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Paraguay Integrated Fiduciary Assessment

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MAIN ABBREVIATIONS AND ACRONYMS

| | |
|----------|------------------------------------------------------------------------------------------|
| AGA | Autonomous Government Agencies |
| AGPE | Office of the Executive's Internal Auditor |
| AII | Spanish acronym for Institutional Internal Audits |
| AIP | Annual Investment Plans |
| ANDE | Spanish acronym for the National Electricity Company |
| BCP | Spanish acronym for Central Bank Of Paraguay |
| CAPACO | Spanish acronym for the Chamber of Construction of Paraguay |
| CAS | Country Assistance Strategy (WB) |
| CDPs | Spanish acronym for Budget Availability Codes |
| CFAA | Country Financial Accountability Assessment |
| CGR | Spanish acronym for the Comptroller General of the Republic |
| CISNI | Spanish acronym for the Council for the National System of Integrity |
| COA | Spanish acronym for Control of Auto-declared Operations |
| COFOG | Classification of the Functions of Government |
| COPACO | Spanish acronym for the State-Owned Telecommunication Company |
| CPAR | Country Procurement Assessment Report |
| CS | Country Strategy (IDB) |
| DGC | Spanish acronym for General Accounting Directorate |
| DGCDP | Spanish acronym for General Directorate for Public Credit and Debt |
| DGP | Spanish acronym for General Budget Directorate |
| DGR | Spanish acronym for General Revenue Collection Agency |
| DGT | Spanish acronym General Treasury Directorate |
| DINCAP | Spanish acronym for the National Directorate for Project Coordination and Administration |
| DNA | Spanish acronym for Customs Administration |
| DSA | Debt Sustainability Analysis |
| EC | European Commission |
| EU | European Union |
| ESSAP | Spanish acronym for the State-Owned Water & Sewage Company |
| FIDES | Spanish acronym for Rural Investment Development Fund |
| GAC | Governance and Anticorruption |
| GDA | General Directorate for Accounting |
| GDP | Gross Domestic Product |
| GDPP | General Directorate for Public Procurement |
| GFS | Government Finance Statistics |
| GTZ | Deutsche Gesellschaft für Technische Zusammenarbeit |
| ICB | International Competitive Bidding |
| IDB | Inter-American Development Bank |
| IFA | Integrated Fiduciary Assessment |
| IFIs | International Financial Institutions |
| IGAP | Institutional Governance Action Plan |
| IGR | Institutional Governance Review |
| INECIP | Spanish acronym for the Institute of Comparative Studies in Penal and Civil Sciences |
| IMF | International Monetary Fund |
| INTOSAI | International Organization of Supreme Audit Institutions |
| IPS | Spanish Acronym for the National Pension Institute |
| LAFE | Spanish acronym for the Central Government's Financial Administration Law |
| LOD | Spanish acronym for Departmental Organic Law |
| LOM | Spanish acronym for Municipal Organic Law |
| LTU | Large Taxpayer Unit |
| MDAs | Ministries, Department and Agencies |
| MoF | Ministry of Finance |
| NCB | National Competitive Bidding |
| OECD | Organization for Economic Co-operation and Development |
| OECD-DAC | OECD-Development Assistance Committee |

| | |
|-----------|-----------------------------------------------------------------------------------------------------------------|
| OPACI | Spanish acronym for the Inter-Municipal Cooperation Organization of Paraguay |
| PC | Spanish acronym for the Colorado Party |
| PEFA | Public Expenditure and Financial Accountability |
| PETROPAR | State-owned oil company, 'Petróleos Paraguayos' |
| PFM | Public Finance Management |
| PGN | Spanish acronym for General State Budget |
| PI | PEFA Indicator |
| PIUs | Project Implementation Units |
| PNI-CISNI | Spanish acronym for National Integrity Program and Inter-institutional Council of the National Integrity System |
| PR | Procurement |
| RAS | Revenue Administration System |
| SEEI | Spanish acronym for Sub-secretariat of Economics and Integration |
| SET | Spanish acronym for State Secretariat of Taxes |
| SIABYS | Spanish acronym for Integrated Goods and Services System |
| SIAF | Spanish acronym for Integrated Financial Management System |
| SIARE | Spanish acronym for Integrated System of Administration of State Resources |
| SICAP | Integrated System of Accountancy and Project Administration |
| SICO | Spanish acronym for National Public Accounting System |
| SICP | Spanish acronym for Procurement Information System |
| SIGADE | Spanish acronym for the UNCTAD Debt Management and Information System |
| SINARH | Government human resources management system |
| SN | Sub-National |
| SOE | State Owned Enterprise |
| SSEAF | Spanish acronym for Sub-secretariat of Financial Administration |
| STP | Spanish acronym for the Technical Secretariat of Planning |
| TI | Transparency International |
| TSA | Treasury Single Account |
| UAF | Administration and Finance Unit |
| UCIP | Spanish acronym for Public Investment Central Unit |
| UIP | Spanish acronym for the Paraguay Industrial Union |
| UNCTAD | United Nations Conference on Trade and Development |
| UOC | Spanish acronym for Operational Procurement Units |
| USAID | US Agency for International Development |
| VAT | Value Added Tax |
| WB | World Bank |
| WBI | World Bank Institute |

| WB | IDB | EC |
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PREFACE

The Paraguay Integrated Fiduciary Assessment (IFA) was prepared jointly by the World Bank (WB), the Inter-American Development Bank (IDB), and the European Commission (EC) on the basis of findings from missions that visited Paraguay in October-November 2006 and April-May 2007. The IFA Team was led by Alexandre Arrobbio (WB). Core team members were: Andres Mac Gaul, Zeinab Partow, and Anthony Gaeta (WB), Gerardo Reyes-Tagle and Gustavo Sierra (IDB), Vera Valente (EC); Federico Guala; Celina Anazco; Justina Duarte; Gerardo Uña; and Marcelo Barg (Consultants). Efraim Jiménez (WB) was the Task Team Leader for the Paraguay Country Procurement Assessment Report.

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EXECUTIVE SUMMARY

- i. This Integrated Fiduciary Assessment (IFA) for Paraguay is an exercise in which the Government convened its development partners, including the World Bank (WB), Inter-American Development Bank (IDB), and the European Commission (EC), in a consultative process designed to establish an Agenda on Public Financial Management (PFM) and Procurement (PR), and other related governance aspects. It is expected that this process will contribute to: i) identify key PFM & PR strengths and weaknesses of the Central Government of Paraguay, including those related to the management and implementation of the foreign-financed (through grants and loans) public investment programs; and ii) prepare an action plan to guide future efforts in PFM and PR for all Central Government spending.
- ii. Paraguay has made important progress in a number of governance areas in recent years. The World Bank Institute (WBI) governance indicators show some progress during the last decade. It is also seen that public services are being delivered more effectively, including in what attains to PFM and PR. Nevertheless, important challenges still remain, particularly in the area of curbing down corruption. Paraguay ranked 111 out of 163 countries in Transparency International's 2006 survey. The purpose of the IFA is to assess PFM and PR performance in Paraguay. It acknowledges the governance context and the corruption in particular, which affects both the PFM and PR, but does not analyze them *per se*.

Recent Achievements in PFM & PR

- iii. Since the beginning of President Duarte Frutos term in 2002, the Government has made significant efforts oriented to PFM & PR reform. On PFM, an important tax and customs reform was initiated in 2004; technical improvements to the budget process have been implemented in the areas of financial planning and cash management, as well as in budget accounting through the introduction of a commitment stage. The external audit function has also been improved through the institutional strengthening of the Comptroller General of the Republic (CGR) supported by IDB and the US Agency for International Development (USAID). Finally, the Government is currently initiating a reform of the internal audit function and the Financial Management Integrated System (SIAF) with the technical and financial support of IDB and USAID. In Procurement, the newly adopted legislation, the enhanced role of the General Directorate for Public Procurement (GDPP), and the development of the centralized public procurement system have strengthened transparency.
- iv. These reforms have contributed to stronger fiscal discipline for the Central Administration, improved tax collection, and more transparency in the area of procurement. However, the initiatives undertaken in the area of control are too recent to show significant results.

Identified PFM & PR Main Weaknesses

- v. The three main PFM and PR challenges identified by IFA are related to improvements on: budget process efficiency, fiscal transparency, and control effectiveness. The common feature of these challenges is their link with Paraguay's political and institutional context and the difficulty in addressing their technical dimension without adopting broader governance changes.
- vi. **Credibility and Efficiency of the budget process.** The credibility and efficiency of the budget process are affected by deficiencies in the following three functions: the ability to effectively execute budgeted expenditures; the multi-year perspective in fiscal planning; and the financial planning of annual cash flows.
- vii. The limited ability to execute budgeted expenditures can be seen in the systematic under-execution of the budget, which has been on the order of 40 percent for the investment budget over the period 2004-06. This under-execution undermines the rationale of the budget process for both domestic and donor funded resource utilization. Three factors in particular are contributing to this problem:
 - Tension between the Congress—which enjoys wide power to increase the budget—and the Executive with respect to the final dispositions of the budget. Congress tends to add expenditure items, while the Executive limits actual execution to cash availability.
 - Technical aspects in PR planning, execution and monitoring. There is no real-time monitoring of contract execution through their different stages: i) draw up of technical specifications and documents, and ii) processing of PR. There is a rigid relationship between the Annual Contracting Plans and the Budget, and adjustments require slow procedures. Also, although it is permitted, there is little authority delegation for contract processing, which usually generates delays.
 - Other factors include the frequent adjustments to budget expenditures during execution and the co-existence of sustained fiscal surpluses with persistent payment arrears within the Central Administration. This is aggravated by the lack of consolidated information on payment arrears from decentralized entities and in particular of state-owned enterprises (SOEs) such as PETROPAR.
- viii. Expenditure efficiency is also affected by the poor capacity of budget execution. From the PR point of view, the impact over efficiency is due, among other things, to: i) delays in payments, forcing the bidders to include financial expenditures in their prices; ii) more than half of the processes are not benefited from economies of scale resulting from the aggregation of acquisition processes; and iii) existence of requirements that hinder the participation of foreign firms.
- ix. **Fiscal Transparency.** Without pretending to be exhaustive, the IFA deals with issues related to fiscal transparency in Paraguay, by considering two dimensions. On one hand, the management of transfers to sub-national governments. These transfers represented 4.3% of consolidated public expenditure during 2006, and respond to a relatively simple distribution scheme. However, the country lacks a

transparent and unified registry of sub-national transfers, which hinders the determination of the real functioning of the system, and also its eventual correlation with current legislation. Since 2006, measures were taken to start reverting this situation. On the other hand, the existence of significant fiscal risks associated to the quasi-fiscal losses by the Central Bank and SOEs, and to the contingent liabilities associated with the pension system.

- x. **Control Effectiveness.** The IFA identifies effectiveness of the control system as Paraguay's biggest PFM and PR challenge. First, shortcomings in internal control framework and procedures weaken the performance in most expenditure categories related to salaries and goods & services. Second, Internal Audit is undermined by lack of trained staff, harmonized norms and procedures, and institutional independence. Third, external audit still experiences weaknesses such as the limited effectiveness of follow up on audit recommendations. Finally, the control environment is weak, due to the lack of accountability and the high level of discretion given to senior management by insufficient and inadequate human resources policies and work practices. This is compounded by the lack of internal control standards and procedures for the public sector, and in some cases by their disconnection from the financial management integrated systems (SIAP). With respect to foreign-financed public investments, the weaknesses noted above are to some extent mitigated by an ad-hoc ring-fenced control framework required by International Financial Institutions (IFIs) and donors operating in the country.
- xi. This discussion has particular relevance for IFIs and donors collaborating with Paraguay. Public sector investment has depended crucially on IFIs and bilateral donor lending and grants. According to budget information, such grants represented 8.3% of Central Administration's total revenues on average terms throughout 2004-2006, whereas lending disbursements amounted to an additional 9.1%. These figures remain significant, despite the existence of negative net transfers with IFIs, driven partly by favorable economic conditions and partly by prudent fiscal practices, as well as by difficulties for obtaining congressional approval of IFIs and donors financed projects.
- xii. In addition to the weaknesses discussed above, and as with other Government spending, Paraguay's governance shortcomings are particularly harmful to the smooth implementation of IFIs and donor financed operations. This becomes evident with respect to the institutional arrangements for planning, monitoring and coordinating donor-funded operations. These arrangements suffer from institutional overlaps and redundant systems, which add unnecessary bureaucracy and undermine information reliability. Similarly, rigidities and instability in human resources may affect the Government's ability to reach its goal of avoiding outsourcing to international organizations for the implementation of new projects without introducing major risks.

The underlying governance challenges

- xiii. The challenges outlined above must be considered within the context of Paraguay's control environment. Lasting effects of technical reforms will not take hold without commensurate changes in the broader governance agenda. This

in turn will require pro-active and sustained dialogue with all segments of Paraguayan society. While the goals of such a dialogue are ambitious, short term objectives can be more modest, including, for example, the initiative to ensure strong ownership by the authorities, beginning perhaps with a single ministry or agency and avoiding unrealistic or overly ambitious measures. These initiatives should, in turn, seek to integrate PFM and PR reform proposals alongside actions in the areas of human resources and institutional strengthening.

Structure of the IFA

- xiv. Chapter 1 provides a descriptive summary of Paraguay's economic and governance context as well as the scope and methodology of the study. Chapter 2 describes the PFM and PR key issues and their inter-connection with Paraguay governance context. Chapters 3 and 4, respectively, describe how PEFA and OECD-DAC indicators are used for the assessment of Paraguay's Central Government PFM & PR. These indicators provide the Government with a powerful analytical tool for cross-country and over-time comparisons. The fifth chapter focuses on fiduciary aspects characterizing the management and implementation of external financing. The paper concludes with Chapter 6.

1. INTRODUCTION: CONTEXT & SCOPE OF THE STUDY

Economic Context

1. **Global Economic Performance.** Real GDP growth reached a high-mark of 4.1% in 2004, to some extent reflecting the recovery from the regional crisis of 2001-02. Growth slowed to 2.9% in 2005 and recovered to 4.0% in 2006.¹ This three-year growth pattern reveals an exceptionally good economic performance, following a decade of stagnation. It also suggests the existence of continued structural impediments to faster growth², and the vulnerability of the economy to supply-driven shocks.³
2. Inflation stayed at record-low levels in 2004 (2.75%) and then spiked to 9.9% in 2005 and 12.5 in 2006. Some of this inflation was “imported”⁴ and some was the consequence of domestic supply constraints on specific sectors⁵.
3. **Public finance.** Under the umbrella of a stand-by agreement with the International Monetary Fund (IMF), the government successfully implemented a fiscal program centered on a tax and customs reforms. This has helped to maintain an overall fiscal surplus, averaging 1.0% of GDP over the period 2004-2006, as well as to reduce debt arrears and the stock of external debt. Further achievements are needed, though, to assure sustained fiscal soundness. For example, while Central Government fiscal revenues (Central Administration and Decentralized Entities) were raised, sustainability remains a question. Part of the increase was brought by exceptionally robust economic activity. Also, overall public expenditures have shrunk in GDP terms, but mostly due to cuts in public investment, whereas little progress was observed during the period in terms of reducing current expenditures and losses from SOEs in terms of the gross product.
4. **External sector.** According to official figures, the current account balance deteriorated gradually, going from a surplus of 2% of GDP in 2004 to a 3.4% deficit in 2006. The main factor explaining this effect is the widening of the trade deficit, largely due the boost of the economy and to a significant increase in recorded imports generated by the strengthening of customs controls and revenue collection. Two additional factors should also be considered when interpreting these figures: first, the sharp increase in revenues from transnational hydroelectric companies; and second, the increase of international remittances. These two sources of revenue prevented the current account gap from growing at a faster rate. Notwithstanding the deterioration of the current account balance and the negative external financing of the public sector, the Central Bank was able to increase its international reserves from US\$1.16 billion at end-2004 to US\$1.67 by end-2006.

Political and Institutional Context

5. **Political Context.** The current Administration began its five-year term in August 2003, with the support of roughly 38% of the vote. The ‘Partido Colorado’ (PC) won 13 of

¹ Brazil, a 100-times larger economy, grew at 4.2% in 2004. Argentina and Uruguay grew at average rates of 8.9% and 8.5%, respectively, during 2004-2006.

² Considering the relatively small size of the economy and the prevalence of exceptionally favorable international conditions.

³ A severe drought that affected agricultural output in 2005, and the rise in oil prices that took place until second quarter of 2006.

⁴ High oil prices.

⁵ Beef, fruit, vegetables, and construction.

the 17 departments and retained its hold on the executive branch, although has lost the majority in both Chambers of Congress.

6. The period (2004-06) brought to an end almost a decade of serious political instability, and it also saw the launching of an ambitious reform agenda, driven by the authorities and supported by International Financial Institutions (IFIs) and donors. The aim of the reforms has been to help the Government tackle the country's most critical challenges, including reducing poverty; creating a sound investment climate for business development and sustained economic growth; and curbing the widespread corruption, at least that associated with public sector decision-making. However, despite some clear successes, there are still many challenges related to the improvement of the institutional framework, and the prevention of politicization of the public management and corruption practices.
7. **Institutional Context.** The 1992 Constitution provides the basic institutional framework for democratic government. Since then, the Legislature has an essential role in the scheme of division of powers, and counts with the capacity to increase the budget proposal expenditure.
8. **Governance.** The perception of quality of governance, measured by the World Bank Institute (WBI) Governance Indicators⁶, indicate that after a worsening in the second part of the 1990s, governance in Paraguay registered an improvement in the current decade. Still, the WBI instruments reveal that all dimensions of governance in Paraguay continue to be weak. The numbers, however, show important variations. Government overall (quality of provision of public services) has improved over the past decade. This suggests that PFM and PR, the subject of this study, are not perceived to be among the most problematic areas of governance. The PFM and PR reforms between 1996 and 2005, and in particular the improvements resulting from the procurement and customs reforms, generated some impact, though limited. Nevertheless, Paraguay continues to suffer from a high perception of corruption. Table 1.1 below shows the evolution of governance indicators from 1996 to 2005.
9. **High perception of corruption.** This high perception of corruption is corroborated by other monitoring mechanisms. Paraguay was ranked close to the bottom—147 of 159 countries surveyed—in Transparency International's (TI) 2005 Corruption Perceptions Index, though improved in 2006—climbing to 111 out of 163 countries surveyed—. Its overall 2005 score on TI's scale of 2.1 (1 being most corrupt to 10 being least) reflects only slight improvement over its 2004 score of 1.9. In 2004, WBI gave Paraguay the lowest control of corruption indicator among Latin American countries (8.8 on a scale from 0 to 100).
10. According to the corruption surveys carried out by the Council for the National System of Integrity (CISNI) and the WBI in 1999 and 2005, respectively, corruption seems to be more prevalent in the political sphere—in particular the Legislature—and the judiciary. The executive is also affected by the politicization of the civil service, which favors cronyism in public employment, and the prevalent corruption practices in services such as the customs administration.

⁶ See Annex 1.1 for the definition of the dimension measured by each indicator.

Table 1.1: WBI Governance Indicators for Paraguay 1996-2005

| Governance Indicator | 1996 | 1998 | 2000 | 2002 | 2003 | 2004 | 2005 |
|---------------------------------|------|------|------|------|------|------|------|
| Voice and Accountability | 35.6 | 39.6 | 29.5 | 29.0 | 36.2 | 40.6 | 41.1 |
| Political Stability/No Violence | 35.8 | 25.9 | 16.5 | 14.2 | 22.2 | 25.9 | 28.3 |
| Government Effectiveness | 15.7 | 9.6 | 9.6 | 9.1 | 10.0 | 12.4 | 23.4 |
| Regulatory Quality | 78.9 | 33.0 | 16.7 | 30.0 | 25.1 | 27.6 | 22.8 |
| Rule of Law | 33.0 | 22.1 | 18.8 | 12.0 | 12.5 | 11.1 | 16.4 |
| Control of Corruption | 33.2 | 7.8 | 9.3 | 4.4 | 4.4 | 8.8 | 7.4 |

11. Limited Impact of Public Sector Reform. Given Paraguay's challenging governance conditions, the impact of public sector reform efforts in Paraguay over the last decade has been moderate. Although the Paraguayan public sector is relatively small compared to regional standards,⁷ it plays a key role in several economic activities, and, despite government efforts and commitment to embark on reform, its functioning is characterized by high levels of inefficiency, a weak institutional framework, and a control environment affected by patronage and widespread corruption. The strengthening of the public sector appears as a key issue within this context, and a necessary condition to assure the effectiveness of recent reform efforts.⁸ Beyond technical aspects, this process will require strong consensus and political will to be successful.

The Public Sector in Paraguay

12. Paraguay's public sector is composed of the Central Administration, 55 decentralized entities and 232 municipalities. The Central Administration covers all the agencies within the executive, legislative and judicial branches as well as the Comptroller General of the Republic (CGR). The Central Government includes the Central Administration and the decentralized entities. The latter represent around half of budgeted expenditures, and include both commercial entities —state-owned enterprises and financial institutions— and non-commercial entities —17 departmental (regional) administrations, social security entities and funds, public universities, and regulatory entities; all of them regulated by the Central Government's Financial Administration Law (LAFE). Municipalities are regulated by the Municipal Organic Law (LOM) and adopt the LAFE only as supplementary.

⁷ In Paraguay, Central Government total expenditures represented 17.5% of GDP in 2005, against 29.5% of GDP in Argentina and Uruguay for the same year.

⁸ Progress was observed during the 2004-2006 in the areas of tax reform, rationalization of the government pension system, and financial sector reform to strengthen the banking system.

Table 1.2: Paraguay Public Sector Expenditure by Entity

| | 2004 | 2005 | 2006 |
|-----------------------------------|--------------|--------------|--------------|
| Central Administration | 43.9% | 42.1% | 51.5% |
| Decentralized Entities | 52% | 52.4% | 44.3% |
| Decentralized Government Agencies | 1.9% | 2.3% | 2.5% |
| SOEs | 32.3% | 32.7% | 26.6% |
| Social Security Agencies | 9.0% | 8.7% | 7.4% |
| Public Financial Entities | 5.4% | 5.0% | 4.6% |
| Universities | 2.0% | 2.1% | 1.9% |
| Regional Government | 1.4% | 1.6% | 1.2% |
| Municipalities | 4.1% | 5.5% | 4.2% |
| TOTAL | 100% | 100% | 100% |

Source: Financial Reports, (2004, 2005 and 2006), Ministry of Finance.

PFM and PR Institutional and Legal Framework

13. **PFM Legal Framework.** The LAFE and its accompanying regulation are well organized and provide a clear and comprehensive legal framework for financial management. The LAFE covers activities related to budgeting, accounting, registry & reporting, control, and debt management. It assigns the supervision of the financial administration to the Under-Secretariat of Financial Administration, which depends on the Ministry of Finance, and requires the use of the Integrated Financial Management System (SIAF) throughout the Central Government.
14. However, there are several exceptions to the application of the LAFE, such as the existence of expenditure increases introduced by Congress to the Executive's budget proposal without identified alternative sources of financing; failures to fully comply with reporting requirements by decentralized entities; the absence of evaluation of budget performance; and the partial use of SIAF.
15. Internal audit is assigned to institutional auditors in the respective agencies with the coordination and supervision of these assigned to the Office of the Executive's Internal Auditor (AGPE). External control, as stipulated in the LAFE and the Constitution, is assigned to the Comptroller General (CGR). Both the AGPE and the CGR have their organic legislation.⁹
16. **PFM Institutional Framework.** As stipulated in the Constitution and the LAFE, the Executive, through the Ministry of Finance (MoF), is responsible for budget formulation and execution. The key public institution for aspects related to the budget process is the Under-Secretariat of Financial Administration. This Under-Secretariat from MoF is in turn made up of eight units, including the General Budget Directorate (DGP), the General Treasury Directorate (DGT), the General Accounting Directorate (DGC), and the General Directorate for Public Credit and Debt (DGCDP).¹⁰
17. The implementation of the budget is decentralized to the Ministries, Departments and Agencies (MDAs) and coordinated and supervised by the Under-Secretariat of Financial Administration. Within MDAs, administrative and financial activities are usually¹¹ managed by the General Directorate of Administration and Finance, acting as

⁹ CGR Organic Law 276/1994; AGPE is regulated by the Decree 13245/2001.

¹⁰ The other units are in charge of Procurement, Norms and procedures, Pensions, IT and Communications.

¹¹ The Ministry of Public Works is an exception, with a Vice-Ministry of Financial Administration.

an Administration and Finance Unit (UAF).¹² The General Directorate includes a Finance Directorate for budget, accounting, treasury, and fixed asset management; an Administration Directorate for general administration and procurement; and a Human Resources Directorate.

18. The Under-Secretariat of Financial Administration, the MDAs and the AGPE share responsibilities for internal control. The Under-Secretariat of Financial Administration ensures overall supervision over budget execution through the SIAF, and also exerts control over cash management. Central Administration MDAs register budget execution figures into SIAF and are responsible for internal control within their administration. In contrast, many decentralized entities operate outside SIAF, and the DGP exerts no control on expenditures funded by resources generated directly by them. The internal audit function is covered by the Institutional Internal Audit (AII) of each MDA, under the coordination of the AGPE.
19. **PR Legal Framework.** In August 2003, Paraguay passed a new Government Procurement Law (No. 2051/03), which substantially improved the previous legal framework and set up an agency within the MoF for regulating and issuing guidelines for public sector procurement, the General Directorate for Public Procurement (GDPP). The drafting of the new Law benefited from the technical support of the IDB and the WB, and contains and promotes internationally-accepted best procurement practices. The regulatory decree 21909/03 was subsequently issued, facilitating the implementation of the Law.
20. **PR Institutional Framework.** The Procurement Law covers almost all types of public procurement¹³ associated with the Central Government and municipal agencies.¹⁴ Within this common legal framework, the GDPP appears as centralized, while its execution is decentralized through over 1,000 Operational Procurement Units (UOC), located in 307 entities from all three levels of Government.
21. The GDPP has six main functions: i) defining policies and issuing regulations regarding public procurement planning and execution; ii) issuing procedure manuals and standard bidding documents; iii) creating and maintaining a Procurement Information System (SICP);¹⁵ iv) providing training and advice to staff working at UOCs; v) prior reviewing of bidding documents, handling procurement complaints and denounces, and, when estimated to be necessary, requesting the intervention of the relevant audit bodies; and vi) sanctioning suppliers and contractors for non-compliance with contract stipulations and bidding procedures. The SICP covers all institutions ruled by the Procurement Law and works as an effective tool for the dissemination of contracting opportunities, managing complaints concerning procurement processes, and providing basic information for civil society monitoring.
22. The GDPP also plays an important role in budget execution by: (i) reviewing and approving Procurement Plans prepared and submitted by each UOC, once their budget allocation process is completed; (ii) controlling that the budget has been properly allocated to each procurement process;¹⁶ (iii) revising (jointly with the DGP) both the

¹² In order to access and operate the SIAF, a given unit has to be accredited to as a UAF or Sub-UAF. A Sub-UAF can be created by a MoF resolution; its basic structure is given by the LAFE ruling decree.

¹³ With the exception of personal services and concessions.

¹⁴ Except for SOEs and financial institutions, and bi-national entities (Itaipú and Yacyretá).

¹⁵ <http://www.contratacionesparaguay.gov.py/>

¹⁶ For institutions operating under the SIAF, expenditure allocation control is done through the SICP.

Procurement Plan and the Financial Plan when the price resulting from a procurement process exceeds the corresponding budget allocation; and (iv) issuing an authorization code (via SICP) for authorizing further payments through the SIAF and the Treasury. The GDPP levies part of its resources directly from the bidding process, which may, eventually, generate undesirable incentives over the medium term.

