

GLOBAL MICROENTERPRISE CREDIT PROGRAM
(PHASE II)

(PR-0094)

EXECUTIVE SUMMARY

BORROWER: The Republic of Paraguay

EXECUTING AGENCY: Program Technical Executing Unit (PTEU) of the Central Bank of Paraguay

AMOUNT AND SOURCE: IDB: US\$20.0 million (OC)
Local counterpart funding: US\$ 2.0 million
Total: US\$22.0 million

Technical assistance:

IDB: US\$ 2.2 million
(Net income of the FSO -
local currency)
Local counterpart funding: US\$ 0.8 million
Subtotal: US\$ 3.0 million
Total: US\$25.0 million

**FINANCIAL
TERMS AND
CONDITIONS:**

OC loan:

Amortization period: 20 years
Commitment period: 3 years
Disbursement period: 4 years
Interest rate: variable
Inspection and supervision: 1%
Credit fee: 0.75% per annum on the
undisbursed balance

Technical assistance (FSO-LC):

(nonreimbursable)
Commitment period: 3 years
Disbursement period: 3 ½ years

Currency:

The Government of Paraguay has requested that this loan be denominated as follows: 50% in United States dollars, 25% in deutsche marks, and 25% in Japanese yen.

OBJECTIVES: The proposed operation will move forward with support for developing the production and business capacity of microentrepreneurs in Paraguay. The specific objectives of the program will be: (i) to make it easier for microentrepreneurs to have access to credit at market rates from financial intermediaries in the formal financial system; (ii) to establish

lending for microenterprise as a regular and self-sustaining activity of participating financial institutions and to eliminate the regulatory barriers that might prevent microentrepreneurs from having access to the formal financial system; (iii) to bring about changes in the way commercial banks lend to microenterprise; and (iv) to open up the program to other market operators, including cooperative banks, if on the basis of their institutional status and regulatory structure they are found to be eligible to participate in the program.

DESCRIPTION:

The proposed program will consist of two components: (i) a line of credit for microentrepreneurs, and (ii) technical cooperation funding (Annex III-1). The credit component will be used to finance 90% of the subloans that the participating IFIs grant to the target group to purchase fixed assets and fund working capital. Approximately 12,000 new loans are expected to be granted. Although the financing involved is substantial, it is justified by the considerable number of microentrepreneurs and their substantial borrowing requirements. The plan would be much the same as the one used in phase one of the global microenterprise credit program, drawing on the lessons learned and broadening the selection criteria for participation in the program. The criteria for the program are as follows: (i) up to 10 employees per microenterprise; (ii) up to US\$20,000 in production assets, (iii) up to US\$100,000 in annual sales, (iv) a maximum amount of US\$12,000 per credit, and (v) an average loan amount of up to US\$3,000 per IFI.

The principal objective of the technical-cooperation component will be to establish regular services for microenterprise. There are five reasons for this: (i) to transfer financial technology to the IFIs in order to enhance their lending capacity and the financial services they offer, through the use of best practices to lower operating costs and facilitate risk analysis of loans to the target group, (ii) to work with the PTEU in identifying and eliminating institutional and regulatory obstacles that impede access to credit from the formal financial system, (iii) to provide institutional strengthening for cooperative banks that meet the eligibility requirements of the program, (iv) to continue evaluating the environmental impact of the subloans, and (v) to stimulate participation by women microentrepreneurs in the program.

ENVIRONMENTAL CLASSIFICATION: The Environment Committee, at its meeting of December 17, 1996, classified this as a Category III operation. The Environmental Assessment was submitted to the Public Information Center on April 9, 1997.

IMPACT ON POVERTY: The program targets microentrepreneurs in low-income groups in Paraguay and contains components that will help to reduce poverty and achieve greater social equity. As the operation will focus on investment to alleviate poverty and more than one half of the end beneficiaries will be in low-income groups, the financing matrix to be applied will permit the Bank to finance 90% of the program.

PARTICIPATION BY WOMEN: The program will encourage participation by women microentrepreneurs, who account for 37% of all microentrepreneurs in urban areas and 57% of one-man operations, mainly in business and services. They also received 47% of the credits granted in phase one of the program. Providing credit for microenterprise is crucial to addressing the issue of poverty reduction in Paraguay. Widening the coverage of the program to include rural areas given the high participation by women in family farming, who in many cases are heads of household, will contribute still further to accomplishing this social objective.

As part of the program, mechanisms will be developed to identify and resolve the obstacles hindering access by women microentrepreneurs to credit. This program will push ahead with the efforts commenced in phase one and the training courses, in conjunction with a worker training program, in which 74% of the participants were women. It will also continue to incorporate the gender dimension in training courses as well as to heighten awareness among women micro-entrepreneurs of their legal rights. The courses will seek to apply a business approach to the task carried out by women.

BENEFITS: The favorable effects of the program and its various components will be: (i) to raise productivity and production by microentrepreneurs, (ii) to consolidate their access to formal credit, (iii) to broaden the range of eligible intermediaries, (iv) to develop new facilities, such as leasing, the use of a credit card, and voluntary savings by participants, (v) to promote participation by women microentrepreneurs, and (vi) to focus the attention of microentrepreneurs on the importance of environmental protection. Opening up the program to other nonfinancial credit

providers will increase the coverage of subloans in urban and rural areas.

RISKS:

One of the risks to the operation is that the macroeconomic program will be suspended and price instability will reemerge, factors that would act as a disincentive to investment and borrowing, and to the willingness of IFIs to lend. Based on past performance, the government's actions give every reason to assume that conditions will remain stable in the country, despite the problems encountered.

Another risk is the possibility of making the regulatory standards and the classification of assets, credit risks, provisions, and accrued interest more flexible. Given the fragile condition of the national banking system, increasing flexibility will make it possible for many banks to evade compliance with the Basle standards and other requirements that are necessary for participation in the program. To minimize this risk, the eligibility criteria will be rigorously applied to ensure that only financially solvent, competitive institutions whose experience has been good with low levels of nonperforming loans in spite of the limited number of borrowers. The BCP will report to the Bank periodically on the condition of the financial system as well as the condition of IFIs taking part in the program. The operation will emphasize the development of a credit card for microenterprise with a centralized risk appraisal system for proper assessment of the subborrowers.

Another risk is that the credit unions do not attain the institutional standing that is needed for access to program resources. However, the program will continue to be implemented with eligible banks and finance companies, and their involvement is expected to be sufficient for the proceeds of the loan to be committed.

The risk of the PTEU losing its effectiveness, and thereby undermining the establishment of credit for microenterprise in the Paraguayan financial system should also be considered. At present, the PTEU's effectiveness depends largely on the technical assistance it receives. To minimize this risk, technical assistance will continue to be provided for a limited period as the PTEU starts hiring fewer phases out its reliance on outside consultants. By the end of this period, sufficient local staff should have been trained under the technical assistance to enable the program to function fully on its own without outside support. This is essential for the

credit support to microenterprise to become firmly established as a normal and regular practice in the financial system, and ceases to be an activity sustained by external technical assistance component. The BCP is committed to ensuring that personnel employed by the PTEU will keep their positions and that they receive the training needed to continue performing their functions.

**THE BANK'S
COUNTRY AND
SECTOR STRATEGY:**

Under the Eighth Replenishment, poverty reduction and social equity were pinpointed as key areas for Bank involvement. To achieve these objectives, the Bank has placed the microenterprise sector high on its agenda, as part of its strategy for the country, in view of the sector's role in economic activity and job creation and the constraints that circumscribe its development. The proposed program is consistent with the Bank's strategy of serving the needs of microentrepreneurs who are mainly from low-income groups.

**CONDITIONS
PRECEDENT TO
DISBURSEMENT:**

Prior to the disbursement of resources, the borrower shall demonstrate, to the satisfaction of the Bank, that: (i) it has entered into an agreement with the BCP, whereby the latter takes on the functions of executing agency for the program, and (ii) it has implemented the Credit Regulations for the program.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

These conditions are:

- (i) When 50% of the proceeds of the loan have been committed for subloans, the borrower shall demonstrate that it has presented a plan to reduce the PTEU's operational reliance on external consultants and a schedule for implementing this plan;
- (ii) the addition of cooperative banks will be predicated on the implementation of the corresponding regulations and a chart of accounts therefor (paragraphs 3.6 and 4.9);
- (iii) the borrower and the Bank will conduct evaluations when 25%, 75%, and all of the program resources have been committed in order to determine: (a) the number and quality of the IFIs taking part; (b) willingness to serve the IFIs through the percentage of the portfolios going to microenterprise; (c) number of loans granted and quality of the portfolio; (d) number of officials assigned to microenterprise; (e) participation by cooperative banks; and (f) annual

increase in operations with microenterprises classified by gender, volume, purpose, geographic location, and line of business (paragraph 3.24);

- (iv) the borrower shall report each year on the condition of the financial system and particularly on the capitalization, solvency, and profitability of its institutions (paragraph 3.25);
- (v) within the first 12 months of the program, the BCP shall submit to the Bank its recommendations on a strategy for credit card use (paragraph 3.32);
- (vi) for the technical assistance, at least 90 days before the consultants are hired, the borrower shall submit to the Bank for approval the terms of reference for consulting services (Annex III-1).

I. BACKGROUND

A. Recent economic developments and outlook

- 1.1 In 1996, economic conditions in Paraguay were relatively stable yet extremely precarious owing to serious problems besetting the financial sector and a slowing in GDP, which was up by 1.3%, the lowest increase since 1988. The lower growth was attributable to: (i) a poor performance by the agricultural sector in the aftermath of the drought; (ii) a slump in business activity in the region, and (iii) cutbacks in public investment. A 15% improvement in soya production was not enough to offset declines in output of cotton, rice, maize, cassava, peanuts, and beans.
- 1.2 Despite a 19% contraction in public investment, the fiscal deficit widened to 0.8% of GDP in 1996 from 0.2% the year before, as a result of a decline in tax revenues from the export sector and in capital inflows and an increase in current expenditure, mainly for wages and salaries. The government drew down its deposits with the Central Bank by approximately US\$130 million, reflecting the growing constraints on public finances.
- 1.3 Year-over-year to December 1996, the inflation rate slipped to 8.2%, well below the annual rates of 15% to 22% posted in recent years, owing to the appreciation of the guaraní, lower domestic demand, and the use of stabilization bonds ("letras de regulación monetaria") under a restrictive monetary policy. The inflation rate was down in spite of salary increases for workers in the public and private sectors, higher public utility rates, and a rise in the price of petroleum products.
- 1.4 During the year, the deficit in the balance of trade narrowed thanks to fewer imports as the economy lost steam and a modest rise in exports, particularly of soya. Exports to MERCOSUR were up by US\$121 million, with Brazil accounting for US\$107 million of the increase. Notwithstanding the improvement in the trade balance, the deficit in the balance of payments current account remained high and international monetary reserves fell by 10% year-over-year to September 1996, as capital flows from abroad diminished, particularly net transfers of official long-term credits from the country which were positive. The external debt remained virtually unchanged. Some disturbing signs are clouding the outlook for the balance of payments in 1997: the guaraní is appreciating and the outlook for exports is sluggish.
- 1.5 The problems of the financial sector put a squeeze on credit to the private sector in 1996. Moreover, the monetary program ran into difficulties as a result of: (i) the insolvency of the four banks, in which the government intervened; (ii) deposits with the financial institutions that were closed, including unregistered

deposits subscribed to by shareholders or directors 1/, were returned to depositors by the Central Bank; and (iii) the choice whether to control the money supply by means of stabilization bonds with a quasi-fiscal cost and high interest rates or to channel credit to the manufacturing sector to stimulate economic recovery with a possible loss of international reserves.

