

**Paraguay: Report on Observance of Standards and Codes—  
Fiscal Transparency Module**

This Report on the Observance of Standards and Codes on Fiscal Transparency for **Paraguay** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **December 19, 2005**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Paraguay or the Executive Board of the IMF.

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PARAGUAY

**Report on the Observance of Standards and Codes (ROSC)  
Fiscal Transparency Module**

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**December 19, 2005**

**EXECUTIVE SUMMARY**

This report assesses fiscal transparency practices in Paraguay against the requirements of the IMF *Code of Good Practices on Fiscal Transparency* (see <http://www.imf.org/external/np/fad/trans/manual/>), based on discussions with the authorities, their response to the IMF fiscal transparency questionnaire, and other sources of information.

In recent years, Paraguay has made important progress toward greater fiscal transparency. The fairly comprehensive financial administration law (1999) has been complemented by recent legal reforms that eliminated most tax exemptions, revamped revenue administration procedures and introduced standardized transparency requirements for public procurement, all of which reduce the scope for corruption. In addition, efforts are ongoing to clarify the relations between the government and the nonfinancial public enterprises (NFPEs), including through tariff adjustments that have reduced quasi-fiscal activities (QFAs) and the launching of external audits of the enterprises' financial health carried out by international firms.

However, Paraguay fails to meet several requirements (at times even basic ones) of the code: (i) the transparency and credibility of the budget as an expression of the government's fiscal objectives and a guide to fiscal policy implementation are severely limited by the lack of an underlying consistent macroeconomic framework, the limited accountability imposed on the amendments introduced either by congress or the executive at both the approval and execution stages, and the lack of a modern framework for civil service; (ii) relations across different branches of government and between the latter and the rest of the public sector are not always clear and little information is provided on QFAs; (iii) few assurances of data quality are provided, as data reconciliation and assessments by the relevant national body are weak; and (iv) disclosure of fiscal information is sparse and its coverage not comprehensive.

A broad and sustained effort is required to address the identified deficiencies. First, it is paramount to ensure the transparency, discipline and realism of the budget process as the key fiscal policy tool, by clarifying the roles and increasing accountability of different government branches, strengthening their capacity for macrofiscal analysis, and completing financial management reforms to tighten control over budget execution. Second, the recent gains in transparency and efficiency of revenue administration should be consolidated. Third, the framework for public employment should be modernized to increase the role of merit-based transparent and objective criteria in the hiring, selection, and promotion procedures. Fourth, relations between the government and the rest of the public sector should be based on clear and stable arrangements, with all the ensuing contingent liabilities and quasi-fiscal costs clearly identified, quantified, and publicized. Fifth, assurances of data quality should be significantly increased. In the short term, the executive could take relatively easy steps within its purview to increase transparency, including by quantifying contingent liabilities, fiscal risks, and QFAs, further institutionalizing the provision of fiscal information and analysis, and extending the focus of fiscal policy and reporting to a *Government Finance Statistics (GFS)*-consistent consolidated central government concept.