Integrated Fiduciary Assessment: Relevance, Objective and Scope

23. The efficient and transparent allocation of public resources, as well as their uses, will be fundamental elements of any successful effort to improve governance and reduce poverty in Paraguay. The analysis of Public Financial Management (PFM) and Procurement (PR) rules, processes and systems can, therefore, constitute a major contribution. The goal of the Integrated Fiduciary Assessment (IFA) is to provide a realistic assessment of these two key public sector functions, through the utilization of a methodology providing a powerful analytical tool for cross-country and over-time comparisons. It is expected that improvements in PFM and PR would contribute to the overall transparency and efficiency of the public sector and provide a more appropriate framework to prevent improper practices. However, sustained progress toward overcoming these governance practices requires addressing other areas, such as the politicization of the State and improper practices affecting the political sphere and the judiciary.
24. **Objectives.** IFA's main objectives are to (i) establish a dialogue between the government and IFIs and donors in Paraguay on PFM-PR and related governance issues; (ii) identify key issues that compromise the effectiveness and integrity of the country's PFM-PR and external funded resources; (iii) contribute to the making of an Action Plan for improvements on PFM-PR.
25. **Scope.** The IFA covers country-level PFM & PR, as well as fiduciary¹⁷ and institutional aspects related to the management and implementation of donor grants and lending, during the period 2004-06. The WB, in cooperation with the IDB and the EC, led the assessment of the country-level PFM component, by using PEFA indicators,¹⁸ which has allowed for a thorough review of Paraguay's Central Government's PFM cycle. The country-level PR component is assessed by using the IDB-led Country Procurement Assessment Report (CPAR), based on OECD-DAC¹⁹ four-pillar characterization assessment. IFA's third component, related to the management and implementation of donor grants and lending, focuses on key Paraguayan public sector institutions, including five Central Government Ministries,²⁰ as well as other institutions responsible for inter-ministerial planning and the coordination and monitoring of donor-funded resources. The analysis of this component also highlights the links between country-level and donor portfolio management and implementation fiduciary aspects, including the degree of reliance on donor grants and lending; the efficiency of project execution processes; the reliability of current control mechanisms, and Central Government's human resources and institutional capacities.

¹⁷ It refers also to PFM and PR aspects.

¹⁸ Public Financial Management Performance Measurement Framework, by Public Expenditure Working Group, available at <http://pefa.org/Documents.htm>.

¹⁹ OECD-Development Aid Committee. See details in 'Methodology' below.

²⁰ Finance, Education, Health, Public Works and Agriculture.

26. The overall effectiveness of governance, and curbing corruption more specifically, remain key challenges for Paraguay public sector. This study does not specifically analyze corruption and broad governance aspects, but rather relies on the conclusions of related studies such as the WB Institutional Governance Review (IGR) and the WBI survey on governance.

IFA Methodology

27. **WB Strategy on Governance and Anticorruption (GAC).** The IFA was implemented in accordance with the guiding principles of the World Bank Governance and Anticorruption (GAC) Strategy; i.e., ensuring country ownership; contributing to strengthening country systems; promoting coordination with other donors to ensure harmonized approaches, and supporting the use of good practices according to international standards.
28. **PEFA & OECD-DAC Indicators.** These indicators are the main instruments used for assessing Paraguay's fiduciary performance. By facilitating a structured measurement of PFM & PR progress on a consistent basis over time, they generate useful information for all donors, which contribute to reach a better coordination. They also make it possible to obtain periodic data allowing follow-up and monitoring by domestic and international stakeholders.
29. **PFM Performance Measurement - PEFA Indicators.** The PEFA methodology measures the soundness of Central Government's PFM framework, by calculating 31 indicators based on specific scoring criteria²¹ defined by the PEFA manual. These indicators provide broad coverage of country PFM systems, assessed around six critical performance dimensions: budget credibility; budget comprehensiveness and transparency; policy-based budgeting; predictability and control in budget execution; accounting, recording and reporting; and external scrutiny and audit.²²
30. **OECD-DAC Procurement Assessment and Indicators.** This methodology is based on the indicators developed by the OECD/DAC-Issue # 4.²³ It assesses the capacity of the public sector procurement system based on 12 baseline indicators with their respective compliance/performance indicators, organized around four pillars: (i) legal and regulatory framework; (ii) institutional framework and management capacity; (iii) market and procurement practices; and (iv) procurement integrity and transparency.
31. **Lessons learned and participatory approach.** Previous experiences with analytical work (evaluations, studies, etc.) in Paraguay show that early involvement of relevant stakeholders, extensive outreach, and timely and broad dissemination are critical for the success of this kind of activities. Thus, the Government, jointly with IFA's main development partners (IDB, EC, and WB) defined a highly consultative approach for conducting IFA's main components. This approach took full account of the specificities of Paraguay's public sector,²⁴ and also gave special attention to proper sequencing by

²¹ See Annex 1.2 for details on PEFA scoring criteria.

²² Information on these six dimensions is available at www.pefa.org

²³ The "Methodology for Assessment of National Procurement Systems (version 4)" was published in July 2006 under the auspices of the joint World Bank / OECD Development Assistance Committee (DAC) Procurement Round Table initiative. It is a benchmarking tool that incorporates robust scoring criteria, performance measurement criteria and a comprehensive users' guide, which developing countries and donors can use to assess the quality and effectiveness of national procurement systems.

²⁴ In particular, lack of institutionalization and inter-institutional links, and the lack of stability.

distinguishing between i) introduction to the diagnostic tools; ii) participation of Government in the analysis; (iii) dissemination and discussion of findings, and iv) joint prioritization of corrective measures with the Government and other donors.

32. **Recommendations.** The IFA has been designed to focus on analytical aspects and promote dialogue with country authorities and donors on available policy options. Given this, its objective was, in principle, to identify issues and propose a prioritization. On this basis, the Government—with technical assistance of the IFA team—elaborated an Action Plan to improve the PFM-PR.
33. **Methodological Limitations.** IFA methodology is deliberately focused on the use of an indicators-based approach. As mentioned above, this provides the Government with a powerful analytical tool allowing for cross-country and over-time comparisons, and it also supports country ownership of the instruments. However, this chosen methodology provides limited flexibility for cases where indicators do not reflect accurately country-specific situations, and offers a limited span for the specific treatment of broad governance issues. IFA conclusions on broader governance aspects rely on previous related studies, such as the WB Institutional Governance Review (IGR) and the WB Institute's survey on governance.

IFA Participatory Process of Implementation

34. **Multi-Donor Cooperation.** Both PEFA and OECD-DAC framework components are multi-donor exercises, within which the WB, the IDB, and the EC consult with other donors and establish a dialogue with the Government on key fiduciary and governance-related issues. The Government took ownership of this coordinated approach and requested donors—through the Under Secretariat of Financial Administration²⁵—to participate on a consultative basis for the elaboration of the Central Government PFM & PR medium-term action plan.
35. **Introductory seminars for dissemination of PEFA & OECD-DAC methodologies.** Prior to launching Paraguay's PEFA and DAC-OECD assessments, the Under-Secretariat of Financial Administration expressed its interest for the diagnosis and assigned, within its administration, coordinating responsibilities to ensure adequate, gradual and participatory implementation of related activities. Seminars were jointly organized with the Under-Secretariat for discussing and disseminating indicators' methodologies, as well as to explain their relevance for assessing PFM & PR issues within Paraguay's Central Government.
36. **Joint Government-IFA Teams for analysis and review of findings.** For each category of PEFA and OECD-DAC indicators, joint government-IFA teams collected relevant data, applied the indicators to Paraguay case, and discussed the findings. In an effort to fit the Government's time constraints, this process was completed throughout several field missions over a six-month period. This allowed for a progressive and more thorough absorption of the methodology, which will encourage a more autonomous updating of the indicators by the Government in forthcoming years.

IFA Dissemination Strategy

37. Dissemination and dialogue are vital components of the IFA process. Dissemination activities are to be developed under the umbrella of a broader governance dialogue

²⁵ Government counterpart for PEFA and OECD-DAC diagnostics.

related to the recently approved WB Governance and Anti-Corruption Strategy. A specific objective of the dissemination strategy is to identify measures to improve PFM, PR, and the management of donor lending and grants. Further to the initial MoF review of the document, the approach will consist of defining for each major topic the key counterparts within the Government, the donor community and other stakeholders.

38. **Government Action Plan for Country PFM-PR improvements.** The Governmental Action Plan was prepared under the leadership of MoF and prioritize actions to be undertaken based on the findings obtained from the indicators analysis of PFM and PR. This plan was elaborated through a consultative process that involved the donor community that supports the public finance reform in the country, and takes into consideration the general governance limitations affecting the country.
39. **Coordination of Donors supporting the public finance reform in Paraguay.** The Under-secretary of Financial Administration counts with the support of the IFA team and leads the coordination of IFIs and donors working on the public finance reform in Paraguay. The main purpose of such coordination is to develop follow-up and monitoring activities that ensure the sustainability of the Action Plan. It will also facilitate consultation between the Government and donors for the identification of eventual financial needs and technical support, and the development of synergies.
40. **Dissemination of PEFA results and Country PFM-PR Action Plan within Government.** PEFA main findings and the PFM-PR Action Plan designed under MoF leadership are to be disseminated to the MDAs for information and consultation. This activity will help develop dialogue on issues that require inter-institutional solutions, and will also contribute to build consensus on the government ownership of the MoF Action Plan.
41. **Institutionalization of PEFA updating in MoF.** MoF, through the Under-secretariat of Financial Administration, expressed interest in regularly updating Paraguay PEFA indicators. While BM, IDB and EC had a leadership role in carrying out 2007 PEFA exercise, it is expected that this role will be gradually transferred to MoF. In this context, dissemination activities will also include methodological support to MoF in updating PEFA indicators.
42. **Policy Notes and Technical Cooperation.** Technical advisory activities and preparation of policy notes on specific topics will be considered upon MoF request and will be informed by the dissemination process.

Structure of the Report

43. Chapter 2 describes the PFM and PR key issues and their inter-connection with Paraguay governance context; chapters 3 to 5 present the detailed analysis for PFM, PR, and Management of Donor Funds, respectively; and chapter 6 concludes on the prospects for improving PFM and PR in Paraguay.
44. While the IFA report captures the different dimensions of the PEFA report, these dimensions have been organized differently to ensure consistency between the different topics covered by this document.

2. KEY ISSUES FOR PUBLIC FINANCIAL MANAGEMENT AND PROCUREMENT

45. This chapter defines the main challenges confronting PFM and PR functions, and analyses them within the current political and governance context of Paraguay. The PEFA and OECD-DAC indicators-based methodologies, which detailed analysis is provided in Chapter 3 and 4, respectively, provide crucial insight to evaluate the technical capacity of Paraguay's PFM and PR functions. This may contribute substantially to the making of an operational agenda to improve the effectiveness and efficiency of these functions. It is important to note, however, that the technical aspects of institutional reform identified by this methodology provide only a partial answer.
46. The real challenge for the achievement of a sustained improvement of PFM and PR functions in Paraguay is the development of a sufficiently broad reform agenda that acknowledges the political context in which public institutions operate, and that allows the delineation of an Action Plan in which the implementation of technical measures take into account the political aspects.
47. The results of the analysis based on these methodologies show that the main PFM and PR issues in Paraguay during 2004-2006 were: the **budget process credibility and efficiency, fiscal transparency, and control effectiveness.**

Credibility and Efficiency of the budget process

48. Three dimensions of the PEFA framework are particularly relevant to understand the credibility and efficiency of the budget process in Paraguay. These are: the ability to execute budgeted expenditures, which indicates the ability of the government to deliver public services in a timely fashion; the multi-year perspective in fiscal planning; and the financial planning of annual cash flows. The limitations identified by the PEFA framework in these areas hinder the use of the budget as a planning instrument of public resources.
49. **Ability to execute budgeted expenditures.** There was a clear trend toward under-execution of Central Government budgeted expenditures over the period 2004-2006. The average deviation from the budget during this period was around 40 percent of capital expenditures, substantially impacting the level of execution of the overall budget. This is critical, as it distorts and undermines the rationale of the budget process. The impact is direct for the case of funds provided by IFIs, since these are essentially addressed to finance investment expenditures. During 2004-06, executed expenditure levels below budgeted amounts were not associated with sudden revenue shortfalls, but were rather related to a combination of governance and PFM factors.
 - On one hand, Congress counts with wide powers to modify the budget submitted by the Executive,²⁶ and used these powers to increase spending without identifying matching revenues, as required by the LAFE. The Executive, for its part, has compensated this practice by executing the budget strictly on the basis of available cash resources, which has contributed to substantial rigidity in budget execution. This conflict between powers can mainly be explained by the lack of a hierarchical structure among various legal sources, and is exacerbated when the executive and

²⁶ For instance, revenues projections were increased by US\$ 62 million by the Legislature for the adoption of 2005 budget law. Source: WB 2006.

legislative branches are controlled by different political parties, such as has been the case during the period under study. This also affects investments financed by IFIs and donors, which are approved through processes correlated to the budget calendar. In addition to problems regarding the level of spending, there is the interference of the Congress on the wage structure of public employment, through the inclusion in the budget of a detailed annex of Government salaries and positions. Paraguay's civil service becomes thus highly vulnerable to politicization.

- On the other hand, there are technical aspects related to procurement planning and monitoring that also contribute to the under execution of budgeted capital expenditures. In particular, there is no real-time monitoring of contract execution during its different stages: i) draw up of technical specifications and documents, and ii) processing of PR. There is a rigid relationship between the Annual Contracting Plans and the Budget, and adjustments require slow procedures. Also, although it is permitted, there is little authority delegation for contract processing, which usually generates delays.
 - Other factors that also help to undermine the ability to execute budgeted expenditures in Paraguay include the existence of frequent adjustments to budget expenditures during execution and the co-existence of sustained fiscal surpluses with persistent expenditure payment arrears within the Central Administration — 5.6% of total expenditures in 2004 and 8.3% in 2006. This is aggravated by the lack of consolidated information on payment arrears from decentralized entities.
50. Expenditure efficiency is also affected by the poor capacity of budget execution. From the PR point of view, the impact over efficiency is due, among other things, to: i) delays in payments, forcing the bidders to include financial expenditures in their prices; ii) more than half of the processes are not benefited from economies of scale resulting from the aggregation of acquisition processes; and iii) existence of requirements that hinder participation of foreign firms.
51. **Multiyear perspective in fiscal planning.** Multiyear budget planning is at an initial stage in Paraguay. In 2005, the MoF carried out an exercise for 2006-2008 that consisted on a simple forecast based on historical trends of main expenditure and revenue categories. In 2006 the MoF undertook the first multi-annual budget for the period 2007-09, although it was only referential. As observed over the period 2004-2006, the assessment of PEFA indicators reveal: i) multi-year projections of expenditures and revenues based on estimations of main macroeconomic variables mainly based on retrospective analysis; ii) absence of periodic analysis of public debt sustainability (DSA); iii) sectoral strategies dissociated from cost analysis, including quantified objectives; and iv) weak links between the Secretariat of Planning (STP) and line ministries, compromising the transition that would help sector strategies to become investment plans. Once again, beyond the real capacity issues —adequate multiyear budget planning is a challenge for many countries— institutional aspects, such as the insufficient inter-institutional cooperation or the lack of consensus between Executive and Legislative with regard to the requirement of multiyear projections within the budget law, constitute the main factors to consider for the achievement of a potential improvement.
52. **Financial Planning.** Cash planning helped preserve fiscal discipline, but it caused rigidities by requiring fixed quarterly expenditure allocations. In fact, Parliament

approval of significantly larger budgets than executive revenues forecasts, has at times encouraged the executive to implement strict financial and cash programs which contributed to the tendency towards under-execution. However, this issue was acknowledged by the MoF, which allowed for automatic transferring of expenditure allocations among different quarters in year 2007, although with a small reduction in transferred amounts as an incentive for timely execution.

53. Restoring credibility to the budget process in Paraguay will require a concerted effort on many fronts. This will have to begin with political dialogue and with the consensus on necessary changes to the budget process, a commitment to compliance with existing legislation, and an adequate approach to the reform of the legal and technical regime of the budget.

Fiscal Transparency

54. The lack of transparency associated with fiscal practices in Paraguay's Central Government has been discussed in several former studies, such as the 2005 IMF Report on the Observance of Standards and Codes. Without pretending to be exhaustive, the IFA illustrates about fiscal transparency issues in Paraguay by addressing two different dimensions: i) procedures for intergovernmental transfers; and ii) fiscal risks and contingent liabilities.
55. **Procedures for Intergovernmental Transfers.** The transfers of fiscal resources to sub-national governments (departments and municipalities) in Paraguay represented 4.3% of the consolidated public expenditure in 2006, and respond to a relatively simple sharing mechanism applied over a fraction of revenues from the collection of the Property Tax, the Value Added Tax (VAT), the Tax on Lotteries, and the distribution of Royalties and Compensations. However, the country still does not count with a transparent registry of sub-national transfers, which hinders the determination of the real functioning of the system, and its eventual correlation with the current normative. Since 2006, measures were taken that start to revert this situation, and as of today it is possible to obtain information on royalties transferred to departments since year 2007. The achievement of a more transparent management of transfers to sub-national governments appears as a necessity today in Paraguay.
56. **Significant Fiscal Risks and Contingent Liabilities.** Although there are no official estimates, Paraguay's fiscal risks and contingent liabilities have been significant in the past, and include: i) quasi-fiscal losses incurred by the Central Bank in the implementation of monetary policy, bank intervention operations and issuance of guarantees; ii) quasi-fiscal operative losses from SOEs; and iii) liabilities accrued by pay-as-you-go pension systems from both the Central Administration and decentralized agencies.

Control Effectiveness

57. The third and perhaps most important challenge to well functioning PFM and PR is related to ineffective control²⁷. A number of factors undermine PFM and PR control

²⁷ The effectiveness of a control system relies on the control framework (policies and procedures which management has established to achieve the entity's specific objectives) and the control environment. The latter refers to the overall attitude, awareness and actions of management regarding compliance, control and accountability. Factors of the environment are the integrity, ethical values and competence of people. These

system, including: (i) ineffective control procedures, which are analyzed through the assessment of PEFA indicators; (ii) a weak control environment; and (iii) a disconnection between both regulatory supervision and cash management exerted by the Under-Secretariat of Financial Administration and the responsibility for internal control and audit, which relies on line ministries and the AGPE. The situation is even more critical for the case of Decentralized Institutions, for which the use of the SIAF remains limited.

58. **Internal Control.** The control framework for payroll is limited by the absence of a proper payroll calculation system, and there is a high risk that the MDAs payroll calculations are not consistent with number of days worked by civil servants. For the case of non-salary expenditures, internal control related to quality and quantity of goods and services delivered is not adequate; shortcomings in existing rules and procedures are allowing non-compliance, such as use of funds for non-intended purposes. In addition, these control procedures are disconnected from MoF integrated financial management system (SIAF). Internal control is also affected by the existence of recording and reporting limitations: bank reconciliations provided by the MDAs usually do not provide adequate information to justify differences between bank statements and accounting; financial information on resources received by services delivery units—such as schools—is not available, which impedes the ability of the government to ensure that those resources are used for their intended purposes; and information on central government fixed assets is incomplete.²⁸ In procurement, available data indicate that around 25% of contracts exceeding the threshold for small purchases do not follow an open competitive process, and there are concerns regarding the way in which the Procurement Information System records these contracts. Also, a significant number of small contracts are awarded under exceptional rules.²⁹
59. **Internal Audit.** Internal audit is still one of the major challenges for improving PFM in Paraguay, as was mentioned in the 2004 Country Financial Accountability Assessment (CFAA). The institutional capacities of AGPE and MDAs Internal Audit Units are undermined by organizational limitations and lack of well-trained human resources. Also, internal audit manuals and norms are not standardized nor in line with international standards. Finally, in terms of effectiveness, both AGPE and AII reports exert a limited role in practice, partly due to the lack of formal procedures for addressing internal audit findings, and partly to the absence of a legally defined regime of sanctions. Although supported by IDB and the United States Agency for International Development (USAID), the success of the Internal Audit system reform will depend on the sustainability and strength of the political support; the strengthened inter-institutional integration and communication—in particular with MoF—, in spite of not being required by law; and the overall attitude towards governance and corruption.
60. **External Audit.** Despite recent progress achieved in terms of norms and procedures, CGR audits remain mainly focused on financial aspects. Moreover, audit reports—other than the Annual Public Accounts to the Congress—are frequently submitted

factors are influenced by the organizational structure, the means of distributing authority and responsibilities, and the management's control system, including control and personnel policies.

²⁸ Covering only 53 percent of total assets, as reported in 2006 Central Government consolidated financial statements, MoF.

²⁹ 68% of the number of contracts amount below US\$20,000 and 12% are procured on exceptional basis

with delays, and there is limited effectiveness of follow-up on audit recommendations, partly due to the absence of regulating norms defining a code of sanction for irregularities associated to the management of public resources.

61. **Control Environment.** The control environment is critical to the effectiveness of the overall public sector control system. Weaknesses in the control environment within the public sector of Paraguay relate to deficiencies in accountability and the high level of discretion given to senior management by insufficient and inadequate personnel policies and work practices.³⁰ This is compounded by the lack of internal control standards³¹ and procedures for the public sector, which in some cases are disconnected from the SIAF.³² This dimension is not entirely captured by PEFA and OECD-DAC indicators, but is more related to broad governance aspects, such as public sector human resources, institutional capacity and ethics. However, control environment weaknesses were already identified in the 2004 CFAA and 2005 IGR, and the IFA Team observed—through the PEFA and OECD-DAC field work—that limited progress has been made since then.
62. **Control of Donor Funds.** Ineffective control affects the fiduciary integrity and effectiveness of Paraguay's Public Sector, and therefore impacts upon the management of IFIs and donors funds. This problem is to some extent mitigated by the existence of a ring-fenced control framework required by each IFI and donor operating in the country. Evaluating whether these systems are sufficient to ensure sound management is outside the scope of this study.

The underlying governance challenges

63. The common feature of the above-mentioned strategic challenges is their link with Paraguay's political and institutional context and the difficulty to effectively address their technical dimension without broader reform efforts. As described above, these challenges are embedded in a series of broad governance issues, both technical—human resources and institutional organization—and "political"—politicization of the civil service and corruption practices analyzed by the WBI governance survey. The full effect of technical reforms will not happen without commensurate changes in the broader governance agenda. This in turn will require pro-active and sustained dialogue with all segments of Paraguayan society. While the goals of such a dialogue are ambitious, near term objectives should be more modest. An initial step could concentrate on (i) improving systems and technical aspects with a view to formalize reforms at the appropriate time; (ii) addressing jointly fiduciary and institutional dimensions at the level of each institution in cases where the institution's senior management supports change; and (iii) encouraging inter-institutional communication and coordination.
64. The scope of this study does not include elaborations on corruption and broad governance issues. However, there exist some institutional and human resources aspects which affect all dimensions of Paraguay's public sector, and are particularly

³⁰ See next section on Institutional Framework and Human Resources.

³¹ To provide the proper control environment within an organization, the International Organization of Supreme Audit Institutions (INTOSAI) has established internal control general standards for (1) reasonable assurance, (2) supportive attitude, (3) integrity and competence, (4) control objectives and (5) monitoring controls.

³² Control procedure deficiencies and disconnections from the financial management integrated system are detailed in Chapter 3, Indicators 18 to 21.

crucial to PFM and PR. Their direct impact on PFM and PR illustrates the necessity to address the issues identified by IFA through a broader governance analysis.

65. **Human resource system.** The effectiveness of Paraguay's public sector human resources system is compromised by both rigidity and instability. There is little connection between effort and reward: job-stability for civil servants is nearly absolute; the job ranking system is inappropriate; core wages were practically fixed over the period under study, and salaries are adjusted mainly through discretionary bonuses. Most civil service positions do not require academic or professional training. These sources of rigidities are combined with the instability resulting from the absence of clear rules with respect to promotion. This allows for positions to be staffed by practically any civil servant category. Ministers and heads of administration are therefore free to exercise their authority in personnel decisions, and retain substantial power to replace staff—at all levels of management—without justification.³³ Also, delegation of payment and contracting is limited.³⁴ These factors can have particularly corrosive effects on the integrity and the efficiency of normal transition processes, and can also undermine the medium-term planning. This can be especially problematic in agencies with frequent turnover at the top, such as the Ministry of Agriculture, which has had five different Ministers since August 2003. Such a human resource system does not provide incentives for integrity, transparency and accountability. Its impact on PFM and PR processes and particularly on control environment is direct and significant. The implementation of IFIs and donors funded operations is not exempted from these issues and human resources factors may also limit the Government's objective to stop outsourcing the implementation of new projects to international organizations.
66. **Inter-institutional coordination.** Public sector performance in Paraguay is also affected by the lack of inter-institutional coordination, which rarely involves a level lower than that of Minister or General Director. In addition, formal mechanisms for inter-institutional communication and coordination are limited. These weaknesses negatively affect public sector capacities for designing and executing multi-sectoral public policies, and they are intertwined with and aggravated by (i) bureaucratic inefficiency, including inadequate record keeping and the lack of manuals or automated systems for registering and tracking documents through government processes; (ii) redundant clearances and checks, superfluous managerial levels, and overlapping of tasks and processes; and (iii) excessive focus on compliance audits rather than those based on results or corruption detection. This institutional dimension can be particularly harmful to the smooth implementation of the budget. An example of the impact this can produce is given by the institutional arrangements for planning, monitoring and coordinating operations financed by IFIs and donors, which include institutional overlaps and redundant systems.

³³ The Decree of '*Cargo de Confianza*' gives discretion to the Minister authority, Director General, Director, and Head of Department.

³⁴ For authorization of expenditure and payments, the Minister may delegate to his General Director of Administration and Finance; for contracting, the Minister may delegate to the level of General Director.