B. Financial sector

- 1.6 The financial system is made up of three government-owned banks, two State-run agricultural banks, 30 commercial banks, and 59 private finance companies. The system has been in a precarious state since May 1995. Because of the excessive number of financial institutions and inadequate oversight by the Superintendency of Banks, deposits were not registered by local banks and finance companies and were often used to cover operating losses and inflate their capital. The accumulated losses frequently exceeded the capital of problem banks and finance companies.
- 1.7 Deposits with the more fragile institutions were transferred to other local banks but mostly to foreign banks. Consequently, many national banks are experiencing liquidity problems. To temper the impact of this loss of funds, the Central Bank set up a Security Network for the National Financial System. It also intervened in 15 finance companies to prevent the liquidity and solvency problems from worsening and assumed responsibility for repayment of deposits with institutions that had been closed down.
- 1.8 Four banks (Bancopar, General, Mercantil, and Bancosur) and 14 finance companies have now been liquidated as a result of the banking crisis. Although the cost has been high (US\$420 million by November 1996), Central Bank's action has saved the economy and society even further outlays.
- 1.9 In pressing ahead with the financial sector reform, the Paraguayan government enacted the Central Bank Charter and the Bank Act, instruments that put supervision and regulation of the financial system on a sound footing. The IDB also approved technical-cooperation funding to strengthen and assist the Superintendency of Banks with the regulation and supervision of the financial system, including the reform of the Centralized Risk Appraisal System to cover microenterprise.

1/ The International Monetary Fund recommended denying claims on the Central Bank for assistance to weak financial institutions or to offset losses incurred by depositors with institutions closed during the crisis. In late December 1996, the Supreme Court of Justice ruled that the Central Bank would have to return the unregistered deposits (in black) held by insolvent institutions, creating for an obligation in an undetermined amount for the Bank.

C. Microenterprise sector

- 1.10 Paraguay has an economically active population (EAP) of 2.45 million people, or 49% of the country's population of five million. Of the EAP, 2.37 million have gainful employment. Participation by women is substantial - 41% of the EAP. Approximately 64% of the EAP work in urban areas and the remainder are in agriculture.
- 1.11 The informal sector employs 1.6 million people, of whom 752,000 work in cities and towns (47% of the informal sector and 30.7% of the EAP). By comparison, the formal sector engages about 782,000 people, of whom 98% work in urban areas (see Table No.1).
- 1.12 Microenterprise 2/ is the principal source of employment in Paraguay, overlapping to a considerable extent with the informal sector. According to National Institute of Statistics estimates based on a 1995 household survey, there are 510,000 microenterprises, including one-person operations, in the country, employing 1.01 million people (41% of the EAP). This figure breaks down into 294,690 one-person operations (12% of the EAP), 580,364 workers in microenterprises with 2 to 5 employees (24% of the EAP), and 135,114 workers in 17,000 microenterprises with 6 to 10 workers (5% of the EAP).
- 1.13 Within the urban informal sector, 54% of microenterprise workers are engaged in commerce, 15.5% in services, 15.4% in industry, 11.1% in construction, and 3.9% in transport. It is evident then from the foregoing that commercial microenterprises exert the greatest impact on employment and income.
- 1.14 Despite the informal nature of this sector and the minimal support it has received from government, microentrepreneurs have succeeded in building up lucrative businesses on their own characterized by a considerable degree of stability. A survey of the Metropolitan Asuncion Area showed that approximately 25% of the microentrepreneurs interviewed had five to 10 years' experience in their business, and 39% had been working for more than a decade. The earnings of microentrepreneurs in this area often exceed the national minimum monthly wage of US\$250.
- 1.15 For microentrepreneurs, the most common source of funding is self-financing, informal agreements with suppliers, and assistance from relations or friends. Most loans are short term, with maturities of 90 days. Although credits at up to 60 days is customary, most suppliers set terms of 7 to 15 days.

2/ The EAP employed by microenterprise embraces self-employed workers, unremunerated family help, and wage earners and operators in the private sector in companies with up to 10 employees.

- 1.16 Microenterprises in manufacturing and business are being adversely affected by the troubles that afflict national banks. Lending rates are high, especially for very small businesses. This scenario is partly due to the following factors: (i) the administrative costs of local banks are high, amounting on average to 7.2% of risk-weighted assets (RWA); and (ii) the proportion of assets is excessive (24.3% of RWA on average). This inefficiency has the effect of raising the gross intermediation margin by more than 20 percentage points. The lending rates to microenterprises often exceed 70% in real terms.

D. Treatment of microenterprise

- 1.17 That women account for a high percentage of urban entrepreneurs (36.8%) and one-person operations (51%) reflects the socioeconomic importance of women microentrepreneurs. Figures for the Metropolitan Asuncion Area where women represent 45% of all microentrepreneurs and run 55% of all one-person operations confirm these findings. Nevertheless, women microentrepreneurs in Paraguay are also subject to sexual stereotyping and bias, the negative effects of which are compounded by their ignorance of their rights under the law. This situation occurs in spite of the recent reforms to the Constitution and the Civil Code. Because women microentrepreneurs are often uninformed, they are unable to develop the microenterprise so that they can pull their families from the shackles of poverty.
- 1.18 The high percentage of women microentrepreneurs in urban areas who have already received credit under the program attests to the success of phase one (see paragraph 1.44). The technical assistance component stressed the need to offer training programs to women microentrepreneurs, with a focus on heightening the awareness of loan officers in IFIs and trainers at training courses and workshops. A specialist in gender issues was also hired as a consultant to ensure that the training took the right approach and women microentrepreneurs were linked up with the credit program.
- 1.19 In phase two of the program, supplementary mechanisms will be developed to identify and eliminate obstacles that restrict access to credit by women microentrepreneurs and to provide the necessary training and assistance. The technical-cooperation funding will be used to coordinate courses that develop the business expertise of women, give their activities a professional touch, and heighten awareness of their rights and what they are entitled to under the law. Bringing cooperative banks into the program will help to augment the number of women microentrepreneurs with access to credit. A survey taken by the consultant in women's issues found that 26% of lending to women microentrepreneurs comes from cooperative banks, a further 26% from suppliers, 24% from banks and private finance companies, 18% from Banco de los Trabajadores, 3% from moneylenders and 3% from other sources.

E. The cooperatives

- 1.20 The cooperative movement, which encompasses cooperative banks, has spread rapidly since 1989. Multipurpose cooperatives also grant credit to their members. In all there are approximately 425 cooperatives, of which 225 are rural-based and 200 urban-based. The regulations governing cooperatives are defined in Law No. 438/94. The National Institute of Cooperatives [Instituto Nacional de Cooperativas] (INCOOP), a branch of the Ministry of Agriculture and Livestock, is responsible for the supervision and oversight of cooperatives. Little information is available on cooperatives. The Department of Cooperatives [Dirección General de Cooperativas] (DGCLOOP) collects information on by-laws, administrative and management boards, and financial statements, but this information is not classified systematically, a problem that prevents effective analysis. With a staff of only eight people, including secretaries and assistants, the DGCLOOP simply does not have the manpower to perform this task. Inadequate supervision of cooperatives makes it difficult to establish programs in which all cooperatives can take part and calls for the development of institutional strengthening programs.

F. Cooperative banks

- 1.21 Paraguay's 130 cooperative banks account for a sizeable share of activity in the financial system. In March 1996, deposits with these establishments amounted to 7% of the total in the system and their loans accounted for 5.9% of bank lending. Approximately 13% of families are members of a cooperative bank and figures for March 1996 show that the average loan was US\$540, a figure that underscores their willingness to serve low-income families.

Table I - 1 Economically active population (000s of persons)			
Occupation	EAP Informal sector	EAP Formal sector	EAP Total
Nonagricultural sectors			
A. Public sector			
Public enterprises	—	115.8	115.8
Civil servants	—	22.7	22.7
Subtotal	—	138.5	138.5
B. Private sector			
Owner or employees	52.9	36.8	89.7
Private companies	38.7	143.6	182.3
Workers	135.2	273.7	408.9
Subtotal	226.8	454.1	680.9
Self-employed workers	400.0	33.4	433.4
Remunerated family workers	22.9	6.8	29.7
Nonremunerated family workers	102.0	2.0	104.0
Housework	—	131.7	131.7
Subtotal	524.9	173.9	698.8
TOTAL NONAGRICULTURAL	751.7	766.5	1,518.3
Agricultural sector			
Independent workers	832.9	15.3	848.2
TOTAL	1,584.6	781.8	2,366.4
Source: National Household Survey 1995			

- 1.22 It is also worth mentioning that cooperative banks have multiplied since 1989, and that the banking crisis contributed still further to their strong growth, as they were able to attract deposits moved out of banks and finance companies in the formal system. The assets of the six largest cooperatives increased by 140% between December 1994 and November 1996 (see table I-2).
- 1.23 The Bank Act of June 1996 broadened bank supervision to include cooperative banks, thereby giving them a more active role as financial intermediaries, once they were up to the SB's liquidity, solvency, and net worth requirements. The SB has set up a division in charge of supervising cooperative banks. The implementing regulations have not yet been issued, but are being prepared under a MIF technical assistance project for the SB (ATN/MT-5479-PR).

Table I-2 Assets of selected cooperative banks (millions of guaraníes)			
Cooperative	December 1994	December 1995	November 1996
Universitaria	38,028	66,991	121,841
COOMECEIPAR	22,141	34,100	43,024
San Cristóbal	17,107	23,184	30,000
Medalla Milagrosa	11,465	18,909	22,816
Coronel Oviedo	6,610	9,321	13,110
San Lorenzo	5,464	7,361	9,232
TOTAL	100,815	159,866	240,023

G. Strategy and justification for the Bank's participation

- 1.24 As justification of the government's investment priorities for the next few years, and in keeping with the guidelines of the Eighth Replenishment, the Bank's strategy for the country recommends that efforts focus on: (i) improving the quality and coverage of basic services and social programs, particularly those that target poverty reduction and greater social equity through assistance for the most vulnerable groups in society; and (ii) support for institutional strengthening and modernization of the State. To bring about poverty reduction, it is proposed that programs be developed to ensure that all segments of the population participate fully in productive activities. As part of this conceptual framework, microenterprise has been targeted for action by the Bank.
- 1.25 The proposed program is justified insofar as it dovetails with the strategy charted by the Paraguayan government and the Bank for low-income groups and accords priority to microenterprise, in view of its prominent role in economic activity and as a source of employment. The program is consistent with the strategy of the microenterprise development program (Micro 2001) approved by the Board of Executive Directors in February 1997. The high number of microentrepreneurs (82,000) who qualify for credit justifies the financing requested for the program, with recoveries from phase one providing additional funding. Given the constraints that microentrepreneurs are up against in pursuing their activities, the program will continue with the Bank's efforts to make it easier for them to obtain credit from the formal financial system. Despite the accomplishments of phase one, loans to microenterprise account for barely 13% of total IFI lending.

H. The Bank's experience with similar operations

1. Global credit program for microenterprise (phase I)

a. Credit component

(i) Development and implementation

- 1.26 Phase one of the microenterprise global credit program (loan 707/OC-PR) for US\$12 million was approved in November 1992. The first disbursement was not made until mid-1994 because of delays in its gaining the approval of the Legislative Assembly. That the loan was fully disbursed by July 1996, approximately two years later, was a source of great satisfaction. A total of 11,295 subloans were granted, in an average amount of US\$1,328 and for an average term of 15 months. The average microenterprise had US\$4,400 in assets, and 2.5 jobs were created on average for each borrower under the program. According to the survey by the environmental consulting firm hired by the Central Bank, approximately 91% of the subloans in phase one were used to finance commercial activities and services, whereas only 9% were used in manufacturing and agriculture.

