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February 10, 2021

**Statement by Mr. Palei and Mr. Shestakov on Paraguay**
**(Preliminary)**
**Executive Board Meeting**
**February 12, 2021**

We thank staff for the informative report and Mr. Chodos and Mr. Corvalan Mendoza for the helpful Buff statement. The Paraguayan economy had just started to recover from the 2019 drought when it was hit by the COVID-19 pandemic. Timely actions on the part of the authorities, as well as Fund support in the form of the RFI arrangement proved critical to contain the pandemic-related shocks. Signaling effect of the RFI also helped Paraguay to issue US$1 billion sovereign bond.

The authorities are pursuing the Economic Recovery Plan, which is focused on safeguarding macroeconomic stability, improving governance and business climate, and strengthening the education system. Monetary policy has been appropriately accommodative with the policy rate reduced by 325 bps cumulatively. However, with policy rate at 0.75 percent, the remaining monetary policy space is limited. In the medium term structural impediments constrain economic growth and call for a comprehensive reform agenda.

**We commend the authorities for the transparency and accountability in dealing with the COVID-related spending**. The authorities report all related expenditures on the public portal, and public tenders will be subject to ex-ante and ex-post audits. *Do the auditing bodies, in staff opinion, possess enough institutional capacity and independence to effectively conduct this task?* We also note Paraguay's successes in implementing the new laws aimed at addressing AML/CFT risks.

**The Fiscal Responsibility Law needs a redesign to better serve the country's needs.** Two subsequent shocks have raised the fiscal deficit above the ceiling set by the FRL. According to the staff report, the authorities plan to return to the FRL limit by 2024. We thank staff for the discussion of the FRL in Annex I and think that the new draft FRL provides clearer guidance with respect to escape clauses. Strengthening fiscal framework is vital, since the much needed fiscal consolidation in 2021-2022 might be halted by political tensions in the run-up to the elections. Given the country's vulnerability to climate change, the FRL based on the hard deficit limit might be too rigid. Under the circumstances, the better rule might be for the overall budget to be balanced over the cycle. *Staff comments on the design of fiscal rules in the volatile environment are welcome.*

**Medium-term fiscal consolidation should safeguard growth-enhancing investment.** According to staff, expenditure compression would not be enough to bring the deficit back toward the ceiling and public investment would likely need to be cut. For 2021-2023 staff project real growth above the potential, yet staff also note that the country has large infrastructure investment needs in the areas of electricity distribution, roads, sanitation, and schools. *Staff's estimates on the adverse impact of investment cuts for economic growth are welcome.*