

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PARAGUAY

SOCIAL PROTECTION PROGRAM FOR PARAGUAY

(PR-0147)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

The basic socioeconomic data for Paraguay available on the Internet at the following address:

English:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

Spanish:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

INFORMATION AVAILABLE IN THE FILES OF RE1

PREPARATION:

World Bank, “Paraguay: Attacking Poverty with Better Factor Markets and Government Services” (Report 22703-PA, November 2002 and preliminary version, September 2001).

Social Action Secretariat: “Estrategia Nacional de Reducción de la Pobreza y Desigualdad” [National Poverty and Inequality Reduction Strategy] (October 2003).

RE1, “Paraguay: Challenges in the struggle against poverty” (2003).

M.C. Flood, “Revisión del Gasto Público Social.” [Revision of Public Social Spending] (June 2002), prepared under contract for the World Bank.

EXECUTION:

Budget codes for protected program and monthly expenditure schedule for 2004.

ABBREVIATIONS

DGEEC	General Directorate for Statistics, Surveys and Censuses
ENREPD	Estrategia Nacional de Reducción de la Pobreza y Desigualdad Nacional (National Poverty and Inequality Reduction Strategy)
EPI	Expanded Program on Immunization
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IFMS	Integrated Financial Management System
ILO	International Labor Organization
IMF	International Monetary Fund
MEC	Ministry of Education and Culture
MSPBS	Ministry of Public Health and Social Welfare
OC	Ordinary Capital
OVE	Office of Evaluation and Oversight
PPF	Project Preparation Facility
PRODECO	Programa Piloto de Desarrollo Comunitario (Community Development Pilot Program)
PROPAIS	Programa de Inversiones Sociales (Social Investment Program)
PTI	Poverty Targeted Investment
SAS	Secretaría de Acción Social (Social Action Secretariat)
UNDP	United Nations Development Programme
WB	World Bank



PARAGUAY

IDB LOANS

APPROVED AS OF OCTOBER 31, 2003

	US\$Thousand	Percent
TOTAL APPROVED	1,838,796	
DISBURSED	1,444,845	78.57 %
UNDISBURSED BALANCE	393,950	21.42 %
CANCELATIONS	91,741	4.98 %
PRINCIPAL COLLECTED	523,402	28.46 %
APPROVED BY FUND		
ORDINARY CAPITAL	1,246,534	67.79 %
FUND FOR SPECIAL OPERATIONS	579,898	31.53 %
OTHER FUNDS	12,363	0.67 %
OUTSTANDING DEBT BALANCE	921,444	
ORDINARY CAPITAL	586,106	63.60 %
FUND FOR SPECIAL OPERATIONS	335,133	36.37 %
OTHER FUNDS	205	0.02 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	243,084	13.21 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	67,241	3.65 %
ENERGY	329,114	17.89 %
TRANSPORTATION AND COMMUNICATIONS	448,093	24.36 %
EDUCATION	192,948	10.49 %
HEALTH AND SANITATION	224,182	12.19 %
ENVIRONMENT	8,192	0.44 %
URBAN DEVELOPMENT	78,343	4.26 %
SOCIAL INVESTMENT AND MICROENTERPRISE	114,649	6.23 %
REFORM AND PUBLIC SECTOR MODERNIZATION	122,033	6.63 %
EXPORT FINANCING	0	0.00 %
PREINVESTMENT AND OTHER	10,916	0.59 %

* Net of cancellations with monetary adjustments and export financing loan collections.



PARAGUAY

STATUS OF LOANS IN EXECUTION AS OF OCTOBER 31, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Before 1997	5	175,045	122,457	69.96 %
1997 - 1998	6	115,951	68,268	58.88 %
1999 - 2000	7	280,200	31,055	11.08 %
2001 - 2002	3	50,400	1,274	2.53 %
2003	2	32,400	0	0.00 %
TOTAL	23	\$653,996	\$223,054	34.11 %

* Net of cancellations. Excludes export financing loans.



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Paraguay

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
PR0132	Cadastral Registry	9.0	APPROVED
PR0124	Primary and Pre-School Education	23.4	APPROVED
Total - A : 2 Projects		32.4	
TOTAL 2003 : 2 Projects		32.4	

2004

Project Number	Project Name	IDB US\$ Millions	Status
PR0147	Paraguay Social Protection Program	30.0	
PR0137	Support to Public Financial System Reform	50.0	
PR0145	CT Loan Support to Financial System Reform	4.5	
PR0146	Strengthening the Judiciary System	10.0	
PR0143	Asuncion Costal Development Program	55.0	
PR1004	Cental Bank Resstructuring Program	N/A	
PR1005	Strengthening negotiating Skills for Foreing Trade	N/A	
Total - A : 7 Projects		149.5	
PR1003	Technical Professional Educational Program	10.0	
PR0127	Medium, Small and Microenterprise Global Credit	25.0	
Total - B : 2 Projects		35.0	
TOTAL - 2004 : 9 Projects		184.5	

Total Private Sector 2003 - 2004	0.0
Total Regular Program 2003 - 2004	216.9

* Private Sector Project

SOCIAL PROTECTION PROGRAM FOR PARAGUAY

(PR-0147)

EXECUTIVE SUMMARY

Borrower and guarantor :	Republic of Paraguay		
Executing agency:	Ministry of Finance		
Amount and source:	IDB: (OC) Emergency Program:	US\$	30 million
	Total:	US\$	30 million
Financial terms and conditions:	Amortization Period:	5	years
	Grace Period:	3	years
	Disbursement Period:	18	months
	Interest Rate:	LIBOR at six months in US\$+ 400 basis points per annum	
	Initial fee:	1.0	%
	Credit fee:	0.75	%
	Currency:	U.S. dollar	
Objectives:	<p>The Program will support the Government of Paraguay to mitigate the effects of the economic crisis on the poorest and most vulnerable segments of the population and prevent setbacks in modernization efforts in an adverse economic climate. The specific objectives are to: (i) support the macroeconomic stabilization process; (ii) protect funding for social programs benefiting the poor; (iii) protect investment spending in poverty-targeted projects and/or strategic projects funded by the Bank and the World Bank, ensuring the availability of local counterpart; and (iv) ensure continuity in ongoing modernization efforts in the social sectors.</p>		
Description:	<p>The Program is an emergency loan which will be disbursed in a period of up to 18 months in two tranches of US\$20 million and US\$10 million respectively. The Program will condition disbursements to actions in three areas: (i) a macroeconomic program with the International Monetary Fund (IMF); (ii) budgetary protection for programs targeted to the poor and important to the modernization of the country; and (iii) support for modernization efforts in the social sectors.</p> <p>Macroeconomic Area. The Program requires that a macroeconomic program with the IMF be in place and in force (see paragraphs 2.4–2.5).</p>		

Budgetary Protection Area. The objective of actions in this area is to protect social expenditures to mitigate the effects of adjustment on poor and vulnerable groups. The selected programs meet the following criteria: (i) they benefit the poor, ensuring their access to basic services; (ii) they provide public goods or have positive externalities; (iii) they are IDB investment loans that target the poor, and thus qualify as Poverty-Targeted Investments (PTI), as well as parallel loans financed by the World Bank; and (iv) they are IDB investment loans strategic to the country's social modernization (see paragraphs 2.6 – 2.13).

Area of Strategic Sectoral Actions. In the context of an adverse economic environment, there is a tendency to defer strategic and modernizing sectoral policies, especially those with a medium term impact. The objective in this area is to prevent the postponement of these actions in the social sectors (see paragraphs 2.14 – 2.17).

