29 | 26 | 26 | 83 | 85 |
| **Capital expenditures and net lending** | **994** | **831** | **1,281** | **1,001** | **1,165** | **1,395** | **1,343** |
| *Of which:* | | | | | | | |
| Net lending | 97 | -80 | -6 | -90 | -88 | -41 | -41 |
| Primary balance | -836 | 60 | -543 | 356 | 344 | 641 | 742 |
| Statistical discrepancy 3/ | 375 | -910 | 271 | ... | 45 | | |
| **Overall balance** | **-774** | **-1,228** | **-728** | **-122** | **-100** | **79** | **234** |
| | (In percent of GDP) | | | | | | |
| **Total revenues** | **15.7** | **17.4** | **15.8** | **15.8** | **16.1** | **16.7** | **16.9** |
| Tax revenues: | 9.9 | 10.1 | 9.1 | 9.9 | 9.8 | 10.8 | 11.2 |
| Income taxes | 1.8 | 1.7 | 1.4 | 1.6 | 1.7 | 1.0 | 1.0 |
| Excises | 1.6 | 2.0 | 1.9 | 2.2 | 1.9 | 3.2 | 3.1 |
| Value added tax | 4.3 | 4.3 | 3.9 | 3.9 | 4.2 | 4.4 | 4.8 |
| Import duties | 1.8 | 1.8 | 1.6 | 2.0 | 1.8 | 1.7 | 1.7 |
| Other | 0.5 | 0.4 | 0.4 | 0.3 | 0.3 | 0.5 | 0.5 |
| Nontax revenues 2/ | 5.4 | 7.1 | 6.6 | 5.9 | 6.2 | 5.9 | 5.7 |
| *Of which:* public pension contributions | 1.1 | 1.1 | 1.0 | 0.8 | 1.0 | 0.9 | 1.1 |
| Itaipu-Yacyreta | 2.5 | 4.1 | 3.9 | 3.7 | 3.9 | 3.4 | 3.1 |
| Capital revenues | 0.3 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Current expenditures**, *of which:* | **16.2** | **15.6** | **14.9** | **13.4** | **13.3** | **13.1** | **13.0** |
| Wages and salaries | 8.9 | 8.5 | 8.1 | 7.3 | 7.3 | 7.1 | 7.1 |
| Goods and services | 1.6 | 1.1 | 1.2 | 1.1 | 1.1 | 1.2 | 1.2 |
| Interest payments | 1.2 | 1.3 | 1.4 | 1.3 | 1.3 | 1.4 | 1.2 |
| Transfers | 4.4 | 4.5 | 4.1 | 3.6 | 3.6 | 3.2 | 3.3 |
| *Of which* : public pensions and benefits | 3.0 | 3.1 | 2.9 | 2.5 | 2.5 | 2.2 | 2.3 |
| Other | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 |
| **Capital expenditures and net lending** | **3.7** | **3.0** | **4.0** | **2.7** | **3.1** | **3.4** | **3.3** |
| Primary balance | -3.1 | 0.2 | -1.7 | 1.0 | 0.9 | 1.6 | 1.8 |
| Statistical discrepancy 3/ | 1.4 | -3.2 | 0.8 | ... | 0.1 | | |
| **Overall balance** | **-2.9** | **-4.4** | **-2.3** | **-0.3** | **-0.3** | **0.2** | **0.6** |
| **Financing** | **2.9** | **4.4** | **2.3** | **0.3** | **0.3** | **-0.2** | **-0.6** |
| External debt (increase +) | 1.7 | -0.1 | 0.4 | 0.6 | 1.6 | 0.7 | -0.9 |
| Disbursements | 2.9 | 1.3 | 2.3 | 2.1 | 3.1 | 3.7 | 2.3 |
| Amortizations 4/ | 1.2 | 1.4 | 1.9 | 1.6 | 1.5 | 3.2 | 3.3 |
| Domestic bonds (increase +) | -0.5 | 1.9 | -0.1 | -0.2 | -0.2 | -0.1 | -0.1 |
| Net credit from the banking system | 2.1 | 0.7 | -0.1 | 0.1 | -1.0 | -0.4 | 0.8 |
| Exceptional financing (incl. change in arrears) | -0.4 | 1.9 | 2.1 | -0.3 | -0.1 | -0.4 | -0.3 |
| **Memorandum Item:** | | | | | | | |
| Balance of the Caja Fiscal 5/ | -497 | -566 | -603 | -624 | -579 | -518 | -476 |
| (In percent of GDP) | -1.8 | -2.0 | -1.9 | -1.7 | -1.6 | -1.3 | -1.2 |

Sources: Ministry of Finance; and Fund staff estimates.

1/ For 2004, includes passage of the *Administrative Reorganization and Fiscal Adjustment Law* by end-May as envisaged in the program.

2/ Includes receipts from the binational hydroelectric plants Itaipu and Yacyreta, and grants.

3/ Measurement error to reconcile above-the-line estimate with measure of the fiscal balance from the financing side.

4/ Includes payments of ESSAP external debt amortizations for US$6.3 million in 2003 and US$11.6 in 2004, as well as arrears.

5/ Includes pension payments to central government employees and Chaco War veterans.

Table 5. Paraguay: Operations of the Rest of the Public Sector 1/

| | | | | | Projections | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | 2003 | | 2004 | |
| | 1999 | 2000 | 2001 | 2002 | Prog. | Est. | Prog. | Proj. |
| | (In billions of Guaranies) | | | | | | | |
| **Revenue** | **1,105** | **1,190** | **1,092** | **1,111** | **1,448** | **1,446** | **1,485** | **1,640** |
| Tax revenue | 0 | 4 | 3 | 3 | 4 | 0 | 6 | 0 |
| Nontax revenue and grants net of transfers to C( | 930 | 935 | 953 | 998 | 1,288 | 1,297 | 1,293 | 1,404 |
| Capital revenue | 174 | 251 | 135 | 109 | 156 | 150 | 185 | 237 |
| **Current expenditure** | **841** | **961** | **1,086** | **997** | **1,183** | **1,272** | **1,288** | **1,383** |
| Wages and salaries | 467 | 519 | 528 | 513 | 573 | 569 | 623 | 658 |
| Goods and services | 184 | 247 | 207 | 199 | 225 | 238 | 247 | 312 |
| Interest payments | 119 | 84 | 107 | 147 | 203 | 239 | 214 | 194 |
| Transfers | 54 | 88 | 70 | 128 | 168 | 202 | 188 | 194 |
| Other | 16 | 23 | 174 | 10 | 14 | 25 | 15 | 24 |
| **Capital expenditure and net lending** | **1,402** | **887** | **599** | **594** | **791** | **667** | **836** | **711** |
| **Primary balance** | **227** | **144** | **227** | **125** | **92** | **366** | **256** | **529** |
| **Public enterprises' operating surplus** | **1,246** | **718** | **712** | **458** | **416** | **621** | **680** | **789** |
| Statistical discrepancy | -515 | 458 | 177 | -236 | ... | 6 | ... | ... |
| **Overall balance** | **-407** | **518** | **297** | **-258** | **-110** | **133** | **42** | **335** |
| | (In percent of GDP) | | | | | | | |
| **Revenue** | **4.6** | **4.4** | **3.9** | **3.5** | **3.9** | **3.9** | **3.6** | **4.0** |
| Tax revenue | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nontax revenue and grants | 3.9 | 3.5 | 3.4 | 3.1 | 3.5 | 3.5 | 3.2 | 3.4 |
| Capital revenue | 0.7 | 0.9 | 0.5 | 0.3 | 0.4 | 0.4 | 0.5 | 0.6 |
| **Current expenditure** | **3.5** | **3.6** | **3.9** | **3.1** | **3.2** | **3.4** | **3.2** | **3.4** |
| Wages and salaries | 1.9 | 1.9 | 1.9 | 1.6 | 1.5 | 1.5 | 1.5 | 1.6 |
| Goods and services | 0.8 | 0.9 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.8 |
| Interest payments | 0.5 | 0.3 | 0.4 | 0.5 | 0.5 | 0.6 | 0.5 | 0.5 |
| Transfers | 0.2 | 0.3 | 0.2 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 |
| Other | 0.1 | 0.1 | 0.6 | 0.0 | 0.0 | 0.1 | 0.0 | 0.1 |
| **Capital expenditure and net lending** | **5.8** | **3.3** | **2.1** | **1.9** | **2.1** | **1.8** | **2.0** | **1.7** |
| **Primary balance** | **0.9** | **0.5** | **0.8** | **0.4** | **0.2** | **1.0** | **0.6** | **1.3** |
| **Public enterprises' operating surplus** | **5.2** | **2.7** | **2.5** | **1.4** | **1.1** | **1.7** | **1.7** | **1.9** |
| Statistical discrepancy | **-2.1** | **1.7** | **0.6** | **-0.7** | **...** | **0.0** | ... | ... |
| **Overall balance** | **-1.7** | **1.9** | **1.1** | **-0.8** | **-0.3** | **0.4** | **0.1** | **0.8** |
| **Financing** | **1.7** | **-1.9** | **-1.1** | **0.8** | **0.3** | **-0.4** | **-0.1** | **-0.8** |

Sources: Ministry of Finance; and Fund staff estimates.

1/ Defined as the nonfinancial public sector and the BCP, excluding the central government.

Table 6. Paraguay: Operations of the Consolidated Public Sector 1/

| | 1999 | 2000 | 2001 | 2002 | 2003 Prog. | 2003 Est. | 2004 Prog. | 2004 Proj. |
|---|---|---|---|---|---|---|---|---|
| | (In billions of guaranies) | | | | | | | |
| **Revenue** | **5,094** | **5,404** | **5,984** | **6,160** | **7,325** | **7,448** | **8,306** | **8,462** |
| Tax revenue | 2,398 | 2,680 | 2,855 | 2,926.9 | 3,687 | 3,676 | 4,384 | 4,555 |
| Nontax revenue and grants | 2,478 | 2,388 | 2,936 | 3,117 | 3,478 | 3,615 | 3,705 | 3,741 |
| Capital revenue | 218 | 336 | 193 | 116 | 160 | 156 | 217 | 166 |
| **Current expenditure** | **4,390** | **5,330** | **5,464** | **5,763** | **6,181** | **6,254** | **6,623** | **6,700** |
| Wages and salaries | 2,488 | 2,920 | 2,928 | 3,095 | 3,301 | 3,293 | 3,505 | 3,539 |
| Goods and services | 434 | 667 | 503 | 572 | 651 | 647 | 752 | 808 |
| Interest payments | 312 | 397 | 485 | 603 | 680 | 728 | 776 | 702 |
| Transfers | 1,064 | 1,285 | 1,340 | 1,455 | 1,508 | 1,535 | 1,492 | 1,542 |
| Other | 91 | 62 | 209 | 39 | 40 | 51 | 98 | 109 |
| **Capital expenditure and net lending** | **2,707** | **1,881** | **1,430** | **1,875** | **1,792** | **1,833** | **2,231** | **2,054** |
| **Primary balance** | **-445** | **-692** | **287** | **-418** | **448** | **710** | **909** | **1,198** |
| **Public enterprises' operating surplus** | **1,246** | **718** | **712** | **458** | **416** | **621** | **680** | **789** |
| Statistical discrepancy 2/ | -515 | 833 | -733 | 35 | ... | 51 | ... | ... |
| **Overall balance** | **-1,272** | **-256** | **-931** | **-986** | **-232** | **33** | **133** | **...** |
| | (In percent of GDP) | | | | | | | |
| **Revenue** | **21.1** | **20.1** | **21.3** | **19.3** | **19.6** | **19.9** | **20.4** | **20.8** |
| Tax revenue | 9.9 | 10.0 | 10.2 | 9.2 | 9.9 | 9.8 | 10.8 | 11.2 |
| Nontax revenue and grants | 10.3 | 8.9 | 10.4 | 9.7 | 9.3 | 9.7 | 9.1 | 9.2 |
| Capital revenue | 0.9 | 1.2 | 0.7 | 0.4 | 0.4 | 0.4 | 0.5 | 0.4 |
| **Current expenditure** | **18.2** | **19.8** | **19.4** | **18.0** | **16.6** | **16.8** | **16.2** | **16.4** |
| Wages and salaries | 10.3 | 10.8 | 10.4 | 9.7 | 8.9 | 8.8 | 8.6 | 8.7 |
| Goods and services | 1.8 | 2.5 | 1.8 | 1.8 | 1.7 | 1.7 | 1.8 | 2.0 |
| Interest payments | 1.3 | 1.5 | 1.7 | 1.9 | 1.8 | 2.0 | 1.9 | 1.7 |
| Transfers | 4.4 | 4.8 | 4.8 | 4.5 | 4.0 | 4.1 | 3.7 | 3.8 |
| Other | 0.4 | 0.2 | 0.7 | 0.1 | 0.1 | 0.1 | 0.2 | 0.3 |
| **Capital expenditure and net lending** | **11.2** | **7.0** | **5.1** | **5.9** | **4.8** | **4.9** | **5.5** | **5.0** |
| **Primary balance** | **-1.8** | **-2.6** | **1.0** | **-1.3** | **1.2** | **1.9** | **2.2** | **2.9** |
| **Public enterprises' operating surplus** | **5.2** | **2.7** | **2.5** | **1.4** | **1.1** | **1.7** | **1.7** | **1.9** |
| Statistical discrepancy 2/ | -2.1 | 3.1 | -2.6 | 0.1 | ... | 0.1 | ... | ... |
| **Overall balance** | **-5.3** | **-1.0** | **-3.3** | **-3.1** | **-0.5** | **0.1** | **0.3** | **...** |
| **Financing 3/** | **5.3** | **1.0** | **3.3** | **3.1** | **0.5** | **1.1** | **-0.3** | **...** |
| **Memorandum item:** | | | | | | | | |
| Overall balance of the social security (percent of GDP) | 0.6 | 0.3 | 0.6 | 0.8 | 0.7 | 0.9 | 0.5 | 0.8 |

Sources: Ministry of Finance; and Fund staff estimates.