(ii) The Bank's experience

- 1.27 The Bank's experience with program execution was satisfactory: (i) loans were placed within a short time frame, (ii) the attitude of microentrepreneurs to the program was favorable, (iii) the reaction of some participating IFIs was positive, (iv) the executing agency functioned effectively, (v) all resources were committed at market rates, and (vi) the pilot program was successful in funding part of the training for microentrepreneurs. The program technical executing unit (PTEU) of the Central Bank, which was in charge of the program, worked well with a staff of only five to administer the operation although outside consultants needed to be called in periodically to help with the operation as well as to administer the technical support for the IFIs.
- 1.28 The operation can be considered a success given the state of the Paraguayan financial system during phase one. Some shortcomings were noted, however, including: (i) lending to microenterprise accounted for a small share of total IFI loans, and is not sufficient to guarantee the program's sustainability; (ii) the program was expensive to run because of high interest rates; (iii) a concentration of credit in a single IFI engenders monopolistic market practices which can in turn contribute to high interest rates; (iv) two IFIs were decertified from the program for failing to comply with the eligibility criteria; and (v) credit was concentrated in the Metropolitan Asuncion Area and microentrepreneurs in manufacturing and agriculture did not benefit.

- 1.29 In phase one, the IFIs were audited and carefully screened, using strict eligibility criteria. Consequently, very few intermediary institutions qualified for the program. Eight finance companies and three (although four were originally contemplated) banks joined the program. "Financiera Familiar was the only institution with a portfolio geared to serving microenterprise, with 6,476 borrowers and US\$6.3 million in loans, or 23% of its net portfolio as of September 30, 1996, followed in turn by FINANCOPAR with 10% of its portfolio oriented to microenterprise. Lending for microenterprise accounted for only 5.5% on average of the net loan portfolio of the remaining institutions, and in the case of Banco de los Trabajadores, the percentage was just 1.1%. In addition, the participating IFIs did not discount all of their loans to microenterprise (62% on average as of September 30, 1996). INTERFISA, for instance, discounted only 15% of its lending to microenterprise in spite of a policy of more active financial involvement in the sector. At the other end of the spectrum, Banco de los Trabajadores discounted 93% of its portfolio and Financiera Familiar 58%, with both institutions channelling approximately 82% of their loans to microentrepreneurs. The threshold set in the Credit Regulations proved excessively restrictive for microenterprises in the manufacturing sector, particularly with respect to the criteria for assets and sales and the ceiling on borrowing.
- 1.30 The financial statements as of December 31, 1996, of the five IFIs in the program, audited by outside firms registered with the Superintendency of Banks, show that their financial condition is satisfactory. Their indicators of performance are given in the table below:

Table I-3 COMPLIANCE WITH ELIGIBILITY CRITERIA (as of December 31, 1996 *)				
IFI	SOLVENCY (1)	NON- PERFORMING LOANS (2)	PROFITABILITY (3)	AUDITORS
Familiar	28.6	2.3	45.9	Rubenstein & Guillén
Visión	17.6	4.1	9.2	Gestión Empresarial
Interfisa	21.0	** 13.9	22.5	Gestión Empresarial
F. de Crédito	26.6	9.6	29.6	Coopers & Lybrand
General	23.0	4.5	17.1	Coopers & Lybrand
Criteria for the program	8.0 minimum	10.0 maximum	8.2 minimum inflation	

* Audited financial statements

** As of March 31, 1997, provisions had been set up to cover 9.9% of the portfolio

(1) Net worth-asset ratio less cash and deposits with Central Bank.

(2) Net portfolio, less provisions charged to losses in categories C, D, E/Total portfolio net of provisions.

(3) Earnings in 1996 less taxes/net worth as of 31/12/95.

Source: PTEU

- 1.31 The eligibility criteria set out in the Credit Regulations have been satisfied. Under the new Chart of Accounts put out by the Superintendency of Banks in 1996, the IFIs are required to consolidate their portfolios. Accordingly, the microenterprise portfolio is not listed separately from other loans in the financial statements. To evaluate compliance with Article 11, subparagraph (a), which stipulates that subloans more than 30 days and 90 days past due may not exceed 10% and 3%, respectively, of the total portfolio, the PTEU conducts periodic evaluations of IFIs in the program. These evaluations show that this requisite was being met as of December 1996 (see table I-4).

Table I-4 COMPLIANCE WITH DELINQUENT PORTFOLIO REQUIREMENT		
IFI	30 DAYS PAST DUE (%)	90 DAYS PAST DUE (%)
Familiar	9.08	2.39
Visión	2.75	0.7
Interfisa	1.03	0.0
F. de Crédito	7.4	1.78
General	8.56	1.03

- 1.32 The good health of these IFIs is corroborated by the evaluation performed through the CAULA - G system, applied by the Superintendency of Banks and published in April 1997.

<p align="center">Table I-5 Financial position of institutions eligible to participate in the program as of December 31, 1996 according to the CAULA-G rating system of Superintendency of Banks</p>					
IFI	Capital: effective adjusted worth/assets and risk-weighted assets (%)	Past-due portfolio/total (%)	Earnings to taxes/average total assets	Risk classification	Comments
Familiar	29.3	11.53	11.38	A-1	Profits sufficient to cover past due
Crédito	31.11	8.25	6.7	A-1	
General	21.3	8.83	3.99	A-1	
Visión	20.27	6.56	1.71	A-1	
Interfisa	22.39	9.11	4.29	A-1	
Paratodo	24.57	13.55	1.95	B-2	Has not received financing under the program
Rural	24.14	13.55	1.95	B-2	Has not received financing under the program
Financopar	20.84	14.30	-1.99	B-2	Line of credit cancelled at PTEU's request
BNT	15.75	29.33	-1.77	C-3	Disbursements suspended
Multibanco	15.78	1.44	1	B-2	Credits for microenterprise channeled through FINCRESA
Continental	23.36	10.44	0.47	B-2	Has not received financing under the program

Source: SB

(iii) Lessons learned

- 1.33 Phase one of the program achieved its principal objective of increasing the flow of credit to microenterprise in Paraguay through a number of banks in the formal financial system although lending continues to be highly concentrated in the Metropolitan Asuncion area. It was also successful in changing the attitude of these institutions and kindling their interest in lending to microenterprise by demonstrating it can be a profitable activity if the right technology is applied. Even with the right technology, improvements are still needed in the overall internal efficiency of participating institutions.

- 1.34 The outcome of the program also points up the need to consolidate and deepen the supply of credit to microenterprise in two ways: (i) by improving the quality of IFIs and stepping up competition in this sector of the market in order to lower lending rates to microentrepreneurs; and (ii) by expanding services within the country. In view of the foregoing, the program will press ahead with the activities initiated in phase one in a move to create a self-funding supply of credit permanently available to microenterprise in the formal sector.

(iv) Approach of phase two

- 1.35 Phase two of the program will: (i) expand the range of eligible IFIs owing to the limited participation by banks and finance companies; (ii) maintain strict eligibility criteria in place in light of the crisis in the financial system; (iii) introduce new operating and control mechanisms (use of credit cards and centralized risk appraisal); (iv) increasing the threshold requirements for assets and sales and the ceiling on loans; and (v) focusing efforts on facilitating access by women microentrepreneurs, who expressed considerable interest in having access to credit.

b. Technical cooperation component

- 1.36 Phase one of the microenterprise global credit program was accompanied by a technical assistance component (ATN/SF-4107-PR), which was in turn divided into five subcomponents: (i) support for the PTEU, (ii) transfer of credit technology to IFIs for the financing of microenterprise, (iii) technical assistance for microentrepreneurs, (iv) heightening environmental awareness among microentrepreneurs and IFIs, and (v) heightening awareness among microentrepreneurs and IFIs of participation by women in the program.
- 1.37 The support for the Central Bank basically consisted of strengthening for the PTEU. This mainly entailed: (i) design and installation of fast loan discounting processing system, (ii) preparation of an accounting handbook and a register of credit operations, (iii) design and implementation of a statistical reporting system, (iv) design of an IFI evaluation mechanism, and (v) coordination of consulting services for the program.
- 1.38 The transfer of technology subcomponent comprised: (i) training courses for loan officers and officials in charge of loans for microenterprise, (ii) advisory support in the field for loans officers, and (iii) advisory assistance for the installation and utilization of microenterprise loan management information systems. The courses in theory were supplemented with on-hands training for loan officers, who were paired up with former loan officers, and accompanied by consultants on their visits to clients in arrears. Thanks to the technical assistance for IFIs, 125 microenterprise loan officers received training, a practice previously unknown in the country. The training also included the installation of

software for the microenterprise portfolio management system and an advisory support on its use.

- 1.39 The technical cooperation service for the microenterprise pilot subprogram funded part of the cost of instruction and the entrepreneurs covered the rest. The PTEU rated 34 Professional Training Institutions as eligible to offer courses by the end of October 1996. These institutions gave 696 courses to 3,880 companies. Of the participants, 70% were owners and the remainder were employees. The courses were offered mainly in manufacturing, arts, and work skills upgrading.

c. Economic impact of phase one

(i) General impact

- 1.40 Phase one of the program has had a favorable impact on the well being of the beneficiaries and their families. The surveys taken in December 1996 found that the credit lifted microenterprise sales by 20% on average in a period of tight money policy and increased employment by 35%.
- 1.41 On the basis of these findings, it is estimated that as of October 31, 1996, the program had generated: (i) total credit of US\$14.3 million, (ii) 7,572 new jobs (the average number of employees per microenterprise rose from 2.0 to 2.7), providing benefits for 15,144 persons ^{3/}, assets of US\$28.6 million, total annual sales of US\$114.0 million, and value added of US\$14.5 million.

(ii) Impact on the financial sector

- 1.42 Phase one of the program was successful in arousing the interest of lending institutions in the formal sector to expand their coverage of the microenterprise sector, thereby increasing access by the target population to the regulated financial system.

(iii) Impact of the credit component on women microentrepreneurs

- 1.43 In phase one, loans to women microentrepreneurs amounted to 47% of total lending, a level that reflects the extent to which the program reached women, who account for 37% of urban microentrepreneurs in Paraguay. Although data by sex are not available (paragraph 1.41), the data on general benefits are a good indicator of the program's economic impact on women microentrepreneurs.

^{3/} As the average family consists of four persons and there are workers per family, each new worker potentially benefits two people.

- 1.44 The training programs were coordinated with the worker training and development program (loan 851/OC-PR) and the Secretariat of Women's Affairs. The activities included:

(iv) Impact of the technical cooperation component on women microentrepreneurs

- 1.45 Women microentrepreneurs were accorded special attention under the technical cooperation component, accounting for 74% of the beneficiaries receiving training in phase one. Let us now look at the programs aimed specifically at women.

(v) Training workshops for loan officers

- 1.46 Training seminars on the theme of "Women and Microenterprise" were organized for loan officers. The participants initially believed that this was not a topic that was related to their professional duties and were reluctant to attend courses on women's issues. By the conclusion of the talks, however, they were more amenable to the need to broach this subject.

(vi) Training workshop for program trainers on the subject of women

- 1.47 A meeting entitled "Participation by women in the global credit program" was held on December 11, 1996. The directors of the training institutions were invited to attend and were encouraged to use a gender-based approach for the courses. Every effort was made to ensure that the courses not only provided technical training but also offered a business approach to the tasks performed by women. With this event, four basic information handbooks on microenterprise were published. The titles were: "How to open and legally establish your business", "How to pay your taxes", "How to register trade marks, designs, industrial models, and patents", and "How to obtain a bar code".