**Bank's country
and sector
strategy:**

The Bank's strategy in Paraguay emphasizes: (i) competitiveness, to ensure Paraguay's effective participation in MERCOSUR; (ii) modernization of the State, so as to strengthen governance, improve efficiency in the delivery of basic social services, and develop institutional capacity; (iii) rural sector development, through an integrated multisectoral approach for sustainable rural development and poverty reduction; and (iv) social sector reforms that contribute to the development of human capital.

In an unfavorable macroeconomic context, social expenditure may be reduced due to fiscal adjustment, and ongoing strategic sectoral actions may suffer setbacks. These events may jeopardize access to basic services by the poor, the development of human capital, and modernizing actions aimed at poverty reduction, many of them supported by the Bank. Given this situation, the proposed Program is consistent with the Bank's strategy for Paraguay as it will help the government mitigate the effects of the crisis on the poor and avoid setbacks in implementing modernization processes (see paragraphs 1.28 – 1.30).

**Coordination with
Other Multilateral
Agencies:**

The Bank has maintained close coordination with other multilateral agencies in preparing the operation. The program is subject to a Stand-by agreement with the IMF, which must be in force. In response to a request from the country's authorities and in coordination with the World Bank, this operation will include protection of resources budgeted for programs targeted to the poor in health, basic sanitation and community development, financed by the World Bank. The country has also requested World Bank support through a fast disbursing loan (see paragraph 1.33).

**Environmental
and
social review:**

Given its special characteristics, the Program does not finance physical or other types of investments, and therefore will have no direct environmental impact. The Bank's investment loans protected by this operation have already been environmentally evaluated, contain the necessary environmental procedures in their operating manuals and therefore require no further analysis. With respect to social impact, this Program is expected to help mitigate the effects of the crisis on poor and vulnerable groups, contributing to alleviate poverty in the framework of the emergency (see paragraphs 4.4 – 4.6).

Benefits:

Budgetary protection for the selected social programs will prevent the effects of the crisis from being felt even more severely by poor and vulnerable groups, ensuring continued operations of health and education facilities as well as programs delivering public goods and/or with high positive externalities.

Protection of programs targeted to the poor financed by the Bank and the World Bank in Education, Health, Social Action, Agriculture, Infrastructure and Basic Sanitation sectors, will guarantee that both loan and counterpart resources are available to ensure an adequate pace of execution. Protection of the Program to Support the 2002 Demographic Census will guarantee the timely availability of socio-demographic data required for planning in the social sectors and for the design of the proposals contained in the National Poverty and Inequality Reduction Strategy (ENREPD), especially the design of a targeting instrument for social programs.

Lastly, the program will prevent setbacks in ongoing modernization efforts in the health and education sectors, many of which are supported by the Bank, and that could otherwise be postponed under adverse economic conditions (see paragraphs 4.7 – 4.9).

Risks:

There is a risk of a resurgence of the economic crisis, putting more pressure on the budget, requiring greater cuts in public spending. Such a situation could entail additional cuts in social programs, affecting the Program's objectives. This risk is mitigated by a realistic level of budgetary protection, representing 4.9% of the total budget, based on an estimate of the minimum amounts needed to maintain delivery of basic services for the low income population (see paragraph 4.10).

**Special
contractual
clauses:**

The disbursement of resources corresponding to each tranche is conditioned on compliance with policy actions specified in Chapter II and in the Policy Actions Matrix (Annex II-1). The opening of a special account for the administration of loan resources will be a condition precedent to the disbursement of the first tranche (see paragraph 3.5).

**Poverty-targeting
and social equity
classification:**

Although the Program protects social spending and reinforces social sector modernization actions, in accordance with the guidelines for emergency loans (GN-2031-10), this operation does not qualify as a poverty targeted or social equity enhancing program (see paragraph 4.4).

**Exceptions to
Bank policy:**

None.

I. FRAME OF REFERENCE

A. Macroeconomic framework

1. Current situation

- 1.1 During the last decade, the Paraguayan economy faced a number of successive shocks that jeopardized its growth and generated high social costs. In the period 1990-2000, Gross Domestic product (GDP) grew at an average annual rate of 2.1%. Given population growth on the order of 2.6% a year, income per capita fell at an average rate of 0.6%. With a drop in GDP of 2.2% in 2002, due primarily to a contraction in agricultural production, average growth in the last five years was below 1%. GDP per capita fell from US\$1,510 in 2001 to approximately US\$940 in 2002.
- 1.2 In this sense, the main problem facing the Paraguayan economy is slow growth. For 2003, it is estimated that the real growth rate of GDP will be in the order of 2%, a result of recovery in most economic sectors, especially agricultural production. However, despite positive signals, the consequences of the crisis are still putting a brake on what should be a vigorous recovery. A sustainable recovery faces two important problems: credit restrictions in the financial system and a liquidity crisis on the Central government which make it impossible to adequately meet financial obligations.
- 1.3 Restrictions on credit negatively affect economic growth, since firms cannot gain access to resources to resolve the over-indebtedness problems resulting from the crisis. The over-indebtedness of firms and a general situation of uncertainty have reduced the banks' willingness to expand credit. In September of 2003, credits in both dollars and guaranis had registered contractions of 24.4% and 19.6% respectively, in relation to September 2002. Credit contraction and the relative stability of deposits generated a situation of excess liquidity in the system which is clearly expressed in the spread: in September, lending rates were in the order of 51.3% while deposit rates were 5.3%.
- 1.4 On the fiscal side, the situation remains critical, despite excellent results in tax collection over the last few months. The floating debt reached US\$183 million in September and the financing gap for 2003 reaches US\$164 million (3.6% of GDP). At the same time, there is a structural problem, and the magnitude of the adjustment necessary to balance the annual flows of revenues and expenditures in the Central Government is slightly above 2% of GDP. A Central Government deficit of 1.2% in 2003 and 2.3% in 2004 is projected, without taking into account the additional measures contemplated under the agreement with the International Monetary Fund (IMF).

2. Agreement with the International Monetary Fund

- 1.5 The authorities are negotiating a 15-month Stand-By Agreement with the IMF, giving it access to US\$100 million in December 2003. The main objectives of the agreement are to stabilize the fiscal situation and the financial sector, laying the foundations for long-term structural reforms.
- 1.6 The objective, on the fiscal side, is to reduce the deficit from 3.1% of GDP in 2002 to 0.6% in 2003 and 0.2% in 2004 (see Table I-1), progressing towards long term fiscal sustainability. The target is to obtain a primary surplus of 1.5% for the Central Government and of 2.5% in the consolidated public sector in 2004. In order to achieve this goal, the approval of the administrative organization law as well as setting ceilings on expenditures on wages and salaries in the Central Government in 2003 and 2004 are required. Agreement has been reached on tariff adjustments for fuel, water and electricity, which fully compensate for inflation and exchange rate variations.

TABLE I-1					
CONSOLIDATED FISCAL BALANCE					
Fiscal Balance		2001	2002	2003*	2004*
Without measures	G\$ billion	-318	-999	-466	-948
	% of GDP	-4.3	-3.1	-1.2	-2.3
With measures	G\$ BILLION	-318	-999	-232	-72
	% of GDP	-4.3	-3.1	-0.6	0.2
Source: IMF as of November 3, 2003					
*Projected					

- 1.7 In relation to the public debt, agreement has been reached on eliminating delays in external debt service, not contracting new short-term debt, reducing floating debt to US\$40 million, and establishing a ceiling of US\$200 million on medium-term external borrowing in 2004.
- 1.8 In the financial sector, Congressional approval of the Public Banking Law and a comprehensive reform of the financial system are expected. Agreement has been reached on establishing supervision of the main financial cooperatives and risk rating of commercial banks by an international agency. With respect to the Central Bank, agreement has been reached with the Minister of Finance to grant it greater autonomy, as well as carrying out an annual external audit.

