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|--|------------------------------|---------------------------------|---------------|
| <b>1. Project Data:</b>  |                              | <b>Date Posted :</b> 08/01/2002 |               |
| <b>PROJ ID:</b> P007917  |                              | <b>Appraisal</b>                | <b>Actual</b> |
| <b>Project Name:</b> Private Sector Development And El Nino Project  | <b>Project Costs (US\$M)</b> | 89.95                           | 137.04        |
| <b>Country:</b> Paraguay   | <b>Loan/Credit (US\$M)</b>   | 50                              | 50            |
| <b>Sector(s):</b> Board: PSD - General industry and trade sector (100%)  | <b>Cofinancing (US\$M)</b>   | 39.95                           | 87.04         |
| <b>L/C Number:</b> L3774; L3775  |                              |                                 |               |
|  | <b>Board Approval (FY)</b>   |                                 | 95            |
| <b>Partners involved :</b> UNDP, Japan, IDB  | <b>Closing Date</b>          | 12/31/1999                      | 08/30/2001    |
| <b>Prepared by :</b>   | <b>Reviewed by :</b>         | <b>Group Manager :</b>          | <b>Group:</b> |
| Michael R. Lav   | Alice C. Galenson            | Rene I. Vandendries             | OEDCR         |
| <b>2. Project Objectives and Components</b>  |                              |                                 |               |
| <b>a. Objectives</b>   |                              |                                 |               |
| NOTE: THIS EVALUATION SUMMARY SUPERSEDES AN EARLIER EVALUATION SUMMARY (ATTACHED BELOW, IN THE SECTION FOR ICR COMMENTS) WHICH HAD BEEN CREATED FOR THE PRIVATE SECTOR DEVELOPMENT COMPONENT OF THIS PRIVATE SECTOR DEVELOPMENT AND EL NINO PROJECT. THIS EVALUATION SUMMARY ENCOMPASSES BOTH COMPONENTS OF THE PROJECT. EACH SECTION HAS TWO PARTS RELATED TO THESE TWO COMPONENTS.   |                              |                                 |               |
| (a) For the Private Sector Development Component (PSD): Foster economic growth by strengthening private sector through provision of medium/long-term credit to overcome constraints on investment financing . Foster financial sector reforms to increase efficiency of resource mobilization,intermediation and allocation and reduce Paraguay's requirements for foreign aid.  |                              |                                 |               |
| (b) El Nino: Help reduce the loss of human life and deterioration of living standards resulting from the 1997/98 El Nino event; help reduce losses and damage to infrastructure and rehabilitate economic and social infrastructure related to the El Nino event; and increase Paraguay's capacity to forecast and respond to future similar events and other natural phenomena .  |                              |                                 |               |
| <b>b. Components</b>   |                              |                                 |               |
| (a) PSD: (i) Investment Component (US\$ 113.41 million) includes two global credit lines to finance export related projects and investments in production for the local market . (ii) The Policy and Institutional Reform Component (\$4.15 million) supports reforms to strengthen the regulatory framework and supervisory capabilities of the central bank (BCP), including raising the quality of prudential control in Paraguay to international standards . Technical assistance was provided to entities that interface with financial markets, and to strengthen the project coordinating unit (UTEP). |                              |                                 |               |
| (b) El Nino: (i) Emergency Prevention/Reconstruction Component (US\$14.74 million) to rehabilitate public infrastructure such as bridges, roads, hospitals, schools, river defenses, etc . (ii) Mitigation Component (US\$0.8 million) to install permanent water and sanitary facilities to improve sanitary and hygienic conditions for people displaced by EL Nino and living in temporary shelters and then to be kept in the future to provide sanitary services for low-income people. (iii) Institutional Support Component (US\$3.94 million).   |                              |                                 |               |
| <b>c. Comments on Project Cost, Financing and Dates</b>  |                              |                                 |               |
| (a) PSD: The cost of the investment component came to \$ 113.41 million. The costs of Technical Assistance to support the investment component came to \$ 4.15 million. The investment component was financed by the Bank (\$34.80 million) intermediary banks (\$7.78 million), and subborrowers (\$70.83 million). The TA component was financed by IDB (\$1 million), Japan (\$2.50 million), and UNDP (\$0.45 million), and the Bank (US\$0.2 million).  |                              |                                 |               |
| (b) El Nino: The project cost US\$ 19.48 million, of which \$16.24 million from IBRD and \$3.24 million from the government.   |                              |                                 |               |