(viii) Gender consultant

- 1.48 The consultants used in phase one arranged to have the gender-based approach included in the courses and provided information to trainees on how to link up with the credit program.

2. Other programs of the Bank

- 1.49 Some of the successes of the investment sector program relating to bank legislation and supervision will serve as a basis for developing the proposed program within the institutional framework of a stronger financial system. The Central Bank Charter and the Bank and Financial Institutions Act were approved. Rules of accounting and audit were issued that are consistent with international standards and the regulations for external audits, and the rules for capitalization and provisions for credit risks, that comply with international standards, were also established.

- 1.50 One MIF technical cooperation program was extended to the SB (ATN/MT-5479-PR) for the strengthening of regulation and supervision of the financial system. The Bank also approved operations under the Small Projects Financing Program in an aggregate amount of US\$6.9 million, and will also help Fundación Paraguaya de Cooperación y Desarrollo (FUPACODE) in convert to a formal financial institution specializing in credit to microenterprise.
- 1.51 The Bank's technical-cooperation activities also attach special importance to activities that support women. A technical-cooperation program (ATN/SF-4021-PR) for US\$1,370,000 is funding the program for participation by women in development (PMD), which is being implemented through NGOs. The consultant's report on women microentrepreneurs (ATN/SF-4107-PR) concludes that the beneficiaries of the PMD are a captive market of the NGOs and are unlikely to benefit from the worker training and development program. The program for strengthening of the Secretariat of Women's Affairs has also benefitted from a number of technical-cooperation funding projects (ATN/SF-4570-PR for US\$30,000 and ATN/SF-5034-PR for US\$550,000).
- 1.52 The Bank has been supporting efforts to improve environmental management in Paraguay with the following operations: the national environmental program (ATN/SC-4236-PR) for US\$390,000 and the accompanying project (ATN/SC-4541-PR) for US\$105,000, support for environmental management (ATN/II-4568-PR) for US\$150,000, and the regulatory framework for water and sanitation (ATN/MT-4865-PR) for US\$980,000.

3. Activities of other institutions

- 1.53 The World Bank has rounded out the Bank's efforts to strengthen institutions in the country's financial sector. Under the private sector development project, the World Bank helped to craft legislation for the financial system and took the first steps towards strengthening IFI regulation and supervision. The World Bank and the IMF have proposed measures for reform of the financial system, particularly the closure or sale of problem banks to preclude a greater crisis in the future. The World Bank could possibly support this activity with financing of US\$100 million for the establishment of an agency to handle the liquidation of banks or assist them in resolving liquidity problems.

II. THE PROGRAM

A. Objectives

- 2.1 The proposed operation will continue to support the development of the productive and business capacity of Paraguayan microentrepreneurs. The specific objectives of this program are: (i) to give microenterprises access to credit from formal institutions using standard market mechanisms; (ii) to create a self-sustaining flow of credit to microenterprises so that lending to small entrepreneurs becomes part of the normal activities of participating financial institutions, while eliminating the regulatory obstacles that hinder access by microenterprises to the formal financial sector; (iii) to encourage commercial banks to change their lending practices to microenterprise; and (iv) to expand the program to include other operators such as cooperative banks, after ensuring that they have the requisite institutional and regulatory structure to participate in the program.

B. Description

- 2.2 The proposed program will have two components: (i) a line of credit for microentrepreneurs; and (ii) technical-cooperation component. The credit component will provide 90% of the funding for subloans that participating IFIs will grant to the target group to finance the purchase of fixed assets and supply working capital. In all, some 12,000 loans are expected to be granted. The large number of microenterprises involved and the substantial financing requirement justify the funding requested for the program. Its operation will be similar to that of phase one of the program, incorporating the lessons learned there (see Chapter I) and modifying the criteria used to select microenterprises. The new selection criteria for microenterprises will be as follows: (i) up to 10 employees per establishment; (ii) up to US\$20,000 in production assets; (iii) up to US\$100,000 in annual sales; (iv) a ceiling of US\$12,000 on loans; and (v) average loan amount of up to US\$3,000 for each IFI.
- 2.3 The principal objective of the technical-cooperation component will be to institutionalize credit services for microenterprises. The reasons for this are fivefold: (i) to encourage new financial intermediaries to join the program; (ii) to provide advice and transfer financial technology to IFIs, thereby increasing their capacity to supply microenterprises with financial services and introducing the use of best practices to reduce operating costs and facilitate credit assessments of microentrepreneurs; (iii) to support the program technical executing unit by helping to identify and eliminate the institutional and regulatory impediments that make it difficult for microenterprises to gain access to formal sources of credit; (iv) to continue to provide assistance in

reviewing subloans with adverse environmental effects; and (v) to continue to encourage participation by women in the program.

C. Participating entities

- 2.4 The institutional framework of the proposed program will consist primarily of the following entities: the PTEU established by the Central Bank of Paraguay in the earlier operation; the Superintendency of Banks; and the intermediary financial institutions taking part in the program - i.e. banks, finance companies, cooperative banks, credit card companies, etc.
- 2.5 The Central Bank created the PTEU under the previous program to supervise lending to microenterprises. The PTEU advises the respective departments of the Central Bank on the use of the mechanism for discounting of loans to microenterprises. It works closely with an Advisory Committee made up of the heads the Central Bank's National Operations and Economic Studies Departments, as well as with the Superintendency of Banks (SB), with which it meets periodically to discuss execution of the program.
- 2.6 An automatic discount mechanism was also set up in the National Operations Department, which administers the various discount mechanisms. This department is responsible for disbursing program resources to the IFIs, as well as for accepting repayments from them.
- 2.7 The SB is in charge of laying down prudential standards and overseeing the solvency of the financial system. Its role in the microenterprise program will be to supervise banks and help the PTEU determine their eligibility to participate in the program. Part of its task will be to provide continuous monitoring of compliance with eligibility requirements and the criteria for awarding subloans to microenterprises. To accomplish this, phase one included inspections of credit institutions and a sampling of microenterprises that had received loans under the program. The activities of the SB will be coordinated with those of the PTEU. Under the proposed program, the SB will broaden its functions to cover the new entities and procedures included in the operation, in accordance with Paraguay's new Banking Act.

D. Costs and sizing of the program

- 2.8 The total cost of the program will be US\$25 million, of which the credit component will account for US\$22 million including a loan of US\$20 million from the Bank plus US\$2 million in local counterpart funding. The terms of the Bank's financing will be as follows:

FINANCING CONDITIONS	
Amount of loan	US\$20 million
Amortization period	20 years
Grace period	4 years
Disbursement period	4 years
Interest rate	variable
Inspection and supervision	1%
Credit fee	0.75% (nonreimbursable)

USE OF THE SINGLE-CURRENCY FACILITY ¹		
TYPE OF CURRENCY (thousands)		
US\$	GERMAN MARKS	JAPANESE YENS
10,000	9,325	637,065
50%	25%	25%
^{1/} The exchange rate used is that published in the <i>Wall Street Journal</i> on April 29, 1997.		

- 2.9 In accordance with the Bank's regulations, the country indicated its desire to make use of the Single-Currency Facility according to the breakdown shown above.
- 2.10 The sizing of the credit component is based on: (i) the experience learned from the earlier program (US\$10 million) in which 11,295 subloans were approved over a two-year period, averaging US\$1,328 each at an average term of 15 months; and (ii) the existence of a huge microenterprise sector with potential demand exceeding the capacity of Paraguay's lending institutions to address its needs. Studies conducted by the PTEU show that some 82,000 microenterprises will qualify for credit. These considerations fully justify the conservative goals of 12,000 and a loan in a larger amount to consolidate and expand access to credit by small producers.
- 2.11 The technical-cooperation component totaling US\$3 million will include US\$800,000 in local counterpart funding and US\$2.2 million in nonreimbursable financing from the Bank chargeable to the net income of the Fund for Special Operations (FSO-local currency).

<p>TABLE II-1 Cost of Technical Cooperation Component by Source of Funding (US\$ thousands)</p>			
	BANK FSO, LOCAL	LOCAL COUNTERPART	TOTAL
Selection and assistance to cooperative banks	750	230	980
Consultants for IFIs	960	410	1,370
Consultants for PTEU and evaluation	260	80	340
Environment	80	30	110
Participation by women	50	10	60
Contingencies	100	40	140
TOTAL	2,200	800	3,000
%	73.3%	26.7%	100%

E. Financial terms and conditions

- 2.12 The credit program will maintain the free market conditions and other terms used for loans and subloans in phase one. Thus, the financial terms and conditions set out in the Credit Regulations will remain the same, except for the new thresholds for operations with microenterprises. A system for automatic discounting of subloans by eligible IFIs is to be used. The financing will be provided at market rates to IFIs, which will, in turn, onlend the resources as subloans to microentrepreneurs at market rates to use as working capital and for purchase of fixed assets.

F. Proposed changes

- 2.13 The differences between the proposed program and the earlier program include: (i) the new eligibility requirements and ceilings on loans to microenterprises; (ii) changes in the eligibility criteria for IFIs requiring a specified ratio of net worth to risk-weighted assets and maintenance of earnings or profits that are positive in real terms, and changing the period used to define late payments from 30 to 60 days; (iii) participation by cooperative banks as IFIs, provided they meet strict solvency, capitalization, and liquidity requirements; (iv) introduction of new operating and control mechanisms such as the use of credit cards and the micro-enterprise centralized risk appraisal system; and (v) awareness of women's rights and their access to the program.
- 2.14 Cooperative banks have proven an effective instrument for the provision of formal credit to microenterprises everywhere. A World

Bank study 4/ shows that the median number of loans granted to microenterprises by cooperative banks is 15,320, compared to 44,271 for banks, with the median amount being US\$449 for cooperative banks and US\$681 for banks. These figures reflect the importance of cooperative banks in lending to microenterprises according to more restrictive criteria.

- 2.15 The key to allowing cooperative banks access to funding in phase two will be to ascertain their financial condition and institutional capacity to administer and monitor loans to microentrepreneurs. To ensure effective participation by these cooperatives: (i) they must meet the eligibility requirements established for the program; and (ii) the PTEU or the SB, or the two institutions together, must have the capacity to supervise and audit the performance of these nonbank financial intermediaries. To assist with this aspect of the program, technical assistance will be provided by the MIF to the SB and Paraguay's new Banking Act will broaden the SB authority to include supervision of the country's cooperative banks. As well, during an interim period independent external auditors will be hired to determine the qualifications of these associations, under the authority of the SB.

1. Eligibility of microenterprises

- 2.16 The earlier loan specified that to be eligible for loans under the program, microenterprises were to have: (i) a maximum of 10 employees, including the owner; (ii) not more than US\$10,000 in total assets; and (iii) annual sales of up to US\$45,000. The requirements proposed for the present operation are: (i) up to 10 employees per microenterprise; (ii) up to US\$20,000 in fixed assets; (iii) up to US\$100,000 in annual sales; (iv) a maximum of US\$12,000 for each loan; and (v) an average loan amount of US\$3,000 for each IFI. The ceiling on the loan amount was raised in order to extend the program to microenterprises in producing sectors, primarily agriculture and manufacturing, and to broaden its geographical coverage to include other urban and rural areas in addition to Asunción area where lending was concentrated in the earlier program.

2. Eligibility of credit institutions

(a) Banks and finance companies

- 2.17 The transparency of the eligibility criteria and their rigorous application to IFIs are crucial for the success of the program. In view of the current condition of Paraguay's financial system, it is recommended that changes be made in the eligibility criteria for

4/ World Bank: *Sustainable Banking with the Poor*.

banks and finance companies. These criteria are set out in Chapter III in paragraphs 3.28 to 3.30.