3. PUBLIC FINANCIAL MANAGEMENT PERFORMANCE FRAMEWORK

Introductory Comments: Prioritization of Indicators and International Comparison

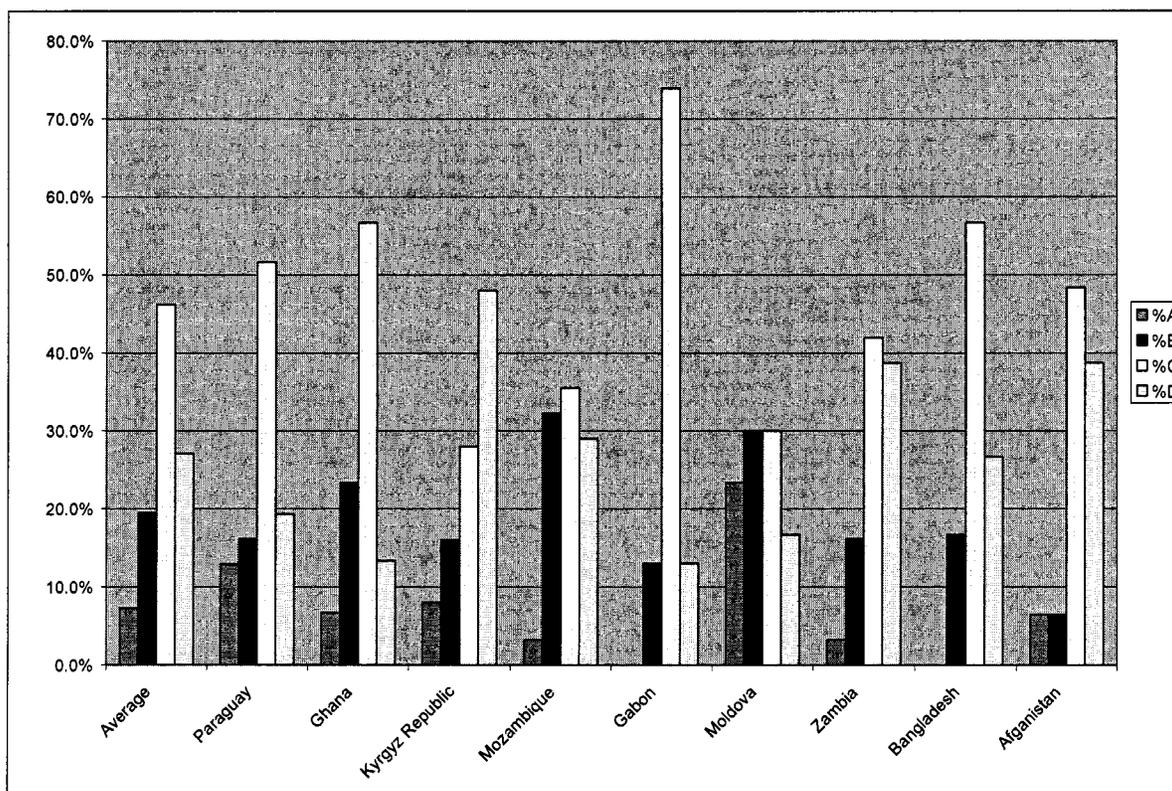
67. The IFA's exercise on Paraguay's Central Government PFM has been made using the 'Public Expenditure and Financial Accountability' (PEFA) Performance Measurement Framework. While it captures all PMF dimensions recommended for a Performance Assessment Report, the present IFA organizes these dimensions in a different way to ensure consistency between the different topics covered throughout its entire content.
68. PEFA indicators allow the assessment, on a comprehensive way, of all aspects of Central Government PFM. They also provide the recipient government with a powerful analytical tool allowing for cross-country and over-time comparisons. However, this methodology provides limited flexibility for cases where indicators do not reflect country-specific situations, and it is limited in its consideration of control environment and governance issues not directly related to PFM. These latter issues have been already covered in the WB Institutional Governance Review (IGR) and the WB Institute's survey on governance, and they have also been mentioned in Chapter 2.
69. **International Comparison.** This IFA on Paraguay's Central Government also includes an international comparison with other middle and low-income countries for which published results on Central Government PFM performance, based on the application of the PEFA framework, are available.³⁵ This comparison is provided through (i) a consolidated table indicating the overall performance of Paraguay's Central Government PFM compared to those from other countries, and their relative weaknesses; (ii) a benchmark for each PEFA indicator (PI); and (iii) a detailed scoring per indicator and per country.³⁶ Through these comparisons, Paraguay's Central Government overall PMF performance appears as slightly better than the average performance of the other selected countries, showing 71.0 percent of scores C and D, against 73.3 percent, respectively.
70. Conversely, with the same selection of countries, Paraguay is below the average for five out of the six WB Governance Indicators in 2005.³⁷ As for time comparisons, there are important variations among indicators.³⁸ Paraguay scores significantly low for *Control of Corruption* and *Rule of Law*, with respectively 14 and 10 points below the selection average. The score for *Government Effectiveness* is relatively close to the average, showing that (i) progress was made in areas such as PFM and PR; and (ii) that most critical governance issue in Paraguay is related to corruption.

³⁵ These countries include Afghanistan, Bangladesh, Gabon, Ghana, the Kyrgyz Republic, Moldova, Mozambique, and Zambia. Their PFM Performance Reports ('PEFA reports' are available at www.pefa.org).

³⁶ Presented in Annex 3.2.

³⁷ See detailed scoring in Annex 3.3.

³⁸ See Table 1.1 in Chapter 1.

Graph 3.1: PEFA PFM Performance Indicators – Cross Country Comparisons

71. **Selection of Key Indicators.** Due to governance and control environment issues identified in Chapter 2, and to the relatively low overall PFM results assessed by the PEFA framework, the monitoring of Paraguay's Central Government PFM performance should be focused on key indicators related to expenditure efficiency and credibility,³⁹ fiscal transparency,⁴⁰ and internal and external control.⁴¹ The proportion of C and D rankings for these indicators was found higher (83 percent) than the proportion of C and D rankings for all indicators (71 percent). In terms of international comparisons, the performance for these indicators remains within the average range of other selected countries.

PFM reform progress during the period 2004-06

72. Since 2004, Paraguay observed progresses in PFM have consisted of: a tax legal reform; improvements related to the budget process; and some recent improvements in the area of control. Except for the tax legal reform, most of progresses were focused on improvements that did not require a high level of political commitment or changes in current legislation. This is explained by the obstacles to reform posed by the current institutional and political context.

³⁹ Indicators 1, 12, and 16. Although Indicator 16 is classified in the section 'Predictability and control in budget execution', the analysis on financial planning relates to both predictability and efficiency of execution.

⁴⁰ Indicators 8 and 9.

⁴¹ Indicators 18 to 21, and 26 to 28.

Tax Reform: New Tax & Customs Codes

73. The introduction in 2004 of a new a new tax code (*Ley 2421 de Reordenamiento Administrativo y de Adecuación Fiscal*) and a new customs code (Law 2422), was aimed to build up a modern and more comprehensive tax legal framework. The new tax code was designed to expand the tax base by both introducing new taxes (e.g., the personal income tax), and reducing tax exemptions. The new customs code granted operational and financial autonomy to customs and expanded its powers of enforcement in order to generate incentives for compliance with custom norms, by contemplating disciplinary sanctions for public servants whose behavior departs from code-established procedures, and a range of pecuniary and non-pecuniary penalties for cases of smuggling, fraud, or other type of non compliance with customs norms. However, smooth implementation of the legal framework has been impeded by technical and dissemination deficiencies, as well as by political factors.

Improvements on the budget process

74. **Budget Planning.** The MoF introduced in 2005 an exercise for the period 2006-2008, and issued a Presidential Decree (8215/06) in 2006 establishing the processes and methodology for developing multi year budgets. Despite these progresses, budget planning is at an initial stage in Paraguay, and is not yet formally included in the formulation of the Central Government budget law.

75. **Predictability of the availability of funds and Financial Planning.** Measures have been adopted since 2005 to give more flexibility to financial planning and to strengthen cash management. Cash management measures are already effective and put the General Directorate of Treasury (DGT) in a position to technically implement the Treasury Single Account (TSA) for the Central Administration. In 2007, the MoF allowed for automatic transferring of expenditure allocations among different quarters to reduce rigidities caused by strict financial planning.

76. **Registration of Expenditure Commitment Stage.** Since year 2005 the Budget Law's commitment stage is included in budget accounting. In year 2006, this stage was incorporated in different categories of expenditures, representing 24.7 percent of Central Administration total expenditures. However, despite of the registering of the commitment stage being a budget accounting process, in Paraguay it is made through the Country Procurement System's portal.

77. **Budget Control and Cash Management.** Since 2007, all Central Administration payments are directly executed from the Treasury. It is expected that the implementation of this new procedure, known as '*direct payment*', improve the efficiency and the control of payments through the reduction of the number of government active bank accounts. However, for decentralized entities, the Treasury is still making transfers to their MDAs' bank accounts.

Improvements on internal and external control

78. **Internal Audit.** The Government, with the assistance of IDB and USAID, has initiated operations to strengthen AGPE and the internal audit units of main ministries.

79. **External Audit.** Paraguay's Supreme Audit Institution, the CGR, which has the responsibility of external audit for the entire the public sector, improved its institutional and operational capacities over the period 2004-2006 through the

development of an audit manual, reporting norms and planning guidelines. Also, risk has been introduced as a determinant factor of audit planning, leading to a focus on areas related to fixed assets, payroll audit and public procurement. These activities were also supported by IDB and USAID.

Credibility of the Budget

Indicator 1: Aggregate expenditure outturn compared to original budget

80. The ability to implement expenditures as budgeted is an important factor in supporting government capacity to deliver public services. This indicator reflects this ability by measuring the government actual annual expenditure compared to the originally budgeted expenditure, as defined in government budget documentation and fiscal reports. More specifically, the indicator is built on the concept of primary expenditure, for which two categories are subtracted from total expenditure, as it is considered that the government may have little control over them. These categories are the debt service payments and expenditures corresponding to programs financed by IFIs and donors.⁴²

Table 3.1: Paraguay: Central Government – Primary Expenditure Deviations (*) (2004-2006)

| YEAR | Budget Law (billions of G\$) | Executed ¹ (billions of G\$) | Deviation (%) |
|------|---------------------------------|--------------------------------------------|------------------|
| 2004 | 12,337.1 | 12,109.7 | 1.8% |
| 2005 | 16,074.9 | 13,623.2 | 15.3% |
| 2006 | 17,144.5 | 15,353.1 | 10.4% |

(*) Primary Expenditure = Total Expenditure – (Debt Service Payments + Expenditure Financed by IFIs and Donors).

¹ Accrual basis.

Source: World Bank staff estimates, based on provided by the Under-secretariat of Financial Administration of Paraguay.

81. The deviation of actual primary expenditure —as defined above— from the budget is summarized in Table 3.1 for the case of the Central Government. The comparison of actual expenditure is made with respect to the Budget Law passed by the Legislature in December prior to the start of the fiscal year. Table 1 figures indicate that there has been a clear trend toward expenditure under-execution in Paraguay over the last years. Naturally, this affects the credibility of the budget as an expression of the government's fiscal objectives and a guide to fiscal policy implementation.
82. Observed expenditure deviations cannot be explained by revenue shortfalls, since the Central Government recorded primary fiscal surpluses in all three years, overachieving IMF's stand-by agreement requirements. However, inefficiencies in initial budget planning and execution at both the central and decentralized levels⁴³ and strict cash management practices⁴⁴ have contributed to deviate outturn from budgeted expenditures.
83. Two important points should be noted with respect to the deviation between primary budgeted expenditure and actual primary expenditure corresponding to the Central Government of Paraguay. First, the most significant deviation corresponds to Decentralized Entities (SOEs, universities, etc.) and it is considerably smaller for the

⁴² Following PEFA Manual methodology.

⁴³ MDAs cannot execute their budgets before the approval of the Annual Financial Plan, which was significantly delayed in 2004 (June of this year), and started to regularize over the two following years (March of 2005 and 2006)

⁴⁴ Some remedial measures have been introduced to reduce these rigidities, which became effective since 2007. See PI-17 for details.

Central Administration.⁴⁵ Second, the low execution of capital expenditures was the main source of under-execution of budgeted expenditures in Paraguay. Using only data from the Central Administration, it was observed that capital expenditures were 40.9% below budgeted figures on average during 2004-2006. These data indicates that cuts in capital outlays are being used as a key factor of fiscal adjustment, even in a period of sustained economic recovery, which has serious implications for a country like Paraguay, where private investment has remained structurally low.⁴⁶ However, it should be recognized that, during previous adjustment periods, the Government had attained much more discretion with capital than with current expenditures, due to the rigidities associated to wage expenditures and also to the effort made to increase social spending, composed mainly by current expenditures.

84. Finally, the lack of consensus between Executive and Legislative with respect to the fiscal situation, in particular as related to the Congress approval of significantly larger budgets than Executive's revenues forecasts, has encouraged sometimes the latter to implement strict financial and cash programs, which contribute to the tendency to under-spend.

Overall Rating 1: "C"

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Difference between actual primary expenditures and the originally budgeted primary expenditure: In no more than one of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure.</i> | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 22.2% | 22.2% | 44.4% | 11.1% |

Indicator 2: Composition of budget expenditure out-turn compared to original approved budget

85. Where the composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of policy intent. The measurement of this indicator therefore entails an empirical assessment of expenditure out-turns against the original budget at a sub-aggregate (ministry and other agencies) level. Specifically, this indicator measures the extent to which reallocations between budget lines have contributed to variation in expenditure composition⁴⁷ beyond the variation resulting from changes in the overall level of expenditure.⁴⁸
86. As shown in Table 3.2, the changes in expenditure composition between the approved and executed budget were moderate during 2004-2006. It is important to note, however, that variances are constrained by the fact that 75% of the budget (as of 2005) is related to the financing of rigid items such as salaries, pensions, transfers and

⁴⁵ According to data provided by the General Budget Directorate (DGP), average deviation between budgeted and executed primary expenditures for Central Administration was 4.6% for 2004-2006, whereas it was 18.7% for the aggregate of the 55 Decentralized Entities.

⁴⁶ Central Government's accrued expenditures in public infrastructure have decreased as a share of total accrued expenditures from 16.6% in 2004 to 9.1% in 2006.

⁴⁷ Calculated as the weighted average deviation between actual and originally budgeted expenditure, on the basis of administrative or functional classification, and using the absolute value of deviation. Based on the available information, 11 categories were used for the Expenditure classification (see Table 3.2).

⁴⁸ As measured by PI-1.

debt servicing.⁴⁹ While this may result in low variances, it may also reduce the government's capacity to achieve a satisfactory, policy-based allocation of resources across sectors.

87. A detailed analysis of the variance between budgeted amounts and actual turn-outs at the ministry and agency level indicates that some administrative units executed significantly different amounts of spending relative to their budgets at least during two of the three years considered by the sample. These units include, for example, the Ministry of Agriculture and Livestock, a Rural Development Fund, and the Pension System for Employees of the National Electricity Company (ANDE). On the contrary, budgets are accurate indicators of actual spending for another set of agencies, in particular for the Ministry of Education and Culture.

Table 3.2: Paraguay: Central Government – Variation of Primary Expenditure Composition^(*) (2004-2006) (in %)

| YEAR | Sum of Variations by 11 Main Categories ¹ | Variation of Primary Expenditure ² | Difference |
|------|------------------------------------------------------|-----------------------------------------------|------------|
| 2004 | 6.3% | 1.8% | 4.5% |
| 2005 | 15.6% | 15.3% | 0.3% |
| 2006 | 16.0% | 10.4% | 5.6% |

^(*) Primary Expenditure = Total Expenditure – (Debt Service Payments + Expenditure Financed by IFIs and Donors).

¹ The classification includes the following categories: Legislative Power, Executive Power, Judiciary Power, Comptroller General of the Republic, National Treasury, Central Bank, Development and Promotion Organizations, Social Security Entities, SOEs, Public Financial Entities, and Education Institutions.

² Using Budget Law as reference.

Source: World Bank staff estimates, based on MoF data.

Overall Rating 2: “B”

| Dimension | Rating |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure: Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than one of the last three years.</i> | B |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 22.2% | 33.3% | 11.1% | 33.3% |

Indicator 3: Aggregate revenue out-turn compared to original approved budget

88. Accurate forecasting of domestic fiscal revenues is an essential factor in determining budget performance since budgeted expenditure allocations are based upon that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting.
89. Table 3.3 shows that Central Government actual total revenues had been very close to budgeted resources in two of three of the years considered. The small difference between revenues registered by the Budget Law and those effectively collected by the Central Government responds to different factors; among them, it stands out the instrumentation of a conservative fiscal policy and the strong recovery of the economy since 2004, mainly brought about by an improvement of the regional and international context.

⁴⁹ Personnel spending is executed at a very high level (98%), while other functional categories, particularly capital spending, are significantly under-executed (56%).

90. The calculation of this indicator allows for a top score, since only in 2005 the outturn of the Central Government was below 97% of budgeted revenue forecasts. However, this general assessment is not capturing the fact that Central Administration resources had been in general underestimated by the budget (around 5% on average during 2004-2006) whereas those corresponding to the aggregate of decentralized entities had been overestimated (around 10% on average during the three years under study).⁵⁰

Table 3.3: Central Government of Paraguay – Actual Total Revenues as a share of Budgeted Total Revenues (2004-2006) ^(*)

| YEAR | Budget Law ^{††} (Billions of G\$) | Actual Revenues (Billions of G\$) | Actual Revenues / Budgeted Revenues (%) |
|------|-----------------------------------------------|--------------------------------------|--------------------------------------------|
| 2004 | 15,016 | 14,993 | 99.8% |
| 2005 | 19,036 | 17,256 | 90.6% |
| 2006 | 20,382 | 19,809 | 97.2% |

^(*) Domestic revenues only (excluding external lending & grants).

^{††} Budget Law – 2004-2006.

Source: World Bank Staff estimates, based information provided by the Vice-Ministry of Financial Administration of Paraguay.

Overall Rating 3: “A”

| Dimension | Rating |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget: Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.</i> | A |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 66.7% | 22.2% | 11.1% | 0.0% |

Indicator 4: Stock and monitoring of expenditure payment arrears

91. Expenditure payment arrears are expenditure obligations that have been incurred by government, for which payment is overdue, and constitute a form of non-transparent financing. A high level of arrears can indicate problems such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and lack of information.
92. This indicator is concerned with measuring the extent to which there is a stock of arrears, and the extent to which the systemic problem is being brought under control and addressed. While special exercises to identify and pay off old arrears may be necessary, this will not be effective if new arrears continue to be created —payments due during the last year but not made. Most fundamentally, however, is the assessment of the existence and completeness of data on arrears, without which no assessment can be made.
93. In Paraguay, the stock of payment arrears is legally defined as follows: “*payments arrears not paid by State entities at December 31 of each year (of any given year) constitute floating debt, which is to be cancelled, at the latest, by the end of February*”

⁵⁰ According to data provided by the DGP.

(of the next year)".⁵¹ By international standards, this is a relatively narrow definition of payment arrears.⁵²

94. Within the Central Administration, there is sufficient institutional coverage and the quality of information on payment arrears is good. All entities submit daily on-line information through the accounting module of SIAF (SICO), as also do a number of decentralized entities, including the National Pension Institute (IPS) and National University of Asuncion.⁵³ Also, a first step toward control of commitments and arrears has been taken with the incorporation of a commitment stage in the accounting module SICO.
95. Weaknesses exist, however, with respect to information coverage on arrears related to Central Government SOEs. This information is available in aggregated terms only and provides no considerations on arrears' age profile, although it is submitted on a monthly basis to the General Accounting Directorate (DGC), in electronic format. There are two state-owned enterprises (COPACO and ESSAP) regulated under private law and excluded from the public sector budget, that do not submit any information on arrears, although they are legally required to do so.⁵⁴
96. The stock of payment arrears from the Central Administration has increased lately, from 5.6% of total expenditures in 2004 to 8.3% in 2006.⁵⁵ The bulk of these arrears were associated to payments due to suppliers of physical investments, transfers (e.g. to municipalities) and wages.

Table 3.4. Central Administration Expenditure Payment Arrears
(million of G\$ and % of total expenditure)

| YEAR | 2004 | | 2005 | | 2006 | |
|---------------------|----------------|-------------|----------------|-------------|----------------|-------------|
| Wages and Salaries | 116,189 | 1.5% | 49,579 | 0.6% | 198,533 | 1.9% |
| Non-wage services | 35,091 | 0.5% | 41,152 | 0.5% | 27,282 | 0.3% |
| Goods | 39,105 | 0.5% | 75,766 | 0.9% | 92,269 | 0.9% |
| Physical Investment | 156,183 | 2.0% | 203,714 | 2.3% | 216,408 | 2.1% |
| Public Debt Service | 1,774 | 0.0% | 145 | 0.0% | 1,026 | 0.0% |
| Transfers | 87,064 | 1.1% | 127,228 | 1.4% | 229,640 | 2.2% |
| Other | 3,768 | 0.0% | 4,059 | 0.0% | 107,151 | 1.0% |
| TOTAL | 439,174 | 5.6% | 501,643 | 5.7% | 872,309 | 8.3% |

Source: Ministry of Finance.

⁵¹ Law 1535/1999, art. 28 (c).

⁵² According to IMF Manual on Fiscal Transparency (2001) payment arrears are expenditure obligations that have not been paid by the date specified in a contract or within a normal commercial period for similar transactions. Payment arrears may arise from nonpayment by government in areas such as bills due from suppliers, due salaries or transfers, or due debt amortizations or service.

⁵³ As mandated by article 66 of the LAFE, government agencies and entities are required to report monthly and annually to the MoF on their budgetary, financial and equity balances. Monthly reports must be submitted within the first 15 days of the following month, and annual reports no later than February 10th of the following year.

⁵⁴ Required by Budget Law.

⁵⁵ Figures used in Table 3.4 are referred to the concept of committed expenditure and not effectively paid, compatible with the IMF definition of floating debt. However, it should be clarified in interpreting percentages on the Table that within the concept of committed expenditures there are—in accordance with art. 58 of Decree 8127/00— items not timely requested by MDAs to the Treasury for payment; and that the concept of “effectively paid” does not consider those items already authorized for payment by the Treasury, but whose payment was not effective.

97. Arrears are increased as a share of public expenditure when public entities outside the Central Administration are considered. This is explained to a large extent by arrears made by state-owned oil company, PETROPAR. Monthly arrears from this company increased from US\$15.6 million (on average) in 2004 to US\$24.6 million in 2005 and US\$26 million in 2006, mostly as a result of the rise in oil international prices that have not been fully reflected in domestic prices.

Overall Rating 4: “C+”

| Dimension | Rating |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock:</i> The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years. | C |
| <i>Availability of data for monitoring the stock of expenditure payment arrears:</i> Data on the stock of arrears is generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions. | B |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 22.2% | 33.3% | 44.4% |

Comprehensiveness and transparency

Indicator 5: Classification of the budget

98. A robust budget classification system enables the tracking of spending by administrative, economic, functional, and programmatic dimensions. Where standard international classification practices are applied, tracking of expenditures can be facilitated. The international standard for classification systems is the IMF’s Government Finance Statistics (GFS), which provides the framework for economic and functional classification of transactions.
99. In Paraguay, the public sector consists of the Central Administration, decentralized agencies and municipalities. Budget reporting is not consistent with a GFS consolidated Central Government concept.⁵⁶ The budget covers the entire public sector and does not differentiate between central government and the rest of the public sector and none of the periodic budget execution reports refer to a GFS-consistent central government concept. The Budget Law contains gross figures classified by institution and by economic, functional and programmatic category.⁵⁷
100. Budgeted expenditures are presented according to programs, economic classification, type of expenditure, function and purpose, source of financing, and entity. However, public investment is not disaggregated by function in the budget classifier, and frequent changes in the classification of programs makes difficult to obtain comparisons across periods.

⁵⁶ According to GFS Manual, the Central Government consists of all government units and all Non Profit Institutions controlled or mainly financed by government units.

⁵⁷ The Financial Administration Law establishes the guidelines to be followed in the revenue and expenditure budget classifier, which is approved annually as an annex to the budget law.

Overall Rating 5: “B”

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>The classification system used for formulation, execution and reporting of the central government's budget: The budget formulation and execution is based on administrative, economic and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.</i> | B |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 33.3% | 66.7% | 0.0% |

Indicator 6: Comprehensiveness of information included in budget documentation

101. The annual budget and budget supporting documents, as submitted to the legislature for scrutiny and approval, should allow a complete picture of central government fiscal forecasts, budget proposals and out-turns of previous years. At a minimum, the following elements should be included: macroeconomic assumptions, fiscal deficit, financing, debt stock, financial assets, prior and current years' budget outturns as well as summarized revenues and expenditures, and an explanation of the budget implications of new policy initiatives.
102. Macroeconomic assumptions used during the Budget preparation stage, even though included in the Budget messages submitted each year to the Congress by the Executive Power, lack sufficient foundations beyond a general revision of the economy of the previous two years.^{58, 59} The fiscal balance for the budget is included, but not for a GFS-consistent definition of Central Government (the balance included refers to the Central Administration and the consolidated public sector).
103. Debt stock figures and composition of borrowing requirements are included in budget reports, which also provide consolidated and disaggregated information regarding current and previous years' budgets. However, budget documents provide no information on financial assets, make no clear and consistent distinction between existing and new budget programs, and do not include adequate estimates of the budgetary impact of all major revenue and expenditure measures and programs.

Overall Rating 6: “C”

| Dimension | Rating |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>Share of the above listed information in the budget documentation most recently issued by the central government (in order to count in the assessment, the full specification of the information benchmark must be met): recent budget documentation fulfils 3-4 of the 9 information benchmarks.</i> | C |

⁵⁸ A comparison of macroeconomic estimates included on the Budget Messages of 2005 and 2006 with the corresponding actual figures, allows observing that there was a tendency toward a slight underestimation of GDP growth, whereas annual inflation rate was strongly underestimated (in more than 50% in 2006); nominal exchange rate appreciated significantly, although none of the budgets anticipated any changes.

⁵⁹ The government counts with a Directorate of Economic Studies that belongs to the Under-Secretariat of Economics and Integration of the MoF, in charge of estimating the evolution of the main macroeconomic variables, as well as the resulting expenditures and revenues. The role of this Directorate is currently under consolidation, and it is expected to be more prominent in the future with respect to the formulation of multi-year budget estimates based on more solid methodologies of calculation.

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 11.1% | 33.3% | 55.6% | 0.0% |

Indicator 7: Extent of unreported Government operations

104. Budget reports should cover all budgetary and extra-budgetary activities of the Central Government in order to provide a complete picture of Central Government, revenues and expenditures across all categories, and overall financing. This indicator attempts to measure the relative size of extra-budgetary operations —i.e., Central Government activities not included in the annual budget law— and activities included in the budget but managed outside the government’s budget management and accounting system.
105. In Paraguay, the bulk of Central Government activities are covered by the budget and its supplementary reports. The budget covers revenues and expenditures from all Central Government public entities, including the Central Administration and decentralized public entities, in particular SOEs. It also covers domestic and external public debt, including multilateral and bilateral lending.
106. Extra-budgetary spending, excluding donor financing, is estimated to represent less than 1% of total expenditures. However, while reimbursable donor financing is totally included in the budget, it is estimated that a significant part of grant financing received by the country is not included.⁶⁰ Also, projects with external financing that are still in the pipeline are not included in the budget. Each new project has to follow an independent track until effective approval, which generates frequent changes to the approved budget to incorporate counterpart financing.
107. Finally, the issue on whether the corporate social responsibility spending by the two hydropower plants should be treated as quasi-fiscal expenditures needs to be addressed. Many of the funds collected by these entities, whose magnitude remains undisclosed, are fully fungible with other budget funds, since they finance the same spending⁶¹ and should therefore be eventually included in the budget, even if the administration of these funds remains within the corresponding enterprise.

⁶⁰ Partial registry on the National Budget of funds coming from external grants is against the requirements of the National Constitution (Art. 202) and the LAFE (Art. 5). In 2007, The CGR has recommended to the DGCDP the compliance to the Manual of Organization and Functions of that Directorate, which establishes: “To administrate information from public credit operations and grants, as well as payments from association agreements with international financial organizations” which consists on “Elaboration of an inventory registering the amounts of grants, undisbursed balances, beneficiaries, and any other data considered to be relevant”. As a follow-up to the recommendation of the CGR, the DGCDP has initiated an inventory of grants financed by international organizations, which is supported by Decree 10064/07. However, the DGCDP has alerted that an overall compliance of the CGR recommendation would require a joint action of other public agencies and the donor community.

⁶¹ Building of new schools, assistance to farmers, etc.