3. Prospects

- 1.9 The major benefit of the agreement with the IMF is the resolution of the liquidity problem faced by the Central Government. In order to achieve this, resources on the order of US\$164 million in 2003 and US\$201 million in 2004 are required. Since the country lacks access to international capital markets, lending by the IDB and the World Bank, under the framework of the agreement with the IMF, is essential to closing the financial gap, as noted in Table I-2.

TABLE I-2 PARAGUAY: CENTRAL GOVERNMENT FINANCING REQUIREMENTS				
	2003		2004	
	Millions US\$	(% GDP)	Millions US\$	(% GDP)
Gross Financing Requirements	284	5.0	345	5.6
Deficit	72	1.2	142	2.3
Amortization of External Debt	89	1.6	125	2.0
Amortization of Internal Debt	107	1.9	9	0.1
Reduction of Floating Debt	17	0.3	68	1.1
Financing	120	2.1	143	2.3
External Disbursements (WB, IDB)\1	107	1.9	144	2.4
Domestic Bonds	0	0.5	8	0.1
Central Bank Deposits	0	0.8	102	1.9
Commercial Bank Deposits	13	0.2	-1	0.0
Financing Gap	164	3.6	201	3.3
<i>Fiscal Adjustment</i>	36	0.6	131	2.1
<i>Refinancing Bonds</i>	98	1.7	0	0.0
Fast Disbursement Financing	30	0.5	70	1.1
IDB\2	0	0.0	45	0.7
World Bank	30	0.5	25	0.4
Bilateral	0	0.0	0	0.0
Source: IMF as of November 3, 2003				
\1 Disbursement of investment loans.				
\2 Disbursement of emergency loan (US\$30 millions) and first tranche of PR-0137 (US\$15 millions).				

- 1.10 The 2003 financing gap would be covered by adjustment measures (US\$36 million), refinancing of domestic debt (US\$98 million), and a World Bank loan for US\$30 million. In 2004, the financing gap would be covered by the results of fiscal measures (US\$131 million), the emergency loan which is the subject of this proposal for US\$30 million, the first disbursement of the public banking reform law financed by the Bank (US\$15 million), and the first disbursement of the World Bank's financial sector loan (US\$25 million). The IDB's contribution in 2004 is essential to close the financing program, making the consolidation of the country's fiscal position viable.

B. The social situation

1. Dimension and profile of poverty and social inequality

- 1.11 Paraguay is characterized by high income concentration and high levels of poverty. Following the 1995 banking crisis and the successive shocks which resulted in low GDP growth rates, poverty rates increased, as shown in Table I-3. Between 1995 and 2001, the percentage of the population below the poverty line increased from 30.3% to 33.8%, and the percentage of the population living in extreme poverty rose from 13.9% to 15.4%.

TABLE I-3 POVERTY LEVELS BY REGION 1995 AND 2000/1 (% of total population)		
	1995	2000/1
Poverty (total)	30.3	33.8
Urban	23.7	27.6
Rural	37.2	41.2
Extreme poverty (total)	13.9	15.4
Urban	6.8	7.1
Rural	21.4	25.1

- 1.12 Poverty is concentrated in rural areas. Although the rural population represents less than half the entire population (approximately 45%), it accounts for 56% of the poor and 75.2% of the extremely poor. Table I-3 shows that the rural area accounts for practically all of the increase in extreme poverty between 1995-2001. In addition to the incidence, the poverty gap and the severity of poverty are higher in rural areas. These two indicators complement the information about incidence, showing that the rural poor are poorer than the urban poor and that inequality among the rural poor is higher. Rural income is highly concentrated, in line with the concentration of property: more than 65% of owners hold less than 5% of the land, whereas one percent own two thirds of the land.
- 1.13 In the rural areas, the groups most affected by high poverty levels are independent farmers that produce cotton or engage in subsistence farming. In the urban areas, heads of poor households tend to be out of the labor force, unemployed or be independent workers. Other variables are also associated with poverty. Large families, low levels of education, and exclusive use of the Guarani language in the household imply a greater probability of being poor. Approximately half the population speaks only Guarani; the per capita income of these households is 15 to 45% lower than similar households.
- 1.14 Although Guarani is an indigenous language, the same cannot be said of the Guarani-speaking population. The indigenous population represents only 1.5% of the country's population. It is concentrated in the rural areas, engaged in subsistence or seasonal labor, activities that are associated with high levels of poverty. Moreover, access to public services is limited. Among 496 indigenous communities in Paraguay, 30% have no school building and 74% lack a health post or center.

2. Evolution of social expenditure

- 1.15 Per capita social spending in Paraguay remains low compared to other countries in the region (16% of the average), only higher than in Nicaragua, Honduras and Guatemala, although it registered one of the highest growth rates of the nineties¹.

¹ See M.C. Flood, "Revisión del Gasto Público Social" [Review of Social Public Expenditure] (June 2002), prepared under contract for the World Bank.

Government spending increased from an average of 8.9% of GDP in the eighties to 16.8% in the nineties, reaching a maximum of 22.7% in 2000. Social expenditure, excluding social security, contributed the most to this trend, increasing from 2% of GDP in the eighties to 4.8% in the nineties, and reaching 6.8% in 2000. That is to say, from the 1980s to 2000, the social expenditure share of total government spending increased from 22.5% to 30%.

- 1.16 The education and health sectors account for more than 95% of public social expenditures, excluding social security. It should be emphasized that in both education and health, wages and salaries were the determinants of the increases in expenditure. The public sector payroll almost tripled its share of GDP in the nineties. Employment in the health and education sectors grew from 45% of total public employment in 1990 to 60% in 2002. However, both sectors have made significant achievements, and the technical efficiency levels of social spending are close to the Latin American average². In health, the technical efficiency of expenditure represents 99% of the average for the region. In basic education, the level is better than the average (104%), although for secondary education it only reaches 86% of the average.
- 1.17 The increase in government spending exceeded GDP growth, especially in the latter half of the 90s, adding to the growing fiscal deficit at the end of the decade. This translated into a lack of sustainability, despite strong pressure on demand for public services due to an increase in poverty and the persistence of a high annual population growth rate (2.6%).
- 1.18 Since 2000, economic adjustments resulted in a reduction of total government spending and of public social spending. In 2001, total expenditure dropped by three percentage points with relation to GDP, and social expenditure by 0.7 percentage points. Since 2001, social expenditures have maintained their share of 30% of total expenditure.

3. Social sector challenges: social action, education and health

a) Social action

- 1.19 Paraguay has a large number of small social programs executed by different agencies, with a very limited impact on poor and vulnerable groups. The scarcity of resources, the absence of targeting mechanisms, limited beneficiary participation in the definition of actions, institutional and technical weaknesses, and the political vulnerability of the institutions in charge, further undermine their ability to respond effectively to the needs of poor and vulnerable groups. In addition, the absence until very recently of a political and institutional framework to ensure cohesive and integrated actions, resulted in programs being executed by

² Technical efficiency was calculated by the World Bank using the relation between selected variables, the most important being expenditure in each sector and results measured by basic indicators for health and education.

a number of weak agencies within the central administration, making it difficult for benefits to reach those that effectively need them.