1/ Public sector comprises the nonfinancial public sector and the central bank.

2/ Measurement error to reconcile above-the-line estimate with measure of the fiscal balance from the financing side.

3/ Assumes quasi-fiscal deficit of central bank entirely financed. Excludes quas-ifiscal loss from payments of *Multibanco* depositors for G123.1 billion.

Table 7. Paraguay: Public Sector Arrears
(In millions of US$)

| | Arrears (more than 1 day overdue) 1/ | | | | | | | End-2003 Program definition 2/ | |
|---|---|---|---|---|---|---|---|---|---|
| | Dec. 2002 | 2003 Q1 | Q2 | Q3 | Oct. | Nov. | Dec. | Target | Outcome |
| **Total public sector arrears** | **253** | **233** | **235** | **204** | **203** | **204** | **182** | **164** | **152** |
| **(In percent of GDP)** | **4.5** | **4.0** | **4.1** | **3.5** | **3.5** | **3.5** | **3.1** | **2.8** | **2.6** |
| Central government | **172** | **187** | **192** | **144** | **143** | **147** | **149** | **107** | **119** |
| Domestic (revised up by $17.2 million) | 115 | 147 | 138 | 75 | 84 | 88 | 63 | 61 | 61 |
| Ian billions of guaranies) | 643 | 880 | 768 | 384 | 431 | 537 | 383 | 384 | 384 |
| *Of which* : bonds 3/ | 22.8 | 19.8 | 14.3 | 14.3 | 14.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| External 4/ | 57.5 | 39.4 | 53.9 | 68.3 | 59.0 | 58.9 | 85.5 | 46 | 58 |
| *Of which:* | | | | | | | | | |
| Multilateral | 21.3 | 10.5 | 15.0 | 4.1 | 0.5 | 0.5 | 20.5 | 0 | 0.003 |
| World Bank | 11.2 | 4.0 | 9.1 | 0.0 | 0.1 | 0.0 | 9.7 | 0 | 0 |
| IDB | 10.1 | 6.5 | 5.9 | 4.1 | 0.5 | 0.5 | 10.8 | 0 | 0.003 |
| Rest of public sector | **81** | **46** | **43** | **60** | **61** | **57** | **34** | **57** | **34** |
| Domestic | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| External | 81 | 46 | 43 | 60 | 61 | 54 | 34 | 57 | 34 |
| *Of which* : PETROPAR arrears to foreign suppliers over 90 days | 70 | 30 | 30 | 44 | 44 | 37 | 22 | 44 | 22 |
| ESSAP arrears 5/ | ... | ... | ... | ... | ... | ... | ... | 8.5 | 4.4 |
| **Memorandum items:** | | | | | | | | | |
| External public debt arrears 6/ | 69 | 55 | 67 | 84 | 76 | 76 | 97 | **102** | **91** |
| Central government total debt service | 216 | 14 | 21 | 2 | 4 | 126 | 31 | ... | ... |
| Annual GDP | 5,633 | 5,782 | 5,782 | 5,782 | 5,782 | 5,782 | 5,782 | 5,782 | 5,782 |

1/ Public sector pending obligations more than 1 day overdue , except for last 2 columns (see footnote 2).
2/ The program considers as arrears: (i) all payments past due over 30 days (ii) nondisputed arrears; (iii) domestic arrears which exclude "normal" floating debt (equal to US$40 million).
3/ An agreement was reached to pay all remaining arrears on treasury bonds on November 15.
4/ Includes about US$14 million in disputed arrears, except for the last two columns (see footnote 2).
5/ Assumed to be paid by the central government under the program.
6/ Excludes Petropar arrears to foreign suppliers.

Table 8. Paraguay: Public Sector Financing
(In millions of US$ unless otherwise stated)

| | 2003 | | | | 2004 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Program | | Actual | | Projections | | | | | |
| | (In Millions of US$) | (In Percent of GDP) | (In Millions of US$) | (In Percent of GDP) | Q1 | Q2 | Q3 | Q4 | (In Millions of US$) | (In Percent of GDP) |
| **Gross financing requirements** | **205** | **3.6** | **202** | **3.5** | **82** | **15** | **18** | **87** | **202** | **3.2** |
| Deficit below the line 1/ | 27 | 0.5 | -6 | -0.1 | -47 | -36 | -44 | 43 | -85 | -1.3 |
| Net domestic debt amortizations 2/ | 9 | 0.2 | 9 | 0.2 | 0 | 0 | 9 | 0 | 9 | 0.1 |
| External debt amortizations paid 3/ | 133 | 2.3 | 127 | 2.2 | 36 | 36 | 38 | 39 | 150 | 2.3 |
| Net reduction in arrears | 37 | 0.6 | 71 | 1.2 | 93 | 15 | 15 | 4 | 127 | 2.0 |
| **Identified financing** | **190** | **3.3** | **152** | **2.6** | **63** | **16** | **18** | **48** | **146** | **2** |
| NFPS net credit from banking system (use of deposits) | 21 | 0.4 | -51 | -0.9 | 44 | -23 | -27 | -44 | -50 | -0.8 |
| *Of which* : BCP loan | | | | | 30 | -10 | -10 | -10 | 0 | 0.0 |
| Financing of the quasi-fiscal deficit | 50 | 0.9 | 54 | 0.9 | 7 | 9 | 9 | 10 | 35 | 0.6 |
| Project lending | 119 | 2.1 | 149 | 2.6 | 12 | 29 | 36 | 83 | 160 | 2.5 |
| **Financing gap** | **15** | **0.3** | **49** | **0.9** | **19** | **-1** | **0** | **39** | **56** | **0.9** |
| **Program financing** | **15** | **0.3** | **49** | **0.9** | **19** | **-1** | **0** | **39** | **56** | **0.9** |
| Fonplatra rescheduling | 0 | 0.0 | 0 | 0.0 | 9 | -1 | 0 | -1 | 6 | 0.1 |
| Program lending: | 15 | 0.3 | 49 | 0.9 | 10 | 0 | 0 | 40 | 50 | 0.8 |
| IDB | 15 | 0.3 | 20 | 0.3 | 10 | 0 | 0 | 15 | 25 | 0.4 |
| World Bank | 0 | 0.0 | 30 | 0.5 | 0 | 0 | 0 | 25 | 25 | 0.4 |
| **Residual financing gap** | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes measures under the program, as well as an assumption of a US$33 million BCP loan to the central government.
2/ Includes rollover of $138 million in maturing domestic bonds on November 15.
3/ Includes amortizations of the financial public sector guaranteed by the Republic of Paraguay.

Table 9. Paraguay: Monetary Program—Central Bank Balance Sheet
(In billions of guaranies; end-of-period; valued at constant exchange rate)

| | Actual | Projections | | | | Program | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2003 | 2004 | | | | Dec. | 2004 | | | |
| | Dec. | Mar. | Jun. | Sep. | Dec. | 2003 | Mar. | Jun. | Sep. | Dec. |
| **Net international reserves** | **6,167** | 5,491 | 5,635 | 5,618 | 6,170 | 5,137 | 4,785 | 5,250 | 5,162 | 5,369 |
| (in millions of U.S. dollars) | 982 | 874 | 897 | 895 | 982 | 818 | 762 | 836 | 822 | 855 |
| | | | | | | | | | | |
| **Net domestic assets** | **-3,961** | **-3,488** | **-3,474** | **-3,511** | **-3,599** | **-2,898** | **-2,783** | **-3,089** | **-3,055** | **-2,761** |
| Net nonfinancial public sector | 1,039 | 1,641 | 1,584 | 1,458 | 1,504 | 1,578 | 1,385 | 1,387 | 1,527 | 1,438 |
| Net credit to the general government | 829 | 1,431 | 1,374 | 1,248 | 1,294 | 1,363 | 1,170 | 1,172 | 1,312 | 1,223 |
| Central government | 828 | 1,431 | 1,373 | 1,247 | 1,293 | 1,363 | 1,170 | 1,171 | 1,311 | 1,222 |
| Credit | 1,974 | 2,160 | 2,098 | 2,036 | 1,974 | 1,986 | 1,986 | 1,986 | 1,986 | 1,986 |
| Deposits | 1,146 | 730 | 725 | 789 | 681 | 623 | 816 | 815 | 675 | 764 |
| Rest of general government | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Credit | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Deposits | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net credit to public enterprises | 210 | 210 | 210 | 210 | 210 | 215 | 215 | 215 | 215 | 215 |
| Credit | 239 | 239 | 239 | 239 | 239 | 232 | 232 | 232 | 232 | 232 |
| Deposits | 29 | 29 | 29 | 29 | 29 | 17 | 17 | 17 | 17 | 17 |
| Net credit to the financial system | -1,375 | -1,541 | -1,587 | -1,629 | -1,738 | -1,177 | -1,149 | -1,178 | -1,121 | -1,074 |
| Credit | 1,513 | 1,513 | 1,513 | 1,513 | 1,513 | 1,502 | 1,502 | 1,502 | 1,502 | 1,502 |
| Deposits | 2,889 | 3,054 | 3,100 | 3,142 | 3,251 | 2,678 | 2,651 | 2,680 | 2,623 | 2,576 |
| Net credit to the banking system | -2,751 | -2,917 | -2,963 | -3,004 | -3,113 | -2,473 | -2,445 | -2,474 | -2,417 | -2,370 |
| Total credit to banks | 2 | 2 | 2 | 2 | 2 | 87 | 87 | 87 | 87 | 87 |
| Loans and liquidity (+ active call) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other loans to banks | 2 | 2 | 2 | 2 | 2 | 87 | 87 | 87 | 87 | 87 |
| Deposits and reserve requirements | 2,753 | 2,919 | 2,964 | 3,006 | 3,115 | 2,559 | 2,532 | 2,561 | 2,504 | 2,457 |
| Bank deposits in local currency | 1,199 | 1,305 | 1,311 | 1,313 | 1,365 | 997 | 931 | 877 | 799 | 730 |
| Legal reserve requirement | 548 | 587 | 619 | 645 | 723 | 502 | 511 | 532 | 529 | 535 |
| Other reserve requirement deposits | 652 | 718 | 693 | 667 | 642 | 495 | 420 | 345 | 270 | 195 |
| Bank deposits in foreign currency | 1,554 | 1,614 | 1,653 | 1,694 | 1,750 | 1,562 | 1,601 | 1,683 | 1,705 | 1,726 |
| (In million of U.S. dollars) | 247 | 257 | 263 | 270 | 279 | 249 | 255 | 268 | 271 | 275 |
| Deposits in current account | 84 | 147 | 147 | 147 | 147 | 52 | 52 | 52 | 52 | 52 |
| (In million of U.S. dollars) | 13 | 23 | 23 | 23 | 23 | 8 | 8 | 8 | 8 | 8 |
| Legal reserve requirement | 1,469 | 1,467 | 1,506 | 1,546 | 1,603 | 1,510 | 1,549 | 1,631 | 1,653 | 1,674 |
| (In million of U.S. dollars) | 234 | 234 | 240 | 246.2 | 255 | 240 | 247 | 260 | 263.2 | 267 |
| Net credit to the rest of financial entities | 1,376 | 1,376 | 1,376 | 1,376 | 1,376 | 1,296 | 1,296 | 1,296 | 1,296 | 1,296 |
| Credit | 1,511 | 1,511 | 1,511 | 1,511 | 1,511 | 1,415 | 1,415 | 1,415 | 1,415 | 1,415 |
| Deposits | 136 | 136 | 136 | 136 | 136 | 119 | 119 | 119 | 119 | 119 |
| Net credit to the private sector | -99 | -99 | -99 | -99 | -99 | -103 | -103 | -103 | -103 | -103 |
| Credit | 34 | 34 | 34 | 34 | 34 | 35 | 35 | 35 | 35 | 35 |
| Deposits and liabilities | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Restricted deposits | 133 | 133 | 133 | 133 | 133 | 138 | 138 | 138 | 138 | 138 |
| Open market operations (LRM and passive call) | 1,071 | 1,113 | 1,094 | 1,038 | 1,184 | 888 | 653 | 1,045 | 1,282 | 1,045 |
| Medium- and long-term external liabilities | 430 | 430 | 412 | 412 | 394 | 441 | 441 | 423 | 423 | 405 |
| Capital and reserves | 2,768 | 2,690 | 2,611 | 2,532 | 2,453 | 2,695 | 2,625 | 2,555 | 2,485 | 2,415 |
| Provisions | 1,107 | 1,107 | 1,107 | 1,107 | 1,107 | 1,102 | 1,102 | 1,102 | 1,102 | 1,102 |
| Other assets net | 1,851 | 1,850 | 1,851 | 1,848 | 1,871 | 1,930 | 1,906 | 1,931 | 1,935 | 1,945 |
| | | | | | | | | | | |
| **Currency issue** | **2,207** | 2,002 | 2,161 | 2,107 | 2,571 | 2,239 | 2,002 | 2,161 | 2,107 | 2,608 |
| Growth | **29.9** | **29.6** | **25.0** | **20.0** | **16.5** | **31.8** | **29.6** | **25.0** | **20.0** | **16.5** |