Overall Rating 7: “B+”

| Dimension | Rating |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>The level of extra-budgetary expenditure (other than donor funded projects) which is unreported, i.e., not included in fiscal reports: The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure).</i> | A |
| <i>Revenue/expenditure information on donor-funded projects which is included in fiscal reports: Complete revenue/expenditure information is included in fiscal reports for all loan financed projects and at least 50% (by value) of grant financed projects.</i> | B |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 12.5% | 25.0% | 37.5% | 25.0% |

Indicator 8: Transparency of Inter-Governmental Fiscal Relations

108. While the PEFA performance indicator set is focused on PFM by Central Government, Sub-National (SN) Governments in many countries have wide-ranging expenditure responsibilities.
109. Paraguay is a unitary State, counting with a Capital District (Asunción), 17 departments and 232 municipalities. The municipalities enjoy fiscal autonomy for approval or their own budgets and the administration of their own assets and resources. Revenues transferred from the Central Government to both departments and municipalities represented 4.3% of the consolidated public expenditure in 2006. These transfers are determined by different sharing mechanisms applied over revenue-collection of the property tax,⁶² the value added tax (VAT), the Tax on Lotteries, and over the distribution of Royalties and Compensations.
110. **Transparency and Objectivity in the horizontal allocation among SN governments.** A correct horizontal allocation of transfers to SN governments assumes the existence and compliance of clear and transparent rules—for example, through formulas established by law—that allow those governments to count with a predictable horizon about resources to be received in transfers from the Central Government.
111. Three main laws exist in Paraguay that define the current transfers regime from the Central Government to departments and municipalities: i) Law 1294 of 1986, denominated Municipal Organic Law (LOM); ii) Law 426 of 1994, denominated Departmental Organic Law (LOD), that establishes main guidelines for the distribution of VAT and the Tax on Lotteries, and iii) Law 1309 of 1998, that establishes the distribution of Royalties and “compensations to flooded territory” to departmental and municipal governments. These last two norms and their respective modifications are founded on the Political Constitution of 1992.
112. These norms had been complemented and modified by several other laws and decrees that in most cases modified the criteria for distributing resources to SN Governments. This is the case, for example, of Law 1016 of 1997 that ruled aspects of the LOM about the distribution and specific destiny of revenues collected from the Tax on Lotteries; and of several other norms that rule—and in some cases modify—what was established in Law 1309/98, such as Law 2148 of 2003—that created the

⁶² This is a case of “reversed transfer”, since the tax is first collected locally, and then 15% of the revenues is transferred to MoF for redistribution among the country’s poorer municipalities in equal parts.

Road Infrastructure Fund— and Law 2419 of 2004 —that creates the Rural Investment Development Fund (FIDES).⁶³

113. The lack of an entity in MoF dealing with fiscal coordination with SN governments that keeps a transparent registry of transfers to municipalities and departments, together with frequent changes in regulations, have hindered the determination of the real operation of the transfers system and its eventual correlation with current norms. Since 2006, measures were taken that start to revert this situation,⁶⁴ and as of today it is possible to obtain information on royalties transferred to departments since year 2007.⁶⁵
114. **Timely provision of reliable information to SN governments regarding central government transfers.** In Paraguay, departmental budgets are included in the national budget, and then they follow the same budget formulation processes than the Central Administration. At the beginning of the budget cycle, the Ministry of Finance issues a *Budget Guidelines Decree*, before April 30th each year, which establishes the maximum value of transfers to departments through a MoF communicated. However, transfer projections for municipalities are not indicated in the same decree.⁶⁶
115. **Extent of consolidation of fiscal data for general government according to sectoral categories.** Most municipalities currently provide (as required by current norms) fiscal information to the DGC that allows the consolidation of fiscal accounts. The consolidation of Central Government fiscal accounts with those from municipalities took place for the first time in year 2006. Although information is still insufficient —due in some cases to low quality of data submitted, and to non-submission in others— there exists a full coverage of major local jurisdictions,⁶⁷ and the MoF is currently making efforts to further improving this situation.⁶⁸

Overall Rating 8: “D+”

| Dimension | Rating |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Transparent and rules-based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations):</i> No or hardly any part of the horizontal allocation of transfers from central government is determined by transparent and rules based systems. | D |
| <i>Timeliness of reliable information to SN governments on their allocations from central government for the coming year:</i> Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable. | D |

⁶³ Among other norms, it is worth mentioning Laws 1829/01, 2391/04, 2442/04, and 2979/06; and Decrees 8012/00, 20936/03, 7888/06.

⁶⁴ For example, by Executive Power Decree 7888 of 2006, municipalities are required to present annual expenditure and revenues budgets in accordance with the current budget classifier, distinguishing by different types of programs, expenditure composition by economic classification, etc., as a necessary condition for the transfer of Royalties, as it is established in Law 1309 and related norms.

⁶⁵ <http://www.hacienda.gov.py/web-presupuesto>.

⁶⁶ Based on information provided by DGC, starting with the 2007 budget, the MoF informs to the Municipalities Council the amount to be transferred to each municipality.

⁶⁷ Out of total 232 municipalities, 50 did not submit their financial statements in year 2006. However, this is not affecting critically the consolidation process, because those not submitting were in all cases small jurisdictions — from categories “III” and “IV” in Paraguay’s municipalities classification system, where “I” is the largest and “IV” the smallest. According to World Bank Report No. 32797, 2006, the municipality of Asuncion represents 41% of total municipal spending and provides information that can be consolidated.

⁶⁸ The DGC sends periodically official notes to municipalities to improve compliance with data reporting.

| | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>Extent of consolidation of fiscal data for general government according to sectoral categories:</i> Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for at least 75% (by value) of SN government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year. | B |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 11.1% | 0.0% | 44.4% | 44.4% |

Indicator 9: Oversight of aggregate fiscal risk from other public sector entities

116. SN governments, autonomous government agencies (AGA), SOEs and financial institutions can create fiscal risks with national implications. The Central Government should require and receive quarterly financial statements and audited year-end statements from these entities, and monitor their performance. Consolidation of information is also important for overview and reporting of the overall fiscal risk faced by the Central Government.
117. In Paraguay, no information on fiscal risks or contingent liabilities, tax expenditures, or quasi-fiscal activities is published or estimated. These risks and liabilities are expected to be significant, and include:
- i) quasi-fiscal costs incurred by the Central Bank in the implementation of monetary policy, bank intervention operations, issuance of guarantees to financial and non-financial public sector institutions;
 - ii) SOEs operations. Although quasi-fiscal activities have been reduced, most SOEs still operate as monopolies, the line separating their commercial and fiscal activities remains unclear, and information is limited;
 - iii) labor-related liabilities accrued by the pension systems of the Central Administration (Caja Fiscal) and those from decentralized agencies.
118. While fiscal reports on these entities are submitted on a monthly basis to the Central Government—with the exception of some SOEs regulated by private-sector laws—the quality of the data is not considered reliable. For example, the financial information sent each year by individual entities to the DGC does not reconcile with information provided by annual reports from these entities, which operate outside SIAF. Moreover, the information is not consolidated.

Overall Rating 9: “C”

| Dimension | Rating |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>Extent of central government monitoring of AGAs and SOEs:</i> Most major AGAs/SOEs submit fiscal reports to central governments at least annually, but a consolidated overview is missing or significantly incomplete. | C |
| <i>Extent of central government monitoring of SN governments' fiscal position:</i> The net fiscal position is monitored at least annually for the most important level of SN government, but a consolidated overview is missing or significantly incomplete. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 0.0% | 66.7% | 33.3% |

Indicator 10: Public access to key fiscal information

119. Transparency of key fiscal information will depend on whether information on fiscal plans, positions and performance of the government is easily accessible to the general public or at least the relevant interest groups. Elements of information to which public access is essential include:

- *Annual budget documentation*: the general public can obtain a complete set of documents through appropriate means, of the budget proposal when it is submitted to the legislature, on the web site of MoF and by press release.
- *In-year budget execution reports*: Since 2006, MoF elaborates a Budget Control and Evaluation Report, published on a half-yearly basis, available to the public through the web page of MoF.⁶⁹
- *Year-end financial statements*: Financial statements corresponding to the Central Government are made available to the public in hard copies within six months of audit completion. The CGR receives the *Informe Financiero* from the Executive before April 30th of the following year, and submit the Audit Report to Congress before October 30th, which is, according to current practices, publicly available since the date of submission.
- *External audit reports*: The reports on central government consolidated operations are included in the audit report of the *Informe Financiero*, which is available within six months of completed audit, as indicated above.
- *Contract awards*: The award of all contracts involving figures equal or above US\$100,000 is published weekly and monthly on the website of the GDPP of the MoF.⁷⁰
- *Resources available to primary service units*: For the cases of Health and Education, information on transfers to primary service units (schools, hospitals, etc.) is only available in aggregate, with the exception of hospitals located at the city of Asunción.

Overall Rating 10: "A"

| Dimension | Rating |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| Number of the above listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met: the government makes available to the public 5-6 of the 6 listed types of information. | A |

⁶⁹ <http://www.hacienda.gov.py>

⁷⁰). This information is available in www.contratacionespublicas.gov.py. This requirement was established by new procurement law (Law 1626/2000).

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 22.2% | 33.3% | 44.4% | 0.0% |

Policy Based Budgeting**Indicator 11: Orderliness and participation in the annual budget process**

120. Effective participation in the annual budget process determines the extent to which the budget reflects fiscal and sectoral policies. This requires an integrated top-down and bottom-up budgeting process, involving central agencies, spending agencies and political leadership⁷¹ in an orderly and timely manner, in accordance with a pre-determined budget formulation calendar. Clear and timely guidance on the budget process should be provided in the budget circular and budget formulation manual.
121. **Existence of and adherence to a fixed budget calendar.** The budget calendar is usually clear and adhered to, and this was the situation verified throughout 2004-2006, except for new foreign-financed investment, which were presented to Congress individually and without a specified calendar. According to Law 1535 of 1999 on Government Financial Administration (LAFE), the calendar begins with the General Budget Directorate (DGP) defining main budgetary guidelines for the following fiscal year. Then, these guidelines are submitted for review to the “Economic Cabinet”,⁷² and by April 30th the Executive issues a budget decree ‘*Decreto de Lineamientos Presupuestarios*’ establishing the guidelines for the preparation of a new Budget Law.
122. According to the LAFE, this would leave sufficient time to line ministries, departments and agencies (MDAs) to formulate their budget estimates by June 30th, date when they have to be submitted to the MoF. The MoF is required to present the Draft Budget Law to Congress by September 1st, and the latter has to approve the new Budget Law by December 20th. Compliance by both MoF and MDAs with this calendar has been high during 2004-2006, with the only exception of Judicial Power entities, which are not subject to it and submit their own budget drafts to the Congress.
123. **Guidance of the preparation of budget submissions.** The budget decree introduces ceilings approved by the Economic Cabinet prior to its distribution to the MDAs.⁷³ While the budget decree does establish clear ceilings, the budgets from ministries and agencies are actually drawn up on a historic basis with two scenarios. The first, called “minimum scenario”, based on the amounts of the “plan financiero”. The second, called “maximum scenario” based on the Budget Law⁷⁴. The substantive

⁷¹ By ‘political leadership’ is meant the leadership of the Executive, such as the Cabinet or equivalent body.

⁷² The Economic Cabinet is composed by the Ministry of Finance, the Central Bank, the Ministry of Industry and Ministry of Agriculture.

⁷³ Treasury revenues are directly limited by the cap established by the MoF in the budget guidelines decree. On the other hand, resources generated by activities of the public entities, particularly decentralized entities, are estimated by them. This final estimate is reached through negotiation with the Ministry of Finance. This may bring an element of uncertainty to budget planning by MDAs, although generally incidence of MoF on entities’ own resources is limited.

⁷⁴ According to Decree N° 7410 / 2006.

impact of the budget circular is thus limited. Once the Ministry of Finance receives the draft institutional budget submissions, it proceeds to analyze them and draws up the final version of the draft budget proposal. During the consolidation process, where the Ministry of Finance consolidates entity budgets prior to submission to Congress, there is little interaction between it and other public entities, reflecting limited participation of the MDAs in the final budget alterations prior to submission to Congress.

124. **Timely budget approval by the legislature.** The legislature has consistently approved the budget in a timely manner before the start of the budget year during 2004-2006.

Overall Rating 11: "A".

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Existence of and adherence to a fixed budget calendar:</i> A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time. | A |
| <i>Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent):</i> A comprehensive and clear budget circular is issued to MDAs, which reflect ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission. | B |
| <i>Timely budget approval by the legislature or similarly mandated body (within the last three years):</i> The legislature has, during the last three years, approved the budget before the start of the fiscal year. | A |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 11.1% | 66.7% | 22.2% | 0.0% |

Indicator 12: Multiyear perspective in fiscal planning, expenditure policy, and budgeting

125. Expenditure policy decisions have multi-year implications and should be aligned with medium-term availability of resources. Multi-year forecasts for revenue and expenditure aggregates and the identification of potential sources of deficit financing are the foundation for a multi-year perspective in budgeting.
126. Multiyear budget planning is at an initial stage in Paraguay. The MoF carried out in 2005 an exercise for 2006-2008 that consisted largely of a forecast of historic trends. Then, a decree (8215/06) was issued in 2006, establishing the processes and methodology for developing multi year budget and considering it as "referential" (i.e. encouraged its use) rather than mandatory.
- *Multiyear fiscal forecast and functional allocations.* Current budgetary procedures involve macroeconomic forecasts for three years covered by the multi-year budget, which has been presented for the first time for the three-year period 2007-2009.⁷⁵ Expenditures and revenues multi-year projections, although presented in disaggregated form by program, function and economic purpose, are obtained using historical averages, and lack the support of robust estimations about the future evolution of the main macroeconomic variables.⁷⁶ Finally, linking the investment

⁷⁵ Decree 8770 of 2006.

⁷⁶ Expenditure projections are based upon current-year budgeted figures; as seen in PI-1, evidence from 2004-2006 indicates that these cannot be considered as an accurate measure of expenditure outturn.

budget to public policy is still challenging in Paraguay, since a significant share of investment—near 50%—is undertaken with external financing funds.

- *Scope and frequency of debt sustainability analysis (DSA).* DSA exercises are carried out on an ad-hoc basis,⁷⁷ and cover the external and domestic debt of the Central Administration only. No clear links were observed during the period under study between the DSA and the formulations of economic policy.⁷⁸
- *Existence of costed sector strategies.* General strategies and sector priorities of the administration are expressed in quarterly strategic documents. These priorities are not clearly based on costed expenditures and generally do not include measurable objectives. Some social ministries, notably the Ministry of Education, are making progress in the preparation of multi-year sector strategies, although multi-year costing is still the exception rather than the norm. The MoF currently conducts expenditures forecasts based on historic trends with few links to sector strategies, although some prioritization of key government objectives (e.g. the Social Cabinet coordinates and prioritizes social expenditures that fall under the umbrella of the poverty reduction program) is being made.
- *Linkages between investment budgets and forward expenditures estimates.* The Secretariat of Planning (STP) works jointly with various line ministries to help sector strategies becoming into Annual Investment Plans (AIP). This has been done so far only on an annual basis, and the link between the AIP and the annual budget is weak and not always based on sector strategies. Also, recurrent cost implications are not generally considered in annual budgets, much less in multi-year ones, although this is gradually changing in some areas such as Education and Public Works. Efforts are underway between the MoF and STP to strengthen the coordination between the budget and sector strategies.

Overall Rating 12: “D+”

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Preparation of multi -year fiscal forecasts and functional allocations:</i> Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis. | C |
| <i>Scope and frequency of debt sustainability analysis:</i> A DSA for external debt undertaken at least once during last three years. | C |
| <i>Existence of sector strategies with multi-year costing of recurrent and investment expenditure:</i> Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure. | D |
| <i>Linkages between investment budgets and forward expenditure estimates:</i> Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared. | D |

⁷⁷ Two different exercises of DSA were undertaken in year 2005. One was coordinated by the Fiscal Policy Directorate of the Sub-secretariat of Economics and Integration (SEEI), and the other by the DGCDP, depending from the Sub-secretariat of Financial Administration (SSEAF).

⁷⁸ It should be noted that the DGCDP developed in 2006 a fiscal sustainability model as an exercise for the analysis of public debt, which seeks to cover the Central Administration, and pretends to extend the analysis to the whole Non-Financial Public Sector. The DGCDP recognizes the necessity to establish a normative and methodological basis enabling the optimization of a fiscal sustainability model for a medium and long run horizon, and it is now promoting several measures with that objective; for example, by ruling an Annual Strategy for Public Debt.

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 11.1% | 33.3% | 55.6% |

Predictability and Control in Budget Execution

127. The next three indicators are related to the transparency, effectiveness, and efficiency of Paraguay's Revenue Administration System (RAS). When considering indicator ratings below, it should be kept in mind that Paraguay shows a historical record of low tax burden compared to regional standards, and it is currently in a transition period towards achieving greater transparency and efficiency of its RAS. The introduction in 2004 of a new tax code (*Ley 2421 de Reordenamiento Administrativo y de Adecuación Fiscal*) and a new customs code (Law 2422), was aimed to build up a modern and more comprehensive tax legal framework. However, as it explained below, the implementation of some changes has been slower than expected.

Indicator 13: Transparency of Taxpayer Obligations and Liabilities

128. Taxpayers' contribution to ensuring compliance with tax policy is encouraged and facilitated by a high degree of transparency of tax liabilities, including clarity of legislation and administrative procedures; access to information in this regard; and ability to appeal administrative rulings on tax liability.

129. **Clarity and comprehensiveness of tax liabilities.** Concise and easily accessible tax laws are critical if tax policy is to be effectively implemented. By the end of 2006, there were seven internal taxes administered by the State Secretariat of Taxes (SET)⁷⁹ and two taxes administered by the Customs Administration (DNA)⁸⁰. Trade taxes —levied on imports only— represent about one half of total tax revenue.⁸¹ Some major taxes are not applied uniformly —e.g., discretionary treatments for VAT and Income Tax, or considerable tax exemptions, which were partly eliminated since 2006 as a result of the introduction of the new tax legal framework (Law 2421)— and the discretionary powers of government entities involved is moderate.⁸² Besides, changes brought by Law 2421 may have affected the clarity of the process along the transition period.⁸³

130. **Taxpayers' access to information on tax liabilities and administrative procedures.** Taxpayer education is an important part of facilitating taxpayer

⁷⁹ The implementation of a personal income tax, introduced by the new Tax Law in 2004, was suspended until year 2007. In that year, the Congress decided to suspend again the treatment of this tax until 2009.

⁸⁰ Customs fee and "*Impuesto Preferencial sobre Zona Franca*".

⁸¹ There is also a customs fee on imports, representing around 15% of total tax revenues.

⁸² Taxes levied on different sectors of the Paraguayan economy may not always respond to well-defined criteria. For example, the sector of transportation is still benefited by preferential (lower) rates for VAT and corporate income tax, despite of these privileges being cancelled by Law 2421 of 2004. There were also cases of temporary tax surcharges applied during the period of analysis, e.g., on agricultural exports (Decree 1836 of 2004, derogated by Decree 6275 of 2005). Finally, evidence on tax exemptions shows a wide dispersion from year to year. According to consolidated data from the Large Taxpayer Unit (LTU) and the General Revenue Collection Agency (DGR) tax expenditures of 2005 were almost four times those of 2006.

⁸³ For example, the elimination of the previous "single tax" and its replacement by the income tax for small taxpayers, which has not been yet instrumented until mid-2007.

compliance with registration, declaration and payment procedures. Actual and potential taxpayers need easy access to user friendly, comprehensive and up-to-date information on the laws, regulations and procedures (e.g. posted on government websites, made available through taxpayer seminars, widely distributed guidelines/pamphlets and other taxpayer education measures).

131. Paraguay is a country with a large informal economy and where the efficacy of tax-education campaigns is limited by the lack of a “culture” for tax compliance. Before the approval of Law 2421 in 2004, there were no systematic initiatives for disseminating tax information. In recent years, some progress has been accomplished in this sense as a result of government efforts to improve the accessibility and understandability of the new tax code.⁸⁴ However, the coverage of the tax guides, public rulings, education campaigns, and administrative procedures is still far from complete, partly because new taxes are still being implemented and the procedures are still being developed. Besides, access to relevant tax information is sometimes blocked by country-specific constraints.⁸⁵
132. Trade taxes are clearly defined by the new customs code, and information on administrative procedures is accessible on-line. However, the DNA is not implementing campaigns for tax education purposes, although informal trade is widespread in Paraguay.
133. **Tax appeals mechanism.** Taxpayers’ ability to contest decisions and assessment made by the revenue administration requires the existence of an effective complaints/appeals mechanism that guarantees the taxpayer a fair treatment. The assessment of the tax appeals mechanism should reflect the existence in practice of such a system ensuring its independence in terms of organizational structure, appointments and finance, its powers in terms of having its decisions acted upon as well as its functionality in terms of access (number and size of cases), efficiency (case processing periods), and fairness (balance in verdicts).
134. The process of appealing internal tax administrative procedures in Paraguay involves the Legal Advisory of the State Secretariat of Taxes (SET) and the Treasury Legal Office. Disputes on external taxes are managed by the DNA Department of Norms and Procedures. When disputes are not resolved by any of these institutions, they are elevated to the Court of Accounts.
135. The DNA keeps a record on the amounts claimed by disputes over the last two years, but there is no record kept —by the SET or the DNA— on the number of tax appeals, processing periods, and verdicts.

⁸⁴ For example, the SET has organized seminars and conferences, distributed pamphlets and used advertising to promote the changes introduced by Law 2421 throughout the country.

⁸⁵ For example, the SET offers a website with basic legislation (www.set.gov.py) and a call center for assisting tax-payers, although the effectiveness of these tools remains poor due to several reasons: i) tax-payers residing close to Asuncion are used to attend to the SET for consultation, and those from remote areas usually do not receive any kind of assistance and information; ii) information provided by SET website is not properly updated and it is addressed only to major tax-payer categories; and iii) access to electronic information is quite limited throughout the country (estimated by SET in less than 1% of actual and potential taxpayers).

Overall Rating 13: “C+”

| Dimension | Rating |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Clarity and comprehensiveness of tax liabilities:</i> Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved. | B |
| <i>Taxpayer access to information on tax liabilities and administrative procedures:</i> Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due to coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date. | C |
| <i>Existence and functioning of a tax appeals mechanism:</i> A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent and effective. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 11.1% | 33.3% | 33.3% | 22.2% |

Indicator 14: Effectiveness of measures for taxpayer registration and tax assessment.

136. Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers. The PEFA methodology uses three dimensions to assess this.
137. **Controls in the taxpayer registration system.** Paraguay uses a “Single Taxpayer Registry” that accounts for around 300,000 taxpayers.⁸⁶ The SET is currently working on updating and increasing the coverage of this database. There are no well-established linkages between these tax registries and other government registration systems (e.g. issue of business licenses, opening of bank accounts).
138. **Effectiveness of penalties for non-compliance with registration and tax declaration.** Law 2421 introduced tax compliance enforcement powers, including periodic random audits of taxpayers from different categories, specific audits ordered by the SET in cases where gross irregularities are detected, and the requirement of a satisfactory opinion from an annual external audit (ruled by the SET) for taxpayers with annual gross revenues above G\$6 billion. Sanctions are also well specified by the Law.
139. Also, the new customs code contemplates both disciplinary sanctions for public servants whose behavior departs from code-established procedures (ranging from five to ten minimum salaries), and several types of penalties, such as pecuniary sanctions, seizure of merchandize, or administrative measures, for cases of smuggling, fraud, or other type of non compliance with customs norms.⁸⁷
140. Notwithstanding the observed recent progress in legislation for tax and customs administrations, enforcement capacity needs to be further developed to revert the current situation of significant non-compliance.⁸⁸
141. **Planning and monitoring of tax audit programs.** The ability of the RAS to identify and investigate important cases of evasion and fraud, and also to promote the

⁸⁶ About one half of these taxpayers do not submit tax forms; they are charged with the “single tax” and represent only 1% of total tax revenue.

⁸⁷ Law 2422, Title XII, Chapters 1 to 4.

⁸⁸ There are no current studies available providing an estimation of informal economic activities and tax evasion in Paraguay. In 2007 the SET started a study for the estimation of evasion of VAT financed by USAID (Umbral-Paraguay Program).

corresponding prosecutions in a regular and effective way, is essential for ensuring that taxpayers comply with their obligations. Modern RAS rely increasingly on tax self-assessment and use risk targeted based auditing of taxpayers as a key activity to improve compliance and deter tax evasion. In Paraguay, the implementation of tax audits and fraud investigations remain at a preliminary stage.⁸⁹ Also, they are not applied systematically, and with the exception of newly introduced practices by the DNA, they are not based on clear risk assessment criteria.

Overall Rating 14: C

| Dimension | Rating |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Controls in the taxpayer registration system:</i> Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. | C |
| <i>Effectiveness of penalties for non-compliance with registration and tax declaration:</i> Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance. | C |
| <i>Planning and monitoring of tax audit programs:</i> There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 12.5% | 62.5% | 25.0% |

Indicator 15: Effectiveness in collection of tax payments.

142. **Collection ratio for gross tax arrears.** The main emphasis of the tax and customs administration reforms has been to develop the capacity and processes to collect current tax liabilities, but little effort has been made to collect tax arrears from previous years. Two main factors explain this situation. First, arrears are intrinsically low in Paraguay, because its tax system is based almost exclusively on self-assessment.⁹⁰ Second, since tax debts prescribe in 5 years and the RAS is slow in notifying taxpayers of arrears, there is an incentive to skip due tax payments from the past.⁹¹

143. **Effectiveness of transfers of tax collections to the Treasury.** There are three main tax collecting agencies in Paraguay.⁹² All of them deposit collected cash funds on a daily-basis in Treasury accounts held at the BCP. The SET started in 2006 a registry of taxes cancelled by using alternative means of payments (credit certificates and bonds), although these are the exception rather than the rule.

⁸⁹ One procedure to detect fraud used by the LTU is named "COA" (Control of Auto-declared Operations) and consists on a crosscheck between information provided electronically each month by suppliers and information on sales and gross revenue provided by firms using these supplies. Payments collected through the application of COA for cases of fraud, other minor infractions, and omissions, represented only 2,0% and 2,2% of total audited cases in 2005 and 2006, respectively.

⁹⁰ Then, arrears are limited to those cases where the taxpayer claims to the Administration for a prorated payment of its tax obligations, and then fails to pay on due time. An exceptional case of a tax not based on self-assessment was the temporary tax on vehicles (currently derogated, applied in 2005 and 2006 only). Still, the base for this tax was limited to cases of registered car sales or imports during these two years.

⁹¹ New computing-based systems developed currently at the SET are expected to reduce these delays.

⁹² Large Taxpayer Unit (LTU), the General Revenue Collection Agency (DGR), and the Customs Administration (DNA).

144. **Frequency of complete accounts reconciliation.** None of RAS's main agencies perform a periodic reconciliation of tax assessments, collections, arrears, and transfers to the Treasury. However, the SET performs through its Department of Tax Studies and Statistics reconciliations on tax assessments and collections. According to this information, tax collections were underestimated by 0,1% and 7,0% in 2005 and 2006, respectively.