- 1.20 The increase in poverty since the mid-90s prompted the country to make an effort to institutionalize and integrate actions designed to reduce poverty. As a result, the government created the Social Action Secretariat [Secretaría de Acción Social or SAS] in 1995, and launched the Social Investment Program (PROPAIS), funded by the Bank through a loan (929/OC-PR) and a technical cooperation (ATN/SF-5228-PR). This program pioneered the use of new models to deliver infrastructure and social services to poor populations through non-governmental organizations. PROPAIS II (1422/OC-PR), approved by the Bank in September 2002, ensures the continuity of these efforts, incorporating investments in social development plans for rural and indigenous communities, as well as providing for the institutional strengthening of the SAS. The SAS is also tasked with execution of the Pilot Program for Community Development (PRODECO), financed by the World Bank, to test a participatory and decentralized development model as a means to improve the quality of life and social inclusion of poor urban and rural communities in three departments in southern Paraguay. However, these modernization efforts are still in their early stages.
- 1.21 An important advance has been the elaboration of the National Poverty and Inequality Reduction Strategy (ENREPD) by the SAS, with the support of the United Nations Development Programme (UNDP), the International Labor Organization (ILO), the Bank, and the World Bank, among others. The ENREPD incorporates the Millennium Development Goals agreed by international development institutions and the countries, as a commitment to pursue specific goals to improve basic social indicators. The ENREPD defines courses of action and short-, medium- and long-term priorities for universal access to the benefits of development by targeting public social expenditures, and emphasizing social inclusion and protection of the most vulnerable groups. One of the greatest challenges facing the ENREPD is the design, financing and implementation of a social promotion and safety net. The Bank is supporting this effort through a non-reimbursable technical cooperation approved at the end of 2002³.

b) Education

- 1.22 Increased education is key to poverty reduction in Paraguay. Estimates suggest that basic education increases a person's income 12 to 45%, and secondary education, 25 to 70%, compared to the income of the uneducated. In the last twenty years, Paraguay has made important strides in education: the number of years of schooling for the population over the age of 10 has doubled, and the illiteracy rate fell by 50%. The substantial process of educational reform initiated in the nineties with the Bank's support increased the internal efficiency for basic schooling, resulting in the fact that 90% of students remain in school for more

³ Support for the Design of a Social Promotion and Protection Net (ATN/SF-8167-PR), in the amount of US\$410,000, with US\$372,000 of resources from the Fund for Special Operations.

than five years. Curricula, school management and teacher training have also been reformed, and given the cultural and socio-linguistic diversity of the country, special needs programs at schools with high educational risk have been implemented and a bilingual education program was introduced in 1994.

- 1.23 Still, many challenges persist in the educational system. Initial and pre-school education is not well developed. In elementary schools, only 43% of each group of children enrolled in the first grade graduate in six years without repeating a year, and only 70% eventually graduate. The percentage of children repeating the first two grades is particularly serious: 14.6% in rural areas and 12.3% in urban areas. On average, it takes nine years for a student to graduate from sixth grade. This translates into a low transition to the third cycle of basic education (grades 7-9) and to secondary school. With respect to financing for the education system, government spending is progressive and free elementary school is guaranteed. However, payroll accounts for 93% of the total expenditure (excluding transfers to private entities), which leaves a very narrow margin for investment and purchase of inputs and services that would help improve the quality of teaching.
- 1.24 Another key problem is the decline in the number of students per classroom in basic education in the nineties, from 20.8 in 1991 to 15 in 1999. The creation of new classrooms with a small number of students has eroded the budgets of the Ministry of Education and Culture (MEC), through an increase in the cost per student, as well as adding requirements for additional physical space and new teachers that are not always sufficiently qualified. The smaller number of students per classroom has not been translated into better quality, and thus the strategy has not improved the effectiveness of the system. An increase in the average number of students per classroom to 25 would result in savings of more than US\$300 million in basic and secondary education over the period 2004-2030, without affecting quality.

c) Health

- 1.25 Health indicators in Paraguay are unreliable because of major under-reporting of vital statistics. Although there have been significant achievements in the last 20 years, the magnitude of the main indicators and their changes vary according to the source. The Ministry of Public Health and Social Welfare (MSPBS) reports a decrease in infant mortality from 46 per thousand live births in 1985, to 19.6 in 2001, whereas the General Directorate for Statistics, Surveys and Censuses (DGEEC) reports a decline from 47.8 to 38.1 in the same period⁴. Maternal mortality is among the highest in the region, but reliable figures are also unavailable⁵. Regardless of the figures used, there is no doubt that high rates of infant and maternal mortality as well as fertility persist in Paraguay.

⁴ The DGEEC figures are considered more reliable since they take into account under-reporting.

⁵ The MSPBS reports a figure of 114.4 per 100,000 live births, but it is believed that the true figure is much higher. The World Health Organization estimates it as 170 in 1995, but with a variation from 65 to 390 per 100,000 live births due to uncertainty.

- 1.26 The principal challenge for the health system is its low coverage. It is estimated that 18-20% of the population is covered by the Social Security Institute and other social security agencies, and 10% by private systems. The rest of the population is theoretically covered by services provided by the Ministry of Public Health. However, it is believed that approximately 30% of the total population does not have regular access to any service, either because of distance to the nearest health care center, lack of financial resources or other barriers to access.
- 1.27 In recent years, with Bank and World Bank support, primary health care is being strengthened through provision of a basic package of quality maternal and child care services, the expansion of infrastructure, and the strengthening of the drug procurement and distribution system. Paraguay has also made a major effort to improve immunization coverage for children under the age of five, introducing the triple viral vaccine in 2001 and the pentavalent in 2002.

C. The Bank's strategy and program justification

- 1.28 The Bank's strategy for Paraguay emphasizes: (i) competitiveness, to ensure Paraguay's effective participation in MERCOSUR; (ii) modernization of the State, to enhance governance, improve efficiency in the delivery of basic social services, and build institutional capacity; (iii) development of the rural sector, through an integrated multisectoral approach to promote sustainable rural development and poverty reduction; and (iv) reform of the social sectors to contribute to human capital development.
- 1.29 The Bank already has a strong presence in the social sectors and in financing projects in other sectors that contribute to poverty reduction. Among projects in execution that qualify as poverty targeted investments (PTI) are the following: Program to Strengthen the Reform of Basic Education (1254/OC-PR), Primary Health Care Reform Program (1006/OC-PR), Water Supply and Sanitation in Small Communities (1312/OC-PR), Program to Support Small-Scale Cotton Farms (1109/OC-PR), and the National Rural Roads Program – 2nd Stage (1230/OC-PR). PROPAIS II (1422/OC-PR) and the recently approved Program to Support Initial and Pre-school Education (PR-0124) are in the stage of ratification by Congress.
- 1.30 In the unfavorable macroeconomic context faced by the country, social spending may be reduced due to fiscal adjustment and ongoing strategic sectoral actions may be deferred. These events may jeopardize access to basic social services by the poorest sectors of the population, development of human capital, and modernization actions in the social sectors. many of which are supported by the Bank. Given this situation, the proposed Program provides a response that is consistent with the Bank's strategy for Paraguay, by providing support to mitigate the effects of the crisis among the extremely poor and to avoid setbacks in the modernization processes.

D. The Bank's Experience and lessons learned

- 1.31 The Bank has accumulated relevant experience in emergency sector loans in countries such as Argentina, Brazil, Peru, and Uruguay. According to the evaluation of emergency loans approved in 1998-1999 carried out by the Office of Evaluation and Oversight (OVE), these operations, implemented in coordination with the IMF and the World Bank, have helped to: (i) calm financial systems in the short-term; (ii) provide liquidity for the economy; and (iii) protect expenditures in social programs due to their buffering effect during the crisis.
- 1.32 This operation is consistent with the Guidelines for Emergency Loans approved by the Bank's Board (GN-2031-10), and incorporates lessons learned from preparation of the Program for Social Protection and Sustainability in Uruguay (1417/OC-UR)⁶, including: (i) conditionality centered on protecting social spending to mitigate the negative impact of the economic adjustment on the social welfare of the most vulnerable groups; (ii) specific budgetary protection targets for health and education, instead of a global spending target, in order to ensure that programs with a large impact are protected; (iii) a small number of additional conditions supporting ongoing modernization efforts; and (iv) coordination between the Bank and other multilateral agencies, while assuming clear leadership in the social area.