Table 10. Paraguay: Summary Accounts of the Banking System
(End-of-period; valued at constant exchange rate)

| | December | | | | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| (In billions of guaraníes) | | | | | | |
| I. Central Bank | | | | | | |
| **Net external assets** | 6,206 | 4,848 | 4,541 | 4,027 | 6,167 | 6,170 |
| (in millions of U.S. dollars) | 988 | 772 | 723 | 641 | 982 | 982 |
| **Net domestic assets** | **-4,618** | **-3,291** | **-2,879** | **-2,329** | **-3,961** | **-3,599** |
| Credit to public sector, net | 181 | 799 | 1,176 | 1,507 | 1,039 | 1,504 |
| Credit to banking system, net 1/ | -2,368 | -2,332 | -2,293 | -1,814 | -2,751 | -3,113 |
| Credit | 5 | 7 | 7 | 4 | 2 | 2 |
| Deposits | 2,373 | 2,339 | 2,300 | 1,818 | 2,753 | 3,115 |
| Central bank securites | -76 | -46 | -297 | -677 | -1,071 | -1,184 |
| Other | -2,355 | -1,713 | -1,464 | -1,345 | -1,177 | -806 |
| **Currency issued** | **1,587** | **1,557** | **1,662** | **1,699** | **2,207** | **2,571** |
| II. Monetary Survey | | | | | | |
| **Net external assets** | **8,086** | **7,503** | **6,907** | **5,497** | **8,397** | **8,948** |
| (in millions of U.S. dollars) | 1,288 | 1,195 | 1,100 | 875 | 1,337 | 1,425 |
| **Net domestic assets** | **2,756** | **3,331** | **4,093** | **3,473** | **2,160** | **2,785** |
| Credit to the public sector | -275 | -21 | 358 | 932 | 575 | 372 |
| Credit to the private sector | 8,038 | 7,951 | 7,872 | 6,230 | 5,081 | 5,860 |
| Other | -5,006 | -4,599 | -4,137 | -3,689 | -3,496 | -3,446 |
| **Broad liquidity (M5)** | **10,842** | **10,834** | **11,000** | **8,970** | **10,558** | **11,734** |
| Money market funds | 0 | 0 | 0 | 0 | 0 | 0 |
| **Broad liquidity (M4)** | 10,842 | 10,834 | 11,000 | 8,970 | 10,558 | 11,734 |
| Bonds and issued securities | 22 | 23 | 50 | 135 | 31 | 35 |
| Other monetary liabilities | 18 | 70 | 16 | 15 | 9 | 10 |
| Central bank securities with private sector | 18 | 8 | 121 | 281 | 469 | 237 |
| **Broad liquidity (M3)** | 10,785 | 10,733 | 10,813 | 8,539 | 10,047 | 11,452 |
| Foreign currency deposits | 7,123 | 6,991 | 6,886 | 4,699 | 5,253 | 5,778 |
| **Money and quasi-money (M2)** | 3,662 | 3,742 | 3,926 | 3,839 | 4,794 | 5,674 |
| Quasi-money | 1,561 | 1,326 | 1,306 | 1,198 | 1,208 | 1,416 |
| Money (M1) | 2,101 | 2,416 | 2,621 | 2,641 | 3,587 | 4,257 |
| (Annual percentage change) | | | | | | |
| M0 (Currency issued) | 12.7 | -1.9 | 6.8 | 2.2 | 29.9 | 16.5 |
| Credit to the private sector | 1.7 | -1.1 | -1.0 | -20.9 | -18.4 | 15.3 |
| M1 | 9.5 | 15.0 | 8.5 | 0.8 | 35.8 | 18.7 |
| M2 | 10.7 | 2.2 | 4.9 | -2.2 | 24.9 | 18.3 |
| M3 | 8.5 | -0.5 | 0.7 | -21.0 | 17.7 | 14.0 |
| *Of which:* foreign currency deposits | 7.4 | -1.9 | -1.5 | -31.8 | 11.8 | 10.0 |
| **Memorandum items:** | | | | | | |
| Ratio of foreign currency deposits to M3 (percent) | 66.0 | 65.1 | 63.7 | 55.0 | 52.3 | 50.5 |
| Ratio of foreign currency deposits to private sector deposits in banks (percent) | 75.6 | 73.6 | 72.5 | 64.9 | 63.5 | 62.0 |

Sources: Central Bank of Paraguay; and Fund staff estimates.

1/ Reflects debt write-offs of central bank credit to commercial banks during 1997 and 1998.

Table 11. Paraguay: Banking System Indicators

| | December | | | | |
|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| **Total foreign banks** | | | | | |
| Share in assets | 48.3 | 47.0 | 45.1 | 48.4 | 47.4 |
| Capital adequacy ratio (percent) | 17.0 | 17.1 | 16.0 | 17.6 | 20.4 |
| NPLs (percent) total loans | 9.3 | 14.1 | 15.3 | 20.1 | 20.8 |
| Provisions (percent) NPLs | 45.7 | 40.2 | 42.6 | 57.5 | 64.2 |
| Rate of return on assets (ROA) | 3.4 | 2.3 | 3.1 | 1.6 | 0.1 |
| Rate of return on equity (ROE) | 33.5 | 20.2 | 30.4 | 15.0 | 1.2 |
| Liquid assets (percent) of total assets 1/ | 24.6 | 21.6 | 22.2 | 27.1 | 29.8 |
| Government bond portfolio in assets | 3.3 | 2.6 | 3.1 | 4.6 | 7.7 |
| Foreign exchange deposits in percent of total | 64.6 | 63.2 | 67.8 | 71.1 | 65.6 |
| **Total majority foreign banks** | | | | | |
| Share in assets | 29.9 | 34.9 | 38.3 | 33.2 | 37.2 |
| Capital adequacy ratio (percent) | 17.7 | 17.7 | 16.8 | 19.9 | 21.0 |
| NPLs (percent) total loans | 9.8 | 10.6 | 10.6 | 10.4 | 12.3 |
| Provisions (percent) NPLs | 46.7 | 39.7 | 36.8 | 43.8 | 52.1 |
| Rate of return on assets (ROA) | 1.5 | 1.0 | 1.8 | 1.4 | 1.3 |
| Rate of return on equity (ROE) | 12.4 | 8.6 | 18.3 | 13.4 | 15.5 |
| Liquid assets (percent) of total assets 1/ | 28.2 | 24.2 | 25.0 | 26.2 | 35.3 |
| Government bond portfolio in assets | 4.8 | 1.9 | 2.1 | 5.3 | 4.0 |
| Foreign exchange deposits in percent of total | 64.9 | 64.3 | 69.3 | 70.7 | 62.3 |
| **Total domestic private banks** | | | | | |
| Share in assets | 9.1 | 6.8 | 7.4 | 10.4 | 7.4 |
| Capital adequacy ratio (percent) | 16.6 | 15.2 | 14.8 | 13.6 | 14.1 |
| NPLs (percent) total loans | 7.5 | 7.0 | 6.5 | 8.8 | 2.9 |
| Provisions (percent) NPLs | 34.9 | 25.0 | 30.8 | 18.7 | 46.2 |
| Rate of return on assets (ROA) | 1.2 | 1.0 | 1.2 | 1.1 | 1.6 |
| Rate of return on equity (ROE) | 9.7 | 8.9 | 13.8 | 14.3 | 21.1 |
| Liquid assets (percent) of total assets 1/ | 18.7 | 17.3 | 20.1 | 18.3 | 38.8 |
| Government bond portfolio in assets | 0.0 | 1.0 | 1.1 | 1.4 | 2.1 |
| Foreign exchange deposits in percent of total | 56.4 | 49.4 | 61.8 | 62.6 | 60.7 |
| **Total banking system excluding BNF** | | | | | |
| Share in assets | 87.3 | 88.6 | 90.8 | 92.0 | 92.0 |
| Capital adequacy ratio (percent) | 17.2 | 17.1 | 16.2 | 17.9 | 20.1 |
| NPLs (percent) total loans | 9.3 | 12.0 | 12.3 | 14.7 | 15.0 |
| Provisions (percent) NPLs | 45.1 | 39.2 | 39.8 | 50.2 | 59.2 |
| Rate of return on assets (ROA) | 2.5 | 1.7 | 2.4 | 1.5 | 0.7 |
| Rate of return on equity (ROE) | 22.7 | 14.6 | 24.1 | 14.3 | 7.7 |
| Liquid assets (percent) of total assets 1/ | 25.3 | 22.3 | 23.2 | 25.7 | 32.8 |
| Government bond portfolio in assets | 3.6 | 2.2 | 2.5 | 4.5 | 5.8 |
| Foreign exchange deposits in percent of total | 64.2 | 62.8 | 68.0 | 70.2 | 63.9 |
| **National Development Bank (BNF)** | | | | | |
| Share in assets | 12.7 | 11.4 | 9.2 | 8.0 | 8.0 |
| Capital adequacy ratio (percent) | 18.4 | 21.2 | 22.9 | 18.8 | 30.0 |
| NPLs (percent) total loans | 49.1 | 44.6 | 46.5 | 56.2 | 56.2 |
| Provisions (percent) NPLs | 34.3 | 38.1 | 31.7 | 39.6 | 47.6 |
| Rate of return on assets (ROA) | 0.2 | -0.5 | 0.3 | -4.7 | -2.8 |
| Rate of return on equity (ROE) | 1.4 | -4.2 | 2.0 | -27.3 | -18.7 |
| Liquid assets (percent) of total assets 1/ | 24.4 | 16.7 | 20.4 | 17.3 | 30.7 |
| Government bond portfolio in assets | 10.9 | 11.6 | 0.0 | 0.2 | 0.5 |
| Foreign exchange deposits in percent of total | 21.6 | 19.3 | 27.0 | 42.5 | 32.7 |

Source: Superintendency of Banks.

1/ Liquid assets are calculated as the sum of cash, reserves, accounts in banks and lending in interbank market.