Overall Rating 15: D+

| Dimension | Rating |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Collection ratio for gross tax arrears:</i> the total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections). | A |
| <i>Effectiveness of transfers of tax collections to the Treasury:</i> All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily. | A |
| <i>Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury:</i> Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually. | D |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 11.1% | 33.3% | 55.6% |

Indicator 16: Predictability in the availability of funds for commitment of expenditures

145. The effective execution of the budget requires that MDAs receive reliable information on availability of funds to commit expenditures. This indicator assesses the extent to which the MoF provides reliable information on the availability of funds to MDAs which manage the main administrative areas—or programs—of the Central Government Budget, and therefore are the primary recipients of such information.
146. Financial and cash planning of Paraguay's Central Government budget execution are coordinated by the General Directorate of Budget (DGP) and the General Directorate of Public Treasury (DGT). The Financial Plan—prepared by each MDA and consolidated by the DGP—determines MDAs monthly allocations for the new fiscal exercise on the basis of the approved budget and its revenue forecasts.⁹³ Then, the Cash Plan elaborated by the Treasury ultimately determines MDAs' monthly payment limits. The Cash Plan is based on available cash resources, and programmed quarterly with monthly quotas of expenses that cannot exceed the Financial Plan allocations.⁹⁴ The Cash Plan preserves fiscal discipline, but it presented rigidities up to year 2006—in particular, allocations not executed during the current quarter were lost by MDAs unless a special request was made to the MoF for transferring them to the next quarter. To mitigate this rigidity, the 2007 Cash Plan authorized the automatic transfer of non-executed funds to the next month throughout the fiscal year, but applying a reduction of 20% of transferred non-executed funds.
147. Central Administration MDAs' payments and transfers are executed by the Treasury according to the Cash Plan and availability of resources. Until year 2006, the Treasury transferred funds to MDA accounts located at state-owned bank 'Banco Nacional de Fomento' for the execution of all their payments, except for wages,

⁹³ In recent years, the Financial Plan helped on maintaining fiscal discipline by adjusting budget changes introduced by the Congress to revenue forecasts.

⁹⁴ As required by the LAFE.

which were paid directly by the Treasury to civil servants' bank accounts.⁹⁵ Since 2007, all Central Administration payments are directly executed from the Treasury.⁹⁶ The implementation of this new procedure, known as 'direct payment', improved the efficiency and the control of payments through the reduction of the number of government active bank accounts.⁹⁷ For decentralized entities financed through Treasury resources,⁹⁸ Treasury is still making transfers to their MDAs bank accounts.

148. Adjustments to budget allocations can be made: *by Law*, in cases where there is an increase in total budgeted expenditures or a reallocation of expenditures among MDAs; *by Presidential Decree*, in cases of expenditure reallocations within the same MDA; or *by a MoF resolution*, in cases of expenditure reallocations within the same program. During the period 2004-06, there was on average 574 of these adjustments per year. Adjustments generating an increase of total budgeted expenditures are normally submitted twice a year, by the end of the first and the second quarter, and in cases of emergency. The other adjustments to budget allocations, variations between functions or category of expenditures are more frequent and require an approval of MOF or Presidency, depending on the level of budget detail.

Overall Rating 16: C+

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Extent to which cash flows are forecast and monitored:</i> A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows. | A |
| <i>Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment:</i> MDAs' are able to plan and commit expenditure for at least six month in advance in accordance with the budgeted appropriations. | A |
| <i>Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs:</i> Significant in-year budget adjustments are frequent, but undertaken with some transparency. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 0.0% | 55.6% | 44.4% |

Indicator 17: Recording and management of cash balances, debt and guarantees

149. **Quality of debt data recording and reporting.** The maintenance of a debt data system and regular reporting on main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt service budgeting, timely service payments, and well planned debt roll-over.
150. More than 60% of 2006 stock of Central Administration debt outstanding in Paraguay consisted of external loans made by official creditors. The registration of these loans and other types of sovereign debt such as domestic and external bonds, is made through SIGADE, a well-known software developed by the United Nations Conference on Trade and Development (UNCTAD) used for debt recording and management by several middle and low income countries.

⁹⁵ Main Treasury bank accounts are located at the Central Bank.

⁹⁶ A system of individual debit cards has also been implemented through the 'Banco Nacional de Fomento' and a commercial bank ('Interbank') for the payment of civil servants wages.

⁹⁷ Direct payment procedures are planned to be expanded in the medium term to Departmental Governments.

⁹⁸ As well as for Municipalities.

151. SIGADE, which is managed by the DGCDP from MoF, allows for public debt classification, recording and monitoring, and worked in an efficient, timely and transparent manner over the period 2004-2006 in Paraguay. All Central Administration domestic and foreign debt commitments are recorded using SIGADE, and then processed periodically for the compilation of debt indicators, which are published and posted periodically on the Internet.
152. However, the quality and updating frequency of debt information is usually lower for the case of domestic debt —typically short-term Treasury bonds issued to commercial banks—, and SIGADE does not provide a good account on the debt of the Central Government —for instance, the debt from bi-national hydroelectric plants, which is estimated around US\$ 200 million, is not considered as ‘regular debt’ for registration purposes.⁹⁹ Although SIGADE is used as tool for inputting estimates and projections concerning next fiscal year borrowing requirements and debt-servicing needs to the draft budget law, it remains disconnected from SIAF for the loading of debt expenditure (debt servicing) and resources obtained through the financing (authorized borrowing) after the Congress’ approval of the Budget.
153. **Extent of consolidation of the government’s cash balances.** Although the treasury function in Paraguay does not include a TSA, the Treasury properly controls cash balances. Also, recently introduced changes, such as the ‘direct payment’ procedure,¹⁰⁰ are significantly improving the quality and frequency of cash balance consolidations.
154. Within the scope of the Central Administration, the Treasury opens both its own and MDAs’ bank accounts; it also monitors the latter, and manages the former. Treasury direct bank accounts are usually located at the Central Bank and their cash balances are calculated and consolidated daily, while MDAs bank accounts are located at the state-owned bank *Banco Nacional del Fomento*, which provide daily banking statements to the Treasury on request. Decentralized entities and Municipalities manage their own bank accounts, but this does not affect cash management of Central Government transfers, as the Treasury exerts a strict control upon them.
155. The introduction of ‘direct payment’ in 2007 is planned to reduce the number of Central Administration MDAs bank accounts from (current) 40 to 17 by the end of 2008,¹⁰¹ and the proportion of resources they represent down to 10 percent of Central Administration cash balances. However, Central Administration MDAs will maintain other active bank accounts¹⁰² for specific purposes, such as the management of IFIs funded operations.
156. Although required legal changes may delay the adoption of a TSA, the consolidation of cash balances is reliable, efficient, and provides the technical conditions to easily implement a TSA, provided the existence of a favorable political context.

⁹⁹ Municipal debt is also not recorded by SIGADE or any other central or local official registration systems. There are 10 “large sized” municipalities currently issuing their own debt instruments in Paraguay, including Asuncion, Ciudad del Este, and Villa Elisa.

¹⁰⁰ See Indicator 16 for details.

¹⁰¹ These 17 bank accounts will serve for payments of relatively small amounts.

¹⁰² The Treasury opens and monitor these accounts as described in the previous paragraph.

157. **Systems for contracting loans and issuance of guarantees.** Since the approval of the Organic Law of the MoF (Law 109 of 1991), which was ratified by the LAFE in 1999, the MoF monopolizes the activities of loan contracting and issuance of guarantees. Considering that most of Paraguay's sovereign debt consists in external loans, this institutional arrangement acts effectively as a barrier for debt mismanagement.

Overall Rating 17:B+

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Quality of debt data recording and reporting:</i> Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually. | B |
| <i>Extent of consolidation of the government's cash balances:</i> Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement. | B |
| <i>Systems for contracting loans and issuance of guarantees:</i> Central government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity. | A |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 62.5% | 37.5% | 0.0% |

Indicator 18: Effectiveness of payroll controls

158. The wage bill represents a substantial proportion of Paraguay's budgeted expenditures (33% in year 2006).¹⁰³ Its control effectiveness depends on the level of integration and reconciliation between payroll data and personnel records, and on the level of internal control and timeliness on changes to personnel records and payroll.
159. **Degree of integration and reconciliation between personnel records and payroll data.** The Treasury pays wages directly to civil servants bank accounts each month, based on MDAs global payment requests. The treasury component of the SIAF is linked to the Government human resources management system (SINARH). This allows the Treasury accessing to SINARH recording of civil servant identification, ranking and salary basis, preventing double-payments and assuring allocation to the correct budget line. However, MDAs payroll calculations cannot be controlled by the Treasury prior to paying wages. Actually, MDAs use their own calculation systems, which are de-linked to the SIAF, as the SINARH module for payroll calculation is not yet developed. However, the resulting risk of miscalculation is globally mitigated through cash ceilings, which limit payroll to total budgeted figures.
160. **Timeliness of change to personnel records and the payroll.** The annual budget law includes an annex stipulating detailed personnel structure and salary categories for each MDA. The SINARH incorporates, on a timely basis, potential changes reflected in the budget law, which is a necessary condition for proceeding with payments by the Treasury, thus preventing the authorization of outdated payments.

¹⁰³ Corresponds to personal services of Central Administration payroll only (sub-groups 110, 130 and 160 of budget classification), excluded contracted personnel and consolidated transfers to Decentralized Entities for salary payments (sub-group 800).

161. **Internal controls of changes to personnel records and the payroll.** Internal control of changes of personnel records is ensured through both the above-mentioned control of Treasury, and the required compliance with budget limits and personnel annex.¹⁰⁴ Conversely, the control framework for payroll calculation is limited and there are no means to detect over-payments within budgeted allocations prior to the audit of the payroll. Besides, due to the weak control environment of the public sector in Paraguay, there is a significant risk that MDAs payroll calculation is not consistent with number of days worked by civil servants.
162. **Existence of payroll audit.** CGR audit plan includes payroll as a priority and its annual audit activities cover the equivalent of 70 percent of public sector expenditures. Therefore, it can be estimated that a payroll audit has been executed for all government entities over the period 2004-2006.

Overall Rating 18: D+

| Dimension | Rating |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Degree of integration and reconciliation between personnel records and payroll data:</i> Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database. | D |
| <i>Timeliness of changes to personnel records and the payroll:</i> Required changes to the personnel records and payroll are updated monthly, generally in time for the following month's payments. Retroactive adjustments are rare. | A |
| <i>Internal controls of changes to personnel records and the payroll:</i> Controls exist, but are not adequate to ensure full integrity of data. | C |
| <i>Existence of payroll audits to identify control weaknesses and/or ghost workers:</i> Partial payroll audits or staff surveys have been undertaken within the last 3 years. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 0.0% | 50.0% | 50.0% |

Indicator 19: Competition, value for money and controls in procurement

163. A well-functioning procurement system ensures that money is used effectively and efficiently. It also impacts on PFM performance and interrelates with the quality of the control environment. In Paraguay, 25% of public expenditure takes place through the public procurement system.¹⁰⁵ The assessment of this indicator is based on the recently completed Country Procurement Assessment Report (CPAR) for Paraguay.¹⁰⁶
164. **Use of open competition for award of contracts exceeding threshold for small purchases.** There is accurate data on the method used to award public contracts, which shows that more than 75% of contracts above the threshold are awarded on the basis of open competition. The procurement information system — assessed as reliable by the 2007 CPAR— reveals that 88 percent of contracts awarded in 2006 resulted from an open competitive process.
165. **Justification for use of less competitive procurement methods.** Regulations establish the exceptional conditions under which competitive procurement may not be used. Less competitive methods, when used, are justified in accordance with

¹⁰⁴ The Annual Budget Law includes an annex detailing, for each MDA, the number of positions per category and their related salary basis.

¹⁰⁵ As cited in the procurement portal and accounting reports from the Central Administration.

¹⁰⁶ See details in Chapter 4.

regulatory requirements, but the Government acknowledges the need to refine the definition of these requirements, as well as the way by which operations under exceptional conditions is recorded by the Procurement Information System.

166. **Existence and operation of a procurement complaints mechanism.** There exists a mechanism for submitting and addressing procurement process complaints, but it lacks the ability to refer the resolution of the complaint to an external higher authority. The legal framework establishes the right of those participating in procurement processes and third parties to challenge the decisions made by the procurement entities by filing a complaint before the Procurement Regulatory Body. However, this Body is part of MOF, and therefore not independent from main procurement entities.

Overall Rating 19: B+

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Use of open competition for award of contracts exceeding threshold for small purchases:</i> Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition. | A |
| <i>Justification for use of less competitive procurement methods:</i> Other less competitive methods when used are justified in accordance with legal and regulatory requirements. | B |
| <i>Existence and operation of a procurement complaints mechanism:</i> A process for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority. | B |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 25.0% | 50.0% | 25.0% |

Indicator 20: Effectiveness of internal controls for non-salary expenditure

167. **Effectiveness of expenditure commitment controls.** According to the LAFE, accounting records do not foresee a commitment stage. Since year 2005 the budget law's commitment stage is included in budget accounting for the categories of expenditures identified in the Table 3.5 below, which represented 24.7 per cent of Central Administration total expenditures in year 2006. The registration of the commitment stage is made by means of the information coming from the Country Procurement System's portal.

Table 3.5: Committed Expenditure Categories used in Paraguay's Budget Accounting – Year 2006

| Budget Category | Committed Budget (billion of G\$) | % of Total |
|-----------------------|--------------------------------------|------------|
| Non-Personal Services | 439.2 | 3.64 |
| Consumption Goods | 618.5 | 5.13 |
| Tradable Goods | 26.7 | 0.22 |
| Real Investment | 1819.7 | 15.7 |

Source: MoF – General Directorate of Accounting

168. **Internal Control.** The LAFE and related secondary legislation foresee that internal control on expenditures on goods and services is to be carried out by each MDA through their own internal control procedures and those incorporated in the SIAF and the Procurement System, which involve the stages of expense commitment and authorization, payment execution, and budget and accounting recording. However, internal control related to quality and quantity of goods and services delivered is merely formal in practice, and relies exclusively on MDA systems. This

is compounded by the absence of a norm enabling the implementation of the Integrated Goods and Services System (SIABYS) and the lack of integration between systems composing the Integrated System of Administration of Estate Resources (SIARE).¹⁰⁷ The resulting lack of integration, the limited internal control capacity of MDAs, and the weak control environment of Paraguay public sector, negatively affect the effectiveness of internal control framework.

Overall Rating 20: D+

| Dimension | Rating |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Effectiveness of expenditure commitment controls:</i> Expenditure commitment control procedures exist and are partially effective, but they do not comprehensively cover all expenditures. | C |
| <i>Comprehensiveness, relevance and understanding of other internal control rules/ procedures:</i> Clear, comprehensive and reliable control rules/procedures are lacking in other important areas. | D |
| <i>Degree of compliance with rules for processing and recording transactions:</i> Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 0.0% | 66.7% | 33.3% |

Indicator 21: Effectiveness of Internal Audit

169. Internal audit has already been identified by the recommendations of both Paraguay's 2004 CFAA and IMF 2006 Report on Budget Preparation and Expenditure Control as one of the major challenges in the improvement process of Paraguay PFM. The LAFE and Decree 1249/03 establish that the internal audit function of the Government should be based on (i) the General Audit of the Executive Power (AGPE), depending on the Presidency; and (ii) the Institutional Internal Audits (AIIs) attached to each MDA. AGPE is responsible for technical and regulatory aspects of Government internal audit and AIIs coordination and organization of their work plans.

170. AGPE's current institutional capacities are not sufficient for allowing the effective achievement of its duties. On one hand, it was insufficiently staffed during the period under study—with fifteen people, out of which only four were career civil servants.¹⁰⁸ On the other hand, except for the Head position, its regulatory framework does not require a college degree or proved years of relevant experience for recruiting its staff members, and it counts with no human resources management or training systems. To date, the AGPE faces challenges ahead in terms of planning its institutional development, providing leadership to AIIs, and reinforcing its working cooperation with the Comptroller General of the Republic (CGR).

171. The other components of the internal audit system, the AIIs, are similarly affected by organizational and human resources issues. They are insufficiently staffed and staff background is not always adequate. In addition, staff recruitment procedures

¹⁰⁷ The SIARE includes the SIAF, the SINARH and the SIABYS. However, the latter still lacks a legal framework, indispensable for the reinforcement of the existing procurement system.

¹⁰⁸ In 2007, AGPE had a staff of twenty-four people, with eleven career civil servants, which was still insufficient.

are not based on a competitive process, and job requirements are not properly defined. Once staff is recruited, there is little in the way of career plans or structured training systems. Finally, AIIs' staff recruitment is under the exclusive responsibility of MDA management, which affects internal auditors' professional independence. Considering the weak control environment of Paraguay public sector, the above-mentioned issues exert a significant impact on internal audit, which cannot be considered as effective.

172. **Internal Audit norms & scope.** Internal audit manuals and norms are not standardized nor in line with international standards.¹⁰⁹ Paraguay's public sector internal audits are ex-post and their scope include financial and performance audit. Although audit planning is required to be prepared by each AII under the coordination of AGPE, in practice, the lack of independence of AIIs and the limited capacity of AGPE appear as impediments for achieving an effective planning. Indeed, audit delays may be substantial (beyond one year).

173. **Internal Audit Reports and Management response to internal audit findings.** As legally required, AIIs prepare an annual report and submit it to their MDA highest management and AGPE; in turn, the AGPE submits an annual report to the President of the Republic. However, the impact of these reports is limited in practice, partly due to the absence of formal procedures for addressing internal audit findings, and partly to the absence of a legally defined sanctions regime associated to detected irregularities.¹¹⁰ Repetitive findings on non-updated inventories and lack of enforcement of basic procurement rules illustrate this ineffectiveness.

174. Both USAID and IDB are currently implementing programs to strengthen public sector internal audit in Paraguay. The IDB program is mainly focused on developing a human resource training system for the AGPE, while the USAID program addresses, on the one hand, AGPE's institutional development;¹¹¹ and on the other, the harmonization and improvement of internal control and internal audit training for several public entities, including the ministries of Agriculture, Education, Finance, Health, and Public Works.¹¹²

Overall Rating 21: D+

| Dimension | Rating |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Coverage and quality of the internal audit function:</i> There is little or no internal audit focused on systems monitoring. | D |
| <i>Frequency and distribution of reports:</i> Reports are issued regularly for most government entities, but may not be submitted to the ministry of finance and the Supreme Audit Institution (SAI)—CGR in the case of Paraguay. | C |
| <i>Extent of management response to internal audit findings:</i> Internal audit recommendations are usually ignored (with few exceptions). | D |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 0.0% | 44.4% | 55.6% |

¹⁰⁹ For instance, an audit risk approach has not yet been developed.

¹¹⁰ Although Law 1626 provides a classification of irregularities, there is no sanction regime associated to them.

¹¹¹ Program activities include the strengthening of strategic planning and organization, the promotion of the Auditor General to the rank of minister, and infrastructure-related support.

¹¹² The USAID program is actually wider in scope, and covers other activities supporting governance and transparency.

Accounting, Recording and Reporting

Indicator 22: Timeliness and regularity of accounts' reconciliation

175. Treasury's own bank accounts are reconciled daily, and the reconciliation of Central Government MDAs' bank accounts is provided to the DGC on a monthly basis. However, for the case of the latter, the control effectiveness is limited due to poor justification of differences between bank and accounting statements, and to delays in clarifying and solving them.

176. Advances, i.e. cash payment from which no expenditures have yet been recorded, are authorized only for petty cash and revolving funds, and, since year 2007, also for projects managed by IFIs.¹¹³ Monthly reporting of these advances is provided timely to the Treasury and, in the case of advances to IFIs, to the corresponding MDA's Administrative and Financial Directorate.

Overall Rating 22: C+

| Dimension | Rating |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Regularity of bank reconciliations:</i> Bank reconciliation for all Treasury managed bank accounts take place quarterly, usually within 8 weeks of end of quarter. | C |
| <i>Regularity of reconciliation and clearance of suspense accounts and advances:</i> Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward. | A |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 37.5% | 62.5% | 0.0% |

Indicator 23: Availability of information on resources received by service delivery units

177. Within Paraguay's context of deficient public sector control environment and framework, the availability of information on resources received by front-line service delivery units, such as schools and health clinics, is critical to ensure that resources are used for their intended purposes and that these units do not suffer from unreasonable delays or reallocations.

178. Financial statements from the Ministry of Health indicate resources transferred to each hospital located at the City of Asuncion—representing one third of the total country's population.¹¹⁴ However, this information is available only aggregated at the level of 'sanitary regions' for all 17 Departments. Since the Ministry manages contracts and payments centrally, hospitals receive the resources in kind. Information from the Ministry of Education is available only aggregated by major categories, such as 'primary school' or 'secondary school'.

Overall Rating 23: C

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics):</i> Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country. | C |

¹¹³ Civil work advance payments are directly recorded as expenses.

¹¹⁴ Information on resources transferred to the National Hospital of Itaguá is also available.

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 11.1% | 55.6% | 33.3% |

Indicator 24: Quality and timeliness of in-year budgetary reports

179. **Scope of reports in terms of coverage and compatibility with budget estimates.** Budget and accounting classifications are the same and are incorporated to the SIAF, which integrates budget and accounting functions. Expenditure is registered at commitment, accrual and payment stages. However, reporting of committed expenditures is limited to those requiring a procurement process such as ‘good and services’, and ‘public investment’.¹¹⁵
180. **Timeliness of the issue of the report.** Budget execution reports and accounts’ balances are prepared monthly by all Government MDAs and reported to the DGC within 15 days after the end of each month, as legally required. Timely compliance is good, since MDAs can be penalized by transfer cuts in cases of delay.¹¹⁶
181. **Quality of information.** Budget execution is recorded through the accounting module of SIAF, following national accounting standards. However, the reliability of accounting records is affected by insufficient internal control on quality and quantity of goods and services delivered,¹¹⁷ and by incomplete information on Central Government fixed assets.¹¹⁸ In particular, the reliability of real estate accounts is negatively affected by the irregular existence of corresponding certificates of ownership, and the inaccuracy of appraisals.

Overall Rating 24: C+

| Dimension | Rating |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Scope of reports in terms of coverage and compatibility with budget estimates:</i> Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages. | A |
| <i>Timeliness of the issue of reports:</i> Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period. | A |
| <i>Quality of information:</i> There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 0.0% | 100.0% | 0.0% |

¹¹⁵ Refer to Indicator 20.

¹¹⁶ In contrast, municipalities are required to report quarterly, and their level of compliance is lower. Due to this situation, the MoF is planning to link systematically Treasury transfers to the timely issuance of municipal reports, starting at year 2008.

¹¹⁷ Refer to indicator 20.

¹¹⁸ Covering only 53 percent of total assets of the Central Administration, as reported in 2006 Government consolidated financial statements, MoF.

Indicator 25: Quality and timeliness of annual financial statements

182. **Completeness of financial statement.** Since year 2006, public sector financial statements consolidate the Central Government accounts with those from the Municipalities. Consolidation procedure and presentation of financial statements are in line with international public accounting standards (IPSAs # 1 & 6).¹¹⁹
183. **Timeliness of submission of the financial statements.** The DGC complies with the timely requirements of submission of financial statements to the CGR, which receives financial statements no later than April 30th following the closing of each fiscal year.
184. **Accounting standards used.** Government financial statements are based on accounting norms described by the annual MoF resolution on preparation of financial statements and by specific notes attached to financial statements. However, there are no specific legally established public accounting standards in Paraguay.

Overall Rating 25: C+

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Completeness of the financial statement:</i> A consolidated government statement is prepared annually and includes, with few exceptions, full information on revenue, expenditure and financial assets/liabilities. | B |
| <i>Timeliness of submission of the financial statements:</i> The statement is submitted for external audit within 6 months of the end of the fiscal year. | A |
| <i>Accounting standards used:</i> Statements are presented in consistent format over time with some disclosure of accounting standards. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 12.5% | 75.0% | 12.5% |

External Scrutiny and Audit**Indicator 26: Scope, nature, and follow-up of external audit**

185. The CGR is assigned the responsibility of public sector external control in Paraguay by its organic Law (276) and by the National Constitution. The former also grants financial and institutional independence to the CGR, which over the period 2004-2006 strengthened its professional and institutional capacity and implemented its 2003-2007 Strategic Plan.
186. **Scope of audit performed.** All public sector resources and expenditures come under the purview of CGR at both central and sub-national levels, including public financial institutions. CGR annual audit activities cover the equivalent of 70 percent of public sector expenditures. Although CGR audit is still mainly focus on financial aspects, the institution has strengthened its internal standards and work methodologies in recent years through the development of an audit manual and a code of ethic, internal rules for auditors, reporting norms, and planning guidelines. Also, risk has been introduced as a determinant factor of audit planning, leading to a focus on areas such as registration and inventory of fixed assets, payroll audit, and public

¹¹⁹ There were 50 small-sized municipalities (out of a total of 232) that did not submit their financial statements; and there were other 31 that presented financial statements with significant inconsistencies, and not allowing for consolidation.

procurement. In terms of human resources capacities, although the recruitment of professional staff and the development of career and human resources plans are required by Law 276, the Congress has not yet approved related regulation.

187. **Timeliness of submission of audit reports to the Legislature.** Based on financial statements submitted by the DGC no later than April 30th of each year, the CGR is legally required to submit an Audit Report of Annual Public Accounts to the Congress by August 30th; i.e., within 6 months of the end of the period covered. The CGR complied with this calendar over the period 2004-2006. By contrast, other audit reports are usually submitted to the Congress within 8 months of the end of the period covered.

188. **Evidence of follow-up on audit recommendations.** The effectiveness of follow-up on audit recommendations is limited in Paraguay. Recommendations follow-up rarely go beyond formal correspondence from the auditee, partly due to the absence of regulating norms defining a code of sanction for irregularities associated to the management of public resources, as defined by Law 1626, and also due to the existence of a weak control environment. The CGR is partially mitigating this ineffectiveness through the review of its recommendations in forthcoming audits.

Overall Rating 26: C+

| Dimension | Rating |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Scope/nature of audit performed:</i> Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only. | C |
| <i>Timeliness of submission of audit report to legislature:</i> Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office. | B |
| <i>Evidence of follow-up on audit recommendations:</i> A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 14.3% | 57.1% | 28.6% |

Indicator 27: Legislative scrutiny of the annual budget law

189. The power to give the government authority to spend rests with the Legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate. The effectiveness of this scrutiny is determined through the assessment of its scope, its internal procedures, its timely and correct implementation, and the rules for budget in-year amendments.

190. **Scope of the legislature's scrutiny.** The scope of the Congress' review includes fiscal policies; budget proposal aggregates figures for the coming year; and detailed estimates of expenditure and revenue. LAFE also authorizes the Legislature to modify the budget at the approval stage, and in particular to increase the overall level of expenditures provided the existence of resources to finance them.

191. Although LAFE limits budget increases to capital spending and requires that a source of additional revenues be identified, in practice the Legislature also increases

allocations to current expenditures and adjusts revenue estimates accordingly.¹²⁰ This is due to the absence of legal hierarchy between laws, which does not prevent, for instance, LAFE provisions to be contradicted by annual budget laws. As a result, given the attributions given by the Political Constitution of 1992, Paraguay's Legislature has a very important role during the budget process, by being able to modify the expenditure composition submitted by the Executive, and also to increase total expenditures. Although the indicator and its score do not capture this characteristic of Paraguay's legislative control of the budget, this is a structural problem, which significantly undermined Paraguay budget credibility during the period under study (2004-2006).

192. **Extent to which the legislature's procedures are well-established and respected.** The legislature's procedures for budget review are firmly established in the Constitution, and are respected.¹²¹

193. **Adequacy of time for the Legislature to provide a response to detailed budget proposals.** The Congress has almost four months to review the budget proposals, from September 1st, when the Executive submits its budget proposal, until December 20th, the last date to approve the budget proposal according to the Constitution.

194. **Existence of rules for in-year amendments to the budget without ex-ante approval by the legislature.** The LAFE defines responsibilities and procedures to increase and reprogram the budget law during its fiscal year of execution. For the case of a budget increase,¹²² the Congress has to approve a law which expressly identifies additional sources of revenues to finance the expenditure increase. To increase external debt, the Executive has also to submit to Congress a budget increase bill accompanied by a request for approval of the loan agreement. Reprogramming of resources is submitted to Congress approval only in the cases of transfers between MDAs. Conversely, transfers within the same MDA and changes of source of funding are to be approved by presidential decree; and transfers within the same budget program are to be approved by MOF Resolution.¹²³ These rules set strict limits on the extent and nature of amendments and are consistently respected. However, delegation to MDAs for transfers within the same budget program could be considered for a more flexible budget execution.