E. Coordination with other multilateral agencies

- 1.33 The Bank has maintained close coordination with other multilateral agencies in preparing the operation. The program is subject to a Stand-By agreement with the IMF, which must be in force. In response to a request from the country's authorities and in coordination with the World Bank, this operation will include protection of resources budgeted for programs targeted to the poor in health, basic sanitation and community development, financed by the World Bank. The country has also requested World Bank support through a fast disbursing loan, based on modernizing actions in public management.

⁶ Uruguay. Program for Social Protection and Sustainability (1417/OC-UR). Project Completion Report (PCR) of 31 July 2003.

II. THE PROGRAM

A. Objectives

- 2.1 The Program will support the Government of Paraguay to mitigate the effects of the economic crisis on the poorest and vulnerable segments of the population, and to prevent setbacks in modernization actions, in an unfavorable economic context. The objectives are to: (i) support the macroeconomic stabilization process; (ii) protect funding for social programs benefiting the poorest sectors; (iii) protect investment spending in poverty-targeted and/or strategic projects financed by the Bank and the World Bank; and (iv) ensure continuity of ongoing social sector modernization actions.

B. Areas of action

- 2.2 The Program is an emergency sectoral operation and disbursements will be conditional on actions in three areas: (i) macroeconomic area; (ii) budgetary protection for selected programs; and (iii) strategic sectoral actions. The Matrix of Policy Actions governing disbursements is contained in Annex II-1.
- 2.3 The logic of the timeline used to draw up the Policy Actions Matrix for the Program conditions the first tranche to actions that are mostly under the authority of the Executive. These actions will provide for budget protection and monitoring of selected actions in the social sectors. The second tranche calls for compliance with budgetary execution goals in fiscal year 2004, and the continuation of budget protection in 2005, as well as progress in complying with strategic sectoral actions.

1. Macroeconomic area

- 2.4 **Objective.** The Paraguayan economy has faced successive external shocks that put at risk its macroeconomic stability and growth. The country is negotiating a Stand-By agreement with the IMF, which has as its main objective laying the foundations for fiscal sustainability, creating a favorable climate for economic growth in the medium-term.
- 2.5 **Actions.** In this policy area, for the first and second tranches, the Government will present evidence that a macroeconomic program has been agreed to with the IMF, and that it is in force.

2. Budgetary protection area

- 2.6 **Objective.** In 2004, total government expenditure could be significantly reduced due to the fiscal adjustment. The objective of the actions in this area is to protect social spending so as to mitigate the effects of the adjustment on the poorest and most vulnerable groups. The selected programs meet the following criteria: (i) they provide benefits to the poor, ensuring their access to basic services;

(ii) they provide public goods or have positive externalities; (iii) they are Bank investment loans targeted to the poor, that are classified as PTI, as well as parallel World Bank loans; and (iv) they are Bank investment loans that are strategic for the country's social modernization. The list of selected programs and their physical targets are shown in Annex II-2.

- 2.7 In the health sector, priority was assigned to spending in public health programs with universal coverage given their public good and/or high positive externalities characteristics. These include the Expanded Program on Immunization (EPI), programs for the prevention and control of tuberculosis, leprosy, rabies, HIV/AIDS, and vector-borne transmissible diseases (Chagas, dengue, malaria and leishmaniasis), and the reproductive health program. In addition, operating expenses for primary health care have been prioritized, since these are geared to poor mothers and children that depend on public services. The Indigenous Health Care program has also been selected, including the Indigenous Hospital, which provides culturally appropriate care. Protected expenditures exclude wages so as to guarantee the availability of complementary inputs that are crucial to assuring the quality of care in a period of budget cuts. The Program also extends budgetary protection to the Primary Health Care Reform Program (1006/OC-PR) and the World Bank's parallel loan, Maternal Health and Child Development, that finances the expansion of coverage and reform actions to improve the most serious public health problems in the country, maternal and perinatal mortality.
- 2.8 In the education sector, priority was assigned to spending for the provision of inputs for initial and basic education, including textbooks and teaching materials, school maintenance, classroom expansion in cooperation with parents' associations to meet growing demand, and technical-pedagogical oversight in the context of the educational reform. In addition, operating expenses for middle and technical education, as well as the permanent education program, geared towards adolescents left out of the education system, will be protected. Wages are not included in the protected expenditures in order to guarantee the availability of complementary inputs. The Program also provides budgetary protection for the Bank-financed Program to Strengthen the Reform of Basic Education (1254/OC-PR), designed to improve the quality and equity of this school cycle, as well as the recently approved Project Preparation Facility for the Initial and Pre-School Education Program (1462/OC-PR).
- 2.9 In other sectors, budgetary protection will be afforded to investment spending in programs funded by the Bank and parallel World Bank programs, selected because they are targeted to the poor and are thus classified as PTI. In social action, the Community Development Pilot Program (PRODECO) financed by the World Bank and the recently approved Project Preparation Facility for PROPAIS II (1481/OC-PR) will be protected. In basic sanitation, priority was given to the Program for Water Supply and Basic Sanitation in Small Rural Communities (1312/OC-PR) that finances potable water systems in poor rural and indigenous communities, as well as the parallel loan financed by the World Bank. In agriculture, priority was given to the Program to Support Small-Scale Cotton

Farms (1109/OC-PR), aimed at increasing the income of small cotton producers by financing a pest monitoring network, improvements in seed quality and provision of technical assistance. In public works, priority was given to the second stage of the National Rural Roads Program (1230/OC-PR), that finances rehabilitation and improvement of rural roads. Finally, protection will be given to the Program to Support the National Population and Housing Census (1301/OC-PR), given its strategic nature for social sector planning, and its importance for the development of a targeting system for social programs. Data were gathered in August 2002, and the analysis is in its final stages.

- 2.10 Actions. Table II-1 states the budgetary protection for each protected program agreed with the Bank. The first tranche is subject to presentation of evidence satisfactory to the Bank of the following: (i) Draft 2004 Budget Law and amendments introduced in Congress, with the budgetary allocations to the protected programs shown in Table II-1 as minimum amounts; and (ii) the schedule for monthly financial execution of the protected programs, using the amounts in the same table as totals for the year.

TABLE II-1 PROTECTED BUDGET - 2004 (IN MILLIONS OF GUARANIS)	
HEALTH	95,969
Primary Health Care	21,235
Indigenous Health Care	846
Expanded Program on Immunization (EPI)	31,141
Nacional Anti-Tuberculosis Program	1,649
Nacional Anti-Leprosy Program	343
Nacional Anti-Rabies Center	977
National Service for the Eradication of Vector-borne Transmissible Diseases (SENEPA)	8,110
Prevention, Education, Surveillance and Control of HIV/AIDS	3,123
Reproductive Health Program	271
Maternal Health and Child Development (WB)	2,354
Loan Resources	2,304
Counterpart Resources	50
Reform of Primary Health Care (IDB)	25,920
Loan Resources	18,720
Counterpart Resources	7,200
EDUCATION	89,621
Initial and Basic Education	18,573
Secondary and Technical Education	11,477
Permanent Education	153
Program to Strengthen the Reform of Basic Education (IDB)	54,378
Loan Resources	48,000
Counterpart Resources	6,378
Initial and Pre-School Education Program (PPF IDB)	5,040
OTHER PROGRAMS WITH EXTERNAL RESOURCES	188,800
PRODECO (WB)	16,000
Loan Resources	14,400
Counterpart Resources	1,600
PROPAIS II (PPF IDB)	8,784
Loan Resources	8,784
Water Supply and Sanitation Program (WB)	58,177
Loan Resources	52,360
Counterpart Resources	5,817
Water Supply and Sanitation in Small Rural Communities (IDB)	6,400
Loan Resources	5,760
Counterpart Resources	640
Support for the Development of Small Cotton Farms (IDB)	37,567
Loan Resources	33,552
Counterpart Resources	4,015
National Program of Rural Roads – Second Stage (IDB)	52,800
Loan Resources	47,520
Counterpart Resources	5,280
Support for the Implementation of the 2002 Census (IDB)	9,072
Loan Resources	7,200
Counterpart Resources	1,872
TOTAL PROTECTED PROGRAMS	374,390
REFERENCE VALUE IN US DOLLARS (*)	52,000
(*) US\$ 1.00 = G\$ 7,200.00	

- 2.11 In the framework of these agreements, the Executive has pledged to protect the budget for these programs, which will not be cut in the event that another adjustment becomes necessary. Table II-2 describes the relative importance of the health and education protected budget allocations in the respective Ministry's budget, as well as the relative importance of the total amount protected in relation to total government spending.