Table 12. Paraguay: Balance of Payments, 2001–04

(In millions of U.S. dollars)

| | 2001 | 2002 | Est. 2003 | Prog. 2003 | Rev. Proj. Q1 | Q2 | Q3 | Q4 | 2004 | Prog. 2004 |
|---|---|---|---|---|---|---|---|---|---|---|
| Current account | -278 | 106 | 118 | 83 | -36 | 251 | 7 | -156 | 66 | 26 |
| Trade balance | -619 | -208 | -282 | -237 | -117 | 150 | -83 | -254 | -305 | -287 |
| Exports | 1,876 | 1,878 | 2,114 | 2,102 | 434 | 761 | 596 | 413 | 2,205 | 2,111 |
| Exports of domestic goods | 990 | 951 | 1,270 | 1,201 | 221 | 484 | 397 | 240 | 1,341 | 1,274 |
| Reexports | 886 | 927 | 844 | 901 | 214 | 278 | 199 | 173 | 864 | 837 |
| Imports | -2,495 | -2,086 | -2,396 | -2,339 | -552 | -611 | -679 | -668 | -2,510 | -2,398 |
| Registered imports | -1,989 | -1,510 | -1,850 | -1,800 | -408 | -422 | -577 | -537 | -1,943 | -1,925 |
| Unregistered imports | -506 | -576 | -546 | -539 | -144 | -189 | -103 | -131 | -567 | -473 |
| Services (net) | 158 | 203 | 226 | 172 | 52 | 52 | 49 | 50 | 203 | 161 |
| Transport | -127 | -109 | -86 | -129 | -24 | -26 | -24 | -31 | -105 | -141 |
| Travel | -7 | -6 | -20 | -20 | -6 | -6 | -6 | -3 | -21 | -20 |
| Other | 292 | 318 | 333 | 321 | 82 | 84 | 79 | 84 | 329 | 322 |
| Factor income | 13 | -7 | 54 | 25 | 1 | 19 | 6 | 13 | 39 | 15 |
| Transfers | 167 | 116 | 120 | 122 | 29 | 30 | 35 | 35 | 129 | 137 |
| Capital and financial account | 152 | 51 | 186 | -308 | -12 | -207 | 25 | 221 | 27 | 116 |
| Capital transfers | 15 | 4 | 15 | 15 | 3 | 3 | 3 | 3 | 12 | 21 |
| Direct investment | 82 | 13 | 35 | 14 | -2 | 3 | 18 | 16 | 34 | 34 |
| Portfolio investment | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investment | 56 | 34 | 136 | -337 | -12 | -213 | 4 | 203 | -19 | 60 |
| Assets (increase -) | 70 | -15 | 126 | -182 | 16 | -208 | 23 | 136 | -33 | -51 |
| Commercial credits | 11 | -7 | -7 | 5 | -7 | -7 | -7 | -7 | -28 | -22 |
| Loans | 1 | 173 | -150 | -168 | -30 | -30 | -30 | -30 | -120 | -47 |
| Foreign currency deposits | -71 | -152 | 276 | -27 | 53 | -173 | 58 | 170 | 108 | 10 |
| Other | 129 | -29 | 7 | 8 | 0 | 2 | 2 | 3 | 7 | 7 |
| Liabilities (increase +) | -14 | 49 | 10 | -155 | -29 | -5 | -19 | 67 | 14 | 112 |
| Commercial Credits | -4 | 16 | -20 | -57 | -7 | -7 | -7 | -7 | -28 | 0 |
| Loans | 9 | 30 | 32 | -98 | -22 | 2 | -12 | 82 | 50 | 107 |
| *Of which:* government disbursements | 144 | 146 | 186 | 128 | 12 | 40 | 36 | 124 | 212 | 242 |
| *Of which:* government payments | -102 | -123 | -112 | -159 | -31 | -34 | -43 | -37 | -146 | -162 |
| Foreign currency deposits | 10 | 8 | 3 | 9 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other | -29 | -5 | -6 | -9 | 0 | 0 | 0 | -8 | -8 | 5 |
| Errors and omissions | 81 | -240 | -70 | 300 | 0 | 0 | 0 | 0 | 0 | 0 |
| Overall balance | -45 | -83 | 234 | 75 | -47 | 44 | 32 | 65 | 93 | 141 |
| Net international reserves (increase -) | 45 | 83 | -326 | -178 | 65 | -10 | 16 | -72 | -1 | -38 |
| Gross reserves | 45 | 84 | -325 | -177 | 66 | -10 | 16 | -72 | 0 | -37 |
| Reserve liabilities | 0 | -1 | -1 | -1 | -1 | 0 | 0 | 0 | -1 | -1 |
| Residual financing gap | ... | ... | 92 | 103 | -18 | -34 | -48 | 7 | -92 | -103 |
| Arrears deferral (+)/clearance (-) | ... | ... | 91 | 103 | -18 | -30 | -35 | -10 | -93 | -103 |
| **Memorandum items:** | | | | | | | | | | |
| Current account in percent of GDP | -4.0 | 2.0 | 2.0 | 1.4 | | | | | 1.0 | 0.4 |
| Gross reserves (in millions of U.S. dollars) | 723 | 641 | 982 | 818 | 916 | 926 | 910 | 982 | 982 | 855 |
| in months of imports of GNFS | 3.6 | 2.8 | 4.1 | 3.6 | ... | ... | ... | ... | 3.9 | 3.5 |
| External public debt in percent of GDP | 33.5 | 44.5 | 44.7 | 44.3 | ... | ... | ... | ... | 41.4 | 42.6 |
| Debt service in percent of exports GNFS | 10.9 | 10.1 | 9.4 | 11.1 | ... | ... | ... | ... | 9.7 | 11.7 |
| Export volume (percentage change) 1/ | 18.2 | -7.2 | 18.3 | 11.9 | ... | ... | ... | ... | 4.0 | 4.2 |
| Import volume (percentage change) 1/ | 0.7 | -21.1 | 15.5 | 12.3 | ... | ... | ... | ... | 4.1 | 2.7 |
| Terms of trade (percentage change) | 0.0 | 7.4 | 6.4 | 6.4 | ... | ... | ... | ... | 0.9 | -4.8 |

Sources: Central Bank of Paraguay; and Fund staff estimates.

1/ Registered trade.

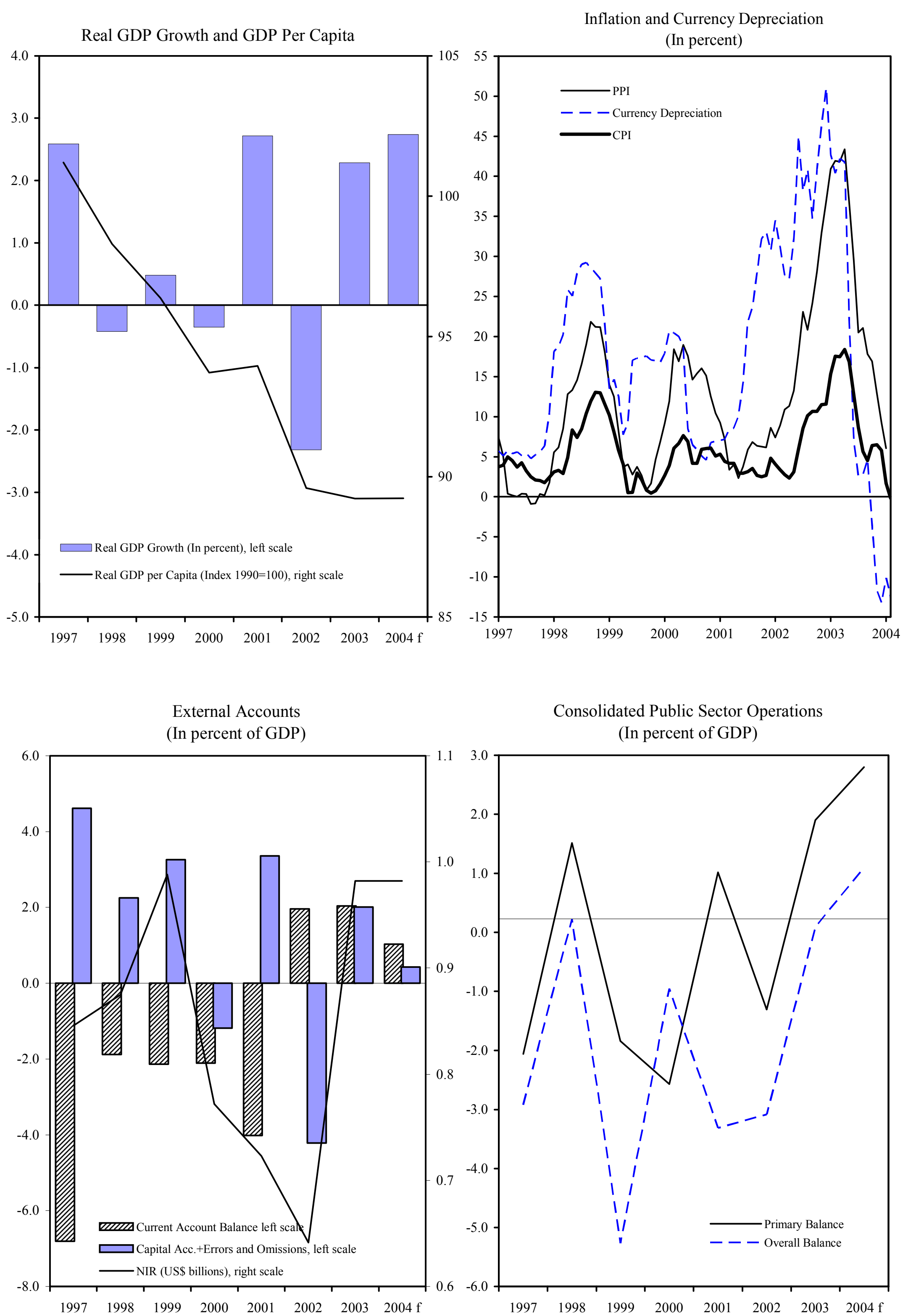
Table 13. Paraguay: Comparison Between the Pre-Existing Law and the New Law Regulating the Caja Fiscal

| | Old Law | New Law | Comments |
|---|---|---|---|
| **I. General provisions** | | | |
| Contribution rate | 14 percent. | 16 percent. | New rate has to remain effective at least until financial balance is achieved. |
| Contribution base | Base salary. | All taxable remunerations, including base salary, overtime, representation charges, bonuses. | The remuneration base excludes family subsidy and health care contributions. |
| Ordinary retirement age *(jubilación obligatoria)* | Between 40 and 50 years depending on occupation, gender and years of service. | 62 years. | Retirement is compulsory at age 62. Employees with less than 10 years of service receive 90 percent of their inflation-adjusted contributions. The new rules do not affect police and army officers. |
| Early retirement age *(jubilación)* | Retirement age can be moved forward through various mechanisms. | 50 years of age. | Early retirement is possible with at least 20 years of service. |
| Replacement rate | 93 percent (lower for early retirement).<br><br>Between 50 and 100 percent depending on years of service for police and army officers. | 20 percent plus 2.7 percent per each year of service. | The replacement rate reaches its maximum at 100 percent after 40 years of service. In case of early retirement, the replacement rate is multiplied by the ratio of the age at retirement and 62. The new rules do not affect police and army officers. |
| Base wage for computing pension benefit *(Remuneración base)* | Last wage. | Average wage in last 5 years of service. | Past wages are not adjusted for inflation in the computation of the base wage. |
| Pension adjustment for inflation | Based on wage increase of working cohort. | Based on average public wage increase, but limited to CPI inflation. | The adjustment to Chaco War pensions is determined in the budget law. |
| Thirteenth month bonus (*aguinaldo)* | Customarily paid but not mandated by law. | Prohibited. | The prohibition applies to all beneficiaries, including Chaco War pensions. |
| **II. Special provisions for teachers** | | | |
| Ordinary retirement | 45 or 40 years of age for males and female, respectively, with at least 25 years of service. Female teachers can count up to five children as years of service. | At least 28 years of service, or at least 25 years of service at a lower replacement rate. Female teachers can count up to three children as years of service. | |
| Early retirement | 20 years of service (for causes preventing ordinary retirement). | Between 15 and 24 years of service (only for physical or mental incapacity). | |
| Replacement rate | 93 percent (lower for early retirement). | 87 percent; 83 percent for at least 25 years of service | |
| Base wage for computing pension benefit | Last wage. | Average wage in last 5 of service (or 10 years in case of an increase in hours or shifts worked). | Past wages are not adjusted for inflation. |