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## ACRONYMS

ACE	State Central Administration	
AII	Institutional Internal Audit Office	
AGPE	Executive Branch General Audit Office	
ANDE	National Electricity Administration	<a href="http://www.ande.gov.py">www.ande.gov.py</a>
ANNP	National Navigation and Ports Administration	<a href="http://www.annp.gov.py">www.annp.gov.py</a>
ANTELCO	National Communications Administration	
BCP	Central Bank of Paraguay	<a href="http://www.bcp.gov.py">www.bcp.gov.py</a>
BNAPV	Banco Nacional de Ahorro y Préstamo a la Vivienda (housing savings and loan bank)	
BNF	Banco Nacional de Fomento (development bank)	<a href="http://www.bnf.gov.py">www.bnf.gov.py</a>
CAH	Crédito Agrícola de Habilitación (farm credit institution)	
CGR	Office of the Controller-General of the Republic	<a href="http://www.contraloría.gov.py">www.contraloría.gov.py</a>
COPACO (ex ANTELCO)	Compañía Paraguaya de Comunicaciones (communications company)	<a href="http://www.copaco.com.py">www.copaco.com.py</a>
CORPOSANA	Corporación de Obras Sanitarias (public sanitary projects)	
DIBEN	National Welfare Directorate	<a href="http://www.diben.gov.py">www.diben.gov.py</a>
DINAC	National Civil Aeronautics Directorate	
DGP	General Budget Directorate	<a href="http://www.hacienda.gov.py">www.hacienda.gov.py</a>
DPF	Fiscal Policy Directorate	<a href="http://www.hacienda.gov.py">www.hacienda.gov.py</a>
EEDDs	Decentralized Agencies	
EEN	National Economic Team	
ESSAP (ex CORPOSANA)	Empresa de Servicios Sanitarios del Paraguay S.A. (public sanitary services)	<a href="http://www.essap.gov.py">www.essap.gov.py</a>
FDC	Fondo de Desarrollo Campesino (rural development fund)	
FDI	Fondo de Desarrollo Industrial (industrial development fund)	
GDDS	General Data Dissemination System	
GFS	<i>Government Finance Statistics</i>	
IPS	Instituto de Previsión Social (social welfare institute)	<a href="http://www.ips.gov.py">www.ips.gov.py</a>
INC	Industria Nacional de Cemento (national cement industry)	
LAFE	Law on Government Financial Administration	
LOD	Departmental Organic Law	
LOM	Municipal Organic Law	
MoF	Ministry of Finance	<a href="http://www.hacienda.gov.py">www.hacienda.gov.py</a>
NFPS	Nonfinancial Public Sector	
NFPEs	Nonfinancial Public Enterprises	
OACs	Central Government Agencies	
PETROPAR	Petróleos Paraguayos (oil company)	<a href="http://www.petropar.gov.py">www.petropar.gov.py</a>
PFI	Public Financial Institutions	
PGN	General State Budget	
QFAs	Quasi-fiscal activities	
RAAF	Administrative Reorganization and Fiscal Adjustment Law	
ROSC	Reports on the Observance of Standards and Codes	
SIAF	Integrated Financial Administration System	
SICO	Integrated Accounting System	
UDAFs	Financial Administration Units	

## I. INTRODUCTION

1. This report<sup>1</sup> assesses fiscal transparency practices in Paraguay in light of the IMF's *Code of Good Practices on Fiscal Transparency*. The assessment has two parts. The first describes current practices based on responses to the IMF's fiscal transparency questionnaire as well as additional information obtained from the authorities; the second part contains IMF staff comments on fiscal transparency in Paraguay.

## II. DESCRIPTION OF PRACTICES

### A. Clear Definition of Functions and Responsibilities

#### The structure and functions of government

2. **From a constitutional and legal perspective, the delineation of functions between the public and private sectors is well defined, but the dividing line between the government and the rest of the public sector needs to be clarified.** 1.1  
According to the constitution,<sup>2</sup> Paraguay is a unified and indivisible—though decentralized—republic. There is no framework law regulating the government. According to the budget law,<sup>3</sup> the public sector consists of the state central administration (ACE), decentralized agencies (EEDDs), and 228 municipalities.<sup>4</sup> The ACE comprises the legislative,<sup>5</sup> executive,<sup>6</sup> and judicial<sup>7</sup> branches, as well as, the Office of the Controller-General of the Republic

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<sup>1</sup> The original version of this report was prepared by a team from the IMF Fiscal Affairs Department (FAD), comprising Mr. J. Seade (head), Mr. J. Viñuela, Ms. T. Dabán, Ms. M. Guin-Siu, and Mr. J. Vinuela, in their visit to Asunción during August 5–16, 2002. The original version was updated with relevant developments in fiscal transparency during the years 2003–05, by a second team from the IMF FAD comprising Ms. M. Albino-War (head) and Mr. D. Lombardo in their visit to Asunción of September 5–13, 2005.

<sup>2</sup> 1992 Political Constitution of the Republic of Paraguay. For purposes of the political and administrative organization of the government, the national territory is divided into departments, municipalities, and districts, which, within certain limits, are granted political, administrative, and regulatory autonomy for the management of their interests, and self-sufficiency in the collection and investment of their resources (Article 156).

<sup>3</sup> Law 1535 of 1999 on Government Financial Administration (LAFE).

<sup>4</sup> The constitution grants municipalities autonomy for the management of matters within their jurisdiction and for the administration of their assets and resources. The municipalities are headed by a local mayor (*intendente*) and a municipal board, both elected.

<sup>5</sup> Legislative authority is exercised by the chamber of deputies, representing departments, and the senate representing the nation.

<sup>6</sup> Executive authority is exercised by the Office of the President of the Republic, consisting of 19 Secretariats headed by staff with the rank of minister, the Office of the Vice President, and the council of state.