The project was appraised in January, 1992, approved by the Board on July 5, 1994, and made effective on January 19, 1995. Following the EL Nino events of 1997/98, US\$ 16.24 million was reallocated with Board approval to a new El Nino component on June 17, 1998 and the name of the project changed to "Private Sector Development and El Nino Project". The original closing date for the project was December 31, 1999, but with the revision of the project to include the El Nino component, the closing date was extended to June 30, 2001. The project closed on August 30, 2001, two months behind schedule.

### 3. Achievement of Relevant Objectives:

(a) PSD: The goals of strengthening the private sector and removing constraints on investment financing were only partially achieved: outputs were produced but the quality was low. For example, the number of sub-loans financed exceeded SAR predictions, but arrears are high, casting doubt on the sustainability and profitability of the operations. The diligence carried out by the PFIs was inadequate and many of the participating banks were subsequently disqualified due to arrears problems. Some progress was made in strengthening the supervisory and regulatory framework, but this did not prevent the deterioration of the country's banking system, which underwent two severe crises during project implementation (in 1995 and again in 1997). Though there were improvements in the transparency of the system, including adoption of a rating system, these were undermined by the Government's lack of political will to intervene quickly and liquidate insolvent banks. In sum, this project is an example of too little too late. The project was approved just months before the first crisis in the banking system and the mid-term evaluation preceded the second crisis by just a few months. On the occasion of both crises, policy measures advocated by the Bank had recently been adopted, indicating some positive momentum. However, like many other projects in Paraguay during this period, success depended on the political will to follow through on important reforms, which was in the end not forthcoming. The project's objectives were too optimistic considering the weakness of the local banking system, limited implementation capacity, and the lack of continuous political support for reform. By mid-1998, after a year of unsatisfactory ratings, the unused Bank loans were transferred to finance assistance for the El Nino emergency, (US\$16.24m, about 30% of original loan). At the time the project was restructured 22 out of the 88 disbursed sub-projects were in arrears for an amount of US\$ 6.1m.

(b) El Nino: While the government moved too slowly to allow the loan to be used to prevent loss of life and a deterioration of living standards as the direct adverse consequence from the 1997/98 El Nino event, the project was successful in rehabilitating public infrastructure (including 55 schools (note: as quoted in section 4.2; however, annex 1 states that only 39 schools were rehabilitated) and 92 health centers), installing the permanent water and sanitary facilities as part of the mitigation component, and strengthening the National Emergency Committee (albeit after considerable delays) and other agencies.

### 4. Significant Outcomes/Impacts:

(a) PSD component: There were almost no significant positive outcomes. What little success the project had in building capacity and supporting reform was overwhelmed by the lack of political will to address larger problems in the banking and financial sector, which were further exacerbated by difficulties in the industrial sector. However, the project proved to be a valuable learning experience and the Fondo de Desarrollo Industrial supported by this component could be transformed into a viable second tier lending institution, so that there were some positive long term outcomes.

(b) El Nino: Infrastructure was substantially rehabilitated from the effects of 1997/98 El Nino. Emergency reaction institutions were strengthened. Facilities were built to assist those displaced by El Nino, and, subsequently, to be used for the poor.

### 5. Significant Shortcomings (including non-compliance with safeguard policies):

(a) PSD: There was lack of consensus within the Government about the design of the project, and, after approval, lack of continuous commitment to reforms. The last minute change in executing agent to a weaker and inexperienced party (UTEPA) jeopardized the project. Further, participating banks lacked the skills required to carry out their functions.