Table 14. Paraguay: Structural Conditionality Under Program

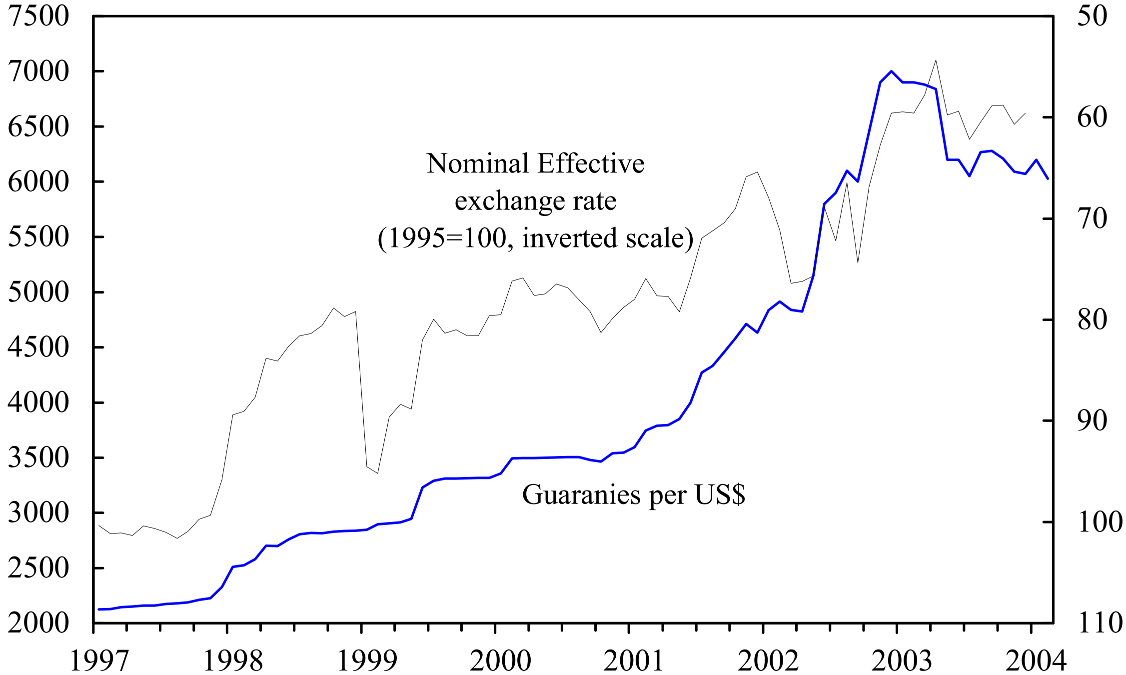
| Measure | Conditionality | Timing | Status and Comments |
|---|---|---|---|
| **Financial Sector** | | | |
| Passage by Congress of a public banking law to consolidate and restructure the public development banks | PC | 31 Jul. 2004 | Law presented to Congress |
| Passage by Congress of new comprehensive banking system legislation | PC | 31 Dec. 2004 | |
| Require all banks to obtain international risk rating | SB | 31 Dec. 2004 | |
| Extension of regulatory supervision to financial cooperatives | SB | 1 Jan. 2005 | |
| **Central Government and Central Bank** | | | |
| No accumulation of multilateral arrears | Continuous PC | | |
| BCP and MOF to sign a memorandum of understanding regularizing financial relationship between the government and the BCP. | PC | 28 Feb. 2004 | Memorandum signed on February 27, 2004. |
| Passage by Congress of reforms in the *caja fiscal* | PC | 8 Mar. 2004 | Law approved by Congress on December 17, 2003. Regulation issued on January 30, 2004. |
| Passage by Congress of Administrative Reorganization and Fiscal Adjustment Law | PC | 31 May 2004 | Law under discussion by Chamber of Deputies. Senate will discuss the law next. |
| Passage by Congress of a new customs code and implementation of a customs reform program | SB | 31 Aug. 2004 | Approved by the chamber of Deputies; submitted to Senate. |
| Full application of Public Procurement Law | SB | 30 Jun. 2004 | |
| Application of international accounting standards and annual external audits of the central bank | SB | 30 Jun. 2004 | External audit under way. |
| Begin implementation of a central bank restructuring plan | SB | 31 Jul. 2004 | |
| Development of a plan for comprehensive civil service reform | SB | 31 Oct. 2004 | Census of civil servants under way. |
| **Public Enterprises** | | | |
| Requirement of regular adjustments in fuel and utilities prices to fully reflect input price and exchange rate changes | PC | 1 Jul. 2004<br>1 Jan. 2005 | Price of diesel adjusted on January 1, 2004. |
| Presentation of a plan for the participation of private capital in key public enterprises | SB | 31 Dec. 2004 | |
| **Governance** | | | |
| Regular independent audits of all public enterprises and the Social Security | PC | 30 Sep. 2004 | |
| Increased data publication for government and public enterprises | SB | 30 Sep. 2004 | |

Figure 1. Paraguay: Selected Economic Indicators

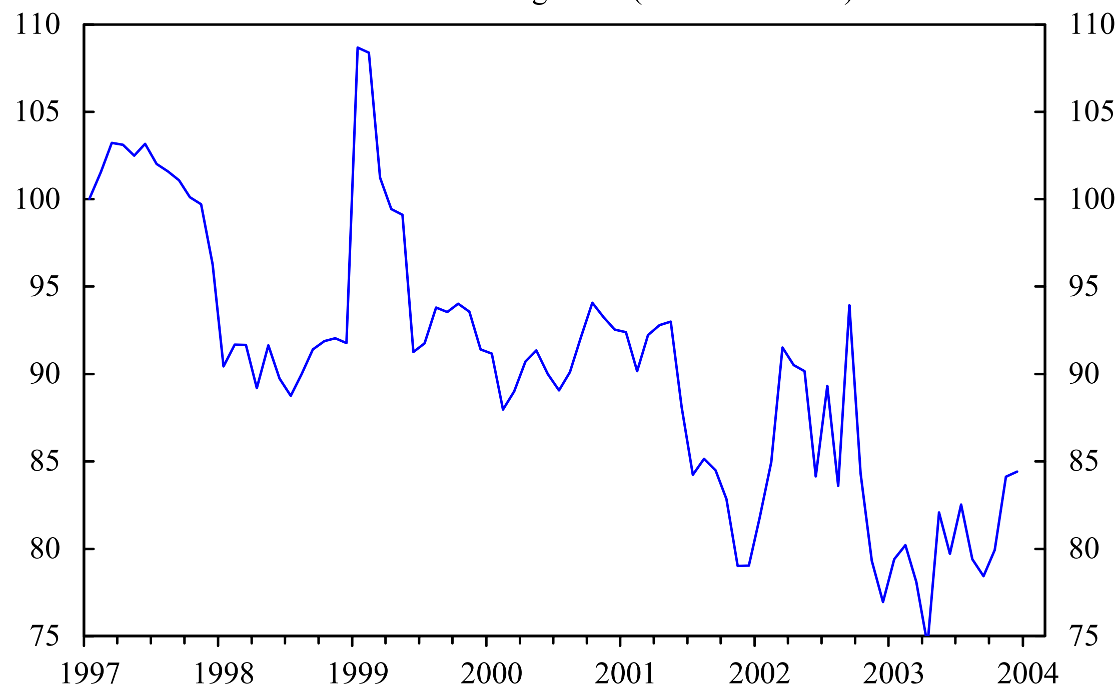



Source: Central Bank of Paraguay.

Figure 2. Paraguay: Exchange Rates

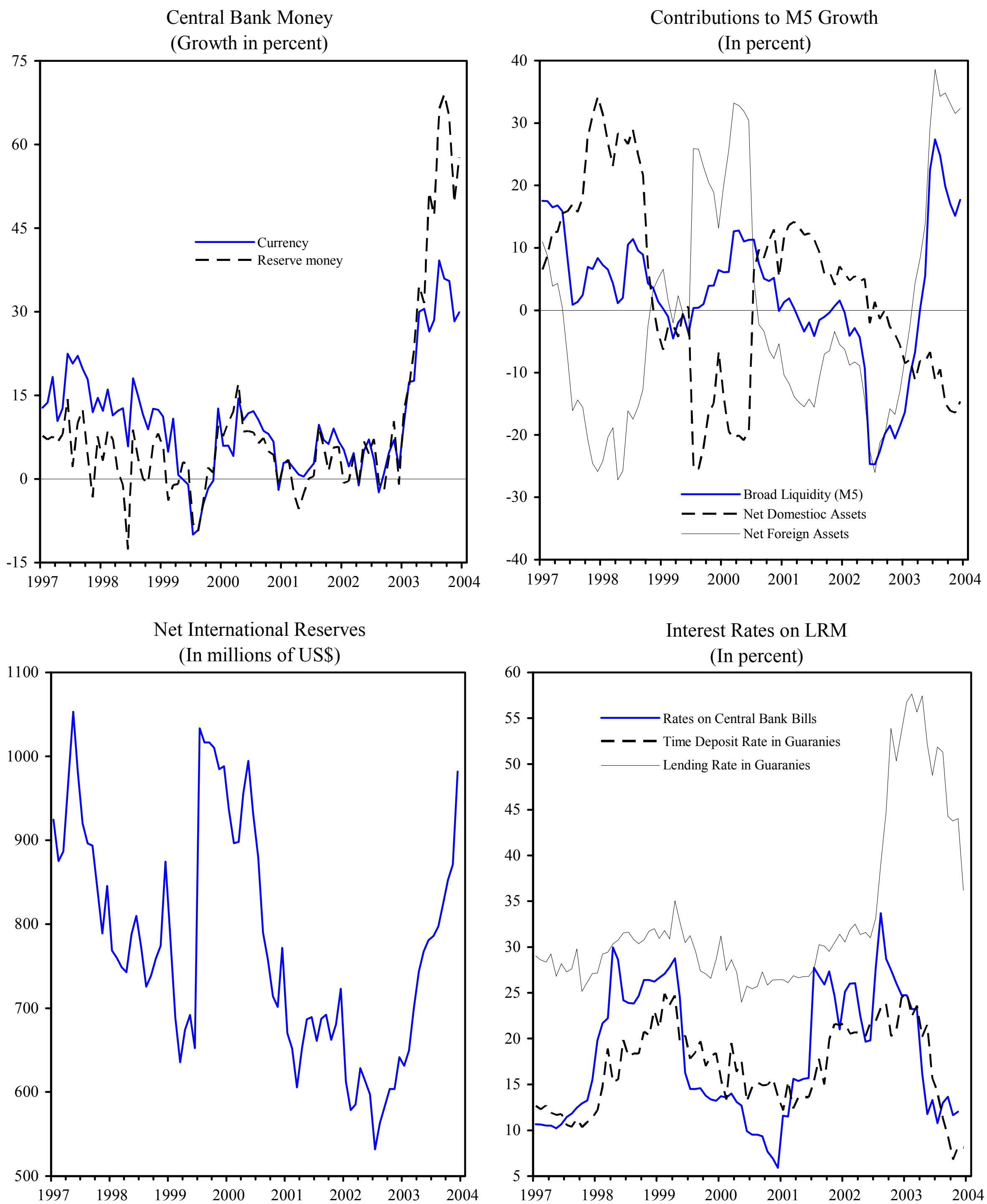



Real Effective Exchange Rate (Index 1995=100)



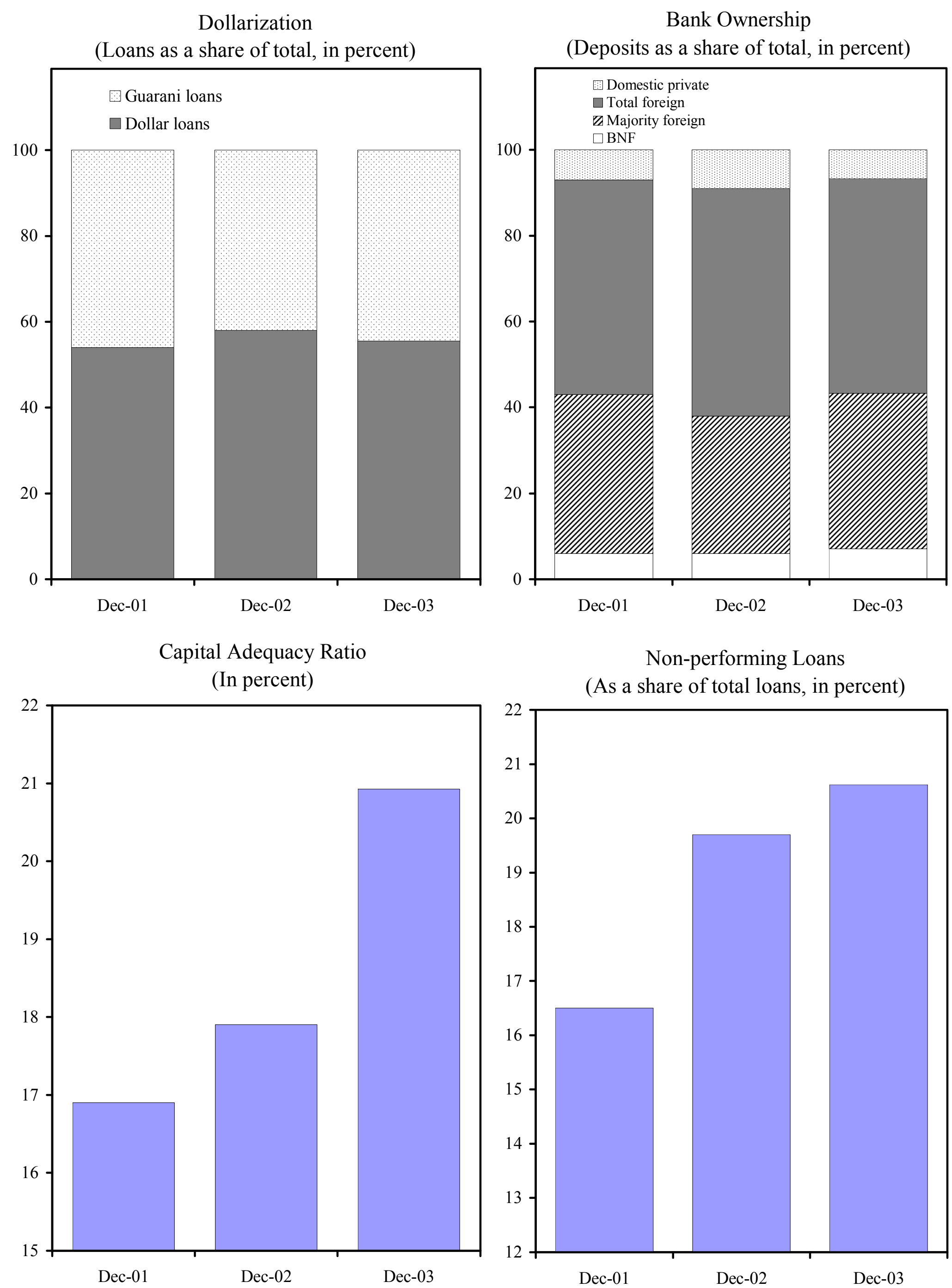

Source: Central Bank of Paraguay.

