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Investing in Paraguay's Future

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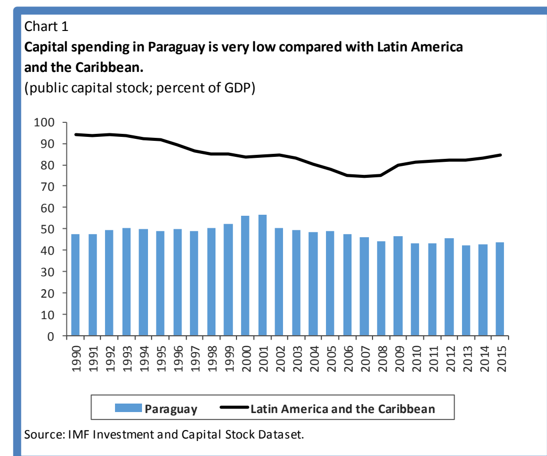
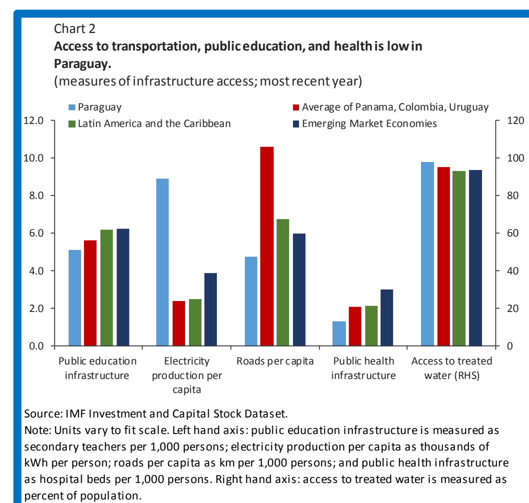
Infrastructure needs in much of Latin America are vast and Paraguay is no exception. The country faces a substantial "infrastructure gap" compared to its regional partners—despite stepped-up efforts in public investment. Fortunately, Paraguay has fiscal space to boost infrastructure spending. The challenge will be convincing a reluctant public that the country can borrow safely and invest effectively to secure a brighter economic future.

Underinvesting in infrastructure

Earlier this month, senior policymakers, officials from international organizations, and local experts gathered in Asuncion to discuss public investment and its financing in Paraguay. The public sector has invested little compared to others over the years, despite being among the less developed countries in the region and having very sound public finances with relatively low levels of public debt. Even in a region not known for large spending on infrastructure, Paraguay has struggled to keep pace with both the quantity and quality of its infrastructure. According to the IMF's Investment Capital Stock Dataset, for example, the stock of public capital in Paraguay stood at 44 percent of GDP in 2015 against an average of 79 percent for emerging markets and 84 percent for Latin America (see Chart 1).



Other indicators also suggest that infrastructure needs remain sizable. For example, *access* to infrastructure is lacking in a number of dimensions (see Chart 2), especially transportation, public education, and health. A notable exception is electricity production—given the country's large hydroelectric power generation capacity; but electricity distribution within the country is still deficient. Infrastructure *quality* also compares less favorably to other emerging markets.



These infrastructure gaps matter because they can have important ramifications for growth. New infrastructure has the potential to raise productivity—of land, labor, and other physical capital—so that new investment and other factors of production are stimulated. For instance, when transportation quality improves, workers are more likely to join the labor force and new

firms can be created because of better roads. Studies show that an increase of one percent of GDP in public investment can spur up to ½ percent higher output or more after four years. In other words, a return of 15 percent per year. The more efficient the public investment, the larger the benefit to growth.

Borrowing to invest?

Given the high social and economic returns of infrastructure investment and Paraguay's stage of development (its income per capita in 2015 stood at 48 percent of the average for South America), a big push on public investment will most likely require some financing through higher public debt. Public-private partnerships can provide an alternative financing option, at least for some type of projects, but Paraguay has less experience with this type of arrangement. More importantly, public concerns about higher government debt and how well funds will be spent may be restraining larger ambitions.

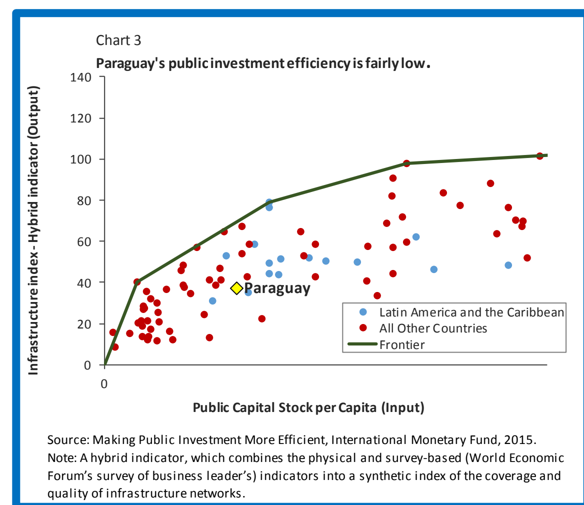
Higher debt increases a country's vulnerability to shocks and can lead to fiscal or financial distress if not managed well. In that context, assessing the appropriate public debt level for Paraguay is important. Recent analysis, as pointed out in an unpublished IMF technical assistance report by Luc Eyraud, Felipe Bardella, and Antonio C. David, indicates that a "safe" level of debt for Paraguay could lie in the range of 30 to 45 percent of GDP, noticeably above the current debt level of under 25 percent of GDP. In some cases, more public borrowing to invest can be desirable because it reduces funding reliance on current (distortionary) taxes, shares the costs with future generations who are likely to benefit from key investments, and can take advantage of the current environment of low interest rates where project returns may well exceed their debt servicing costs. Paraguay has been quite successful in raising capital in international sovereign debt markets, most recently at a 10-year maturity with a 5 percent interest rate.

Value for money

Another challenge—a complementary one—involves the *efficiency* of investment. In Paraguay, low public capital reflects not only years of underinvestment, but also inefficiencies in infrastructure investment. Here, Paraguay is situated well below the frontier (that is, below top performers; see Chart 3). This indicates that it could be reaping substantially more infrastructure for the same amount of dollar invested—in other words, more "value for money." How? According to a recent study, there is considerable scope for Paraguay to enhance its efficiency given the country's limited capacity for project selection and evaluation, absence of a multiyear budgeting processes, and insufficient regulation of infrastructure companies—all important bottlenecks in the management of efficient public investment. Efforts on these fronts to strengthen underlying institutions, frameworks, and processes are under way (for instance, with the National System for Public Investment), but

Chart 3

Paraguay's public investment efficiency is fairly low.



Source: Making Public Investment More Efficient, International Monetary Fund, 2015.
Note: A hybrid indicator, which combines the physical and survey-based (World Economic Forum's survey of business leader's) indicators into a synthetic index of the coverage and quality of infrastructure networks.

much more needs to be done to reassure a concerned public that borrowing safely and investing wisely is in the nation's best interest.

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