¹²⁰ For example, revenues projections were increased by US\$ 62 million by the Legislature for the adoption of 2005 budget law. Source: WB 2006.

¹²¹ As an initial phase of the approval process, the Joint Budget Committee —composed by 15 deputies and 15 senators— reviews the budget proposal submitted by the Executive between September 1st and October 30th, and presents a report to the two Chambers. From October 1st to 15th, the Chamber of Deputies debates the draft budget in plenary sessions, and has to vote during this period. Between November 16th and 30th, the Senate considers the budget proposal submitted by the Executive and the changes introduced by the Chamber of Deputies. If the Senate does not express any objections, the budget law is adopted; otherwise, the draft is returned to the Chamber of Deputies, which has to vote exclusively on Senate objections between December 1st and 10th. The draft then returns to the Senate to debate exclusively on the Chamber of Deputies reaction to its objections till December 20th. This last phase and the Senate adoption close the approval process. Legislature complete rejection of the budget proposal can be obtained only by a vote with an absolute majority of two thirds in each Chamber.

¹²² Article 23, LAFE.

¹²³ Article 24, LAFE.

195. As a conclusion, it is worth making clear that although most of the processes involved by the Budget revision by the Legislature in Paraguay are respected, which leads to a high overall rating for this indicator, the latter does not reflect the limitations of such processes, as mentioned above.

Overall Rating 27: B+

| Dimension | Rating |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Scope of the legislature's scrutiny:</i> The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. | B |
| <i>Extent to which the legislature's procedures are well-established and respected:</i> The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures. | A |
| <i>Adequacy of time for the legislature to provide a response to detailed budget proposals:</i> The legislature has at least two months to review the budget proposals. | A |
| <i>Rules for in-year amendments to the budget without ex-ante approval by the legislature:</i> Clear rules exist for in-year budget amendments by the executive, which set strict limits on extent and nature of amendments and are consistently respected. | A |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 37.50% | 25.0% | 37.5% |

Indicator 28 – Legislative scrutiny of external audit reports

196. This indicator focuses on the submission of audit reports regarding the execution of the budget from Central Government entities to the Legislature, the ability of the Legislature to examine these reports on time, and the ability of those entities to implement recommended actions. In Paraguay, the National Constitution and the LAFE foresee the creation of a Legislative Committee —composed by members of both Chambers— that exercises the revision and scrutiny of the executed budget each year. The efficacy of this Committee will depend on the availability of sufficient financial and technical resources, as well as on its ability to review external reports on due time. The Committee may also recommend actions and sanctions to be implemented by the Executive, in addition to adopting the recommendations made by external auditors.

197. **Timeliness of examination of audit reports by the legislature.** According to what is stipulated by the LAFE (Art. 67), the MoF must submit to the Executive and the Congress the Financial Report before March 31st, which should include consolidated financial statements, reflecting the financial, economic, budgetary and asset position of government entities, as well as a comparative statement of amounts budgeted and executed in each fiscal year. The LAFE establishes (Art. 69) that within the four months after the presentation of the Executive annual report, the CGR has to submit to the Congress a report and audit opinion about the Financial Report, based on the Annual Audit Plan, which include a representative sample of public entities and uses for its elaboration information provided by MoF and CGR own information.¹²⁴ According to Art. 70 of the LAFE and Art. 282 of the National Constitution, the Legislature Joint Congressional Committee¹²⁵ has a maximum and not deferrable deadline of 30 days to approve or reject the Financial Report and the

¹²⁴ The CGR is currently under a stage of redesign of its Annual Audit Plan, as part of the activities being financed through USAID's *Programa Umbral*.

¹²⁵ Five senators and eight deputies.

related CGR report and audit opinion, being able to request for this decision any additional report, both to entities of the State and the CGR.

198. During the period under analysis of the IFA, both the review process by Congress of the Financial Report and the corresponding decision report of the CGR suffered difficulties. In 2004, delays existed because of the rejection of the Report by the Chamber of Deputies, whereas in 2005 and 2006 it was not possible to constitute the Joint Congressional Committee, which implies a failure to comply with the constitutional mandate.¹²⁶
199. **Extent of hearings on key findings undertaken by the Legislature.** In-depth hearings on key findings take place periodically and cover only a few audited entities. Most findings addressed by these hearings are usually related to accounting issues detected through CGR audit, and do not consider the effectiveness and the quality of expenditures.
200. **Issuance of recommended actions by the Legislature and implementation by the Executive.** The Legislature makes recommendations on the basis of CGR findings. However, there are no follow-up procedures to determine the degree of implementation of its recommendations by the Executive.

Overall Rating 28: D+

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| <i>Timeliness of examination of audit reports by the legislature (for reports received within the last three years):</i> Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. | D |
| <i>Extent of hearings on key findings undertaken by the legislature:</i> In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with ministry of finance officials only. | C |
| <i>Issuance of recommended actions by the legislature and implementation by the executive:</i> Actions are recommended, but are rarely acted upon by the executive | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 28.6% | 14.3% | 42.9% | 14.3% |

Donor Practices

Indicator D1 - Predictability of Direct Budget Support

201. Between 2003 and 2006, four direct budget support lending operations financed by IFIs were approved in Paraguay, which represented a total amount of US\$85 millions (see Table 3.6). Annual disbursements of these operations coincided with the estimates obtained by the IFIs in 2003 and 2004. However, foreseen disbursements for 2005 —according to the agreements between the IFIs and the Government— suffered delays, since these operations lacked the Congress approval required by the country legislation. This cause of delays has been a recurrent factor related to external financing by donors in Paraguay during the period under analysis, so it is taken into consideration for the overall rating of this indicator.

¹²⁶ For additional information, see www.contraloria.gov.py

Table 3.6: Direct Budget Support External Loans (2003 – 2006)

| Creditor Institution | 2003 | | 2004 | |
|----------------------|--------------------------------------|----------------------------|--------------------------------------|----------------------------|
| | <i>Financial Assistance Foreseen</i> | <i>Assistance Provided</i> | <i>Financial Assistance Foreseen</i> | <i>Assistance Provided</i> |
| IDB | US\$20 million ¹ | US\$20 million | US\$ 0 | US\$ 0 |
| World Bank | US\$30 million ² | US\$30 million | US\$ 0 | US\$ 0 |
| Creditor Institution | 2005 | | 2006 | |
| | <i>Financial Assistance Foreseen</i> | <i>Assistance Provided</i> | <i>Financial Assistance Foreseen</i> | <i>Assistance Provided</i> |
| IDB | US\$30 million ³ | US\$ 0 | US\$ 0 | US\$ 0 |
| World Bank | US\$15 million ⁴ | US\$ 0 | US\$ 0 | US\$15 million |

Source: MoF – General Directorate for Public Credit.

¹ 1520/OC PR (*Programa de Protección Social*) Other US\$ 10 million were cancelled.

² 7210-PA (*Programa de Recuperación Económica*).

³ 1682/OC PR (*Programa de Reforma Actividad Financiera Pública*).

⁴ 72880-PA(*Programa Sectorial Financiero*).

Overall Rating D1: C+

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body):</i> In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 15%. | C |
| <i>In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates):</i> Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years. | A |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 28.6% | 14.3% | 42.9% | 14.3% |

Indicator D2 – Financial Information provided by donors for budgeting and reporting on project and program aid

202. IFIs and donors operating in Paraguay provided financial information referred to each of the lending operations in a complete and timely manner during the period under analysis (2004-2006). Given that disbursements corresponding to lending operations are incorporated to the budgets of their respective MDAs, financial information is consistent with the budget classifier. As confirmed by the MoF, foreseen deadlines for planned disbursements corresponding to different lending operations were respected by IFIs and donors, which count with quarterly information about these disbursements. Table 3.7 shows the distribution of disbursements corresponding to lending operations during the period under analysis.

Table 3.7: Loan Disbursements (2004-2006)

| IFI-Donor | Disbursement 2004-2006 |
|--------------------------------------|------------------------|
| IDB | 44% |
| Japanese Government – JBIC | 26% |
| World Bank | 16% |
| FINAME – Brasil | 6% |
| <i>Corporación Andina de Fomento</i> | 4% |
| FONPLATA | 2% |
| Other | 2% |
| Total (US\$ 385 millions) | 100% |

| Dimension | Rating |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| <i>Completeness and timeliness of budget estimates by donors for project support: Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start.</i> | D |
| <i>Frequency and coverage of reporting by donors on actual donor flows for project support: Donors provide quarterly reports within two months of end-of-quarter on the all disbursements made for at least 50% of the externally financed project estimates in the budget. The information does not necessarily provide a break-down consistent with the government budget classification.</i> | C |

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 0.0% | 42.9% | 57.1% |

¹²⁷ Only WB and IDB provided complete information during this period.

Indicator D3 – Proportion of aid that is managed by use of national procedures

206. Country systems are used only for the execution of loan operations, which are estimated to represent around 60% of total financing from IFIs and donors in Paraguay during 2004-2006, as mentioned in indicator PI-2.
207. However, the use of country systems is partial, since it only comprises the budgeting, accounting consolidation and treasury stages, and excludes government accountability to IFIs and donors, internal control and external audit, which are managed by independent systems.
208. Currently, accountability to IFIs is not possible in an automatic form through country systems, and CGR audit norms are still not considered acceptable by IFIs for the external audit of projects. With respect to budget execution, entities in charge of the implementation of the projects usually run ‘ring-fenced’ systems parallel to SIAF.¹²⁸

Overall Rating D3: C

| Dimension | Rating |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| Overall proportion of aid funds to central government that are managed through national procedures: 50% or more of aid funds to central government are managed through national procedures. | C |

Benchmarking

| % of countries with rating A | % of countries with rating B | % of countries with rating C | % of countries with rating D |
|------------------------------|------------------------------|------------------------------|------------------------------|
| 0.0% | 14.3% | 14.3% | 71.4% |

¹²⁸ See Table 5.5, Chapter 5.

4. INPUTS FROM COUNTRY PROCUREMENT ASSESSMENT

Main Features of Public Procurement in Paraguay

209. In terms of government procurement (PR) Paraguay has made great progress in the regulatory and institutional fields, major improvements have been introduced in the PR processes and in conflict resolution and the generalized perception is that there is a lot of improvement, both in terms of the quality of processes and in their efficiency and efficacy.
210. The new PR legal framework and the dynamism of the recently created GDPP introduced substantive changes in the operation of the country's public PR. The principles of economy and efficiency, equality and free competition, transparency and publicity are explicitly set forth in the new Law and began being applied, to a great extent, since the law was enacted. A fundamental element that contributed to these achievements is the development of a public PR system and the Website, <http://www.contratacionesparaguay.gov.py>, where most of the Government's purchases and contracts are published.¹²⁹ This has introduced efficiency and greater speed and transparency in the public PR process.
211. The improvements in the above areas have not been accompanied by a strengthening of the oversight and audit mechanisms. On the other hand, the positive development of IT tools is limited by the substantive deficits in the digital communications infrastructure available in Paraguay. Also, with the exception of the Project Implementation Units (PIUs), public PR in Paraguay is carried out by procurement units lacking clear terms of reference for the responsibilities and duties of procurement officials, and likewise, the minimum qualifications of the members of the UOCs have not been defined. Some improvements were observed with respect to the relationship with the private sector and other public entities after the publication of CPAR: procedures for carrying out Public Hearings were formalized¹³⁰; and agreements were signed with several civil society organizations, as well as with local and foreign public entities.¹³¹
212. It is also true that in terms of market opening and efficiency and in the processes of transparency and control, there exist opportunities for substantial improvements in order to bring the overall performance of the system closer to what is internationally considered satisfactory, in accordance with the methodology applied.
213. There is still evidence of inefficiencies in public PR, with a relevant percentage of contracts in arrears and being awarded through procedures not benefited from economies of scale. Likewise, the Law favors domestic companies over foreign ones, which is considered an important restriction to international participation in PR processes. On the other hand, although the GDPP is an independent unit, its staff is still vulnerable to political eventualities.

¹²⁹ Excluding only public works concessions, personal services, purchases using revolving funds, contracts by public financial companies and institutions, and those by bi-national entities —Itaipú and Yaciretá.

¹³⁰ Refer to Resolution 208/07 of the Legal and Technical Central Unit of the GDPP.

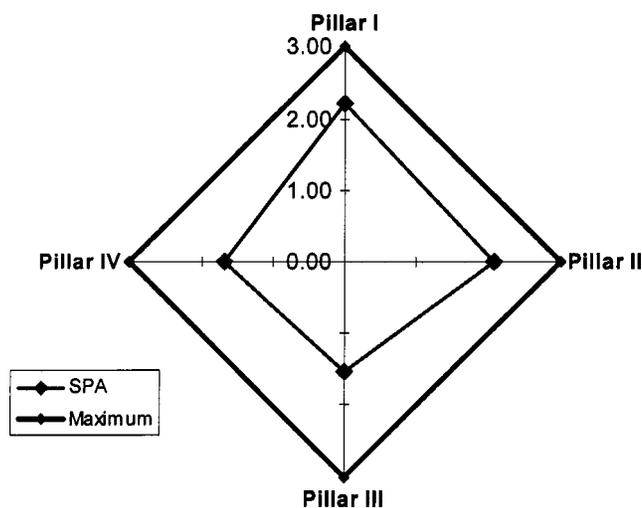
¹³¹ Agreements were signed with INECIP (Institute of Comparative Studies in Penal and Civil Sciences), CAPACO (Chamber of Construction of Paraguay), UIP (Industrial Union of Paraguay), Transparencia PY, CGR, GTZ, OPACI (Inter-Municipal Cooperation Organization of Paraguay) and with 'ChileCompra'.

214. As for control and transparency, major weaknesses are evidenced by the control systems, with an almost total absence of follow-up of the penalization processes and a recurrence of irregular practices, something that generates a climate of relative tolerance regarding processes with poor transparency.
215. Based on the work conducted, the banks' joint fiduciary review team considers that Paraguay's public PR system **requires substantial improvements** in its market development practices and transparency, internal control and internal and external audit processes. To a lesser extent, the system should also further strengthen the existing regulatory framework, provide stability to the key staff of the GDPP, and adopt systems that contribute to the monitoring, performance evaluation and observation of payments. To move forward with the reform and modernization of PR, the national challenge lies in complementing the efforts already made with the support of judiciary agencies and effective control methods that prevent, identify, correct and penalize acts of corruption or improper practices. Even in those instances where cases of timely and appropriate control instances have been detected, the resulting findings have had no concrete consequences, diluting the importance of controls and consecrating the *status quo*, even within a more efficient regulatory framework and with a proactive and trained regulatory agency.
216. The Government's and civil society's commitment, as well as timely action for the implementation of the measures included in the Action Plan will contribute to the consolidation of the important progress made by Paraguay since the last review, conducted by the Banks in 2003.
217. The Chart below summarizes the final results of the characterization of the level of performance evaluated for each of the above-mentioned four pillars. Over a maximum score of 3, the Public Procurement System scored 2.2 for pillar (i), Legal and Regulatory Framework; 2.08 for pillar (ii), Institutional Framework and Management Capacity; 1.53 for pillar (iii), Procurement and Market Practices; and 1.68 for pillar (iv), Integrity and Transparency of the Public Procurement System.

Paraguay OECD-DAC Assessment

(Baseline and Compliance/Performance Indicators)

| Indicators | Scored | Maximum | Assessment |
|---------------------------------------------------|--------|---------|-----------------------------------|
| 1 Regulatory Framework | 2.22 | 3.00 | Improvements Required |
| 2 Institutional Framework and Management Capacity | 2.08 | 3.00 | Improvements Required |
| 3 Procurement Operations and Market Practices | 1.53 | 3.00 | Substantial Improvements Required |
| 4 Integrity and Transparency | 1.68 | 3.00 | Substantial Improvements Required |



| Capacity | Min | Max |
|-----------------------------------|------|------|
| Under Minimum Standards | 0.00 | 1.00 |
| Substantial Improvements Required | 1.01 | 2.00 |
| Improvements Required | 2.01 | 2.75 |
| Satisfactory Accomplished | 2.76 | 3.00 |

Pillar I. Regulatory Framework

Pillar I. Legislative and Regulatory Framework – OECD-DAC Indicators

1. The country's procurement legislative and regulatory framework complies with applicable obligations deriving from national and international requirements.
2. The country has appropriate regulations & tools to support implementation of its framework

218. The main conclusion with regards to the regulatory framework is that it promotes effective, competitive and transparent PR processes, and it represents a major improvement as compared to the previous situation, since it includes in a single, complete and consistent framework all the regulations relating to PR. Furthermore, the new regulatory framework reflects the international best practice, adjusted to Paraguay's context, although it still retains some discriminatory provisions, especially against foreign companies.

219. The work of standardizing the bidding documents carried out by the GDPP, together with the concomitant process control, has produced major improvements in the quality of PR. Substantial progress has been found in the quality of the bidding documents (although their use is not yet mandatory, in practice they are used in 90% of the tenders and competitions), in the process implementation times, in the exponential increase of the publication of the calls for bids, and in the objectivity of

factors and criteria for the evaluation of proposals.¹³² The draft contracts in public tenders reflect conditions that are generally acceptable according to international standards. Additionally, an effective and agile mechanism has been established to receive and manage complaints, in the first instance by the GDPP and secondly, before the administrative courts. In that sense, it is necessary to deepen these actions to thus continue with the development of the system, e.g. by developing a Procurement Manual applicable to all the UOCs which is still an outstanding area.

220. Likewise, it is important to develop bidding documents for faster modalities of PR, such as the Proposal Competitions and Direct Procurement (which in actual fact are price comparisons or “Shopping”), in view of the fact that they are the modes usually employed by the Municipalities.¹³³ Although the Municipalities (232 in total) jointly represent no more than 2% of the total national PR, their impact in the efficiency of public PR is important from the point of view of citizens’ perceptions.
221. There are regulatory tasks that are complimentary to the existing legal framework, a majority of which can be implemented through resolutions from the GDPP, such as determining the timeframes for consultant short listing and selection. Additionally, the creation and implementation of a registry of suppliers and PR through framework agreements with suppliers should also be subject to standardization.
222. Regarding possible legislative reforms, it should be noted that the International Competitive Bidding (ICB) process is not established as the most appropriate or default arrangement for contracts for significant amounts or with high degree of complexity, but rather applied as an exception to the National Competitive Bidding (NCB) method, in which foreign companies that are not established in Paraguay cannot bid; and that ICBs are only used as a result of international agreements or when it has been established that there are no domestic suppliers. On the other hand, we should note that most of the contracts with a reference value above US\$ 500,000 were awarded through ICBs.
223. In this sense, it is also necessary to take into account that Paraguay’s private sector has a low level of development, with over 85% small and medium enterprises and with sectors where it has been established a possible cartelization of suppliers and builders, resulting in a limited competition at the local level and with little use of imported new technologies. Although the impact of a greater international opening of the Paraguayan business structure needs to be evaluated, it is clear that a greater use of ICBs—which include margins of local preference— will not only ensure the best use of public funds, but will also provide incentives for the domestic private sector to modernize and seek out markets.¹³⁴ The adoption of ICBs would also contribute paving the road to the extension of the country’s free trade agreements, which so far has market reserve in government PR but shall eventually have to be opened up to the trade partners.

¹³² After the preparation of CPAR, the use of three standard bidding documents was required (Goods, Consultancy and Public Works; see Decree 10395 of 05/21/07) and there are other six bidding documents drafts published in the Web.

¹³³ It is expected to introduce the Note of Invitation and Purchase Order for Direct Contracts during 2008, and the implementation of electronic purchases was approved through ‘*Convenios Marco*’ (Decree 11193/07). The implementation of the bidding to lowest price mechanism is under analysis.

¹³⁴ See paragraph 209.

224. Another aspect of the Law subject to reforms relates to the procurement of consulting services, since it would be possible to specify in a clearer way that the selection of consultants should be based on technical qualifications and the quality of proposals, more than as a function of the most economical offer. This clarification is pertinent because the Law provides no special treatment to that end, although in it and—in the rules—it is determined that consultants should be selected based on some selection model such as quality and cost, quality, lowest price, fixed budget, or consultant’s background.
225. The legal framework establishes the right of the individuals who participate in bidding processes to challenge the decisions adopted by the requesting entities, by means of a filing before the GDPP. Although this is an important progress compared to the previous legislation and the GDPP is an entity different from the requesting agencies—except for the case of PR by the Ministry of Finance—in December 2007 the Parliament approved a Law giving autonomy and autarchy to the GDPP, changing its name to “National Directorate of Procurement”.
226. As for the enforcement of the Law, it should evolve in the direction of eliminating, or at least reducing significantly, the cases of excessive use of non-competitive methods. For example, from the information analyzed, it may be seen that almost 13% of the public contracts (both in terms of amount and number of processes) in years 2005 and 2006 were awarded directly without competition (Direct Procurement by Exception). Annex I includes statistical information on the methodologies employed for contracts in various value ranges.

Pillar II. Institutional Framework and Management Capacity

| Pillar II. Institutional Framework and Management Capacity – OECD-DAC Indicators |
|-------------------------------------------------------------------------------------------------------|
| 3. The public PR system is mainstreamed and well integrated into the public sector governance system. |
| 4. The country has a functional normative/regulatory body. |
| 5. The country has institutional development capacity. |

227. The GDPP reports directly to the Under-secretariat of Financial Administration under the MoF. This placement within the MoF gives it institutional weight and facilitates its operational capacity. The possibility of conflict of interests in cases of oversight of PR conducted by the Ministry’s UOC exists, although to date, the current management has given proof of its independence with the annulment of contracts and even administrative summaries of officials of the above mentioned department. The GDPP has budgetary autonomy through a budget that is funded out of the equivalent of 0.5% of the value of the contracts that are executed under the public system. However, the importance of securing the stability of its key officials is noted, by establishing arrangements that limit the possibility of their removal for factors alien to their professional performance or ethical behavior, thus promoting their independence, albeit remaining within the structure of the Ministry of Finance.
228. The regulatory centralization and operational decentralization has a weak link which is the limited influence that the GDPP has over the Operational Procurement Units (UOCs) and PIUs, which report administratively to each agency; and which put their staff, hierarchy, composition, experience and other operational characteristics outside the sphere of control of the GDPP. At the operational level, the UOCs lack consistently applied procedures in terms of an orderly and systematic recording of the documentation related to PR processes, or a security protocol for files, as well as for

maintaining updated records referring to such processes. Likewise, there are insufficient records on the quality and quantity inspection processes prior to the acceptance of the goods.

229. In the case of civil works certificates, deficiencies were found in the sample reviewed. There are no systematic compliance reports to certify the execution of the budget and reconcile such execution with the budget programming. It is essential for the UOCs to have unified operating parameters across the various agencies to which they belong and to develop contract follow-up and monitoring systems to enable them, beyond obtaining data on the execution, commitments and balance, to have a useful tool for a better management of contracts and data in real time, including a mechanism of disclosure of the presentation of work certificates and payment dates, as explained below.¹³⁵
230. The budgetary management of public PR has substantially improved with the use of control and planning tools —the budget availability codes (CDPs) and the Annual Contract Plans (PACs)— although there is a significant gap in the entities that are not connected to the SIAF. These entities —representing 59% and 57% of the country’s public procurement in the years 2004 and 2005, respectively— lack a budget availability control in real time, and present risks of financial unavailability at the time of payments for the procurement systems and limit the capacity to monitor public expenditure in terms of financial management.
231. Also lacking in the contracting entities —including those connected to the SIAF— is a real time monitoring and control system of contract execution. The PACs should evolve towards a greater level of use, which is the on-line updating with the GDPP, indicating the progress status of each process in real time and including the amounts and data of the awardees once the contracts have been executed. Such information should also be publicly disclosed, which will provide better quality information to the private business sector and facilitate control by civil society.
232. The development and start up of the Public Procurement Information System (SICP) is a landmark in the management of public PR in the country. The use of this system as an operating and control tool and as database is the pillar of the public PR system, with initiatives existing within the GDPP to expand its functionality. The system provides key utilities for internal users (Government) and external users (suppliers, civil society).
233. Currently the SICP seeks to solve the issue of disseminating the calls in the procurement processes and the later dissemination of their results. Pending development are the more transactional stages of the PR platform (framework agreements, e-procurement, electronic payment cycles, factoring, ordering and other financial instruments associated with the procurement cycle) as well as the complementary systems of a solution of such characteristics, among which we may mention, a registry of suppliers, contract management, financial management and the integration with third-party systems.

¹³⁵ After the CPAR was published, Decrees 7981 and 8602 were issued, allowing GDPP to verify contract executions; also, the Department of Contract Executions of the GDPP was created (which will become a Directorate after the National Directorate of Public Procurement is established).

234. The limitations faced by the SICP result mainly from the little development of Paraguay's IT infrastructure and the low connectivity, where the penetration of the Internet is one of the lowest in the world.

Pillar III. Procurement Operations and Market Practices

| Pillar III. PR Operations and Market Practices – OECD-DAC Indicators |
|------------------------------------------------------------------------------|
| 6. The country's PR operations and practices are efficient. |
| 7. The country's public PR market functions well |
| 8. The country has contract administration and dispute resolution provisions |

235. The officials assigned to PR management tasks are the current target of a comprehensive training process by the GDPP. There are uneven capacities in the UOCs and PIUs, which is explained by the different hierarchy of each UOC within the agency in which it operates. Across PIUs, on average the level of training is higher since they benefit from courses and workshops facilitated by the funding organizations. A problem associated with the difficulties for the development of local PR management capacities is explained by the high turnover of staff in these units.
236. Training of the private sector is incipient, although the GDPP has plans to expand the offering of courses and workshops for suppliers, mainly on aspects relating to the preparation and submittal of bids and the contents and practices included in the new Law.
237. Paraguay lacks a legal framework to enable public-private partnerships; however, these are feasible under the current legal framework. There are, however, dialog and coordination forums with chambers and associations. Some examples such programs are: the National Integrity Program and Inter-institutional Council of the National Integrity System (PNI-CISNI); Transparencia Paraguay, as watch-dog of the procurement system; and the whistle-blower protection system developed by the private and public sector (INECIP), primarily with a control focus, postponing a dialog and agreements between the buyer and the supplier. Taking into account the significant limitations in the control agencies and the perceived high corruption indexes, not surprisingly the first instance of relationship with the private sector is targeted at tackling the problems resulting from the lack of effective controls in public PR.
238. At the operational level, there some agreements signed between private sector companies and trade chambers and the GDPP. Agreements are being made, for example, regarding the limitation of the documentation requirements in PR processes, and work is under way to establish a Voluntary Supplier Registry that will replace these filings in each process.
239. Another area where improvements are being introduced is in payment management, which has been identified as one of the weak points in the system. The delay in effecting payment negatively impacts the willingness to participate in public PR processes or is reflected in quoting higher prices, discounting the financial costs associated to such delays, thus producing inefficiencies in the system. It also has negative effects particularly for small and medium enterprises. The Treasury has initiated a process of direct payment to suppliers, which substantially reduced the payment times. This initiative is still in its first stages, but its dissemination to a majority of the state suppliers is being contemplated. The payment delay or risks of timely payment privileging favored contractors are factors that reduce the credibility

of governmental PR systems, so that actions that contribute to systematizing and rationalizing payments should be firmly promoted in the reform and modernization of government financial management and PR.