(b) Other credit institutions

- 2.18 **Cooperative banks** along with other credit institutions that join the program, must be supervised by the SB, and must satisfy the PTEU that they meet all of the requirements pertaining to solvency, arrears rate and real income.
- 2.19 Cooperative banks hold great promise as vehicles for effectively reaching microenterprises in urban and rural settings. In Paraguay, these associations have closed memberships and do not lend to all potential borrowers. However, there are only two simple requirements for becoming a member: (i) the approval of current members; and (ii) a relatively modest capital contribution which serves as partial guarantee on any loans taken out by the prospective new borrower, and ensures the member's commitment to the association's lending operations. Finally, since the deposits of a cooperative bank belong to its members, they exercise prudence in deciding who to lend to.

3. Centralized risk appraisal system and credit cards

- 2.20 An efficient microenterprise lending system requires the establishment of a **centralized risk appraisal system** which is an information system that keeps reliable records on the subborrowers' compliance with credit obligations.
- 2.21 There is a company called INFORCONF in Paraguay which offers selected information on borrowers and potential borrowers. It has been well regarded locally for more than ten years and currently works with Dunn & Bradstreet to provide information on Paraguayan borrowers to other parts of the world. Many banks, finance companies and commercial money lenders, including the IFIs participating in the program, use the services of INFORCONF.
- 2.22 The program will introduce, on an trial basis, a system to provide financing to microentrepreneurs under a business credit card (automatic loan) arrangement which will expedite the recording of financial transactions and establishment of a centralized risk appraisal system. There are two credit card companies that operate in Paraguay: BANCARD and BEPSA. The latter is the larger of the two and works with most local banks. Within the first 12 months of the program, the PTEU will propose a strategy to the Bank with recommendations on the use of this credit card.
- 2.23 The company administering the credit card (MICROEMPRESA) will maintain a centralized risk appraisal system with updated information on: (i) the borrower's and his microenterprise's current balance under the intermediation system of the program;

(ii) cumulative arrears for each borrower, payments in default, and number of delinquencies during the last ten years; and (iii) the maximum number of days in arrears.

4. Leasing

- 2.24 The proposed program will include an arrangement for the leasing of capital goods to microentrepreneurs. At present, most IFIs are reluctant to finance the purchase of capital goods by microentrepreneurs, mainly because of the risk in providing long-term credit (i.e. over two years) to these clients. However, the financial intermediaries may be willing to purchase capital equipment on their behalf for leasing on terms of up to five years to microentrepreneurs who meet all of the program's requirements. At the end of the lease period, the IFIs would give lessees the option to purchase the equipment. Leasing agreements will specify that the cost of maintaining and operating the equipment will be borne by the microentrepreneur. It is also recommended that intermediaries purchase insurance covering standard risks including damage and even theft. Paraguay does not yet have regulations governing all aspects of leasing, but leasing is permitted under the Civil Code.

5. Savings accounts for microentrepreneurs

- 2.25 One way of lowering the interest rates charged to microentrepreneurs would be to encourage voluntary savings in the IFIs providing their loans since these deposits could serve as partial guarantees, reducing the risk borne by the intermediaries, who would be able to charge a lower rate on the portion of a loan guaranteed by the saving account. Participating IFIs will thus be stimulating voluntary savings by the microentrepreneurs (see Credit Regulations).

6. Evaluation of IFIs by independent auditors

- 2.26 Within the first twelve months of the program, the SB, with technical assistance from the Bank (ATN/MT-5479-PR), will draw up criteria for evaluating the independent auditors that will be used to rate the IFIs, particularly those of participating cooperative banks.

7. The executing agency

- 2.27 In phase two of the program, the PTEU will be responsible for the credit component and the technical assistance for IFIs. The task of providing technical support for microentrepreneurs will continue to be coordinated with the PFCL (Loan 851/OC-PR), which allowed entrepreneurs to choose from different training institutions. Training will be provided under a voucher system, and will be administered by the government agency in charge of vocational and job training programs at the national level.

G. Rationale for phase two of the global microenterprise credit program

(a) Socioeconomic considerations

- 2.28 The program will continue to provide credit and technical assistance as a means of building reliable sources of financing for microenterprise, which is the principal source of employment in Paraguay where roughly 40% of the EAP work for microenterprises. The importance of these mini-businesses to the country's economic activity and employment justifies the support proposed, which will help to improve the economic and social conditions of microentrepreneurs in urban and rural areas.

(b) Institutional considerations

- 2.29 The program will help to develop and strengthen an institutional framework for participating IFIs, particularly the nonbanking institutions (cooperative banks), as a means of reinforcing the supply of formal credit for microentrepreneurs. This support will include enhancing the institutional and administrative capacity of eligible IFIs, as well as providing microentrepreneurs with financial technology. These considerations are particularly important in view of the financial crisis afflicting the country.

(c) Financial situation

- 2.30 Given the problems affecting Paraguay's banking system, providing credit for microenterprises in the volume needed to meet their needs will require expanding the spectrum of eligible IFIs. In addition, incorporating cooperative banks and credit companies into phase two will create competition, that will force finance companies charging high rates of interest to reduce their operating costs and lower the rates they charge microentrepreneurs. Hereinafter, the acronym IFI will be used to designate all credit companies participating in the program.

H. Technical assistance

- 2.31 The technical-assistance component will support the development of an institutional framework for IFIs interested in offering loan services to microenterprises, along with incentives for them to open savings accounts. Specifically, it will: (i) strengthen the IFIs through the transfer of appropriate credit technology and performance plans to improve their organization and administration, while encouraging new IFIs to join the program; (ii) increase the operating and supervisory capacity of the PTEU so that it is better able to carry out its functions under the program; and (iii) heighten awareness among IFIs of environmental protection and the gender dimension in lending for microenterprises, especially among loan officers. The technical assistance component is discussed more fully in Annex III-1.

I. Environmental impact

- 2.32 Given the global nature of this operation, any environmental effects it might have will stem from the economic activities financed by the program. And since there are no restrictions on the type of activity or geographical location, these effects could be of various kinds. Some activities could have a positive impact, such as those carried out by microenterprises that recycle certain products or seeking more efficient fuel consumption. On the negative side, adverse environmental effects could result from inadequate waste disposal systems or threats to public health due to improper handling of food. The program includes the necessary safeguards for protection of the environment where potentially harmful effects could occur (see paragraphs 3.37 to 3.40).

III. FINANCING AND EXECUTION

A. The borrower and the executing agency

- 3.1 The Government of the Republic of Paraguay has requested financing from the Bank to support a credit program for microenterprises, together with technical assistance for the institutional strengthening of the entities participating in the program.
- 3.2 The borrower will be the Republic of Paraguay, and the executing agency will be the Central Bank, acting through the PTEU created under the earlier program.

B. Program execution

1. The program technical executing unit (PTEU)

- 3.3 The PTEU will be responsible for implementing the two components of the program, as well as applying the eligibility requirements for the IFIs.
- 3.4 The PTEU will continue its role as advisor to the relevant departments of the Central Bank on the use of the discount mechanism now in place, and the new facilities that will be developed for the proposed program, such as the MICROEMPRESA card, the credit card clearing system, and the centralized risk appraisal system. The PTEU demonstrated its efficiency in phase one, managing the operation with just five employees and the technical assistance provided.
- 3.5 The Central Bank will assign to the SB the tasks of closely monitoring the capitalization requirements in accordance with the Basle standards, with adequate reserves to cover loan and investment portfolios, solvency and liquidity. The SB will not only supervise banks and financial institutions, but also other intermediaries joining the program, such as cooperative banks, once they have passed the initial stage of independent audits and have met the eligibility requirements for the program.
- 3.6 The PTEU will hire external auditors to audit the new IFIs incorporated into the program, on terms and conditions approved by the Bank. The cost of these audits will be covered with resources from the technical cooperation program. The SB, in cooperation with the PTEU, will use the results of these audits to analyze the economic and financial solvency of applicants, looking at the quality of their lending operations, their rate of default, risk exposure, net worth and risk-weighted capital requirements, as well as their operating profit. This evaluation will determine whether an entity can join the program. Cooperative banks will be allowed to join the program if: (i) prudential standards are issued for

cooperatives; and (ii) a chart of accounts has been introduced for these entities.

- 3.7 The PTEU will be responsible for submitting progress reports to the Bank, and together with the SB, for conducting periodic evaluations of the IFI compliance with loan conditions. It will also coordinate the technical cooperation activities.

2. Discount mechanism

- 3.8 The resources for the program will consist of the funds from the IDB loan in an amount equivalent to US\$20 million, and local counterpart funding for the equivalent of US\$2 million. Resources provided by participating IFIs that meet the conditions established in the IDB loan contract and the Operating Regulations will be considered part of the local counterpart. As well, the recoveries in excess of the amounts needed to service the loan will be used for the same purposes as program resources from the IDB loan and the local counterpart.

(a) Banks, finance companies and other credit institutions

- 3.9 The National Operations Department of the Central Bank will administer the discount mechanism, including automatic discounting for the previous program which was designed with the help of the PTEU. The department will oversee discounts to the banks, finance companies and other credit institutions eligible for the program.
- 3.10 For the automatic discounting of loans, the IFIs will open a line of credit with the Central Bank in an amount in line with their projected volume of operations. The line of credit may never exceed the net combined total of reserves and contributions. To discount subloans, an IFI will provide the Central Bank with a list of its loans from time to time, setting out the amortization schedule, due dates and interest payments. This list must also include the names and addresses of all subborrowers, their sales volume and line of business, total fixed assets and number of employees.
- 3.11 The PTEU will not analyze the subloans or require that the corresponding documentation be submitted to the IFIs. The PTEU will only verify compliance with the rules of the program.
- 3.12 Participating IFIs will assume the credit risk for subloans and will be responsible for ensuring that resources are used as specified in the subloan contracts.

(b) The MICROEMPRESA card

- 3.13 The PTEU will issue a formal call for bids from credit card companies, asking them to specify their conditions (minimum and maximum commission to be negotiated with merchants and

intermediaries, in the case of cash disbursements). The system will include all of the financial intermediaries selected to take part in the program, including nonbank intermediaries.

- 3.14 The Central Bank will manage compensation for payments under the MICROEMPRESA card in order to be able to credit and debit the corresponding amounts to each financial intermediary, including the banks of suppliers. To this end, each eligible IFI will maintain a current account with the Central Bank.
- 3.15 Participating intermediaries will have direct on-line access to the MICROEMPRESA card risk appraisal center. In addition, the card administrator will keep intermediaries informed of their borrowers' transactions, and keep this information on file. This is a significant improvement on the present system in which there is no record of a borrower's transactions with program resources. The record of each borrower's expenditures will also assist the Bank with the tasks of supervision and oversight.

3. Eligible borrowers

- 3.16 IFIs may lend to microentrepreneurs who have: (i) up to 10 employees, including the owner; (ii) a maximum of US\$20,000 in fixed assets; and (iii) annual sales not exceeding US\$100,000.

4. Interest rates

- 3.17 The interest rates charged on loans to microentrepreneurs are high, reflecting the high cost of financial intermediation and the high risk inherent in credit operations, particularly for micro-enterprises, because of the limited volume of operations per loan officer and the small amount of each loan. The rates charged under the program will continue to be based on current market rates freely negotiated between the IFIs and microentrepreneurs. For each subloan the IFIs will add a spread to the transfer rate referred to in paragraph 3.19.
- 3.18 The financial costs to microentrepreneurs could be lowered by reducing: (i) the spread through the transfer of the right financial technology; (ii) the risks to IFIs through better information on microentrepreneurs (centralized risk appraisal); and (iii) the financial costs of microentrepreneurs by encouraging voluntary savings. The proposed program includes specific provisions for all these features.
- 3.19 The transfer rate will be variable and will be reviewed quarterly. It will be calculated on the basis of the marginal cost of certificates of deposit at 180 days in the local market, including adjustment for reserves. This rate may not be less than the cost of resources from the IDB.

