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**Statement by Mr. Moser and Mr. Weber on Paraguay  
(Preliminary)  
Executive Board Meeting 07/56  
June 29, 2007**

1. Paraguay has recovered well from its financial crisis in 2002 and the authorities deserve much credit for making macroeconomic stability a priority, fostering the conditions for growth, as well as steadfastly pursuing structural reforms. The track record on the latter, helped by substantial amounts of technical assistance and supported by this precautionary Stand-By arrangement (SBA), is reassuring. We commend staff for a very informative and comprehensive set of papers. In particular, the selected issues paper looks like a handbook on how to rebuild Paraguay's public institutions and should serve as a blueprint in this regard.
2. The consultations have appropriately focused on ways to improve the legal, institutional, and procedural underpinnings of macroeconomic management. We consider the hurdles in this regard to be substantial and would hope that the authorities' detailed and well-designed structural reform agenda (SI p.109 ff.) will not turn out to be overly ambitious. This points to a key issue of the program, namely the political feasibility of the demanding reform catalogue, including the obstacles set by Congress. While our assessment may thus be less upbeat than staff's, we support the completion of this joint 2<sup>nd</sup> and 3<sup>rd</sup> review of the SBA. Our comments below focus on the institutional and structural dimensions of the program.
3. Regarding fiscal policy, we commend the authorities for putting the public finances on a solid footing (tax reforms) and the debt-to-GDP ratio on a declining path. A medium-term budget framework is now urgently needed in order to preserve fiscal sustainability. In addition, the unclear division of responsibilities between the executive and the legislature on budget matters has to be solved (SI II, para 30 ff.). The results from the DSA are benign, although it is worrisome that the fiscal authorities do not always appear to be aware of the debt profile and obligations falling due (SI I para 15). It might be advisable to reduce the sensitivity of the debt burden to exchange rate changes by shifting the public debt profile.
4. Monetary policy has to be conducted in a challenging environment of substantial capital inflows, high dollarization (leading to a fear of floating), and a weak balance sheet of the central bank. The fact that there is still no agreed strategy to strengthen the financial

position of the Central Bank, together with weak prudential regulations for the banking system, undermines its credibility and the stability of the financial system. We hope that staff's baseline scenario in case of no action being taken (SI III, para 37 ff. and annex 2) will receive the appropriate attention among Paraguayan political decision makers.

5. Memories should not be too short to make tangible headway with strengthening financial sector supervision. We encourage the authorities to seize the opportunity provided by the current favorable global economic environment to tackle these reforms hitherto delayed. Given that basic improvements in the regulatory framework are unlikely to occur until 2008 at the earliest, we are somewhat concerned about how the numerous financial system weaknesses can be mitigated in the interim. A related issue is the need to modernize the payments system infrastructure. Over what time horizon and at what costs can RTGS and ACH be introduced, given that, at present, even a basic electronic payment system does not seem to be available (SI III para 23)?

6. We would like to be updated by staff on the status of the proposed structural benchmarks to be fulfilled under the program by end-June 2007 as well as on the prospects of the September target being met in eliminating the overdue obligations of PETROPAR. While the technical assistance provided to Paraguay is welcome as capacity constraints can indeed hamper the implementation of reforms, we would welcome staff's comments regarding a sensible sequencing and the coordination of this multi-source technical assistance program.

7. We welcome the authorities' intentions stated in the MEEP and TMU to speedily and in good faith seek a resolution on the issue of claims in dispute with private creditors. This will help regularize relations with commercial creditors.