240. It will be important to develop partnerships with the private sector, to establish action roles and codes and to gradually eliminate the cartelization that exists in certain sectors —e.g. the road construction sector— and the collusion consequences that in practice have been recorded in processes with a limited number of offers and for amounts consistently higher than those of the official budgets.

Pillar IV. Integrity and transparency of the public procurement system

| Pillar IV. Integrity of the Public Procurement System – OECD-DAC Indicators |
|------------------------------------------------------------------------------------|
| 9. The country has effective control and audit systems |
| 10. The country has an efficient appeals mechanism |
| 11. The public has broad access to information |
| 12. The country has ethics and anticorruption measures in place |

241. Paraguay has substantially improved its relative ranking in the Corruption Perception Index prepared by Transparency International: from holding position 141 among 146 countries in 2004, and 147 of 159 countries in 2005, the 2006 CPI ranked it 111th of the 163 countries surveyed.
242. In spite of the improvement in the perception of corruption, Paraguay's control arrangements continue being weak and inefficient. There are limitations in the policies, the scope of the control procedures and the audit methodology applied by the General Controllershship of the Republic (CGR) and the Executive Power's General Audit Office (AGPE) regarding public PR, wherefore the internal control of these essentially falls on the reviews by the Institutional Internal Audit offices (AII), which have a lower level of effectiveness, since they report directly to the authorities of each institution. The CGR concentrates its review activities in those cases where irregularities have been reported, something which absorbs a great share of the time of its staff, with little additional time to conduct investigations on their own initiative.
243. Likewise, the audits focus in the verification of compliance with formal requirements of a financial type to be verified once the processes cannot be reverted. The audit methodologies employed do not include risk analysis in order to determine the opportunity, nature and extension of the procedures to be used and types of transactions and functional processes to be audited. The CGR is therefore reactive instead of proactive, something that limits its capacity to prevent, detect and correct faulty procedures at an early stage.
244. The reports of AII are sent to the AGPE generally without adequate feedback processes for their follow-up, something that completes a scenario of low control with few corrective actions or sanctions. Currently, the sanctions of an administrative nature (disbarment by the GDPP) are applied in an effective manner and on a due process basis; however, the criminal behaviors are not sanctioned when the corresponding files are sent to the courts, in view of the fact that there is no system in place to follow-up on the procedures. The CGR, on its part, can act towards public prosecution only when it has been proven that there has been damage to the state assets. In all other cases, the sanctions are purely of an administrative nature. There are notable weaknesses in the capacity to sanction public officials, and even less those who hold first or second line positions in the hierarchy.

245. Since there is no effective sanction mechanism, both for the private sector and the public sector, the removal of negative elements is delayed, both in bidding companies and in officials responsible for the management of the various stages in the contracting process, hindering further the objective of attaining greater efficiency and transparency.
246. Transparency Paraguay notes among the recommendations resulting from their Evaluation of the Procedures applied by the GDPP:
- (i) the need of setting up operational agreements with the General Audit Offices of the three branches of Government and with the General Controllershship of the Republic, in order to improve the control of the procurement and contract management processes, preventing the summaries that are initiated from being closed due to lack of information or follow-up; and
 - (ii) the communication of the GDPP resolutions to the Civil Service Secretariat (*Secretaría de la Función Pública*) and to the Prosecution Service (*Ministerio Público*) in those cases where the administrative and/or criminal liability of public officials has been ascertained.
247. Both actions are currently being implemented, to the extent that the GDPP and the CGR have agreed with the Prosecutions on the filing of the complaints in pre-established formats for the purpose of avoiding duplications. However, the results of these actions will take some time to bear tangible results.
248. There is no code of ethics for public officials or specific rules to resolve cases of conflicts of interests, which implies an important regulatory gap. Although public officials are obliged to file financial disclosure forms, their frequency is not regulated, so that they lose their validity when they are not updated. The actions relating to collusion with suppliers have not been criminalized or regulated, so there are no legal tools for the authorities to identify and sanction such practices on the part of the private sector.

5. MANAGEMENT OF IFIs AND DONOR FUNDS

IFIs and Donor Funds in Paraguay - 2004-06

249. By being a small sized economy with restricted access to both domestic and external financial markets, Paraguay's public sector financing depends crucially on IFIs and donors loans and grants.

250. Table 5.1 shows grants disbursements and official lending net transfers during 2004-2006. Donor grants reached US\$ 62.2 million in 2005, and represented 8.3% of Central Administration's total revenues on average terms throughout 2004-2006.¹³⁶ Lending disbursements amounted US\$ 128.3 million in 2004 and US\$ 150.4 million in 2006. These lending disbursements decreased along the period as a share of total budgeted expenditures from the Central Administration —from 11.4% in 2004 to 8.4% in 2006.

Table 5.1: Disbursement Aid (million of US\$, unless specified)

| Concept | 2004 | 2005 | 2006 |
|-------------------------------------------------------------------------------------------|--------|--------|--------|
| Grants | | | |
| Gross Disbursements | 33.3 | 62.2 | 51.9 |
| Relative size (in %) | | | |
| Gross Disbursements / Central Administration Budgeted Total Revenues | 8.7% | 8.6% | 7.5% |
| Multilateral Lending | | | |
| Gross Disbursements | 88.2 | 77.0 | 110.6 |
| Amortizations | 102.3 | 80.6 | 82.7 |
| Net Disbursements | -14.1 | -3.6 | 27.9 |
| Interest Paid | 49.0 | 39.8 | 41.2 |
| Annual Net Transfers | -63.1 | -43.4 | -13.3 |
| Bilateral Lending | | | |
| Gross Disbursements | 40.10 | 30.04 | 39.78 |
| Amortizations | 72.23 | 55.34 | 59.51 |
| Net Disbursements | -32.13 | -25.30 | -19.73 |
| Interest Paid | 28.05 | 18.41 | 17.93 |
| Annual Net Transfers | -60.18 | -43.71 | -37.66 |
| Official Lending Relative size (in %) | | | |
| Gross Official Lending Disbursements / Central Administration Budgeted Total Expenditures | 11.4% | 8.1% | 8.4% |

251. Multilateral and bilateral lending net transfers were negative in all three years considered, which is consistent with the observed economic growth and the implementation of sound fiscal policies that allowed the country to leave behind its record of debt payment arrears.

252. Table 5.2 illustrates changes and trends in terms of the stock of multilateral and bilateral lending —public sector's main source of financing— in Paraguay during 2004-2006. Overall, the Table shows that Paraguay has maintained the composition and reduced the burden of its external debt during these three years. Both multilateral and bilateral debt decreased in nominal (US\$) and relative (GDP) terms. The nominal decrease is a consequence of negative net transfers —net debt repayment¹³⁷— consistent with the context of continued primary and financial fiscal surpluses.

¹³⁶ Grants figures included here are those included on the Budget. As was mentioned in Chapter 3 (PI-7), the Government estimates that such figures represent only a fraction of the total amounts received by the country in terms of grants.

¹³⁷ See Table 5.2 for details on debt flows.

Another factor behind negative net transfers in recent years is the political unwillingness of Congress to approve loans which have already been signed by the government. The relative decrease —from 23.1% to just 14.6% of GDP— compounds the effect of the nominal debt reduction with both economic recovery and the nominal appreciation of the Guaraní with respect to the Dollar.¹³⁸ As of year 2006, 80.2% of the Central Administration's stock of external debt outstanding consisted in multilateral and bilateral loans.

Table 5.2: Paraguay – Central Administration: Stock of Multilateral and Bilateral Debt (2004-2006)

| Concept | 2004 | 2005 | 2006 |
|----------------------------------------------|--------|--------|--------|
| IFIs LENDING | | | |
| Stock of Lending (million of US \$) | 1062.5 | 1010.9 | 1056.5 |
| IDB | 725.3 | 704.0 | 743.3 |
| WB | 233.3 | 213.7 | 226.0 |
| Other | 103.9 | 93.2 | 87.2 |
| Stock of Lending/ Total External Debt (in %) | 54.9% | 55.7% | 58.2% |
| Stock of Lending/ GDP (in %) | 16.0% | 13.4% | 10.6% |
| BILATERAL LENDING | | | |
| Stock of Lending (million of US \$) | 471.71 | 415.85 | 399.02 |
| Japan | 212.92 | 178.43 | 191.35 |
| Taiwan | 129.71 | 123.76 | 114.82 |
| Other | 129.09 | 113.66 | 92.84 |
| Stock of Lending/ Total External Debt (in %) | 24.4% | 22.9% | 22.0% |
| Stock of Lending/ GDP (in %) | 7.1% | 5.5% | 4.0% |

Sources: Public Accounting Financial Reports (2004-2006)

Institutional arrangements

253. The coordination and management of IFIs and Donors funding is defined by the LAFE and its application decree as well as by the annual budget law. While the execution of donor funded operations is the responsibility of the recipient institutions,¹³⁹ the MoF and the Secretariat of Technical Planning of Economic and Social Development (STP) are the main entities responsible for the processes of planning, approving, monitoring and coordinating IFIs and donor funded operations. The STP is involved in the planning and approval of donor funded operations, the monitoring of technical cooperation grants, and donor coordination, through the General Directorate of International Technical Cooperation and the General Directorate of Investment Promotion and External Financing. The MoF has an overall responsibility upon country donor funded resources. Through the DGCDP and the Debt Policy Directorate, the MoF plays a key role in the negotiation and approval of donor and IFIs lending, as well as in the monitoring of those loans through the DGCDP and the Public Investment Central Unit (UCIP).¹⁴⁰

¹³⁸ End-year nominal exchange rates where G\$ 6240 and G\$ 5170 per US\$ in 2004 and 2006, respectively.

¹³⁹ Except for the cases where donors directly implement their operations – See Section on Implementation of Donor funds.

¹⁴⁰ The scope of the Department of Control and Evaluation (General Directorate of Budget), established in 2007, also includes control of donor and IFIs lending operations.

254. The five above mentioned Directorates of MoF and STP have limited human resources, with less than 60 staff in total, and their activities are partially overlapping¹⁴¹, which generates redundancies such as the existence of several donor monitoring databases¹⁴², or redundant reporting requirements.

Table 5.3: Staffing of Directorates involved in horizontal management of IFIs/Donors funding¹⁴³

| General Directorate of Public Credit | Directorate of Debt Policy | UCIP | STP – Directorate of Investment Promotion and External Funding |
|-------------------------------------------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|
| 1 General Director 1 Coordinator 3 Heads of Departments 11 Technical Specialists | 1 Director 3 Heads of Departments 9 Specialists | 1 General Coordinator 1 Coordinator for norm compliance 1 Coordinator for monitoring 6 monitoring specialist | 1 Director 5 Specialists 1 Assistant Ability to include specialists from other departments if needed |
| Total staff: 16 | Total staff: 13 | Total staff: 9 | Total staff: 7 |

255. Although an institutional re-organization may appear relevant, its implementation would be complex in the current context, and solutions based on strong inter-institutional cooperation are probably more appropriate in the short term. This is illustrated by the cooperation developed between the DGCDP and the Debt Policy Directorate for their common mandate on IFIs loan negotiations. Those Directorates agreed to develop a task-force approach, whereby joint teams are systematically set up for loan preparation and negotiation. This approach, which streamlines the activities of both units, is easy to implement and should be considered for replication.

Planning and Approval of Donor funded operations

256. **Impact of country sector planning on donor funded operations.** Despite the recent efforts from the MoF, the STP and line ministries, sector strategies still consist of broad objectives and do not link to budgeting.¹⁴⁴ As a result, the preparation of donor operations, although consistent with government strategic objectives, relies on donor planning expertise, which inevitably reduces the country ownership on the design.

257. **Legalistic and fragmented process and calendar of preparation and approval.** As shown in the table 5.4, the preparation and approval phase is punctuated by the adoption of several legal documents, and associates an important number of actors. Thus, there is an opportunity for streamlining this process without affecting the control effectiveness, provided strong political will.

¹⁴¹ Such as in the case of IFIs loan monitoring covered by UCIP and Public Credit General Directorate.

¹⁴² Public Credit General Directorate database (SIGADE) for debt monitoring; UCIP database for project monitoring of physical and financial execution; STP database of Pre-investment projects - Those databases are not systematically inter-linked, nor integrated to SIAF.

¹⁴³ The General Directorate of International Technical Cooperation is staffed with twelve civil servants.

¹⁴⁴ Refer to Chapter 3, Indicator 12.

Table 5.4: Planning and Approval of Donor Funded Operations

| Phase | Lending & Grants included in the Budget | Other Grants |
|------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Pre-Identification | Line ministries | Line Ministries/Donor |
| Initiation of the process of authorization to prepare the operation | Request sent by line ministries to MoF and transmitted after review to STP for prioritization | Request sent by line ministries to (i) MoF for IFIs grants and (ii) Ministry of External Relations for the others. |
| STP Prioritization ¹⁴⁵ | STP - General Directorate of Investment Promotion and External Funding | STP - General Directorate of International Technical Cooperation |
| MoF receives STP conclusions | Transmits the request to Economic Committee | N/A |
| Economic Committee Approval (MoF, Min of Agriculture, Min of Industry) | Review of the request; if approved, it is sent to the Presidency for approval. | N/A |
| Presidency Authorization to prepare an operation | Presidency adopts a decree of authorization to prepare the operation. | Not mandatory – usually applied for grant requests sent by MoF |
| Start working on the Project Preparation Document | Line Ministry and IFI/Donor | Line Ministry and IFI/Donor |
| Negotiation | DGCDP & Debt Policy Directorate; Line Ministry and IFI. MoF assures the transmission of the document throughout the phase of approval of loan agreement | Line Ministries, MOF, Ministry of External Relations and Donor |
| Impact Assessment of the proposed project | <ul style="list-style-type: none"> Central Bank: monetary impact Secretariat of Environment: environmental impact | N/A |
| CGR Approval | If approved, the proposal is sent back to MoF | N/A |
| Presidency Approval of loan agreement | Authorization decree, which also assigns the responsibility to sign the loan agreement to a member of government | Authorization decree, which also assigns the responsibility to sign the grant agreement to a member of government |
| Agreement Signature | Once the contract is signed, MoF sends to Presidency the contract with budget provisions for first year of execution | <ul style="list-style-type: none"> Grants in cash: same procedures as for loans; copy of the agreement sent to STP Grants in kind: agreement sent to STP |
| Incorporation of the first year of execution in the budget | Presidency transmits to Congress | For grants in cash only, Presidency transmits to Congress |
| Ratification by Ministry of External Relations | Only in the cases of operations with the government of Germany and Japan | <ul style="list-style-type: none"> Grants from IFIs followed by MoF (grants from IFIs): N/A Applied for other grants followed by Ministry of External Relations |
| Congress Approval | Publication in the Official Journal | Publication in the Official Journal |

Execution of Donor and IFIs funded operations and reliance on country systems

258. Country PFM and PR systems can be defined as those used for the management of country public financial resources. Their use for the execution of donor funds depends on whether (i) the donor organic rules authorize the transfer of implementation responsibility to the beneficiary country; (ii) funds are lent or granted; and (iii) the reliability of those country systems allows the donor to transfer partially or totally the responsibility. Thus, two aspects should be measured to determine the level of reliance on country systems: the proportion of donor funds

¹⁴⁵ The STP reviews (i) consistency between the project proposal and the sector strategy; (ii) risk of overlap with existing projects; (iii) sustainability of the project proposal; and (iv) relevance of the targeted beneficiaries.

whose execution responsibility is given to the country; and for these funds, which steps of the budget and PR cycles are implemented with the same systems as country own resources. The present section analyzes those two dimensions for the case of Paraguay.

259. **Estimation of the proportion of donor funds under government execution.** In Paraguay, 100 percent of IFIs and donors lending operations are administrated by the Government. Conversely, most of bilateral donors manage directly the financial and PR execution of their grants. The EC manages directly the execution of grant funds if they finance a specific activity - service, goods, or work - but the execution responsibility is transferred to government for budget support grants. Finally, IFIs transfer the execution responsibility to government for all their grants. Over the period 2004-2006, an estimated average of 60 percent of total annual donor-IFIs disbursements was executed by the Government,¹⁴⁶ although the use of such systems was partial, as explained below.
260. **Level of reliance on Country system.** Lending and grant funds executed by government rely on country system for budgeting, accounting consolidation, and treasury. Conversely, reporting to IFIs, internal control and external audit rely on 'ring-fenced' systems. IFIs-purpose reports cannot currently be automatically produced through country system, and CGR audit standards are not yet estimated acceptable by IFIs for external audits of projects. For budget execution, project implementing entities usually run 'ring-fenced' systems parallel to SIAF.¹⁴⁷
261. On the institutional dimension, the situation is also balanced: in 2006, out of the 23 project implementation units (PIUs) of the Central Administration, 39 percent were staffed exclusively with external consultants; 35 percent were staffed with civil servants only; and 26 percent included both civil servants and consultants. Interestingly, while some ministries —such as the Secretariat of Social Action— manage projects only through consultant-staffed PIUs, others —like the Ministry of Public Works— are relying mainly on civil servants.
262. Relative to neighboring countries with more stable and effective public sector, and considering Paraguay PFM and PR challenges, the level of reliance on the country system in Paraguay is high, and government decisions to avoid outsourcing project execution is reinforcing this tendency.
263. **Government decision to avoid outsourcing project execution.** Through the 2006 budget law, the Government prohibited new projects to outsource their execution to international organizations. The government position was motivated by the objectives of reducing the outsourcing transactional cost¹⁴⁸, and developing sustainable capacity. This measure was quickly implemented throughout the Government. For instance, the Ministry of Agriculture, whose strategy in the early 2000s was to extensively outsource, is now only outsourcing one loan and two grants that will all be closed by mid-2008. Still, this strategy puts more directly the government in front of the fiduciary and governance challenges of budget efficiency, control and institutional weaknesses.

¹⁴⁶ See indicator PI-2.

¹⁴⁷ See Table 5.5

¹⁴⁸ Between 3 and 7 percent of the volume of funds managed.

Table 5.5: Level of reliance on country systems for donor and IFIs funds executed by Government

| Implementation | Use of Country System |
|---------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Budget formulation | 100% of IFIs/Donors funds executed by the Government are included in the budget. |
| Use of PR Portal | - Projects whose implementation outsourced to international organization: 'ring-fenced' system - Project directly managed by government institution: rules followed for donor funded resources are similar to those for national resources. |
| Budget execution (excluding the treasury function) | - Recording of the execution is done through 'ring fenced' systems - The Government is developing, with the support of IDB, a module of SIAF specifically designed for the recording of the execution of IFIs and donor projects, the Integrated System of Accountancy and Project Administration (SICAP). The SICAP is planned to be implemented for IDB projects by 2008 and expanded to all donor projects executed by government in the forthcoming years. |
| Treasury function | - Projects whose implementation outsourced to international organization: payment procedure similar to that used for decentralized entities - Project directly implemented by Government: payment procedure similar to that used for Central Administration |
| Internal Control: Financial Management & Control Systems | IFIs require systematically the design of project specific procedures of internal control. Those procedures are compiled in an operational manual |
| Accounting & Reporting | IFIs funded expenditures are incorporated in the National Public Accounting System (SICO) and consolidated in the National Public Investment Account. |
| Reporting to IFIs | Executed through 'ring fenced' systems |
| External audit. | Executed through 'ring fenced' systems (private sector audits) |

Institutional settings for managing donor funded projects: Public Works, Agriculture, and Social Action

264. The organization and the constraints associated to the execution of donor funds vary among ministries. This section intends to illustrate this variety through three distinct examples: Ministry of Public Works, Ministry of Agriculture, and Secretariat of Social Action.

265. As mentioned in the previous section, the Ministry of Public Works is relying mainly on civil servants and organic directorates to execute donor funded programs. Coordination units are light entities to guide and monitor the execution by ministry's directorates. Project contracts, payments and accounting are executed by the Vice-Ministry of Administration and Finance¹⁴⁹. In addition, the Ministry includes a DGCDP, responsible for the IFIs specific reporting and disbursement requirements. The Ministry agreed with the WB to design an Institutional Governance Action Plan (IGAP) to improve its fiduciary and governance framework. The impact of such a plan is higher on an institution like the Ministry of Public Works where human resources are stable.

266. The organization is different at Ministry of Agriculture, where a specific General Directorate was established in 2000 to coordinate and manage donor funded projects (DINCAP). This Directorate was also delegated financial authority, with the set up of an autonomous financial sub-direction (Sub-UAF). However, due to the limited effectiveness of DINCAP, the implementation of donor funded projects has usually been outsourced. Besides, unlike the Ministry of Public Works, this ministry is unstable with a high rotation of Ministers since 2003¹⁵⁰, generating in the context of Paraguay public sector, high managerial rotation and affecting planning capacity,

¹⁴⁹ Usually in Paraguay, this is function assigned to the level of General Director.

¹⁵⁰ Five ministers since 2003.

efficient execution, and control. However, within a year, the Ministry of Agriculture succeeded to substantially reduce the proportion of outsourced operations, with the execution of only one operation still outsourced, and IDB and WB support an Action Plan under preparation to re-activate the financial and administration directorate of DINCAP. This plan intends to address in an integrated way fiduciary and governance aspects, while focusing the activities on only one directorate. It foresees an agreement and a formal commitment from the Minister; well defined procedures for internal competitive recruitment and replacement; defined job requirements; measures to provide economic incentives; and the implementation of an effective control framework.

267. The Secretariat of Social Action faces another challenge than the two previous cases. This is a relatively small entity in terms of staff strength, where project were and are still implemented through PIU staffed with consultants and where implementation was outsourced. The additional workload of fiduciary execution combined with its flat limited human resources will probably lead to maintain PIUs staffed with consultants. It is however key for the Secretariat to receive delegation of authority for financial aspects (establishment of a Sub-UAF).

The challenge of efficient execution

268. While control is the main fiduciary challenge at country level, its impact upon the management of donor funds is adjusted by the ring-fenced control framework¹⁵¹ required by IFIs and donors operating in Paraguay. Conversely, execution of donor operations is equally affected by country-level issues than national budget execution, as the below examples illustrate. First, the initial plan of execution of a donor operation is usually distorted by an initial delay, frequently higher than nine months, between the IFI and the Congress approval of the operation. Then, the annual rate of execution is usually under-performing. For the period 2004-2006, the rate of execution of donor funded operations at Ministries of Education, Health and Public Works represented on average less than 60 percent of the budgeted amounts. As a result, a high proportion of operations are extended. During the same period, 42 percent of active lending operations at the Ministries of Agriculture, Education, Health, and Public Works extended their closing dates for a period between 13 and 49 percent of their initial life-span.

¹⁵¹ For lending operations, control requirements include a clear design of flow of funds, a manual of internal control procedures, an accounting and budget execution system, an independent annual external audit. For operations involving transfer of funds to beneficiaries, concurrent audit are now systematic. In addition, operations are regularly supervised by fiduciary staff from the IFIs.

6. CONCLUSIONS

269. Paraguay has taken important steps in recent years to improve the effectiveness of its PFM and PR functions. These reforms have contributed to stronger fiscal discipline, improved tax collection, and greater transparency, particularly in the area of PR. Much work remains, however. The analysis produced by IFA has made clear that the PFM and PR agenda in Paraguay faces three main challenges: efficiency of the budget process; fiscal transparency, and; control effectiveness. This agenda calls for a range of technical and operational interventions. Meaningful and sustainable change, however, will depend on broad and intensive dialogue within Paraguayan society about good governance. Such a dialogue, led by Government with the participation of civil society and the private sector can help create the incentives, political will, and crucial checks and balances necessary for difficult, long-term reforms.
270. These far-reaching changes will take time, but Paraguay can pursue a pragmatic, realistic and achievable set of objectives over the near term. First, any initiative must have strong ownership of the authorities. This may mean that efforts will focus on a single ministry or agency; sweeping measures across Government unaccompanied by real commitment are doomed to fail. Second, measures should integrate PFM and PR reforms alongside actions in the areas of human resources and institutional strengthening. Third, specific actions planned during this immediate stage of the Government's reform strategy should avoid reliance on the passage of laws.
271. The PEFA and OECD-DAC exercises have provided useful information on PFM and PR functions in Paraguay. They also include methodology, which is designed to allow the Paraguayan authorities to take ownership of the process of monitoring PFM and PR performance over time. Most important, these cooperative instruments are establishing an important forum for dialogue and consultation for Paraguay and its development partners.

GOVERNMENTAL ACTION PLAN FOR PUBLIC FINANCIAL MANAGEMENT AND PROCUREMENT REFORM

The Action Plan was prepared by the Government of Paraguay, under the coordination of the Ministry of Finance. It is based on main findings identified by the Integrated Fiduciary Assessment (IFA) and other recent studies related to Public Finance Management (PFM) and Procurement (PR) in Paraguay, and it was undertaken with the technical support of the World Bank, the IDB and the European Commission. The Plan was presented to and discussed with representatives from international organizations and donors supporting PFM reform in the country.

Although the Plan was elaborated taking into account PFM's three general principles—strategic resource allocation, fiscal discipline, and effective and efficient delivery of public services—it is structured around four thematic areas, which reflect main findings identified by the IFA and stress out PFM limitations in Paraguay. These four areas are:

- Credibility and Efficiency of the Budgetary Process;
- Control Effectiveness;
- Aggregate Fiscal Risk; and
- Management of Funds from IFIs and Donors.