TABLE II-2 RELATIVE IMPORTANCE OF BUDGET PROTECTION	
Health Sector Protected Programs	
% of the MSPBS* budget	14.5%
% of the MSPBS budget excluding wages	27.6%
Education Sector Protected Programs	
% of the MEC budget	6.0%
% of the MEC budget excluding wages	29.6
Total Protected Programs	
% of total budget of the Central Government	4.9%
*Excludes National Environmental Sanitation Service (SENASA)	

- 2.12 In addition, the first tranche is subject to presentation of evidence, satisfactory to the Bank that three new loan contacts financed by multilateral agencies have been presented to the Congress for ratification: (i) PROPAIS II (1422/OC-PR); (ii) Initial and Pre-School Education Program (1467/OC-PR); and (iii) Program to Reform Secondary Education, financed by the World Bank.
- 2.13 The second tranche is subject to presentation of evidence that at least 75% of the resources programmed for the health, education, and other sectors, in agreement with the Bank have been committed. Given the country's intention to continue honoring the Program commitments in the 2005 fiscal year, evidence of the Guidelines for the 2005 Budget Decree will also be required, maintaining the amounts budgeted for protected programs financed with national resources in real terms, and assigning the expected counterpart resources to protected programs financed with external resources. Furthermore, the second tranche will be conditional on evidence that the loan contracts for PROPAIS II, Initial and Pre-School Education Program, and Program to Reform Secondary Education are in force, and that their respective budgetary allocations of loan and counterpart resources have been made.

3. Area of strategic sectoral actions

- 2.14 **Objectives.** In an unfavorable economic context, there is a tendency to defer strategic or modernizing sectoral actions, especially those of medium-term impact. The objective in this area is to prevent the postponement of such actions in the social sectors. The selected actions are already ongoing and address the implementation of a mechanism to coordinate social policies, the continuity of the educational reform, and the improvement of health indicators related to the Millennium Development Goals.
- 2.15 **Actions.** For the first tranche, the establishment of a Social Cabinet, integrated by the Ministers of the SAS, Education and Culture, Public Health and Social Welfare, Agriculture and Livestock, and Finance, chaired by the President of the Republic, is expected. This initiative reflects the priority given to the social sectors by the new administration, and has among its objectives a reduction in the

fragmentation of social programs and in the dispersion of efforts and resources. Moreover, the participation of the Minister of Finance in the Social Cabinet is designed to make social policies compatible with economic policies. For the second tranche, the work plan of the Social Cabinet will be presented, identifying the key areas in which social policies require greater coordination.

- 2.16 With respect to education, the first tranche is subject to presentation of evidence, satisfactory to the Bank, of a Ministerial Resolution approving the criteria and procedures for adding new classrooms in public educational institutions at the initial, basic and secondary levels. This will lay the basis for rationalizing expenditures in the sector by increasing the number of students in the classroom. In addition, evidence of the establishment of Departmental Education Councils and Departmental Supervisory Coordination Committees in the 17 Departments of Paraguay, including Asunción is required. The second tranche is subject to presentation of evidence, satisfactory to the Bank, of the following: (i) approval of the updated regulations for Educational Supervision and for the Departmental Educational Councils; and (ii) publication and dissemination of the Strategic Departmental Education Plans. These actions will lend continuity to the ongoing education reform, supported by the Bank.
- 2.17 With respect to health, actions are envisaged in two areas: design and implementation of a new Vital Statistics System to address the serious problem of under-reporting of births and deaths, and an improvement in the reliability of basic health indicators. With regards to vital statistics, the first tranche requires evidence, satisfactory to the Bank, that new forms for the registry of births and deaths, as well as the accompanying Manual of Norms and Procedures for the Information Subsystem of Vital Statistics have been approved. The development of the new forms was supported by the Primary Care Reform Program (1006-OC-PR). For the second tranche, evidence that the new forms are being utilized in Metropolitan Asunción is required. In addition, the first tranche is conditioned on evidence, satisfactory to the Bank, that an Advisory Committee for Vital Statistics and Health Indicators has been created, comprised of representatives from the Ministry of Public Health, the General Directorate for the Civil Registry, and the General General for Statistics, Surveys and Censuses; for the second tranche, this Committee must present its recommendations to the Minister of Public Health. The work of this Committee will make it possible for different agencies to share data and methodologies and develop mechanisms of coordination among them, which are currently absent.

C. Cost and size of the operation

- 2.18 The Program will allocate a total sum of US\$30 million to the Treasury that will be charged to the Bank's Ordinary Capital through the emergency loan window. The size of this operation is justified in terms of the financial programming of external resources required by the economic authorities, as well as the resources involved in the policy actions to be undertaken by the Government of Paraguay to ensure the budgetary protection of the programs identified.

III. EXECUTION OF THE PROGRAM

A. Borrower, guarantor and executor

- 3.1 The borrower will be the Republic of Paraguay, and the executing agency will be the Ministry of Finance. The Ministries of Public Health and Social Welfare, Education, Agriculture, Public Works, the Social Action Secretariat and the General Directorate for Statistics, Surveys and Censuses will be responsible for executing the protected social expenditure. The first two and the Social Cabinet will also be responsible for compliance with the strategic sectoral actions.

B. Project execution and administration

- 3.2 A commission coordinated by the Director of Fiscal Policy, who reports to the State Under-Secretariat for Economy and Integration, will be responsible for the execution, coordination, administration, and monitoring of the Program. The commission is comprised of the General Directors of the Government Budget and of the Treasury, and the Head of the Department for Analysis of Economic Trends and Fiscal Monitoring. The commission will submit a report every two months to the Finance Minister with its findings concerning the financial execution of the protected programs in compliance with the agreed upon actions under the Program. It will also coordinate and supervise compliance with the actions carried out by the corresponding sectoral agencies.
- 3.3 For execution and coordination with the Bank, the commission will: (i) gather and submit to the Bank the relevant information to justify compliance with the policy actions agreed in the loan contract for each tranche; (ii) monitor progress under the program agreed with the Bank to facilitate compliance with the proposed second tranche policy actions, providing status reports every two months; (iii) administer the financial resources provided under fast disbursement in accordance with Bank rules; and (iv) draft the reports required by the Bank, including the final report.

C. Period of execution, amounts and disbursement schedule

- 3.4 The Bank has an 18 month maximum period of execution for emergency loans, but in this particular case, it is expected that the resources will be disbursed in a period of less than 12 months in two tranches, the first of US\$20 million and the second of US\$10 million.

D. Conditions precedent to disbursement

- 3.5 Disbursement of the resources for each tranche will be contingent upon compliance with the policy actions agreed for that tranche, as described in Chapter II and in Annex II-1 of this loan document. The establishment of a special account to manage the program's resources will be a condition precedent to the first disbursement.