5. Supervision of the credit component

- 3.20 The SB will supervise participating IFIs regularly, including the cooperative banks, for which it has set up a special department. Initially, this department will use independent external auditors: (i) to determine whether the cooperative banks have the institutional and administrative capacity to evaluate loan applications; and (ii) to assess their financial solvency, the status of their portfolios and their liquidity.
- 3.21 The PTEU, in coordination with the SB, will monitor and assess compliance with the Credit Regulations by all participating entities, based on a representative sampling of subloans. In the event that clear violations of the Regulations are discovered, access to the discount mechanism will be suspended until the violations are corrected. In addition, the Central Bank could also demand immediate repayment of the balance owing on operations in dispute.

6. Inspection of IFIs

- 3.22 The SB will verify compliance with the Credit Regulations and the participation agreements by the IFIs by means of scheduled quarterly inspections or on the basis of a statistical sampling.

7. Audits of the program and the executing agency

- 3.23 During each year of the program, the PTEU will submit to the Bank the financial statements for that year, including its own statements which must be duly audited by an external firm of auditors acceptable to the Bank. These financial statements shall report separately on the credit and technical assistance components.

8. Scheduled evaluations of the program

- 3.24 The PTEU will be responsible for reporting to the Bank on the progress and impact of the program, as well as the extent to which its objectives have been achieved. Three such evaluations will be submitted: the first when 25% of the program resources have been disbursed; the second when 75% have been disbursed; and the third when all of the funds have been disbursed. The evaluations should indicate: (a) number and quality of participating IFIs; (b) the willingness of IFIs to lend to the target sector, based on the percentage of their lending to microenterprises; (c) the number of loans granted and the quality of the portfolio; (d) the number of loan officers assigned to microenterprises; (e) participation by cooperative banks; and (f) annual increase in loans to microenterprises, with a breakdown by gender, volume, purpose, location, and type of activity.
- 3.25 The Central Bank will be responsible for informing the Bank on the status of the financial system and its liquidity, the evaluation of

its portfolio and reserves, 5/ solvency, contingent obligations and equity position, in accordance with the Basle standards and criteria, as well as the impact of these factors on institutions participating in the program. The evaluation will include the standard ratios of capital adequacy, return on assets and return on equity.

9. Ex post evaluation

- 3.26 In consultation with the executing agency, the borrower decided not to include an ex post evaluation as part of this program. This decision conforms to Bank policy and was based on the fact that the scheduled evaluations of the program will provide sufficient information on its progress and results. Were the need to arise, however, an ex post evaluation could easily be conducted inasmuch as the necessary information will be readily available.

C. Credit Regulations

- 3.27 A preliminary draft of the Credit Regulations governing execution of the program is presented in Appendix II. These Regulations are consistent with the standards and policies of the Bank, and the laws and financial practices of Paraguay. This document is designed to cover the main features of the operation, and will supersede the Regulations used in the earlier program.

1. Eligibility of financial intermediaries

- 3.28 The PTEU, with the help of the SB, will supervise and determine the eligibility of IFIs participating in the program (banks, finance companies, cooperative banks, credit cards companies, etc.). IFIs which meet the applicable regulatory standards set by the SB, together with specific eligibility requirements established for the program, will be eligible to participate. Only cooperative banks that qualify as IFIs will be eligible to receive technical assistance for institutional strengthening.
- 3.29 The minimum regulatory requirements for an IFI to be eligible are as follows:
- a. It must be under the supervision of the SB, and must satisfy the technical ratios required by the Central Bank and SB for each type of credit institution;

5/ This will include classifying portfolios according to degree of risk (normal, potential, real, high risk and uncollectible), and indicating whether general and specific reserves have been created to match the inherent risk.

- b. It must demonstrate that it has the capacity to promote, evaluate and administer the subloans for microentrepreneurs; and
 - c. In accordance with the Basle standards, banks and finance companies are required to have a net worth to total risk-weighted assets ratio of not less than 10%. The portfolio classification and reserve estimates must be based on audits conducted by independent external auditors approved by the SB. Cooperative banks must maintain as institutional equity at least 10% of risk-weighted assets, in accordance with the Basle Committee standards.
- 3.30 Other specific criteria that the PTEU must apply in selecting and monitoring credit institutions seeking financing are as follows:
- a. The proportion of subloans more than 60 days past due may not exceed 10% of the total loan portfolio;
 - b. The proportion of subloans more than 90 days past due may not exceed 3% of the total loan portfolio;
 - c. Annual financial results must be positive in real terms after adjusting for cumulative annual inflation.

2. Participation agreements

- 3.31 Each IFI that is deemed eligible to participate in the program will sign a participation agreement with the Central Bank, which will set out the terms and conditions of the line of credit granted to the institution, in accordance with the provisions of the loan contract with the Bank and the program regulations. This line of credit will provide for access to the resources of the program up to the net value of reserves and contributions.

3. MICROEMPRESA card

- 3.32 The IFIs will have the option of using a credit card system. A line of credit will be extended by the Central Bank (through the PTEU) to those IFIs that wish to make use of this mechanism. The line of credit may not exceed the limits established for banks and finance companies or, in the case of other credit institutions, the limits set under the MICROEMPRESA card, i.e. not more than 50% of the IFI's assets, to a maximum of US\$1 million. Within the first twelve months of the program, the Central Bank will present recommendations on a strategy for use of this credit card.

4. Default by IFIs

- 3.33 An IFI that fails to meet its obligations under the Regulations or the Participation Agreement will be requested to do so within 15 days by the PTEU. If it fails to comply, the IFI will be

suspended from the program until this situation has been corrected. After 90 days have elapsed, all loans received from program resources will immediately become due and payable.

5. Interest rate and spread

- 3.34 Interest will accrue on funding received by the IFIs at a rate calculated according to the marginal cost of borrowing in the local market, on the basis of certificates of deposit at 180 days, adjusted for reserve requirements and the administrative costs of the program. This rate of interest may not be less than the cost of resources from the Bank plus the administrative costs incurred by the PTEU. IFIs will be free to set their own spreads in order to obtain returns that are positive in real terms.

6. Terms and currency

- 3.35 The period for repayment of the subloans will be determined by the IFIs based on a subborrower's capacity to pay, but will not be more than 48 months. All subloans will be denominated in guaraníes.

7. Environment

- 3.36 The PTEU and the Paraguayan environmental agencies will take special care to ensure that projects financed with program resources do not adversely affect the environment in any way. The projects financed will be classified as activities without an environmental impact, and those with an environmental impact. Before a subloan is granted for activities classified as having adverse environmental effects, the subborrower will be required to agree to preventive measures during execution of the project. Subborrowers will have to work with an independent environmental consulting firm to draw up a timetable of measures to be taken, provide the IFI with certification that they have received the necessary training concerning adverse environmental impacts, and agree, in the Environmental Commitment Declaration, to periodic inspections by the PTEU, and to observe all national and local environmental protection standard applicable to the respective activity. The cost of correcting environmental problems will be eligible for financing under the program.
- 3.37 Microentrepreneurs engaged in activities that may have an adverse effect on the environment will sign an environmental commitment declaration in which they undertake to abide by the necessary environmental protection and health measures. This document will be part of the loan agreement with the IFI. Microentrepreneurs carrying out activities with food products will be required to submit a health certificate issued by the competent authority attesting to the fact that the microentrepreneur does not have any contagious disease.

- 3.38 Activities decertified as a result of an annual evaluation of compliance with measures to mitigate adverse environmental effects will not be eligible for funding.
- 3.39 The PTEU, in coordination with specialized Paraguayan agencies, will submit assessments of a representative sample of activities with adverse environmental effects prior to the review of the evaluation reports to be submitted when 25% and 75% of the program funds have been disbursed, for purposes of verifying compliance with the recommended corrective measures.

D. Execution of the technical assistance component

- 3.40 The PTEU will be responsible for executing and/or supervising execution of the technical assistance component. The Central Bank, through the PTEU, will hire consulting firms, specialized agencies and/or individual consultants to provide technical assistance to the IFIs, encourage participation by women, and coordinate activities related to the environment. A detailed description of this component is given in Annex III-1 to the present report.

E. Supervision of the program

- 3.41 The proposed program will be closely supervised by the Bank and its Country Office in Paraguay. Supervision will focus on: (i) evaluating the impact of the financial crisis on the banks, finance companies, and other entities participating in the program, and assessing compliance with the requirements for access to the program; (ii) ensuring adequate support for bank and nonbank IFIs, and for the credit card system; (iii) assessing training programs (including the legal considerations) that affect the development of women microentrepreneurs and have an impact on their access to the credit program; (iv) encouraging the development of leasing operations; and (v) promoting voluntary savings by the microentrepreneurs. Additionally, the Bank will supervise progress made in upgrading the PTEU's management information system. The borrower and the executing unit will cooperate fully in these activities.

IV. BENEFITS AND RISKS

A. Benefits

1. Strengthening and expanding credit facilities for microentrepreneurs

- 4.1 The program and its various components will have a beneficial effect by: (i) raising the productivity and production of microenterprises; (ii) reinforcing access to formal sources of credit by microentrepreneurs; (iii) broadening this coverage to include rural microentrepreneurs; (iv) strengthening the system for supervision of cooperative banks which have an opportunity to qualify as financial intermediaries under the program; (v) developing new business facilities such as leasing operations and voluntary savings programs for participants; (vi) promoting participation by women microentrepreneurs; and (vii) fostering environmental protection at the microenterprise level.

2. Access by microenterprises

- 4.2 The program will place great emphasis on promoting participation by women microentrepreneurs who now represent 37% of all one-person operations, and who accounted for 47% of participants in phase one and 74% of persons attending the training programs. Expanding the program into rural areas will advance this objective as well, given the high proportion of women involved in family farm operations, often as head of the household.
- 4.3 The program will develop means of identifying and removing obstacles that hinder access to its resources by women microentrepreneurs, and will offer the training necessary for this purpose. The technical cooperation component will be used to coordinate the courses of the PFCL to bring a business approach to the tasks performed by women; inform them of the current regulations and the benefits available to them under the 1992 Constitution and the Civil Code Reform; and provide professional development in their economic activity. These courses will provide an excellent means of disseminating information on improvements in the legal status of women microentrepreneurs and informing them of their rights and the benefits available to them under the law.

3. Poverty reduction

- 4.4 The program will assist microentrepreneurs, one of the country's low income groups, and also contains features aimed at reducing poverty and attaining greater social equity.

B. Risks

1. Macroeconomic risks

- 4.5 One of the main risks in this operation is the possible disruption of the macroeconomic program and the current setting of price stability, which would discourage investment, curb demand for credit under the program, and undermine the willingness of IFIs to grant loans. However, the actions taken by the government indicate an intention to stay the course it has mapped out, notwithstanding the difficulties encountered as a result of the financial crisis and the danger of slipping back into an expansionary fiscal policy.

2. Relaxing the regulatory framework

- 4.6 Another risk under this program concerns the possible temptation to ease the regulatory standards, rules for classification of assets and credit risks, reserve requirements, and interest accrual. However, the program has its own eligibility requirements, making it possible to overcome this risk.