Reaching an effective and timely implementation of the measures proposed in the Plan depends to a large extent on the progress obtained by the country on broader governance aspects, in particular:

- Constitutional Aspects:
 - Checks and balances, with a focus on the relationship between the Executive and the Legislative;
 - Hierarchical Relationship between different laws.
- Civil Service and Architecture of the State:
 - Human Resources Management: rules for recruitment, promotion, mobility, training and civil service career;
 - Wage Policy;
 - Inter-institutional Coordination and Communication;
 - Architecture of the State, considering, inter alia, better adequacy between available functions and resources; and reduction of overlappings of functions and tasks.
- Transparency and Control of Corruption.

| Credibility & Efficiency of the Budgetary Process | Potential Legal Implications | Short Run < 2 years | Medium-Long Run > 2 years |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|---------------------|---------------------------|
| <p>Budgeting, strategic planning and resource allocation</p> | | | |
| <p>Further develop the initiative of the Ministry of Finance on multi-year budgeting, emphasizing implementation aspects of the computing system, already initiated, and a better coordination and ownership of Ministries, Departments, and Agencies (MDAs).</p> | | X | X |
| <p>Develop MDAs capacities in strategic planning through extensive training programs.</p> | | X | X |
| <p>Calculate multi-year cost for sectoral strategic programs.</p> | | | X |
| <p>Integrate the budget process with pre-investment activities.</p> | X | | X |
| <p>Reinforce inter-institutional coordination, in particular between the Ministry of Finance and the Technical Secretariat of Planning (STP).</p> | | | X |
| <p>Enhance the quality and transparency of annual budget information, including: macroeconomic assumptions, comprehensive fiscal revenues and expenditures of current and previous year, fiscal balance, stock of debt outstanding and borrowing requirements, a clearer distinction between new and existing budget programs, and budget implications of new policy initiatives.</p> | X | | X |
| <p>Define expenditure priorities within the Annual Budget Submission Message to the Congress, therefore complementing the overall objective of 'increasing social expenditure' through the introduction of more specific sectoral objectives.</p> | | | X |
| <p>Modify the Law of Financial Administration (LAFE) to formally introduce multi-annual framework in the annual budget law.</p> | X | | X |
| <p>Role of the Congress during the budget approval process</p> | | | |
| <p>Strengthen technical and professional capacities of the Congress on budgetary issues.</p> | | X | X |
| <p>Ensure that budget increases are financed by an increase in the country's tax burden.</p> | X | | X |
| <p>Eliminate the Annex on Personnel from the budget draft submitted to the Congress to reduce its discretionality on wage policy and the potential impact on fiscal discipline.</p> | X | | X |

| Credibility & Efficiency of the Budgetary Process | | Potential Legal Implications | Short Run < 2 years | Medium-Long Run > 2 years |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|------------------------------|---------------------|---------------------------|
| Budget Execution | | | | |
| Introduce commitment phase to all expenditure categories defined in the LAPE. | | | | |
| Further delegate authorization of payments and contracts within MDAs. | | | | |
| Delegate expenditure reallocation within the same budget program to the MDA level, (excluding personnel and capital expenditure). | | | | |
| Treasury and Cash Management | | | | |
| Track down bottlenecks and adopt mitigating measures to reduce Central Administration's floating debt. | | | | |
| Further reduce the number of Central Administration bank accounts. | | | | |
| Deepen efforts to flexibilize cash management through the integration of financial and cash plans. | | | | |
| Calculate the floating debt corresponding to the whole Non Financial Public Sector, including in particular state-owned enterprises. | | | | |
| Adopt the Treasury Single Account and establish a cash management unit. | | | | |
| Procurement | | | | |
| Advise authorities on the relevance of delegation of power in procurement—signature of contracts and budget reallocations—and issue regulatory norms to make delegation effective. | | | | |
| Improve the report issued by the Integrated Public Procurement System (SICP), and add systematic planning and monitoring mechanisms for the procurement process. | | | | |
| Implement e-purchasing by using Framework Contracts for goods used frequently and with low individual monetary value. | | | | |
| Extend internet cabins to all municipalities, and assure that they count with the necessary computational equipment, in order to spread out the use of the on-line SICP. | | | | |
| Analyze alternatives to the current conditionalities holding for the participation of foreign firms in national procurement bidding processes. | | | | |

| Control Effectiveness | | Potential Legal Implications | Short Run <2 years | Medium-Long Run >2 years |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|------------------------------|--------------------|--------------------------|
| Internal Control | | | | |
| Standardize and complement existing internal control rules and norms. | | | | |
| Update and expand the coverage of the Integrated Financial Management System (SIAF), and reinforce its integration with the other systems of the Public Administration (in particular the system for human resources management). | | | | |
| Design, develop and implement the FMIS application for good and services (SIABYS). | | | | |
| Consolidate and clarify the responsibilities about payroll and personnel control within the Central Administration. | | | | |
| Finalize the development and implementation of the human resources management system (SINARH). | | | | |
| Reinforce existing controls for inventories. | | | | |
| Promote inter-institutional dialogue on the current internal control model with a view to emphasize the information disconnection between actual budget outputs and budget accountability & reporting. | | | | |
| Internal audit. | | | | |
| Strengthen staff professional skills and competences through extensive training programs. | | | | |
| Redefine the role of the institutional internal audits (within MDAs) and the Office of the Executive's Internal Auditor. | | | | |
| External Audit | | | | |
| Further develop measures for improving audit methodology, organizational aspects, and human resources management. | | | | |
| Control Environment | | | | |
| Reinforce the coordination between internal and external audit. | | | | |
| Strengthen cooperation between the Office of the Executive's Internal Auditor and the Ministry of Finance. | | | | |
| Strengthen the Financial Administration Units of the MDAs through more transparent and meritocratic human resources management. | | | | |
| Take preliminary public administration reform measures related to civil service (career management, salaries and training), and inter-institutional coordination. | | | | |

| Control Effectiveness | Potential Legal Implications | Short Run < 2 years | Medium-Long Run > 2 years |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|---------------------|---------------------------|
| <p>Procurement</p> <p>Add an e-contract management system to the SICP, which includes the use by contract awarding entities of: (a) computational systems of management for programs, contracts, payments and inventories; (b) web-dissemination of program and contract management, progress on the fulfillment of contractual terms, and reports on the performance of contractors and suppliers; and (c) digital archives corresponding to the different stages of the procurement process and contract management. Establish an ethics code for public functionaries.</p> | | | X |
| | X | | X |

| Aggregate Fiscal Risk | Potential Legal Implications | Short Run <2 years | Medium-Long Run > 2 years |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|--------------------|---------------------------|
| Improve the estimation of inflation and nominal exchange rates incorporated in the budget. | | X | X |
| Develop a fiscal sustainability model allowing for the definition of medium-term fiscal policy targets. | | X | X |
| Perform periodically an analysis on fiscal aggregate risks and contingent liabilities, considering in particular the banking system and the decentralized public entities. | | X | X |
| Establish a Directorate of Fiscal Coordination with Municipalities within the Ministry of Finance (Under-Secretariat of Financial Administration). | X | | X |

| Management of Funds from IFIs and Donors | | Potential Legal Implications | Short Run < 2 years | Medium-Long Run > 2 years |
|----------------------------------------------------------------------------------------------------------------------------------|--|-------------------------------------|-------------------------------|-------------------------------------|
| Better coordinate the management of funds from IFIs and donors to avoid overlapping of tasks and other potential inefficiencies. | | | X | X |
| Centralize financial management monitoring for programs financed by IFIs and Donors. | | | | X |
| Design, develop and implement a specific FMIS application for the management of programs funded by IFIs and Donors. | | | X | X |
| Integrate databases and information flows related to IFIs and Donors funded programs | | | | X |
| Replace the current Congress approval process for external financing (by individual operation) with an overall annual quota. | | X | | X |

ANNEX 1.1 – WBI GOVERNANCE INDICATORS - DEFINITIONS

WBI Governance Indicators provide (i) an analytical framework for measuring the quality of governance; and (ii) time and cross country comparison. They include six dimensions: Voice and accountability; Political Stability and Absence of Violence; Government Effectiveness; Regulatory Quality; Rule of Law; and Control of Corruption. The table below provides the definition of these six dimensions.

| Dimension | Definition |
|---------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Voice and Accountability | Measures the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. |
| Political Stability and Absence of Violence | Measures the perceptions of likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including domestic violence and terrorism. |
| Government Effectiveness | Measures the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. |
| Regulatory Quality | Measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development |
| Rule of Law | Measures the extent to which agents have confidence in and abide by the rules of society, in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence. |
| Control of Corruption | Measures the extent to which public power is exercised for private gain, including petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests. |

ANNEX 1.2 – PEFA SCORING METHODOLOGY

Most of the indicators have a number of dimensions linked to the subject of the indicator. Each of these dimensions must be assessed separately. The overall score for an indicator is then based on the assessments for the individual dimensions of the indicator. Combining the scores for dimensions into the overall score for the indicator is done by Scoring Method 1 (M1) for some indicators and Scoring Method 2 (M2) for other indicators. It is specified in the indicator guidance for each indicator what methodology should be used.

Method 1 (M1) is used for all single dimensional indicators and for multi-dimensional indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance on other dimensions of the same indicator (in other words, by the weakest link in the connected dimensions of the indicator). For indicators with 2 or more dimensions, the steps in determining the overall or aggregate indicator score are as follows:

- Each dimension is initially assessed separately and given a score.
- Combine the scores for the individual dimensions by choosing the lowest score given for any dimension.
- A ‘+’ should be added, where any of the other dimensions are scoring higher (Note: It is NOT possible to choose the score for one of the higher scoring dimensions and add a ‘-’ for any lower scoring dimensions. And it is NOT possible to add a ‘+’ to the score of an indicator with only one listed dimension).

Method 2 (M2) is based on averaging the scores for individual dimensions of an indicator. It is prescribed for selected multi-dimensional indicators, where a low score on one dimension of the indicator does not necessarily undermine the impact of a high score on another dimension of the same indicator. Though the dimensions all fall within the same area of the PFM system, progress on individual dimensions can be made independent of the others and without logically having to follow any particular sequence. The steps in determining the overall or aggregate indicator score are as follows:

- For each dimension, assess what standard has been reached on the 4-point calibration scale (as for M1).
- Go to the Conversion Table for Scoring Method M2 (below) and find the appropriate section of the table (2, 3 or 4 dimensional indicators),
- Identify the line in the table that matches the combination of scores that has been given to the dimensions of the indicator (the order of the dimensional scores is immaterial),
- Pick the corresponding overall score for the indicator.

The Conversion Table applies to all indicators using M2 scoring methodology only and cannot be used for indicators using M1, as that would result in an incorrect score. The Conversion Table should NOT be used to aggregate scores across all or sub-sets of indicators, since the table was not designed for that purpose. In general, the performance indicator set has not been designed for aggregation, and therefore, no aggregation methodology has been developed

Conversion Table for Scoring Method M2

| Scores for individual dim. | | Overall score M2 | |
|---------------------------------|---|------------------|----|
| 2-dimensional indicators | | | |
| D | D | D | |
| D | C | C+ | |
| D | B | C | |
| D | A | C+ | |
| C | C | C | |
| C | B | C+ | |
| C | A | B | |
| B | B | B | |
| B | A | B+ | |
| A | A | A | |
| 3-dimensional indicators | | | |
| D | D | D | D |
| D | D | C | D+ |
| D | D | B | D+ |
| D | D | A | C |
| D | C | C | D+ |
| D | C | B | C |
| D | C | A | C+ |
| D | B | B | C+ |
| D | B | A | B |
| D | A | A | B |
| C | C | C | C |
| C | C | B | C+ |
| C | C | A | B |
| C | B | B | B |
| C | B | A | B |
| C | A | A | B+ |
| B | B | B | B |
| B | B | A | B+ |
| B | A | A | A |
| A | A | A | A |

| Scores for individual dim. | | | | Overall score M2 |
|---------------------------------|---|---|---|------------------|
| 4-dimensional indicators | | | | |
| D | D | D | D | D |
| D | D | D | C | D |
| D | D | D | B | D+ |
| D | D | D | A | D+ |
| D | D | C | C | D+ |
| D | D | C | B | D+ |
| D | D | C | A | C |
| D | D | B | B | C |
| D | D | B | A | C+ |
| D | D | A | A | C+ |
| D | C | C | C | D+ |
| D | C | C | B | C |
| D | C | C | A | C+ |
| D | C | B | B | C+ |
| D | C | B | A | C+ |
| D | C | A | A | B |
| D | B | B | B | C+ |
| D | B | B | A | B |
| D | B | A | A | B |
| D | A | A | A | B+ |
| C | C | C | C | C |
| C | C | C | B | C+ |
| C | C | C | A | C+ |
| C | C | B | B | C+ |
| C | C | B | A | B |
| C | C | A | A | B |
| C | B | B | B | B |
| C | B | B | A | B |
| C | B | B | A | B |
| C | B | A | A | B+ |
| C | B | A | A | B+ |
| C | A | A | A | B+ |
| B | B | B | B | B |
| B | B | B | A | B+ |
| B | B | A | A | B+ |
| B | A | A | A | A |
| A | A | A | A | A |

Note: It is of no importance in which order the dimensions in an indicator are assigned the individual scores

The table CANNOT be applied to indicators using scoring method M1.

ANNEX 3.1 – SUMMARY TABLE OF PEFA PERFORMANCE INDICATORS

Summary Table of PEFA Indicators Scoring

| No. | Indicator | Scoring |
|-------|-------------------------------------------------------------------------------------------------|---------|
| | PFM-OUT-TURNS: Credibility of the budget | |
| PI-1 | Aggregate expenditure out-turn compared to original approved budget | C |
| PI-2 | Composition of expenditure out-turn compared to original approved budget | B |
| PI-3 | Aggregate revenue out-turn compared to original approved budget | A |
| PI-4 | Stock and monitoring of expenditure payment arrears | C+ |
| | KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency | |
| PI-5 | Classification of the budget | B |
| PI-6 | Comprehensiveness of information included in budget documentation | C |
| PI-7 | Extent of unreported government operations | B+ |
| PI-8 | Transparency of inter-governmental fiscal relations | D+ |
| PI-9 | Oversight of aggregate fiscal risk from other public sector entities | C |
| PI-10 | Public access to key fiscal information | A |
| | BUDGET CYCLE | |
| | Policy-Based Budgeting | |
| PI-11 | Orderliness and participation in the annual budget process | A |
| PI-12 | Multi-year perspective in fiscal planning, expenditure policy and budgeting | D+ |
| | Predictability and Control in Budget Execution | |
| PI-13 | Transparency of taxpayer obligations and liabilities | C+ |
| PI-14 | Effectiveness of measures for taxpayer registration and tax assessment | C |
| PI-15 | Effectiveness in collection of tax payments | D+ |
| PI-16 | Predictability in the availability of funds for commitment of expenditures | C+ |
| PI-17 | Recording and management of cash balances, debt and guarantees | B+ |
| PI-18 | Effectiveness of payroll controls | D+ |
| PI-19 | Competition, value for money and controls in procurement | B+ |
| PI-20 | Effectiveness of internal controls for non-salary expenditure | D+ |
| PI-21 | Effectiveness of internal audit | D+ |
| | Accounting, Recording and Reporting | |
| PI-22 | Timeliness and regularity of accounts reconciliation | C+ |
| PI-23 | Availability of information on resources received by service delivery units | C |
| PI-24 | Quality and timeliness of in-year budget reports | C+ |
| PI-25 | Quality and timeliness of annual financial statements | C+ |
| | External Scrutiny and Audit | |
| PI-26 | Scope, nature and follow-up of external audit | C+ |
| PI-27 | Legislative scrutiny of the annual budget law | B+ |
| PI-28 | Legislative scrutiny of external audit reports | D+ |
| | DONOR PRACTICES | |
| D-1 | Predictability of Direct Budget Support | C+ |
| D-2 | Financial information provided by donors for budgeting and reporting on project and program aid | D+ |
| D-3 | Proportion of aid that is managed by use of national procedures | C |

| No. | Indicator | Scoring | Brief Explanation and Cardinal Data used |
|-------|--------------------------------------------------------------------------|-----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | PFM-OUT-TURNS: Credibility of the budget | | |
| PI-1 | Aggregate expenditure out-turn compared to original approved budget | C | In no more than one of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure. |
| PI-2 | Composition of expenditure out-turn compared to original approved budget | B | Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than one of the last three years. |
| PI-3 | Aggregate revenue out-turn compared to original approved budget | A | Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years. |
| PI-4 | Stock and monitoring of expenditure payment arrears | C+ | The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years. Data on the stock of arrears is generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions. |
| | KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency | | |
| PI-5 | Classification of the budget | B | The budget formulation and execution is based on administrative, economic and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards. |
| PI-6 | Comprehensiveness of information included in budget documentation | C | Recent budget documentation fulfils 3-4 of the 9 information benchmarks. |
| PI-7 | Extent of unreported government operations | B+ | The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure). Complete income/expenditure information is included in fiscal reports for all loan financed projects and at least 50% (by value) of grant financed projects. |
| PI-8 | Transparency of inter-governmental fiscal relations | D+ | No or hardly any part of the horizontal allocation of transfers from central government is determined by transparent and rules based systems. Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable. Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for at least 75% (by value) of SN government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year. |
| PI-9 | Oversight of aggregate fiscal risk from other public sector entities | C | Most major AGAs/PEs submit fiscal reports to central governments at least annually, but a consolidated overview is missing or significantly incomplete. The net fiscal position is monitored at least annually for the most important level of SN government, but a consolidated overview is missing or significantly incomplete. |
| PI-10 | Public access to key fiscal information | A | The government makes available to the public 5-6 of the 6 listed types of information. |

| No. | Indicator | Scoring | Brief Explanation and Cardinal Data used |
|-------|-----------------------------------------------------------------------------|-----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | BUDGET CYCLE | | |
| | Policy-Based Budgeting | | |
| PI-11 | Orderliness and participation in the annual budget process | A | A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time. A comprehensive and clear budget circular is issued to MDAs, which reflect ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission. The legislature has, during the last three years, approved the budget before the start of the fiscal year. |
| PI-12 | Multi-year perspective in fiscal planning, expenditure policy and budgeting | D+ | Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis. A DSA for external debt undertaken at least once during last three years. Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure. Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared. |
| | Predictability and Control in Budget Execution | | |
| PI-13 | Transparency of taxpayer obligations and liabilities | C+ | Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved. Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date. A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent and effective. |
| PI-14 | Effectiveness of measures for taxpayer registration and tax assessment | C | Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance. There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria. |
| PI-15 | Effectiveness in collection of tax payments | D+ | The total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections). All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily. Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually. |
| PI-16 | Predictability in the availability of funds for commitment of expenditures | C+ | A cash flow forecast is prepared for the fiscal year, and is updated monthly on the basis of actual cash inflows and outflows. MDAs' are able to plan and commit expenditure for at least six month in advance in accordance with the budgeted appropriations. Significant in-year budget |

| | | | adjustments frequent, but undertaken with transparency. |
|--------------------------------------------|-----------------------------------------------------------------------------|-----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| No. | Indicator | Scoring | Brief Explanation and Cardinal Data used |
| PI-17 | Recording and management of cash balances, debt and guarantees | B+ | Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually. Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement. Central government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity. |
| PI-18 | Effectiveness of payroll controls | D+ | Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database. Required changes to the personnel records and payroll are updated monthly, generally in time for the following month's payments. Retroactive adjustments are rare. Controls exist, but are not adequate to ensure full integrity of data. Partial payroll audits or staff surveys have been undertaken within the last 3 years. |
| PI-19 | Competition, value for money and controls in procurement | B+ | Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition. Other less competitive methods when used are justified in accordance with legal and regulatory requirements. A process for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority. |
| PI-20 | Effectiveness of internal controls for non-salary expenditure | D+ | Expenditure commitment control procedures exist and are partially effective, but they do not comprehensively cover all expenditures. Clear, comprehensive and reliable control rules/procedures are lacking in other important areas. Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern. |
| PI-21 | Effectiveness of internal audit | D+ | There is little or no internal audit focused on systems monitoring. Reports are issued regularly for most government entities, but may not be submitted to the ministry of finance and the SAI. Internal audit recommendations are usually ignored (with few exceptions). |
| Accounting, Recording and Reporting | | | |
| PI-22 | Timeliness and regularity of accounts reconciliation | C+ | Bank reconciliation for all Treasury managed bank accounts take place quarterly, usually within 8 weeks of end of quarter. Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward. |
| PI-23 | Availability of information on resources received by service delivery units | C | Budget information shows the level of resources received by primary health clinic covering a significant part of the country. |

| No. | Indicator | Scoring | Brief Explanation and Cardinal Data used |
|------------------------------------|-------------------------------------------------------|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| PI-24 | Quality and timeliness of in-year budget reports | C+ | Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages. Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period. There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness. |
| PI-25 | Quality and timeliness of annual financial statements | C+ | A consolidated government statement is prepared annually and includes, with few exceptions, full information on revenue, expenditure and financial assets/liabilities. The statement is submitted for external audit within 6 months of the end of the fiscal year. Statements are presented in consistent format over time with some disclosure of accounting standards . |
| External Scrutiny and Audit | | | |
| PI-26 | Scope, nature and follow-up of external audit | C+ | Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only. Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office. A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up. |
| PI-27 | Legislative scrutiny of the annual budget law | B+ | The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures. The legislature has at least two months to review the budget proposals. Clear rules exist for in-year budget amendments by the executive, which set strict limits on extent and nature of amendments and are consistently respected. |
| PI-28 | Legislative scrutiny of external audit reports | D+ | Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with ministry of finance officials only. Actions are recommended, but are rarely acted upon by the executive. |

| No. | Indicator | Scoring | Brief Explanation and Cardinal Data used |
|------------------------|-------------------------------------------------------------------------------------------------|---------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| DONOR PRACTICES | | | |
| D-1 | Predictability of Direct Budget Support | C+ | In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 15%. Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years. |
| D-2 | Financial Information provided by donors for budgeting and reporting on project and aid program | D+ | Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start. Donors provide quarterly reports within two months of end-of-quarter on the all disbursements made for at least 50% of the externally financed project estimates in the budget. The information does not necessarily provide a break-down consistent with the government budget classification. |
| D-3 | Proportion of aid that is managed by use of national procedures | C | 50% or more of aid funds to central government are managed through national procedures. |

ANNEX 3.2: OVERVIEW OF PEFA INDICATORS – BENCHMARKING COUNTRIES

| | <i>A. PFM-OUT-TURNS: Credibility of the budget</i> | <i>Paraguay</i> | <i>Average</i> | <i>Ghana</i> | <i>Kyrgyz Republic</i> | <i>Mozambique</i> | <i>Gabon</i> | <i>Moldova</i> | <i>Zambia</i> | <i>Bangladesh</i> | <i>Afghanistan</i> |
|-------|-----------------------------------------------------------------------------------|-----------------|----------------|--------------|------------------------|-------------------|--------------|----------------|---------------|-------------------|--------------------|
| PI-1 | Aggregate expenditure out-turn compared to original approved budget | C | C+ | B | D | A | B | A | C | C | C |
| PI-2 | Composition of expenditure out-turn compared to original approved budget | B | C+ | D | A | B | D | A | D | B | C |
| PI-3 | Aggregate revenue out-turn compared to original approved budget | A | B+ | A | A | B | B | A | A | C | A |
| PI-4 | Stock and monitoring of expenditure payment arrears | C+ | C | B+ | D | D+ | C | B | D+ | D | C |
| | <i>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</i> | | | | | | | | | | |
| PI-5 | Classification of the budget | B | C+ | B | C | B | C | C | C | C | C+ |
| PI-6 | Comprehensiveness of information included in budget documentation | C | C+ | C | B | B | C | A | B | C | C |
| PI-7 | Extent of unreported government operations | B+ | C+ | A | N/A | C+ | C | B+ | D+ | D | B |
| PI-8 | Transparency of inter-governmental fiscal relations | D+ | C | C | C+ | C+ | C | A | D+ | D+ | D |
| PI-9 | Oversight of aggregate fiscal risk from other public sector entities. | C | C | C | D+ | D+ | C | C+ | C | C | D |
| PI-10 | Public access to key fiscal information | A | B | B | C | C | C | A | B | C | B |
| | <i>C. BUDGET CYCLE</i> | | | | | | | | | | |
| | <i>C(i) Policy-Based Budgeting</i> | | | | | | | | | | |
| PI-11 | Orderliness and participation in the annual budget process | A | B | B | B | B | C | B+ | B | B | C |
| PI-12 | Multi-year perspective in fiscal planning, expenditure policy and budgeting | D+ | D+ | C | D+ | C+ | D | B | C+ | D+ | D+ |
| | <i>C(ii) Predictability and Control in Budget Execution</i> | | | | | | | | | | |
| PI-13 | Transparency of taxpayer obligations and liabilities | C+ | C+ | B | C | B | C | A | B | D+ | D+ |
| PI-14 | Effectiveness of measures for taxpayer registration and tax assessment | C | C | C | N/A | C+ | C | B+ | C+ | D+ | D+ |
| PI-15 | Effectiveness in collection of tax payments | D+ | D+ | C | B+ | D+ | C | D+ | D+ | C | D+ |
| PI-16 | Predictability in the availability of funds for commitment of expenditures | C+ | D+ | C | D | D+ | C | C+ | D+ | C | D+ |
| PI-17 | Recording and management of cash balances, debt and guarantees | B+ | C+ | B | B+ | B+ | N/A | B | C | C | C+ |
| PI-18 | Effectiveness of payroll controls | D+ | D+ | C+ | N/A | D+ | C | D+ | D+ | C | C |
| PI-19 | Competition, value for money and controls in procurement | B+ | C | N/A | C+ | C | D | C+ | D+ | B | C+ |

| | C. BUDGET CYCLE | <i>Paraguay</i> | <i>Average</i> | <i>Ghana</i> | <i>Kyrgyz Republic</i> | <i>Mozambique</i> | <i>Gabon</i> | <i>Moldova</i> | <i>Zambia</i> | <i>Bangladesh</i> | <i>Afghanistan</i> |
|-------|-------------------------------------------------------------------------------------------------|-----------------|----------------|--------------|------------------------|-------------------|--------------|----------------|---------------|-------------------|--------------------|
| | C(ii) Predictability and Control in Budget Execution | | | | | | | | | | |
| PI-20 | Effectiveness of internal controls for non-salary expenditure | D+ | D+ | C | D+ | D+ | C | C+ | C | C | C |
| PI-21 | Effectiveness of internal audit | D+ | D+ | D+ | D | C+ | C | C+ | D+ | D | C |
| | C(iii) Accounting, Recording and Reporting | | | | | | | | | | |
| PI-22 | Timeliness and regularity of accounts reconciliation | C+ | C+ | C | N/A | B | B | B+ | C+ | C | C+ |
| PI-23 | Availability of information on resources received by service delivery units | C | C | D | D | C | C | B | C | C | D |
| PI-24 | Quality and timeliness of in-year budget reports | C+ | C | C+ | C+ | C+ | C | C+ | C+ | C | C |
| PI-25 | Quality and timeliness of annual financial statements | C+ | C | C+ | D | B | N/A | C+ | C+ | C | C |
| | C(iv) External Scrutiny and Audit | | | | | | | | | | |
| PI-26 | Scope, nature and follow-up of external audit | C+ | C | C+ | D | D+ | N/A | C+ | B+ | N/A | C |
| PI-27 | Legislative scrutiny of the annual budget law | B+ | C | C+ | D+ | B+ | N/A | B+ | C+ | D | D |
| PI-28 | Legislative scrutiny of external audit reports | D+ | C+ | C+ | D | C+ | N/A | D+ | C+ | C | D |
| | D. DONOR PRACTICES | | | | | | | | | | |
| D-1 | Predictability of Direct Budget Support | C+ | C+ | C+ | C+ | C+ | N/A | N/A | D | B | A |
| D-2 | Financial information provided by donors for budgeting and reporting on project and program aid | D+ | D+ | C | N/A | D+ | N/A | D | D+ | C | D+ |
| D-3 | Proportion of aid that is managed by use of national procedures | C | D+ | D | N/A | D | N/A | D | D | B | D |

ANNEX 3.3: 2005 WBI GOVERNANCE INDICATORS – BENCHMARKING COUNTRIES

| 2005 Governance Indicators | Paraguay | Average | Ghana | Kyrgyz Republic | Mozambique | Gabon | Moldova | Zambia | Bangladesh | Afghanistan |
|-------------------------------------------|-----------------|----------------|--------------|----------------------------|-------------------|--------------|----------------|---------------|-------------------|--------------------|
| Voice and Accountability | 41.1 | 34.24 | 58.9 | 22.7 | 44.4 | 29.5 | 32.4 | 36.2 | 31.4 | 11.6 |
| Political Stability/No Violence | 28.3 | 30.62 | 50.5 | 13.7 | 47.2 | 53.8 | 27.8 | 45.3 | 6.6 | 2.4 |
| Government Effectiveness | 23.4 | 27.92 | 53.6 | 20.6 | 44.0 | 32.1 | 27.8 | 19.6 | 21.1 | 9.1 |
| Regulatory Quality | 22.8 | 28.66 | 49.5 | 24.8 | 28.2 | 47.5 | 38.1 | 26.7 | 14.9 | 5.4 |
| Rule of Law | 16.4 | 26.72 | 48.3 | 13.5 | 31.4 | 40.1 | 35.3 | 34.3 | 19.8 | 1.4 |
| Control of Corruption | 7.4 | 21.52 | 45.3 | 13.8 | 31.0 | 35.5 | 27.1 | 23.2 | 7.9 | 2.5 |

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PARAGUAY

- SELECTED CITIES AND TOWNS
- ⊙ DEPARTMENT CAPITALS
- ⊕ NATIONAL CAPITAL
- RIVERS
- PAN-AMERICAN HIGHWAY
- MAIN ROADS
- RAILROADS
- DEPARTMENT BOUNDARIES
- INTERNATIONAL BOUNDARIES