- 3.6 The Borrower, through the executing agency, will be responsible for the maintenance of accounting and financial records related to use of the funds, for preparing and submitting the disbursement requests, and for ensuring these documents are available for possible inspection by the Bank and/or external auditors. The Borrower will maintain a special account to manage the loan funds, and account information will be provided to the Bank prior to the first disbursement.
- 3.7 The Project Team will evaluate the information submitted by the country concerning compliance with the agreed policy actions, and will prepare the corresponding reports for the Bank's Administration and Board of Directors, in order to obtain authorization for disbursements, in accordance with Bank policy.

E. Program monitoring and assessment

- 3.8 Given the short time frame for execution of this program, it was agreed that the executing agency will provide reports every two months to monitor progress in compliance with the policy actions, especially for the authorization for the second tranche disbursement. Clear budget codes have been identified for the protected programs, which will permit accurate verification of budgetary execution through the Integrated Financial Management System (IFMS) of the Ministry of Finance. In addition, the reports will present progress on the strategic sectoral actions in progress, milestones that will serve as an early warning system to detect any delays and take corrective measures to ensure compliance with all agreed policy actions.
- 3.9 While physical targets for December 2004 have been set for all protected programs (Annex II-2), the final report for the program will emphasize the main programs in health and education financed with national resources to assess the performance of budgetary protection. The main assumption underlying these targets is the absence of major labor conflicts that could paralyze activities in the education and health sectors. The selected programs are those whose potential impacts are high and for which information can be collected with relative ease. Protected programs financed by the Bank and the World Bank will continue to be monitored and evaluated as established in the respective loan agreements. The selected programs and the coverage targets for 2004 are shown in Table III-1.

Table III-1 Performance Evaluation	
Program	Target (December 2004)
Health: Expanded Program on Immunization National Service for the Eradication of Vector-Borne Transmissible Diseases National Anti-Tuberculosis Program	Children aged 0 to 4 years vaccinated: 168,500 with BCG, 294,848 with DPT, 445,275 with OPV, 154,427 with MMR and 154,427 with pentavalent. Malaria: 48,000 dwellings sprayed. Dengue: 700,000 dwellings sprayed. 2,000 cases treated.
Education: Initial and Basic Education	65,800 students in the first and second cycles receive textbooks 123,900 didactic guides for the first and second cycles printed and distributed.

- 3.10 Since the second disbursement may take place before December 2004, the executing agency will report on progress in the achievement of the goals details in Table II-1. Nevertheless, the Ministry of Finance has committed itself to preparing and presenting a report describing the achievements of the targets agreed upon in Annex II-2 for all protected programs at the beginning of 2005. This report will contribute to the preparation of a baseline for various health and education programs financed with national resources, which currently lack reliable information. This will allow the Government to fine-tune the preparation of zero-based budgets, introduced in 2004, in subsequent years.
- 3.11 Taking into account the special nature and specific circumstances surrounding this emergency operation, the Paraguayan authorities do not wish to carry out an ex-post evaluation. Information on the performance of the protected social programs, especially those financed by the Bank and the World Bank, will be available in case OVE wishes to carry out such an evaluation. In this case, it is recommended it is recommended that an analysis of the situation “with and without” the program be performed. In other words, the analysis should compare the results of the budgetary protection of programs targeted to the poorest sectors with across the board cuts in all Government programs.

F. Policy Letter

- 3.12 The Policy Letter is attached as Annex III-1 to this document. This letter presents a synthesis of the economic and social policies advanced by the Government of Paraguay, while formulating specific actions to provide budgetary protection to the agreed programs, and carry out strategic sectoral actions in education and health. In the framework of the agreements and proposals embodied in the Policy Letter, the Paraguayan authorities have also committed themselves to maintaining the protection of the selected programs in the 2005 budget, allocating the

counterpart resources to programs financed by the Bank and the World Bank and preparing a report on the achievements of the targets by the protected programs by early 2005.

G. Accounting and financial records and external audit

- 3.13 The Borrower shall: (i) maintain separate accounting records with supporting documentation, which allow the use of resources to be audited and/or verified by the Bank, if it so desires; and (ii) maintain a special bank account for the administration of loan resources.

H. Inspection and oversight

- 3.14 The Bank shall determine the inspection procedures it deems necessary to ensure satisfactory execution of this special loan. To this effect, the Borrower shall cooperate fully, providing all the necessary assistance and information.

IV. VIABILITY AND RISKS

A. Viability

- 4.1 The institutional arrangements for this operation take into account the short time frame allotted to program execution. Since this is a priority program for the Government, the composition of the commission responsible for execution was defined to maximize its capabilities to monitor, administer and coordinate actions. The members of the commission are directly responsible for budgetary programming and execution, as well as oversight of the fiscal accounts, and will have the information and tools necessary to expedite Program execution and achieve its goals. The execution plan also calls upon sectoral representatives from each area to help prepare the Program reports and follow-up actions.
- 4.2 Oversight of the policy actions will be corroborated through bimonthly reports designed to monitor timely compliance with such actions, especially in terms of obtaining authorization for second tranche disbursement. To this effect, budget lines were identified and coded to facilitate the accurate verification of budgetary execution of the protected programs through the IFMS. In addition, the monitoring reports will present progress on the achievements of the strategic sectoral actions that will serve to provide early warnings of delays and take corrective measures.
- 4.3 From the perspective of the Program's economic viability, it should be noted that this operation comes under the umbrella of a comprehensive assistance package provided by the IMF, the IDB and the World Bank, in a difficult regional economic situation.

B. Environmental and social viability

- 4.4 Given its special characteristics, the Program does not finance physical or other types of investment, and therefore has no direct environmental impact. The Bank investment loans protected under this operation have already been environmentally evaluated, contain the appropriate environmental procedures in their operational manuals, and therefore require no further analysis. With respect to the social impact, this Program has as its objective the mitigation of the effects of the crisis on poor and vulnerable groups, thus contributing to alleviate poverty in an emergency situation. However, under the guidelines for special emergency loans, this operation does not qualify as a poverty-targeted investment (PTI) or one that promotes social equity.
- 4.5 From a gender perspective, the programs protected under this operation have a major impact on women's lives: (i) in health, through protection for maternal care and reproductive health; (ii) in education, through protection for basic education programs which emphasize equal access and retention of girls in the school system; and (iii) through programs with international financing, such as

PROPAIS II and PRODECO, that include community strengthening activities in which women play a lead role.

- 4.6 Indigenous peoples are also an important beneficiary group in several programs selected for protection under this operation. PROPAIS II, the Program for Water Supply and Sanitation in Small Communities, and the protected programs in Education and Health, among others, include actions specifically designed to benefit these populations.

C. Benefits

- 4.7 Budgetary protection of the selected social programs will prevent the crisis from having an even greater impact on poor and vulnerable groups ensure continued operation of health and education establishments as well as programs delivering public goods and/or with high positive externalities. Moreover, protection of the selected programs will allow the country to continue its efforts to articulate a social strategy centered on poverty reduction.
- 4.8 Protection for programs targeting the poor, financed by the Bank and the World Bank in the Education, Health, Social Action, Agriculture, Infrastructure and Basic Sanitation, will guarantee the necessary external financing and counterpart resources at a pace commensurate with execution. Budgetary protection of the Program to Support the Demographic Census will guarantee the timely availability of socio-demographic data used for planning in the social sectors and the implementation of proposals contained in the ENREPD, specifically the design of a targeting instrument for social programs.
- 4.9 Lastly, the program will prevent setbacks in ongoing modernization actions in the health and education sectors, many of which are supported by the Bank that could otherwise be deferred in an unfavorable economic climate.

D. Risks

- 4.10 There is a risk that the economic crisis could resurge, applying greater pressure on the budget, which could lead to more cuts in government spending. This, in turn, could entail additional cutbacks in social programs, impacting on the Program's objectives. This risk is mitigated by setting a realistic level of protection, representing 4.9% of the total budget, based on an estimate of the minimum amounts needed to maintain delivery of basic services for the low income population.