3. Condition of the national banking system

- 4.7 Another major risk facing the program involves the delicate condition of the national banking system. To minimize this risk, the program will incorporate rigorous eligibility requirements so that only fully solvent entities, with good track records with respect to the level of delinquencies in their loan portfolios and their ability to operate competitively, will be allowed to participate – even if only a small number of such entities can be found. As well, participation by other, nonbank institutions such as cooperative banks will be encouraged, based on very strict evaluations. By the same token, the program will emphasize the development of a microenterprise credit card system, complete with centralized risk appraisal for proper evaluation of subborrowers.

4. Inclusion of cooperative banks in the program

- 4.8 Another risk to the operation is that the cooperative banks may not be financially sound enough to qualify for the resources of the program, in which case the latter will continue to operate with banks and finance companies that are able to meet the eligibility criteria. Their participation alone is sufficient for distribution of the resources set out in this operation.

5. Effectiveness of the PTEU

- 4.9 Finally, consideration needs to be given to the risk of the program executing unit losing its effectiveness and thereby undermine efforts to entrench microenterprise lending within the Paraguayan financial system. At the moment, the effectiveness of the PTEU depends largely on the technical assistance it receives. To

minimize this risk, the program will continue the technical assistance while reducing its reliance on technical assistance. To do this, it will prepare a plan and schedule for using the technical assistance to provide sufficient training to local personnel so that they are able to function independently without the need for outside support by the end of the period. This is essential in order to strengthen lending to microentrepreneurs, making this part of the normal and habitual practices of the Paraguayan financial system and not an activity whose continued existence is dependent on subsidized lending and outside technical assistance. When 25% of the financial resources have been committed through subloans, the borrower will demonstrate that it has submitted a plan to reduce the PTEU's reliance on external consultants for its operations, along with a timetable to carry out this plan. The inclusion of cooperative banks in the program will be conditional upon implementation of the corresponding regulations and a chart of accounts. The Central Bank has undertaken to maintain stability in the staff of the PTEU, and to ensure that it is properly trained to continue with these activities.

LOGICAL FRAMEWORK
GLOBAL MICROENTERPRISE CREDIT PROGRAM II
(PR-0094)

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
GOAL 1. Develop the productive and business capacity of Paraguayan microentrepreneurs. 2. Reinforce the self-sufficiency of the program.	The subloans granted through the program will provide working capital and equipment, and their effectiveness will be measured on the basis of their success in: (i) raising the incomes of microentrepreneurs through expansion of their operations; (ii) increasing sales; and (iii) boosting the number of employees of both sexes. 2. Loans to microentrepreneurs are made using the IFIs' own resources.	1. Annual reports prepared by the PEU covering the previous indicators. 2. Periodic reports.	(Goal to supertarget) Realization of assumptions concerning local counterpart and annual quota of loans granted.
PURPOSE Increase the supply of credit to microenterprises on market conditions at competitive terms and rates, due to the importance of these enterprises to the national economy.	Over the four-year execution period of the program, loans totalling the equivalent of some US\$7 annually will be granted, and the results of these loans will be reported in terms of: (i) the increase in the number of participating IFIs, and the amount of their portfolios; (ii) share of their overall portfolios that serves microenterprise; (iii) number of loans granted, in progress, completed and repaid per IFI and per sector; (iv) number of loan officers assigned to microenterprises within each IFI; and (v) annual increase in lending to microenterprises (by number of loans, volume, purpose and gender).	Annual reports prepared by the PEU covering the previous indicators.	(Purpose to goal) Modernization and expansion of the microenterprise sector will be brought about, and its share of GDP will be increased due to the effectiveness of Program II in raising the incomes of microentrepreneurs.
COMPONENTS 1. Subloans through participating IFIs in amounts averaging US\$3,000. 2. Technical cooperation to improve operation of the PEU, promote access to the program by IFIs, and train microentrepreneurs.	1. Upon completion of the program, the IFIs will have granted and discounted at least 12,000 subloans in an average amount of US\$3,000. 2. Training for local personnel of the PEU, number of IFIs receiving assistance, and micro-entrepreneurs trained, with breakdown by gender.	1. Annual reports prepared by the PEU.	(Component to purpose) 1. The goals of subloans will have been achieved. 2. The goals of training program will have been achieved.

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>ACTIVITIES</p> <p>1. Enforcement by the BCP of the eligibility conditions for disbursement of the program resources.</p> <p>2. Execution of the program itself by the BCP/PEU:</p> <ul style="list-style-type: none"> - Eligibility of IFIs. - Setting IFI lines of credit. - Operating IFI lines of credit. - Supervision of IFIs. - Supervision of discounted portfolios. - Periodic evaluation of program execution. - Preparation of progress reports. - Follow-up reports. <p>3. Establish a mechanism to provide legal advice for women micro-entrepreneurs, and to protect their rights in case of discrimination under the program.</p>	<p>2. Annual budgets showing disbursements under the program:</p> <ul style="list-style-type: none"> - Number of eligible IFIs. - Number and amount of IFI lines of credit. - Disbursements and recoveries by IFI. - Report by the SB. - Analysis of the status of IFI portfolios. <p>3. Number of complaints and queries, and their nature.</p>	<p>2. Annual progress reports prepared by the PEU.</p> <p>3. Report on resolution of gender complaints.</p>	<p>(Activity to component)</p> <p>2. Local counterpart available on time.</p> <p>3. Enquiries received for legal advice on gender issues. Dissemination in the press and the media.</p>

PLAN OF OPERATIONS FOR TECHNICAL-COOPERATION FUNDING
FOR PHASE TWO OF A GLOBAL MICROENTERPRISE CREDIT PROGRAM
(TC-97-01-13-8-PR)

I. BACKGROUND

- 1.1 The development of microenterprise in Paraguay has traditionally been hampered by poor access to adequate formal sector services, as well as by lack of interest among institutions to provide financial services and other services to address the needs of microenterprise in a consistent fashion.
- 1.2 Phase one of the global microenterprise credit program (loan 707/OC-PR for US\$10 million, with local counterpart funding of US\$2 million) included a technical cooperation component (ATN/SF-4107-PR) for a total of US\$2.7 million, consisting of US\$1.8 million in local currency drawn on the Fund for Special Operations; US\$700,000 in Swiss francs from the Swiss Fund for Technical Cooperation and Small Projects; and a total of US\$200,000 in local counterpart funding. These resources were used to: (i) provide technical support for the program technical executing unit (PTEU) of the Central Bank of Paraguay (BCP); (ii) transfer credit technology to the IFIs for use in financing microenterprises; (iii) supply technical assistance for microentrepreneurs; and (iv) heighten awareness among the microentrepreneurs and IFIs concerning environmental protection and participation by women.
- 1.3 This technical assistance was used primarily to finance a percentage of the cost of training microentrepreneurs, with the latter paying the rest. The PTEU approved a total of 34 training institutions (ICAPs) which were accredited to offer courses through the end of October 1996. These ICAPs provided 696 courses to 3,880 firms. Some 70% of participants were microenterprise owners, while the remainder were microenterprise employees. The demand for these courses was concentrated in areas of manufacturing, crafts and skills upgrading. Women microentrepreneurs made up 74% of the participants in the training program. This component has now become an independent activity, separate from the program and continues to operate effectively.
- 1.4 The activities involving transfer of financial technology to participating IFIs consisted mainly of: (i) developing training courses for loan officers; (ii) providing specialized field training for loan officers; and (iii) advising on the installation and use of computerized systems for microenterprise loan portfolio management. The results of these activities have been satisfactory. However, technology transfer processes require time to be

fully effective, and the work needs to be consolidated and reinforced.

- 1.5 The present plan of operations incorporates the lessons learned in phase one and is designed to provide optimal conditions for implementation of phase two of the global microenterprise credit program.

II. OBJECTIVES

- 2.1 The primary objective of this Technical Cooperation is to institutionalize credit services for microenterprises. This will serve five purposes: (i) to encourage new financial intermediaries to join the program, such as savings and loan associations; (ii) to provide advice and transfer financial technology to the intermediary institutions, in order to boost their capacity to supply microenterprises with financial services and introduce best practices to reduce operating costs and facilitate risk analysis of lending to microenterprise; (iii) to help PTEU identify and eliminate the institutional and regulatory impediments that make it difficult for microenterprises to access formal credit; (iv) to continue assisting with the review of subloans with adverse environmental effects; and (v) to continue offering encouragement for women's participation in the program.

III. DESCRIPTION

- 3.1 The project will have the following components, entailing the specific activities listed below:
 - A. Encourage new financial institutions to join the program
- 3.2 This component will identify potential new intermediary institutions that are viable from an institutional, economic, and financial standpoint, and that are willing to provide loans to the program's target population on a continuing basis.
- 3.3 In this regard, one option is to recruit savings and loan associations. However, considering the current status of these organizations, technical assistance in this area will be carried out in the following sequence: (i) to conduct a study of the principal associations and select primarily those that meet the necessary conditions and are willing to underwrite loans to the target population on a continuing basis; (ii) to assist the Superintendency of Banks (SB) in designing the rules for supervising and monitoring this type of entity, and develop specific

training programs to teach SB personnel how to apply these rules; (iii) to have the selected savings and loan associations audited by independent firms to verify their financial condition and accounting and internal controls; and (iv) provide technical cooperation to the associations that have been preselected to help them meet the eligibility requirements and participate in the program.

- 3.4 In evaluating the savings and loan associations referred to in paragraph 3.3(iii), auditors will consider their institutional and administrative structure, procedures and criteria used in granting loans, and portfolio quality; and will verify their internal controls, and look for projects that demonstrate interest in granting loans to the target population of the program on a continuing basis. These activities will be carried out by the SB, or by independent external auditors hired by the SB.
- 3.5 Qualifying savings and loan associations and other IFIs that join the program will, where necessary, receive technical assistance under the program in setting up an organizational, administrative and operating structure that is suited to lending for microenterprises. This will be carried out under the component described in the following paragraphs.

B. Technical assistance and transfer of technology in administration and microcredit operations

- 3.6 This component will help institutions that qualify for the program to incorporate microcredit technology into their operations and their accounting and computer systems. In addition, these institutions must submit indicators demonstrating compliance with program requirements.

1. Advice on organizational structure

- 3.7 Participating institutions that so request will receive advice on adding microenterprise credit transactions to their existing operations and administrative structure. This structure will include controls and internal efficiency parameters enabling the institution to meet the general regulatory requirements of the Superintendency of Banks (SB), as well as to measure the specific results achieved in the program.

2. Designing an information system

- 3.8 This will include activities for effective monitoring and administration of small loans for a variety of purposes, mostly short-term projects with monthly payments. To handle such loans, eligible institutions will need to create an information system which is compatible with their existing accounting and information systems, and which will, *inter alia*, accomplish the following: (i) enable them to evaluate the performance of loan officers;

(ii) provide an instrument for the analysis and monitoring of small loans; (iii) incorporate the use of technologies such as credit cards to simplify transactions and a risk appraisal center; and (iv) incorporate the social and economic parameters needed to analyze the impact of the credit program.

3. Training and development

- 3.9 This will include activities for training loan officers concerned with microenterprise in the promotion, evaluation, monitoring and repayment of loans, and with particular emphasis on institutions that have recently joined the program. Plans in this area include having certain experts attend national training courses and seminars on financing for microenterprises. Information on the promotion of credit operations for women microentrepreneurs will also be included under this training component.

4. Acquisition of computer equipment for intermediary institutions

- 3.10 This includes procurement of the minimum computer hardware required for initiating support activities for microenterprise credit operations. Financial assistance of this sort will go only to institutions that demonstrate the greatest commitment to participating in the program. In appropriate cases, participating IFIs will purchase additional material for use with the hardware acquired under this component.

