BASIC INFORMATION

A. Basic Project Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Project ID</th>
<th>Project Name</th>
<th>Parent Project ID (if any)</th>
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<tbody>
<tr>
<td>Paraguay</td>
<td>P169505</td>
<td>Paraguay Development Policy Loan (P169505)</td>
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<table>
<thead>
<tr>
<th>Region</th>
<th>Estimated Board Date</th>
<th>Practice Area (Lead)</th>
<th>Financing Instrument</th>
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</thead>
<tbody>
<tr>
<td>LATIN AMERICA AND</td>
<td>Nov 29, 2019</td>
<td>Macroeconomics, Trade</td>
<td>Development Policy</td>
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<tr>
<td>CARIBBEAN</td>
<td></td>
<td>and Investment</td>
<td>Financing</td>
</tr>
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<tr>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
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<tbody>
<tr>
<td>Ministry of Finance</td>
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Proposed Development Objective(s)

The Development objectives of the proposed DPL are (i) to reduce distortions and improve market efficiency and (b) to promote fiscal efficiency and accountability of public sector.

Financing (in US$, Millions)

SUMMARY

| Total Financing | 200.00 |

DETAILS

| Total World Bank Group Financing | 200.00 |
| World Bank Lending              | 200.00 |

Decision
The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. Paraguay has been characterized by solid economic growth, strong poverty reduction and macroeconomic stability in recent years – an adjustment of the development model, however, could increase sustainability and inclusiveness in the future. Economic growth has been above the regional average. Macroeconomic stability has been achieved; inflation is under control and public debt is low. Poverty reduction has been substantial, and several social
indicators have shown significant improvements. Apart from solid macroeconomic policy, growth has been based on extensive leveraging of the country’s natural wealth, particularly land and hydroelectric potential. Demographic change in Paraguay has led to a sizable expansion of the working-age population, adding to economic output. If the current model is adjusted, the sustainability of these achievements could be increased substantially, since two of the main sources of growth in the past decade (use of natural capital and the demographic bonus) will slowly reduce their contribution to growth. To meet the population’s expectations, Paraguay needs higher growth rates, but, even more importantly, this growth should become inclusive and sustainable in the medium and long term.

2. **Paraguay’s macroeconomic policy framework is sustainable and adequate for the proposed operation.** The macroeconomic framework is based on fiscal rules, inflation targeting, and a flexible exchange rate regime. The Fiscal Responsibility Law (FRL) caps annual deficits at 1.5 percent of GDP and real current primary expenditure growth at 4 percent. The Central Bank targets consumer inflation at 4 +/- 2 percent, while a flexible exchange rate allows to cushion external shocks. In recent years, the authorities have adhered to the main parameters of the framework. Sound macroeconomic policies have enabled high economic growth, with low public and external debt, and predictable inflation. Foreign reserves at about 7 months of imports are above the IMF’s metrics for a small open economy.

Relationship to CPF

3. **The proposed DPL is a key component of the country engagement strategy discussed by the Board in January 2019.** The CPF presented a big shift in WB engagement relative to previous strategies, with support to governance and institutional reforms at the center and a move towards environmental governance. In this context, the DPL was envisioned as an anchor instrument that if successful could be the basis for future lending operations. The two pillars in the proposed DPL are directly linked to the first CPF Focus Area - “Promoting accountable institutions and an improved business climate”, while also contributing to CPF Focus Area 2 – “Reducing volatility, natural capital management and integration into sustainable value chains”, and CPF Focus Area 3 – “Building human capital”. Overall, the proposed operation directly contributes to 6 out of the 10 objectives stated in the CPF. These focus areas, in turn, are closely aligned with the priorities identified in the SCD, which highlighted the need to strengthen public institutions and the business climate, natural wealth management, quality of public services, and human capital, to make the development path more inclusive and sustainable.

C. Proposed Development Objective(s)

4. **The Development objectives of the proposed DPL are (i) to reduce distortions and improve market efficiency and (b) to promote fiscal efficiency and accountability of public sector.** Firms face multiple barriers and competitiveness challenges when doing business, preventing the development of a healthy competitive environment that promotes firm and productivity growth. At the same time, investment needs and environmental sustainability challenges are big, and they require the active role of the private sector. The objective is to support policies that would relax these constraints and strengthen the foundations for private sector-led growth. At the same time, poor quality of public policies and services is a major constraint to Paraguay’s development, with high perceptions of corruption permeating thought-out. The second objective consists of supporting policies to improve public-sector performance, with a particular focus on fiscal efficiency and accountability.