Figure 3. Paraguay: Selected Financial Indicators




Source: Central Bank of Paraguay.

Figure 4. Paraguay: Selected Banking Indicators




Source: Central Bank of Paraguay.

## FUND RELATIONS
(As of January 31, 2004)

I. **Membership Status**: Joined December 28, 1945; Article VIII

II. **General Resources Account**:

| | In millions of SDRs | In percent of Quota |
|---|---|---|
| Quota | 99.90 | 100.00 |
| Fund holdings of currency | 78.43 | 78.51 |
| Reserve position in Fund | 21.48 | 21.50 |

III. **SDR Department**:

| | In millions of SDRs | Percent of Allocation |
|---|---|---|
| Net cumulative allocation | 13.70 | 100.00 |
| Holdings | 84.63 | 617.84 |

IV. **Outstanding Purchases and Loans**: None

V. **Exchange Rate Arrangement:** The currency of Paraguay is the Paraguayan *guaraní*. The exchange rate regime is a managed float. The exchange rate is determined in the interbank foreign exchange market, but the central bank intervenes in the foreign exchange and monetary markets to smooth out exchange rate fluctuations in real effective terms. The U.S. dollar is the principal intervention currency. On January 31, 2004, the average interbank rate for the U.S. dollar was ₲6,200=US$1.

VI. **Article IV Consultation:** The 2002 Article IV consultation was concluded by the Executive Board on March 10, 2003; the documents are IMF Country Reports No. 03/94 and 03/95.

VII. **Technical Assistance:**

| Department | Purpose | Date of Delivery |
|---|---|---|
| MFD | Policy Advisory to the Central Bank | March 1994 – Present |
| FAD | Tax Policy | February 1999 |
| FAD | Tax Administration | March 1999 |
| STA | Monetary Statistics | February 2000 |
| STA | Balance of Payments Statistics | June 2000 |
| STA | Multisector, GDDS accession | February 2001 |
| MFD | Currency Operations | March through September 2002 |
| MFD | Financial Sector Surveillance | July 2002 |

| Department | Purpose | Date of Delivery |
|---|---|---|
| FAD | ROSC | August 2002 |
| STA | Multisector, follow-up | September 2002 |
| MFD | Banking Supervision | September through November 2002 |
| MFD | Central Bank Operations | November 2002 |
| FIN | Safeguard Assessment | January 2003 |
| MFD | Banking Supervision | January through August 2003 |
| MFD | Currency Handling and Reform | July 2003 |
| MFD | Payment System | July 2003 |
| FAD | Customs and Tax Administration | December 2003 |
| MFD | Central Bank Operations | January 2004 |

VIII. **Safeguard Assessment:** Under the Fund's safeguards assessment policy, Central Bank of Paraguay (CBP) is subject to an assessment with respect to the expected arrangement. A safeguards assessment of the CBP was completed on January 31, 2003. The assessment concluded that substantial risks may exist in legal structure and independence of the central bank, and in its control environment. Staff findings, proposed recommendations under program conditionality, and other recommendations are reported in IMF Country Report No. 03/94. The BCP has made substantial progress in implementing safeguard recommendations and staff is monitoring the continued progress.

X. **Resident Representative:** None. Mr. Luis H. Durán-Downing has been appointed as MFD Resident General Adviser since February 2002.

## FINANCIAL RELATIONS WITH THE WORLD BANK[1]

January 21, 2003

A new Paraguay Country Assistance Strategy (CAS) was approved on December 16, 2003, covering the period from mid-FY04 to FY07. The Bank's strategy as outlined in the new CAS aims to restore confidence in the economy and lay the basis for sustainable growth and poverty reduction. To this end, the CAS supports (i) the fiscal and financial reforms the Administration has to send to Congress; (ii) improved governance and transparency in public administration; (iii) sustained growth, particularly in the rural areas where poverty is concentrated and deepest; and (iv) social inclusion, to improve the coverage and efficiency of basic social services to help Paraguay meet the millennium development goals. The proposed base case lending program for the CAS periods is for US$325 million, of which US$80 million, or about 25 percent, are envisaged for two adjustment operations. One of them, the Economic Recovery Loan in the amount of $30 million was approved on December 16, 2003 together with the CAS, and has been fully disbursed.

The previous CAS for Paraguay, covering the 1998–2000 period, planned for lending in the order of $50 million per year, subject to improved portfolio performance and keeping the fiscal deficit below 2 percent of GDP. However, due to portfolio performance problems, the Bank did not approve any new loans until last year, when a $9 million Community Development project was approved in March 2002, followed by the approval in July 2003 of a $24 million Secondary Education project. The Bank nevertheless maintained an active policy dialogue with Paraguay, and analytical work during 2002 included a poverty assessment, a country procurement assessment, and informal work on public expenditures and pensions. In addition, the World Bank Institute provided technical assistance during 2000 to help a joint Government-Civil Society Commission prepare a National Anti-corruption Plan, which is now being supported by other donors. The Bank together with the UNDP also assisted the government in the preparation of a Poverty Reduction Strategy paper. A comprehensive Policy Notes document was completed in May 2003 and discussed with the new Administration in June 2003. Preparation of a financial accountability assessment is underway, and it is expected to be completed by February 2004.

Five World Bank-financed projects are presently under implementation, for a total value of $144.8 million, of which $71.1 million are undisbursed as of January 20, 2004. These projects include: Rural Water Supply, Natural Resource Management, Maternal Health and Child Development, Community Development, and the Secondary Education, which is awaiting approval by Congress in order to become effective.

A technical assistance loan to assist in the restructuring of the Ministry of Finance and help it become a Ministry of Excellence is also under preparation for FY04 delivery. In addition, a Financial Sector Adjustment Loan and Technical Assistance Loan are at an advanced stage of preparation.

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[1] Prepared by the staff of the World Bank.

## FINANCIAL RELATIONS WITH THE WORLD BANK

(In millions of U.S. dollars)

### I. IBRD/IDA Operations (as of January 20, 2003)

| | Committed (Net of Cancellations) | Undisbursed | Disbursed |
|---|---|---|---|
| **Active loans** | | | |
| Natural Resource Management | 50.0 | 14.4 | 35.6 |
| Maternal Health | 21.8 | 1.0 | 20.8 |
| Fourth Rural Water Supply | 40.0 | 26.2 | 13.8 |
| Community development | 9.0 | 8.1 | 0.9 |
| Education Reform | 24.0 | 24.0 | 0.0 |
| **Total active loans** | 144.8 | 73.7 | 71.1 |
| **Total inactive loans** | 711.6 | 0.0 | 708.5 |
| **Total IBRD/IDA** | **856.4** | **73.7** | **779.6** |

### II. IFC Operations (as of December 31, 2003)

| | Loans | Equity | Total |
|---|---|---|---|
| Commitments | 0.0 | 0.0 | 0.0 |
| Repayments and cancellations | 0.0 | 0.0 | 0.0 |
| Now held by IFC | 0.0 | 0.0 | 0.0 |
| Undisbursed | 0.0 | 0.0 | 0.0 |

### III. IBRD/IDA Loan Transactions (calendar year) (as of December 31, 2003)

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|---|---|---|
| Disbursements | 25.7 | 27.5 | 41.2 | 37.7 | 42.1 | 46.6 | 26.8 | 13.5 | 42.3 |
| Repayments | 42.6 | 35.2 | 27.5 | 24.6 | 24.6 | 20.2 | 15.3 | 16.8 | 21.0 |
| Net lending | -16.9 | -7.7 | 13.8 | 13.1 | 17.5 | 26.4 | 11.5 | -3.3 | 21.3 |

Source: World Bank.

1/ After exchange rate adjustment.

## RELATIONS WITH THE IDB[1]

**Portfolio**

1. There is close collaboration between the IDB and the IMF, as the IDB had operations contingent on the approval of an agreement with Paraguay, which had been included in the IMF's assessments of the situation. Furthermore, there is close coordination between the IDB and the World Bank in specific issues regarding financial sector reform.

2. The operations of IDB, Paraguay's main creditor, have been affected by fiscal constraints and political instability with regard to decisions concerning new loans. As a direct consequence, Paraguay entered in default in 2002 and again in 2003, loans had to be postponed, loan disbursements were slow, and the net cash flow to the country was negative for the third consecutive year.

3. During 2003 IDB approved three loans: for Cadastre Registry, for US$9.0 million, for Initial and Preschool Education, for US$23.4 million and an Emergency Loan for Social Expenditure Protection, for US$30 million. In addition, three loans to support the preparation and initial execution of new operations were approved: Costal Development in Asunción, for US$1.5 million, Initial and Preschool Education, for US$0.9 million and Social Investment Program, for US$1.2 million.

4. The active portfolio of loans amounts to US$657.3 million, of which 41.6 percent have been disbursed. As for Technical Cooperation, the approved total amounts to US$20.0 million, of which 47.5 percent have been disbursed.

**Operations Program**

5. In the first half of 2004 we expect approval of a policy-based loan for US$50 million for a public financial sector reform, cofinanced with the World Bank, which is being closely coordinated with the IMF with regard to conditionality.

6. Other investment loans with approval expected in 2004 include:

    a. The Costal Development (*Franja Costera*) Project for US$55 million.
    b. TC loan for the Public Bank Reform, for US$4.5 million.
    c. Global Credit Line, for US$20 million
    d. Support to the Judiciary System, for US$10 million
    e. Restructuring of Central Bank, for US$2,0 million
    f. Professional Technical Education System, for US$8 million

7. The Bank's new country strategy with Paraguay is expected to be approved during the first semester of 2004.

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[1] Prepared by the staff of the IDB.

## Statistical Issues
(As of March 17, 2004)

### A. Real Sector

National accounts have a number of shortcomings, including the use of an outdated conceptual framework and an outdated base year for constant prices (1982). The data are, however, currently being made compatible with international standards *(1993 SNA)* with the assistance of an expert financed by the IDB. This entails a fuller coverage of industries, an input-output matrix, and an expansion of data sources for the compilation of the 1994 new benchmark and base year. Quarterly information recently became available for 1997–2001.

Both the consumer and producer price indices are reported on a regular and timely basis. The CPI has a base period of 1992, and the PPI of December 1995. A change in the base period and basket of the CPI is scheduled to take place after the results of a new household income and expenditure survey covering the period 2001–02 become available. The coverage and quality of employment and unemployment statistics have improved their coverage and quality significantly since a regular household survey was introduced in 1998. However, frequencies remain at the annual level, and the publication lag is close to one year. Wage indices are updated twice a year.

Paraguay became a GDDS participant in 2001 with the publication of its metadata on the Fund's Dissemination Standards Bulletin Board (DSBB).