C. Assistance for the program execution unit (PTEU)

- 3.11 Support for the PTEU will be aimed at increasing its operating and monitoring capacity in functions under phase two of the program. Plans call for continued technical assistance and the carrying out of studies of the microenterprise sector, as well as external audits to reorganize and analyze the financial condition of IFIs interested in participating in this program. The technical assistance provided for the PTEU will be conducted under an action plan and specific timetable for reducing the unit's dependence on external consultants to carry out its operations.

1. Analysis of portfolios, audits and evaluation

- 3.12 Under this activity, IFIs will be evaluated to determine their eligibility to participate in the program. This will entail analyzing the institutional and administrative structure of individual entities, their procedures and criteria for granting loans, the quality of their portfolios, and the reliability of their internal controls. These tasks will be carried out by the SB directly, or by independent external auditors selected and hired by the SB.

- 3.13 Audits will be conducted as well to review the program's portfolio, its advisory activities on organizational structure, and its training courses in the technology required for administration and periodic evaluation of the program, assessing both its execution and its impact. Finally, this series of activities will provide independent evaluations of the program and its components.

2. Studies

- 3.14 The following studies are planned: (i) survey of microentrepreneurs participating in the program to obtain information on management profiles before and after the program, achievement of objectives, impact, gender considerations, etc.; (ii) study of the regulatory framework for microenterprise aimed at analyzing the obstacles that keep them from joining and operating in the formal economy; (iii) compiling of information on savings and loan associations for entry into the data base and information system for phase two; (iv) designing of a strategy for incorporating the use of credit cards into phase two as a means of simplifying transactions and keeping more accurate records of operations; (v) development of a centralized risk appraisal system, including provision of consulting services to help existing services meet the needs of the program; and (vi) developing leasing operations as a financing facility under the program. The PTEU will prepare the terms of reference for each of these studies, and will submit them to the Bank for its nonobjection prior to start-up.

3. Specialized short-term consulting services

- 3.15 These will be consultants hired on a short-term basis to meet specific needs as they arise in the course of the program. Examples include consultancies to advise the IFIs or to assist with the training program, information system, studies, environmental and gender issues, or the interim evaluations. Support for the transfer of the training voucher pilot program to the worker training and development program will also be considered consulting assistance. The PTEU will prepare terms of reference for each such consultancy, and these will be submitted to the Bank for its nonobjection before hiring begins.

D. The environment

- 3.16 Activities under this heading include efforts to raise awareness of the environment and strengthen the capacity of the PTEU and IFIs to supervise activities with potentially harmful environmental effects, and conduct inspections and verify compliance by sub-borrowers with their environmental declarations. In addition, these activities will: (i) provide support to help subborrowers design the timetable for corrective measures, and give them training on environmental issues; and (ii) establish procedures which the PTEU can use to verify compliance with the requirements

set out in (i) above by subborrowers with projects that may have adverse environmental effects. The IFIs will not grant subloans for activities with potentially harmful effects until provided with the required documentation by the PTEU, which will be responsible for conducting periodic inspections to verify compliance with the corrective measures.

E. Participation by women

- 3.17 The object here will be to continue providing the PTEU and participating institutions with advisory assistance to promote participation by women microentrepreneurs and remove barriers, particularly those of a legal nature. To accomplish this, the actions begun in phase one to encourage participation by women will be continued.
- 3.18 Specifically, activities will be developed in order to: (i) expand the range of training opportunities available to women; (ii) assess demand for the services provided by women microentrepreneurs; (iii) contribute items aimed at raising gender awareness for inclusion in promotional campaigns and documents issued by the PTEU; (iv) provide advisory assistance and help to ICAPs in the preparation of comprehensive training programs for women microentrepreneurs; and (v) disseminate information on aspects relating to the legal rights and benefits to which women microentrepreneurs are entitled.

IV. COSTS AND FINANCING

- 4.1 The estimated cost of this technical cooperation project is US\$3 million, broken down as follows by category and source of financing:

BUDGET (US\$ thousands)			
CATEGORIES	BANK	LOCAL COUNTERPART	TOTAL
	MIF (m)		
1. Selection and assistance for savings and loan associations	750	230	980
1.1 Fees for consultants in institutional strengthening	600	200	800
1.2 Fees for consultants in the preparation of supervisory standards for associations and training in the area (SB)	100	20	120
1.3 Fees for independent auditors	50	10	60
2. Advisory assistance and transfer of microcredit and organization technology to the IFIs	960	410	1,370
2.1 Specialized entities or consulting firms	880	300	1,180
2.1.1 Fees for coordinators/experts in IFI organization	600	0	600
2.1.2 Fees for information systems specialists	200	200	400
2.1.3 Training and development	80	100	180
2.3 Equipment and other	80	110	190
2.3.1 Procurement of information systems hardware for IFIs	80	110	190
3. Consultancy for PTEU and evaluation	260	80	340
3.1 Analysis of portfolio, audits and evaluations	80	10	90
3.2 Studies	100	40	140
3.3 Specialized short-term consultancies	80	30	110
4. Consulting services on the environment	80	30	110
5. Consulting services on issues concerning women microentrepreneurs	50	10	60
6. Contingencies	100	40	140
TOTAL	2,200	800	3,000
%	73.3	26.7	100

V. RECRUITMENT OF PARTICIPATING INSTITUTIONS

- 5.1 Bearing in mind the limited amount of resources and the period over which the technical cooperation will be carried out, and in order to maximize its effect, only those institutions in the financial sector that meet the requirements of the program will be eligible to participate in the technical cooperation component.

VI. EXECUTION OF THE TECHNICAL ASSISTANCE

A. Consulting services

- 6.1 To carry out the project, the PTEU will hire consulting firms, specialized institutions or individuals experts, hereinafter called the "Consultants", described in the present Plan of Operations, following the procedures established in Annex C of the Loan Contract.
- 6.2 The Consultants will carry out their tasks in accordance with the terms of reference prepared for each of them and approved in advance by the PTEU, SB or BCP (the executing agency) and the Bank, on the understanding that these terms of reference may be amended or supplemented during execution of the program by mutual agreement of the PTEU and the Bank.

B. Purchase or leasing of assets

- 6.3 The PTEU is empowered to purchase or lease the assets planned for the project, to be charged against the contribution and up to the amount that has been allocated for this purpose in the budget included in the present Plan of Operations.
- 6.4 Such assets are to be purchased at a reasonable cost, which in most cases will be at the lowest market price, taking into account quality, efficiency, maintenance and other appropriate factors. Procurement of assets will, in principle, be governed by applicable local law provided that these afford the basic guarantees that must be met in bidding competitions conducted in accordance with the Bank's policies in this area. The PTEU will adopt procedures for ensuring the participation of several bidders, with due attention to economy, efficiency and reasonable price levels.
- 6.5 The resources from the contribution may only be used to pay for goods and services originating in member countries of the Bank. Taxes on value added of purchased goods may not be paid out of the Bank's contribution.

C. Financial statements

- 6.6 The PTEU will submit annual financial statements, plus a final statement at the end of the program, listing expenditures made under the technical cooperation and charged against the Bank's contribution and the local counterpart, and these statements which must be approved by the Bank. All statements must be audited by an independent certified accountant or firm of independent certified accountants acceptable to the Bank, in accordance with standards satisfactory to the latter.
- 6.7 The annual financial statements must be submitted within three (3) months following the close of each accounting period, beginning with the period corresponding to the fiscal year in which disbursements of the Bank's contribution begin. The final set of financial statements must be presented within six (6) months following the date of the final disbursement from the contribution.

D. Other obligations of the PTEU

- 6.8 The PTEU will undertake to:
- a. Provide consultants and local experts with secretarial services, offices, office equipment, communications, transport and any other logistical support they require to carry out the project during the execution period, to be charged against the local counterpart.
 - b. Present to the Bank – within 30 days following the date on which it receives each of the final reports from the consultants – a memorandum either expressing approval of the respective final report or noting any observations it may have in this regard.
 - c. Provide the Bank with any other information it may reasonably request concerning execution of the project and the use of its contribution.

E. Period for execution and disbursement of the technical cooperation

- 6.9 The technical cooperation must be fully completed with a period of 36 months reckoned from the date of signature of the respective agreement. This period, and any others specified in that agreement, may be extended if reasonably justified, with the written consent of the Bank.
- 6.10 The contribution shall be fully disbursed within a period of 42 months from the date of signature of the agreement. Any portion of the contribution not disbursed within that period shall be canceled, unless the period is extended by express agreement between the parties prior to its expiry.

F. Form in which the contribution will be disbursed

- 6.11 The Bank will make disbursements of the contribution to the PTEU as it receives duly justified requests from the PTEU indicating expenditures chargeable to the contribution.
- 6.12 Prior to the first disbursement and after the specified requirements have been met, the PTEU may request that an amount equivalent to 10% of the contribution be used to establish a revolving fund. Before this revolving fund is created, the PTEU must submit to the Bank for approval an itemized list of the expenses to be charged against the contribution during a period of 120 days after the date of the request.
- 6.13 The Bank may replenish the revolving fund in whole or in part if the PTEU so requests and presents to the Bank, to its satisfaction, within a period of 180 days reckoned from the opening or renewal of this fund, a description of expenses incurred and charged to the fund, together with the corresponding supporting documents and due justification of its request.
- 6.14 The final disbursement of the contribution, which may not be less than 10% of the total amount of fees payable under agreements with program consultants, will be subject to approval by the PTEU and the Bank of the final reports submitted by those consultants.

G. Suspension of disbursements

- 6.15 The Bank may suspend disbursements of its contribution if any circumstance arises which, in its opinion, makes it unlikely that the objectives of the technical cooperation will be achieved. Should such a circumstance arise, the Bank will provide written notice to the PTEU in order that the unit may express its opinion. Thirty (30) days after the date of its written notice to that effect, the Bank may proceed to suspend the disbursements.

H. Scope of the Bank's commitment

- 6.16 The granting of its contribution does not imply any commitment whatever on the Bank's part to finance, in part or in whole, any program or project which may result, either directly or indirectly, from execution of the present technical cooperation.

PROPOSED RESOLUTION

PARAGUAY. LOAN /OC-PR TO THE REPUBLIC OF PARAGUAY
(Global Credit Program for Microenterprises II)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Paraguay, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Second Global Credit Program for Microenterprises. The financing, which will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal, will be for the following amounts: (a) ten million dollars of the United States of America (US\$10,000,000); (b) nine million three hundred twenty five thousand two hundred fifty German marks (DM9,325,250); and (c) six hundred thirty seven million and sixty five thousand Japanese yen (JP¥\$637,065,000). Such amounts form part of the Single Currency Facility^{2/} of the Ordinary Capital resources of the Bank.

^{2/}These amounts reflect the official exchange rate published in the May 28, 1997 issue of the "Wall Street Journal".

PROPOSED RESOLUTION DE- /97

PARAGUAY. NON REIMBURSABLE TECHNICAL COOPERATION FOR THE
SUPPORT OF A GLOBAL CREDIT PROGRAM FOR MICROENTERPRISES II

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is hereby authorized, in the name and on behalf of the Bank, to enter into such agreements with the Republic of Paraguay and to adopt such other measures as may be pertinent for the execution of the plan of operations referred to in Document_____ with respect to a non reimbursable technical cooperation to strengthen the Executing Agency and the Intermediate Financial Institutions which will participate in a Global Credit Program for Microenterprises II.

2. That up to the equivalent of US\$2,200,000 (two million two hundred thousand dollars), in local currency, is authorized for the purposes of this resolution, chargeable to the net income of the Fund for Special Operations of the Bank.

3. That the above-mentioned sum is to be provided on a non-reimbursable basis.