Key Results

5. **Policies supported under this operation are expected to have significant results over a wide-ranging set of indicators.** The expected impact from policies under Pillar I include: reducing foreign trade transaction costs and increasing collection from taxes and duties; facilitating business entry and exit; improving access to finance; strengthening financial
market integrity; supporting the development of local capital markets; unlocking the PPP market; and boosting demand for Environmental Services Certificates. Main expected results from policies under Pillar II include: a more simplified and efficient tax structure, expanded tax base, and moderate increased in collections; improved targeting of the poor and vulnerable and an expansion of the social assistance coverage; increased value for money for procurement contracts; improved coordination and effective implementation of transparency, public integrity and open government reform initiatives; better protection of environmental rights; and a well-articulated National Statistical System.

D. Concept Description

6. The proposed DPL aims to achieve the development objectives by addressing critical constraints of the private and public sector. The actions supported under Pillar I aim at improving growth prospects and boost private sector development through policies or regulations that: promote competitiveness and facilitate trade (business package and customs reform); promote the development and transparency of the financial market (Anti Money Laundering and Pensions); facilitate private investment (PPPs and Anti Money Laundering); and align private incentives to environmentally sustainable practices (forest regulations). Pillar II is centered around measures that promote fiscal efficiency and accountability of the public sector. The measures proposed under this pillar seek to improve public-sector performance by (i) simplifying and making more efficient the collection of domestic resources (tax reform), and (ii) improving the use of those resources by making expenditure more effective, equitable, and transparent (procurement, Social Assistance, citizen budget). Moreover, better articulated policies require interinstitutional coordination (Social Assistance and Transparency), and an environment that guarantees transparency, public integrity, and timely and good-quality data to inform policy-making (Transparency, Escazu Agreement, Statistical System).

7. The proposed DPL is fully aligned with the core priorities of the Government’s program laid out in its two key development strategy documents – namely, the long-term NDP 2030 which was developed in 2014 under the previous administration and the Plan de Gobierno (PdG) 2018-2023 “Paraguay de la Gente”, which lays out the medium-term priorities of the Abdo Benitez administration. The first pillar of the proposed DPF is fully aligned with the PdG’s second priority area (ii) on “Sustained, inclusive growth with a focus on diversification and on increased private sector investment via an Improved investment climate”, and the measures on social protection and the environment contribute to priorities (i) on “Social Development” and (iv) on “Energy and Environment”. Furthermore, the overall operation supports the ambitious institutional reform agenda in terms of transparency and accountability, in wide-ranging and sensitive areas such as custom, procurement, anti-money laundering, and tax reforms.

E. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

The poverty and social impacts of the policies supported by this operation are expected to be neutral or positive in the short run, and overall positive in the medium and long-term. Policies aimed at reducing distortions and improving market efficiency (Pillar I) are expected to facilitate private sector development, and ultimately lead to more and better-quality jobs, raising living standards. Improved access to credit and a simplified registration process is expected to benefit mostly MIPYMES, which employ over 75% of the workforce. These benefits may be complemented by the policies on custom management and foreign transaction costs, provided export diversification takes place and expands into more labor-intensive sectors. Positive effects can be expected in the medium term from the improved regulatory framework on natural resources, as this helps protect the livelihoods of indigenous communities, small-scale producers and rural households who depend directly on forest ecosystems for subsistence. Policies aimed at promoting fiscal efficiency and accountability of the public sector (Pillar II) are expected to ultimately result in better quality public service provision,
which is a critical bottleneck for more inclusive growth. In the short term, the tax reform is not expected to have negative effects on poverty and a small but positive effect on income distribution. In the medium term, the creation of a simplified tax structure for small and medium enterprises may have positive indirect effects through potential formalization. The rise in excise taxes could have a negative but very small impact on poverty, though complemented by potential positive health effects in the long term. The expansion of Tekopora has a direct positive impact on poverty and inequality reduction, and a unified approach to the identification of the vulnerable sets the basis for more effective and equitable assistance to those in need. Increased resources through higher collection and more efficient spending, together with improved monitoring, transparency and accountability should set the basis for improved policy-making and service provision in the long term.

Environmental Impacts

8. The policies supported by the DPL are not likely to cause any negative effect on the environment, forests, or other natural resources. Positive effects are expected, however. The policies supported under the first pillar of this DPL relating to the ease of business registration and access to credit, as well as the amendment of environmental legislation to streamline the enforcement of anti-deforestation provisions are likely to have positive effects on the environment and contribute to a more dynamic forestry sector that is currently handicapped by a high degree of informality and illegality. In contrast, no significant effect is expected from improvements in customs and trade management and regulations. Eventual improvements in traceability in the forestry and agricultural sectors, which to date remains weak, could make this reform beneficial for the management of natural resources as it would help reduce illegality in the sector. Under the second pillar of this DPL, the policies relating equity and efficiency of the social assistance programs, as well as the ratification of the Escazú Agreement, are also likely to have significant positive effects on the environment. General governance-related policies, such as those relating to public procurement, integrity and the national statistics system, are unlikely to have a significant environmental impact. Overall, the proposed set of reforms would contribute a better enabling environment for sustainable development in Paraguay, encompassing its economic, social and environmental aspects.

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APPROVAL

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