### B. Public Finances

Reliable monthly data are available on a timely basis for the central government, where much improvement has been made over the past years. The asset position of the social security system is available on a daily basis. However, shortcomings in the classification and recording remain and the Paraguayan GFS is not fully consistent with the methodology of the IMF *Government Finance Statistics Manual 1986 (GFSM 1986).* For instance, nontax revenues include social security contributions. Additionally, public enterprises and the social security system have been following somewhat different classifications of revenues and expenditures than the central government. A law (*Ley* 1535) that was passed in 2000 should allow closer integration, as it sets uniform standards and creates a database for the entire public sector. Data on medium- and long-term external debt are reliable and available on a monthly basis. Internal debt data are available on request, but need to be more fully integrated with the external debt database. Deficiencies remain in the registration of short-term supplier and commercial credit of the public sector. Moreover, there is a discrepancy in the fiscal data reported by the monetary and fiscal authorities. On November 203, the Ministry of Finance issued a decree requiring all decentralized entities and public enterprises to provide updated monthly financial data to the Ministry of Finance, as well as the balance sheet. Other measures are being taken to make reporting more transparent. Under the SBA, all public enterprises and the IPS are required to undergo a complete financial audit by an internationally-recognized auditor.

Annual data covering only budgetary central government through 2001 have been published in the *2002 GFS Yearbook*. However, since 1994 no financing and outstanding debt data, and no breakdowns for expenditure by function data have been provided for publication in the GFSY. Monthly and quarterly data are not reported for publication in *IFS*. The resumption of reporting quarterly and monthly data for the *IFS* is highly recommended. Data on local governments and public enterprises are deficient and not reported regularly.

### C. Money and Banking

Money and banking statistics are broadly reliable as a result of the adoption in 1995 of a new accounting plan for commercial banks and finance companies. Following the work on methodologies initiated in the 2000 STA mission, Paraguay completed the establishment of a unified compilation and reporting system for the whole range of monetary data. This new system intends to harmonize monetary data for use of the CBP, for reporting to STA for publication in *IFS*, and for operational and monitoring purposes. A revision of the classification criteria has led also to a marked reduction in the discrepancies of interbank positions. A recent STA money and banking statistics mission recommended that (i) institutional coverage of the depository corporations survey be expanded to include financial investment funds and financial cooperatives; (ii) the compilation unit be given on-line access to the database maintained by the Superintendency of Banks; and (iii) methodological notes be disseminated, including an explanation of improvements and reasons for breaks in the series.

The Superintendency of Banks publishes a detailed and informative report on the soundness of the financial system.

### D. External Sector

Quarterly and annual data on balance of payments and the international investment position (IIP) are available from 2001 onwards on the central bank website, and reported to STA with some delay. Annual IIP data have been compiled and disseminated for the period 1995–2002. The classification of the balance of payments and of the IIP follows the recommendations of the Balance of Payments Manual (5th edition). Technical assistance by STA led to improvements in the quality of the data on capital flows, especially in the coverage of foreign direct investment, and in the recording of external debt transactions in the balance of payments and in the IIP. The central bank now produces a highly informative bulletin on balance of payments statistics. Special studies by the central bank have improved the estimation methods for remittances of Paraguayans abroad and unregistered trade transactions, but serious deficiencies remain due to the level of unrecorded trade.

Deficiencies remain in the area of private capital outflows, which are difficult to register due to Paraguay's liberal capital account. Major recommendations of the multisector statistics mission include the need to: (i) introduce quarterly surveys for recording services, transfers, and financial transactions of the nonfinancial private sector; (ii) apply quality control procedures for surveys; (iii) revise and improve the statistical techniques to take into account unrecorded merchandise trade and smuggling; (iv) improve the compilation procedures of several services and financial transactions; and (v) institute a system of coordination with other official agencies, and within the CBP, to promote intersectoral data consistency. Sizable negative errors and omissions over the last few years can be attributed mostly to unregistered outflows of portfolio capital and unregistered trade.

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**CORE STATISTICAL INDICATORS**
(As of February 10, 2004)

| | Exchange Rates | Interna-tional Reserves | Central Bank Balance Sheet | Reserve/ Base Money | Broad Money | Interest Rates | Consumer Price Index | Exports/ Imports | Current Account Balance | Central Government Balance | GDP/ GNP | External Debt/ Debt Service |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date of Latest Observation | 02/29/04 | 02/29/04 | 02/29/04 | 02/29/04 | 1/31/04 | 1/31/04 | M01/04 | M12/03 | Q3/2003 | M01/04 | 2002 | Q3/03 |
| Date Received | 03/04 | 03/04 | 03/04 | 03/04 | 03/04 | 03/04 | 02/05/04 | 10/31/03 | 07/28/03 | 02/07/04 | 7/01/03 | 07/23/03 |
| Frequency of Data | Daily | Daily | Daily | Daily | Monthly | Monthly | Monthly | Monthly | Quarterly | Monthly | Annual | Quarterly |
| Frequency of Reporting | Daily | Daily | Daily | Daily | Monthly | Monthly | Monthly | Monthly | Quarterly | Monthly | Annual | Quarterly |
| Source of Update | Central Bank | Central Bank | Central Bank | Central Bank | Central Bank | Central Bank | Central Bank | Central Bank | Central Bank | Ministry of Finance | Central Bank | Central Bank |
| Mode of Reporting | E-mail | E-mail | E-mail | E-mail | E-mail | E-mail | E-mail | E-mail | E-Mail | E-mail | Publication | E-mail |
| Confidentiality | None | None | None | None | None | None | None | None | None | None | None | None |
| Frequency of Publication | Daily | Daily | Daily | Daily | Monthly | Monthly | Monthly | Monthly | Quarterly | Monthly | Annual | Quarterly |

Asunción, March 26, 2004

Ms. Anne O. Krueger
Acting Managing Director
International Monetary Fund
Washington, D.C.

Dear Ms. Krueger:

The macroeconomic policies and important structural reforms being pursued by the government since taking office are bearing fruit. The rebound in economic activity that started last year is expected to continue in 2004, and 12-month inflation is now comfortably in single digits. Recent rescheduling of the public debt has increased maturities and improved its structure, while the rebuilding of international reserves has reduced external vulnerabilities. We have accelerated considerably the timetable for the payment of arrears compared to the schedule envisaged under the Stand-By Arrangement. With the help of a short-term loan from the Central Bank the government will eliminate most bilateral arrears by end-March 2004. Congress recently passed important pension and financial sector reforms, as well as a prudent 2004 budget. Their implementation, together with continued efforts to improve tax administration, should enable us to meet the fiscal targets for 2004.

We continue to be fully committed to achieve the objectives of the program outlined in the Memorandum of Economic and Financial Policies, as stated in the letter of intent dated December 5, 2003. A key objective of the program is to set the stage for medium-term fiscal consolidation. To this end, we have focused our efforts on working with Congress, trade groups, and civil society to garner support for the swift passage of the *Administrative Reorganization and Fiscal Adjustment Law*, a performance criterion for end-May under the Stand-by Arrangement. While there is opposition to the law by some political parties and social groups, we are optimistic that the Law will eventually be approved. In the meantime, to ensure achievement of the 2004 fiscal target, we have instituted a temporary US$3.20/ton tax on soy exports as an interim measure, and have prepared other contingent revenue-raising measures which we will apply if revenues begin to lag or if there is a delay in the passage of the *Fiscal Adjustment Law*. The soy tax will be repealed once the *Fiscal Adjustment Law* is approved.

All but two quantitative performance criteria for the first review under the Stand-By Arrangement were met in December. The two applicable structural performance criteria, related to Congressional approval of the Public Pension Reform Law and signing of a memorandum of understanding between the Central Bank of Paraguay and the Ministry of Finance, were also observed. The Public Pension Reform Law was approved at the end of December 2003 and full implementation began in January 2004, both ahead of schedule. For this reason the benefit for government finance will be greater than expected for the 2004 fiscal year. Both Net International Reserves (NIR) and Net Domestic Assets (NDA) targets were achieved with large margins. Despite the large increase in reserves over the program targets, the Central Bank maintained overperformance on NDA to achieve a growth rate in currency issue consistent with the original monetary program. The targets for the central government and consolidated general government balances were both met, as was the target for the ceiling on the central government wage bill. The ceilings on short-term external debt and the contracting or guaranteeing of new nonconcessional external debt were observed, as was the target on reduction of external arrears.

The target on domestic arrears reduction was not observed. While the reduction in arrears was greater than contemplated under the program, the initial stock proved higher than original estimations due to methodology calculation issues, causing the target to be missed. The improved cash flow of the public sector and implementation of enhanced monitoring of debt payment through a newly-created government committee should ensure that this target will be observed in the future. The continuous performance criterion on no new external arrears was also not observed, as some new external arrears were accumulated. These arrears have since been cleared. We anticipate that the payment of bilateral arrears ahead of schedule, together with the new monitoring committee will guard against future deviations from this target as well. On this basis, we request a waiver for the missed continuous performance criterion on no new external arrears. We also request a waiver of applicability for all end-March performance criteria (except for those on NDA and NIR) since data will not be available at the time of the Executive Board meeting in early April.

We hope to maintain a close policy dialogue with the Fund and stand ready to take additional measures, as necessary, to achieve the objectives of the program.

Sincerely yours,

/s/
Angel Gabriel González Cáceres
President
Central Bank of Paraguay

/s/
Dionisio Borda
Minister of Finance

**Statement by the IMF Staff Representative**
**April 12, 2004**

The following information has become available since issuance of the staff report. This information does not alter the thrust of the staff appraisal.

- **Inflation has continued to fall.** Monthly consumer price inflation in March 2004 was 0.5 percent, bringing the 12-month rate to 3 percent (from 5.4 percent in February).

- **Exports and imports are growing rapidly.** Exports in January-February almost doubled relative to the same period of last year, mainly due to high soy prices and strong volume growth of other exports, in particular oils, meats, and cereals. Import growth was broadly based, and the trade deficit was roughly as programmed.

- **The *guaraní* remains strong.** Relative the U.S. dollar, it has risen by 5.5 percent so far this year. However, in real effective terms it has remained roughly constant over this period.

- **Preliminary data show that end-March program targets on NIR and NDA were met by large margins.** Net international reserves stood at US$1,016 million on March 31 (compared to an adjusted floor of US$786.5 million). Reflecting the central bank's efforts to sterilize the NIR overperformance, NDA were at G.-4,266 billion on March 31 (compared to an adjusted ceiling of G.–2,924 billion) and currency growth was only slightly above the monetary program.

- **Preliminary data show that the central government posted an overall surplus of G. 243 billion (2.5 percent of GDP) in the first quarter, in line with the programmed surplus of 2.5 percent of GDP.** The overperformance is attributable to strong performance of tax revenues (up 38 percent relative to the first quarter of 2002), while spending was broadly in line with the program. General government outturn and below-the-line data (required to evaluate observance) are not yet available for March.

- **The authorities have cleared most bilateral arrears, though the settlement of small remaining amounts have been delayed for technical reasons or are still under discussion with creditors.** As noted in the staff report, the authorities accelerated the repayment of arrears and committed to clear all bilateral arrears by end-March (ahead of the original program schedule which foresaw gradual repayment during 2004). They have now done so except in the following cases where there are either outstanding disagreements or technical difficulties: (1) interest payments to France ($1.3 million), which are under negotiation; (2) arrears to Belgium ($14.7 million), which are disputed and also under negotiation; (3) arrears to Germany (€2.1 million), the legality of which is under review; and (4) very small amounts due to a South African creditor and USAID. The authorities expect to resolve the remaining outstanding arrears in the near future.

- **Congressional discussion of the Administrative Reorganization and Fiscal Adjustment Law (a PC for end-May) has been further delayed.** The draft law, currently being considered by a committee of the Chamber of Deputies, is scheduled to be discussed by the full Chamber on April 15 (it was originally scheduled to be discussed on March 31). The delay reflects continuing disagreements among political parties and business associations on important elements of the draft law. The authorities still expect to secure congressional approval in accordance with the program timetable.

Press Release No. 04/74
FOR IMMEDIATE RELEASE
April 12, 2004

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Completes First Review of Paraguay's Stand-By Arrangement**

The Executive Board of the International Monetary Fund (IMF) completed today the first review of Paraguay's 15-month, SDR 50 million (about US$73.4 million) Stand-By Arrangement (see Press Release No. 03/218), and granted the authorities' request for waivers of non-observance and applicability of performance criteria. The authorities are treating the arrangement as precautionary and do not intend to make a drawing.