POLICY ACTIONS MATRIX

PROBLEM	PROGRAM ACTION	IMPACT	FIRST TRANCHE	SECOND TRANCHE
1. MACROECONOMIC AREA				
The Paraguayan economy has been hit by successive external shocks that undermine macroeconomic stability and growth, with a high social cost.	Follow-up of the Stand-By agreement between the country and the International Monetary Fund (IMF).	Achieve macroeconomic stability, creating a favorable environment for economic growth and improvements in the social situation.	Macroeconomic program with the IMF agreed and in force.	Macroeconomic program with the IMF agreed and in force.
2. BUDGET PROTECTION AREA				
Social expenditure may be significantly reduced due to fiscal adjustment, negatively impacting the poorest and most vulnerable segments of the population.	Budget protection for expenditures in Education, Health, Social Action, Basic Sanitation, Agriculture, Rural Roadways, and the Census, selected primarily for their impact on the poorest and most vulnerable segments of the population, and for their importance to the modernization of the country.	Mitigate the negative impact of the economic adjustment on the poorest segments of the population through budgetary protection of expenditures for selected programs.	<p>Draft 2004 Budget Law and amendments introduced in Congress, with budgetary allocations for the protected programs agreed with the Bank as minimum amounts.</p> <p>Schedule for monthly financial execution for the protected programs in 2004, based on the budgeted amounts agreed with the Bank.</p> <p>Contract for PROPAIS II presented to Congress for ratification.</p> <p>Contract for Program to Support Initial and Pre-School Education presented to Congress for ratification.</p> <p>Contract for Program to Reform Secondary Education presented to Congress for ratification.</p>	<p>Evidence that 75% of the funds programmed to date for the protected programs in health, education and other sectors in agreement with the Bank have been committed.</p> <p>Guidelines for the 2005 Budget Decree, maintaining the budgeted amounts to protected programs financed with national resources in real terms, and allocating the expected counterpart resources for programs funded with external resources.</p> <p>Loan contract for PROPAIS II in force, with the corresponding budget allocation.</p> <p>Loan contract for the Program to Support Initial and Pre-School Education in force, with the corresponding budget allocation.</p> <p>Loan contract for the Program to Reform Secondary Education in force, with the corresponding budget allocation.</p>

PROBLEM	PROGRAM ACTION	IMPACT	FIRST TRANCHE	SECOND TRANCHE
SECTORAL STRATEGIC ACTIONS AREA				
In an unfavorable economic scenario, strategic actions to modernize the social sectors may be deferred.	Support the continued implementation of modernization policies and actions in the social sectors, especially in Education and Health.	Avoid setbacks in programs and actions aimed at improving managerial efficiency and equitable access in the social sectors.	<p>A – Social Sector Decree creating Social Cabinet.</p> <p>B – Education Ministerial Resolution establishing criteria and procedures for adding new classrooms in public educational institutions at the initial, basic and secondary levels.</p> <p>Departmental Education Councils and Departmental Supervisory Coordination Committees established in Paraguay's existing 17 Departments, including Asunción.</p> <p>C – Health</p> <p>Forms and accompanying Manual of Norms and Procedures for the Information Subsystem for Vital Statistics approved.</p> <p>Advisory Committee for Vital Statistics and Health Indicators established by Decree.</p>	<p>Presentation of work plan of Social Cabinet.</p> <p>Approval of the updated regulations for Educational Supervision and for the Departmental Education Councils.</p> <p>100% of the Strategic Departmental Education Plans published and disseminated.</p> <p>Forms for birth registration in use in Metropolitan Asunción.</p> <p>Report of the Advisory Committee presented to the Minister of Public Health and Social Welfare.</p>

OBJECTIVES AND TARGETS OF PROTECTED PROGRAMS

PROGRAM	OBJECTIVES	TARGETS BY DECEMBER 2004
HEALTH		
Primary Health Care.	Prevent and treat common illnesses, especially those affecting mothers and children.	350,000 prenatal visits.
Expanded Program on Immunization.	Prevent childhood infectious diseases.	Number of children aged 0 to 4 vaccinated: 168,500 with BCG; 294,848 with DPT; 444,275 with OPV; 148,399 with MMR; and 154,427 with pentavalent vaccine.
National Anti-Tuberculosis Program.	Prevent and treat tuberculosis, especially among the indigenous population.	2,000 cases treated.
National Anti-Leprosy Program.	Provide leprosy treatment.	Treat 510 cases.
National Anti-Rabies Center.	Prevent and treat rabies.	8,000 cases treated and 450,000 dogs vaccinated.
National Service for the Eradication of Vector-Borne Transmissible Diseases.	Prevent the transmission of malaria, Chagas, dengue and leishmaniasis.	Malaria: 48,000 dwellings sprayed and 105,000 cases treated. Dengue: 700,000 dwellings sprayed.
Prevention, Education, Surveillance and Control of HIV/AIDS.	Prevent and control the transmission of HIV/AIDS.	350 patients treated.
Reproductive Health Program.	Promote reproductive health.	57,260 women receive contraceptives.
Indigenous Health Care.	Provide culturally appropriate care to indigenous populations.	250 outpatient consultations a month at the Indigenous Hospital.
Primary Health Care Reform Program (IDB) and Maternal Health and Child Development (WB).	Decrease maternal and perinatal mortality.	1 regional hospital and 2 district hospitals renovated and/or expanded and equipped.
EDUCATION		
Initial and Basic Education.	Improve access, relevance and quality of initial and basic education.	65,800 students in the first and second cycles of basic education receive textbooks. 123,900 didactic guides for the first and second cycles are printed and distributed.
Middle and Technical Education.	Improve access to secondary education and assure operation and maintenance of schools, as well as adequate pedagogical supervision.	Increase length of school day in third cycle in accordance with new curriculum. 30 new classrooms built and equipped.

PROGRAM	OBJECTIVES	TARGETS BY DECEMBER 2004
Permanent Education.	Meet the basic learning needs of the population left out of the formal education system.	12,000 youth and adults alphabetized (Guaraní-Spanish Alphabetization Program).
Program to Strengthen the Reform of Basic Education (IDB).	Improve the quality and equity of basic school education.	144 new classrooms built and equipped. 1,200 new classrooms equipped. 300,000 textbooks and/or study guides distributed.
Project Preparation Facility for Initial and Pre-School Education Program (IDB).	Support the national technical team to initiate execution of the new program.	Design and validation of the curricular and policy guidelines for initial and pre-school education.
SOCIAL ACTION		
Project Preparation Facility for PROPAIS II (IDB).	Support the Social Action Secretariat in complying with the conditions prior to the first disbursement of the program and carrying out the necessary institutional arrangements.	Conditions prior to the first disbursement of PROPAIS II met. Program monitoring and control mechanisms implemented.
SANITATION		
Program for Water Supply and Sanitation in Small Rural Communities (IDB) and Water Supply and Sanitation Program (WB).	Improve sanitary conditions in rural and indigenous communities.	115 new potable water systems built in rural communities and 55 new systems built in indigenous communities.
AGRICULTURE		
Program to Support Small-Scale Cotton Farms (IDB).	Increase the income of small-scale cotton producers.	20,000 producers receive technical assistance. 1,200 traps installed. 150,000 producers use certified seeds.
PUBLIC WORKS		
National Rural Roads Program-Second Stage (IDB).	Rehabilitate and improve secondary roads in rural areas.	100 km rehabilitated.
CENSUS		
Program to Support Implementation of Census 2002 (IDB).	Support analysis of the 2002 Census.	Geographically referenced database of population, housing and indigenous peoples completed, cleaned, processed and recorded on magnetic media, published and distributed. Publication of Indigenous Census.