(b) El Nino: The government moved slowly in meeting conditions of effectiveness which delayed implementation, which was serious because of the emergency nature of the project. However, some of the "emergency" works supported by the project were actually not "emergency" works (see annex 3 of the ICR entitled "Economic Costs and Benefits) and would have benefitted from economic analysis. One such work, the large flood protection works in Pilar which cost US\$43.6 million were evaluated ex post and found to have an estimated ERR of only 5.4%. There is no further evidence presented for other components.

| 6. Ratings:     | ICR            | OED Review                | Reason for Disagreement /Comments  |
|-----------------|----------------|---------------------------|--|
| <b>Outcome:</b> | Unsatisfactory | Moderately Unsatisfactory | All of the "ICR" ratings given in this ES are taken to be the weighted average of the ratings in the two ICRs for the two components of this project. Thus, for "Outcome" the ICR rating is taken as the |

|                             |                |                |   |
|-----------------------------|----------------|----------------|---|
|                             |                |                | <p>weighted average of the ICR rating for PSD (Unsatisfactory, 70 percent of the total) and the ICR rating for El Nino (Satisfactory, 30 percent of the total). As a rating of "moderately unsatisfactory" is not available for the ICR, the closest rating available is "Unsatisfactory".</p> <p>The OED rating of "moderately unsatisfactory" results from an evaluation of both components of the project.</p> <p>OED agrees with the ICR rating of "Unsatisfactory" for the PSD portion of the project.</p> <p>OED rates the El Nino portion of the projects as "Moderately Satisfactory", rather than the ICR rating of "Satisfactory" for two reasons. First, some of the benefits of the project were lost when the government moved too slowly to allow the project to address the immediate consequences of El Nino. Second, at least one of the major works supported by the project (flood protection works at Pilar, which accounted for US\$3.6 million, or one quarter of the total) has a rate of return of only 5.4%, calculated ex post. No information is given on rates of return for other components, although calculating a rate of return for some of the components would be difficult.</p> <p>Combining OED's "Unsatisfactory" rating for the PSD portion of the project with OED's rating of "Moderately Satisfactory" for the El Nino portion of the project gives OED's rating for the project as a whole as "Moderately Unsatisfactory".</p> |
| <b>Institutional Dev .:</b> | Modest         | Modest         | The ICR rates ID as "modest" for both the PSD and El Nino components.   |
| <b>Sustainability :</b>     | Unlikely       | Unlikely       | The ICR rates sustainability "unlikely" for the PSD component, and "likely" for the El Nino component, yielding a weighted average of "unlikely" for the project as a whole.  |
| <b>Bank Performance :</b>   | Satisfactory   | Satisfactory   | The ICR rates Bank Performance as "Satisfactory" for both the PSD and El Nino components.   |
| <b>Borrower Perf .:</b>     | Unsatisfactory | Unsatisfactory | The ICR rates Borrower Performance as "Unsatisfactory" for the PSD component, and "Satisfactory" for the El Nino component, yielding a weighted average of "Unsatisfactory" for the project as a whole.   |
| <b>Quality of ICR :</b>     |                | Satisfactory   |   |

**NOTE:** ICR rating values flagged with '\*' don't comply with OP/BP 13.55, but are listed for completeness.

#### **7. Lessons of Broad Applicability:**

(a) PSD: The project was based on unrealistic conclusions about the robustness of the banking system . Credit should

not have been extended until the banking and financial sector reforms proposed by the Bank had produced

results. (Note project design was said to have incorporated past lessons, specifically the need to have the full backing of government for the location of the second -tier and to ensure that it is agile and well managed . BCP was selected to act as the second-tier unit but declined on the eve of project effectiveness . It was replaced by a new body without the legal stature, budget or personnel to function effectively . The Bank seems to have overestimated the extent of Government backing despite having noted its importance in the lesson section of the project document). Credit lines should not use public banks as financial intermediaries (as lending is often based on political rather than commercial criteria). Laws and regulations alone will not produce policy change without political will to apply them. Where commitment is uncertain, the Bank should invest more resources in analyzing the probability of political support before launching this type of reform program and attendant investment operation.

(b) El Nino: After an immediate emergency has passed, reconstruction works (especially those involving large capital expenditure) should be carefully appraised, including economic and financial analysis . This would have prevented the low-return investment in flood prevention works in Pilar .

(c) Only one ICR should be prepared for a project, no matter how disparate the components .

**8. Assessment Recommended?**  Yes  No

**9. Comments on Quality of ICR:**

Satisfactory. Clearly written, thorough, frank with good supporting arguments .

The earlier Evaluation Summary for the Private Sector Development Component is preserved in its entirety and



attached follows:

Paraguay ES.pdf