Following the Executive Board's review of Paraguay's economic program, Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"Paraguay's performance during the early months of the Stand-By Arrangement has been favorable. There is renewed confidence in economic policy management, and the new government has been successful in mobilizing support for its reform agenda. Economic recovery is under way, inflation has fallen, and the regional environment remains positive. These elements, together with continued prudent macroeconomic policies, provide favorable conditions for Paraguay to implement far-reaching economic reforms and lay the groundwork for sustained growth and poverty reduction over the medium term.

"The authorities are committed to attaining the fiscal objectives under the program through intensified efforts to boost tax collections, prudent budget execution, and close attention to debt management. The recent reform of the public pension fund and plans to rationalize the rosters of public employees and pension beneficiaries will help strengthen expenditure control. Progress with tax reform is also essential for sustained fiscal consolidation. The next phase of the agenda gives priority to passage of the Administrative Reorganization and Fiscal Adjustment Law. The clearing of almost all bilateral arrears, ahead of the program schedule, is a welcome step, and efforts should continue to improve debt management.

"Prudent monetary policy and increased confidence have helped boost banking system deposits and central bank international reserves. The authorities intend to maintain this policy stance and strengthen further the capacity of the central bank to implement an independent monetary policy.

"Financial system reforms are progressing well and banking system indicators are improving. Nonetheless, continued efforts are needed to strengthen the banking system. An important challenge in the months ahead will be the passage of the comprehensive public banking reform plan currently before Congress.

"The authorities have made a strong start with their structural reform agenda, including key reforms of the public pension and procurement systems. For the period ahead, approval of the Customs Code and completing external audits of the main public entities will be key priorities—in particular, for the petroleum and cement companies, which have a significant debt service burden.

"The new government has placed a welcome strong emphasis on strengthening governance. New management teams in key institutions such as Tax and Customs Administration, the social security institute, and many public enterprises have made advances in following their mandates to attack corruption and improve efficiency. These essential efforts are underpinned by wider initiatives to enhance transparency and reconstitute the Supreme Court and other legal institutions," Mr. Kato said.

**Statement by Guillermo Le Fort, Executive Director for Paraguay**
**and Dimas Ayala, Advisor to Executive Director**
**April 12, 2004**

***Key points***

- *Implementation of the program supported by the SBA, improved domestic political outlook, and better regional conditions have contributed to Paraguay's ongoing economic recovery.*

- *Structural performance criteria and all but two quantitative performance criteria for this review have been met. The deviations were of a technical nature and quickly corrected, and the authorities have taken the necessary measures to prevent their occurrence in the future.*

- *The program has already attained important advances in fiscal consolidation, monetary stability, and structural reforms, thus, setting the ground for sustained growth and poverty reduction.*

- *A strict implementation of the reform agenda, including improvements in governance and transparency, is considered a top priority for the Government as the key to enhanced macroeconomic performance and strengthened domestic and international confidence.*

1. We wish to convey to the staff and Management our authorities' appreciation for their valuable support and assistance in the design and implementation of Paraguay's economic program. The program remains on track and is reaching its main goals, thus, placing the country in a path of sustainable growth and poverty alleviation. Our authorities' ownership of the program and their commitment with the Fund's arrangement is reflected in their intention to publish the documents submitted for today's Board discussion.

2. Improvements in the political outlook, and in the regional and global conditions, a good harvest in the agricultural sector, and the implementation of sound macroeconomic policies and structural reforms, have been the main factors that contributed towards Paraguay's economic recovery in 2003. Real GDP grew 2.6 percent last year, inflation closed at 9.3 percent, the guarani has appreciated by over 15 percent against the dollar —partly recovering after the sharp depreciation in 2002—, and official reserves have risen over 50 percent since end 2002. The SBA arrangement has bolstered domestic and international confidence in Paraguay's economic policies. It is expected that the authorities' continuous efforts and determination to achieve the objectives of the program will contribute to an economic expansion in 2004 of around 3 percent, within an environment of stable prices and sustainable external position.

3. Substantial progress has been made in addressing long-term structural weaknesses during the initial months of the program, throughout the strict implementation of the economic strategy supported by the Fund. All but two quantitative performance criteria for end-December were met, including the monetary and fiscal targets, and most of them with large margins. There was also full observance of the two structural performance criteria, which includes the Parliament's approval of the Public Pension Reform Law, and the signing of the memorandum of understanding between the Central Bank and the Ministry of Finance, aimed to strengthen Central Bank operational autonomy. The Pension Law was implemented in January 2004, ahead of the program's schedule, and it is expected to contribute to important fiscal savings, especially over the medium- and long-term.

4. The authorities regret the non-observance of two performance criteria regarding debt arrears which occurred because of technical reasons. The target on domestic floating debt was missed because there was actually a higher initial stock than in the original estimations due to methodological problems. Moreover, funds from the multilateral institutions came late last year, causing difficulties in clearing most of the domestic arrears at the end of 2003. Nevertheless, the authorities' rapid response to the problem resulted in a sharper reduction in the stock of the arrears than originally envisaged in the program. Also, the continuous performance criteria on the non-accumulation of new external arrears was not observed due to inadequate monitoring of payments. However, as soon as the problem was noticed, the arrears were immediately cleared. And, in order to avoid repeating these technical deviations, our authorities have created a committee, comprised of officials from the Central Bank and Ministry of Finance, to enhance monitoring of debt payments. They will also monitor the fulfillment of all the other program targets. Our authorities wish to assure the Executive Board of their commitment with the program and their decision to implement any necessary corrective measures to ensure meeting the targets in a timely and consistent manner.

5. The main objective of the program is to reverse the deterioration of the country's public finance and to attain a consolidated fiscal position. Adjustment measures, including substantial improvements in tax and customs administration, as well as the recovery in economic activity, have contributed to a rapid increase in revenues, above program projections, thus reducing the central government deficit to 0.3 percent of GDP in 2003. In addition, measures directed at revamping public enterprises management and pricing policies for utilities and fuel, and the continued strength of the local currency have helped to obtain better financial results in public enterprises than initially programmed. All of these lead the consolidated public sector to a registered surplus of 0.1 percent of GDP last year.

6. Fiscal performance is expected to strengthen further in 2004 as a result of the implementation of additional fiscal measures, as well as advances in tax and custom administration and by better expenditure control. According to preliminary information, government revenues during the first three months of this year rose by 38 percent, as compared to the same period in the previous year. The government acknowledges that even when there is still space for further improvement in tax and

custom administration, it is imperative to advance with the structural reform agenda to ensure meeting the program's fiscal goals. Our authorities remain committed and have focused their efforts in obtaining Congressional approval of the Fiscal Adjustment Law. This law is crucial to streamline the tax regime by simplifying the structure, widening the tax base, strengthening control, and eliminating distortions. Despite a strong opposition to the law by some political parties and interest groups, our authorities remain optimistic in obtaining its approval.

7. The authorities have considered alternative actions to increase revenues in case the approval of the Fiscal Adjustment Law is delayed. In this vein, they have developed a contingency plan to ensure achievement of the 2004 fiscal targets, including the implementation of an export tax on soy. Regarding the staff's concerns about that tax, the authorities reaffirmed the temporariness of the measure, until the Fiscal Adjustment Law is approved, and would like to emphasize that the tax has been imposed at a time of good harvest and historically high prices, with a low rate, thus, keeping distortionary effects to a minimum. Other measures, such as revising the assessed base of the tax on agricultural land, increasing the VAT tax base including transport services and certain imported raw materials, rising the excise tax rate of regular gasoline and diesel, among others, are part of the contingency plan that will be implemented gradually in the event of delays in the approval of the Fiscal Adjustment Law, or if revenues are behind the envisaged. At the same time, the authorities are determined to improve the performance and the efficiency of public enterprises, especially the petroleum company (Petropar), the water company (ESSAP), and the cement company (INC), which are facing financial difficulties. The new managements in Petropar and INC have the main responsibility to find alternatives and take corrective actions to reduce their costs and improve their financial situation.

8. The intention of the Paraguayan government to comply in time with their compromises and enhance international credibility, is reflected in the authorities decision to use short-term financing from the Central Bank for US$33 million, considering its comfortable official reserves position, to clear all bilateral arrears by early April 2004, well in advance of the program's timetable. The loan will be repaid by the Government during the current fiscal year, and to secure the recovery the Ministry of Finance has transferred to the Central Bank the rights from the fore coming payment of royalties from the Itaipu Dam. Furthermore, the authorities would like to assure their commitment to solve any dispute debt with external creditors and are actively reviewing the claims that are in dispute. On the other hand, the government has successfully rescheduled domestic public debt held by local banks and is confident about the outcomes on the current negotiations being taken with creditors from Taiwan, aimed to extend its maturities and improve the overall debt structure.

9. All monetary targets were met with wide margins reflecting the authorities' prudent policy stance geared toward inflation controls while maintaining exchange rate flexibility with only limited intervention to smooth-out volatility, including seasonal fluctuations. Annual inflation has fallen to single digits, reaching 3 percent in March,

the lowest since 1978, and after registering 20.2 percent in the same month of 2003. The guarani has recovered its value by over 15 percent since end-2002, while the Central Bank reserves have risen to US$ 982 million at end 2003. Although they declined slightly reflecting the short-term loan to the Ministry of Finance and seasonal payments slightly below US$ 950 millions during February; they have increased again up to US$ 1.011 million at end-March 2004, well above program targets. On the other hand, we would like to emphasize the Central Bank's continuous efforts in implementing the recommendations of the safeguards assessment in order to enhance its operational autonomy, improve its administration, and its monetary and foreign exchange rate operations.

10. The Central Bank's monetary program for 2004 shows the authorities' determination to maintain a prudent monetary stance. Our authorities are well aware of the importance of closely monitoring the monetary developments. However, they want to be cautious and would like to avoid setting up very demanding accumulation of international reserves and low NDA targets, particularly considering the volatility of international capital flows and that the recovery in private lending is a top priority for the government and a key element to support growth. In this regard, our authorities believe that their monetary program for 2004 is very realistic and incorporates the main ingredients for economic recovery in a non-inflationary framework.

11. The authorities have made good progress in strengthening the financial sector. In fact, the new and improved regulation on banks' assets classification and provisioning will place the financial sector in a better position to confront domestic and external shock, and make bank's managers to reduce risks by implementing sound and prudential loan practices. Moreover, the Bank Resolution Law, which regulations were recently approved by the Central Bank, is an important tool to address the vulnerabilities and reinforce the confidence in the sector. In this vein, since all the financial entities in liquidation process will be managed and monitored by the Judicial Bankruptcy Institution, the new law will allow that most of the supervisors return to their main duties in Superintendence of Banks and, consequently, enhancing banking system supervision. In addition, further steps will be taken to enhance the banking system. The authorities' highest priority is the Bank Public Reform Law, which will be key in improving efficiency in the allocation of resources to development and agricultural sectors, as well as to reduce fiscal burden. The draft law, submitted to Congress last December, incorporates the consolidation of several public lending institutions in order to create two new banks, a development bank for micro enterprises and small farmers, and a second tier bank to on-lend resources from bilateral and multilateral development lenders. The restructuring plan will be supported by a US$ 50 million sectoral loan from the IDB, and the authorities are confident that, despite the political opposition, it will be completed by the expected deadline.

12. The authorities are committed to pursue the full implementation of the structural reform agenda. They are aware that strengthening public sector efficiency and improving the institutional environment are vital to laying the basis for sustained economic stability and growth over the medium-term. The government considers that

all actions that are being taken to improve governance and transparency are crucial, and they see all efforts in that direction important to increase social and political support to the economic program. Beginning to implement the new procurement system early this year is a clear step towards reducing corruption in the management of public expenditure. In addition, regular independent audits of public enterprises are being undertaken; at the same time, technical and financial support have been requested to multilateral institutions in order to implement and complete the process in all the public institutions.

13. Since the new government took office in August 2003, they have considered the reform of the judicial system as crucial to succeed in the combat against corruption and illegal activities. At the end of December 2003, six of the nine members of the Supreme Court suspected of wrong doing resigned or were impeached by Congress. The replacement process was successfully finalized last March.

14. Our authorities have indicated their strong determination in taking any action to restore credibility in the policy framework and investors confidence, substantially improving the business environment. They acknowledge that those goals will be achieved as a result of a timely and full implementation of their own economic program, supported by a Stand-By Arrangement with the Fund. They recognize the challenges lying ahead, especially those to keep domestic consensus for the sensitive structural reforms envisaged in the program. Efforts towards maintaining a favorable political environment would be a priority for the government, which will ensure the smooth approval of the needed measures to address the weaknesses in the fiscal area, public enterprises, and in the financial system. Our authorities appreciate the continuous support of the international community, decisive in facilitating the reforms' implementation to address the long standing vulnerabilities, thus laying the ground for high and sustained growth, and poverty alleviation.