<sup>7</sup> The judicial branch comprises the supreme court of justice, the superior court of electoral justice, the office of the attorney general, and the judiciary council (*Consejo de la Magistratura*).

(CGR). The EEDDs<sup>8</sup> include a number of very different entities, some of which have strictly noncommercial functions, such as the 17 departmental governments,<sup>9</sup> the public social security agencies, the national universities, regulatory bodies, and other agencies with various political functions. Others however, such as the NFPEs and public financial institutions (PFIs), in addition to the specific commercial functions assigned to them, engage in important QFAs. The general state budget (PGN) covers the entire public sector without differentiating between central government, as defined in the *GFS*, and the rest of the public sector. The periodic budget execution reports only cover the ACE. None of these documents provide information on the fiscal activity of the consolidated central government. The municipalities have the power to approve their own budgets while departmental governments must submit a general departmental budget proposal to the national government, which is included in and approved as a component of the PGN.

### Fiscal management across different levels of government

#### **3. Legally, the division of taxation responsibilities among government levels is clear, but determination of the subnational governments' share of general revenue is based on discretionary criteria.** 1.1.2

The constitution states that congress has exclusive powers to establish national and subnational level taxes. Municipalities and departmental governments, by ordinance or resolution, may only set rates for services provided.<sup>10</sup> The constitution<sup>11</sup> also states that real property taxes are to be collected by the municipalities, which are to share them with the departmental governments, in accordance with a formula.<sup>12</sup> The LOD states that revenue from levies on games of chance is to be distributed among the municipalities (30 percent), the departmental governments (30 percent), the national welfare directorate (30 percent) and

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<sup>8</sup> From a legal standpoint, the EEDDs are public law entities with legal status and their own capital. When financially self-sufficient, they are known as “self-sufficient” entities. When they have regulatory autonomy, they are called “autonomous” entities. They are governed by their own charter or special law, and, in general, are attached to or report to an agency of the ACE.

<sup>9</sup> The departmental organic law (LOD) defines the departmental governments as public law entities with political, administrative, and regulatory autonomy for the management of their interests, and self-sufficiency in the collection and investment of their resources. Each departmental government is headed by a governor and a departmental board, both elected.

<sup>10</sup> Municipal Organic Law (LOM) 898/1996, Article 20, and LOD 426/1994, Article 19.

<sup>11</sup> Article 19.

<sup>12</sup> Each municipality retains 70 percent of the revenue collected in its jurisdiction, 15 percent goes to the respective department, and the remaining 15 percent is divided equally among the low-income municipalities in accordance with the distribution criteria set forth in the LOM. According to this law, a *municipio* is considered low-income if its per capita income is less than two times the minimum daily wage established for an unskilled worker in the capital of the republic. The ministry of finance (MoF) is responsible for this redistribution.

the national treasury (10 percent),<sup>13</sup> and those governors' offices are entitled to 15 percent of the value-added tax (VAT) collected in their respective departments. The criteria for the distribution of royalties and compensation payments (from the Itaipú and Yacyretá hydroelectric reservoirs co-owned with Brazil and Argentina, respectively) between the central and subnational governments are objective and established by law.<sup>14</sup> The LOD defines the criteria<sup>15</sup> that should inform the distribution of discretionary transfers (i.e., beyond the tax and royalties sharing) to departmental governments and municipalities, but does not specify the relative weights of the different criteria. Since the departmental governments' budgets are included in the PGN, which is discussed and approved in the chamber of deputies (a chamber with department-based representation), the discretionary transfers ultimately received by the departmental governments are determined through negotiations held during budget talks. In practice, such transfers are small.

**4. The legislation governing the borrowing capacity of *municipalities* and departments is very general.** 1.1.2

The municipalities' capacity to borrow is foreseen in the constitution, which states that municipalities shall have free access to private and public credit, both domestic and foreign; there are no other laws establishing ceilings or restrictions.<sup>16</sup> In the case of departmental governments, the LOD gives the governor the authority to sign loan agreements and forward them to congress, subject to approval by the departmental board; there is no limit on such borrowing.

**5. Ambiguity in the assignment of responsibilities among the three levels of government, especially between the departmental governments and the rest of government, may result in duplication of expenditure.** 1.1.2

Neither the constitution nor the laws clearly assign expenditure authority to the departmental governments.<sup>17</sup> However, the LOD does allocate some departmental revenue to certain

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<sup>13</sup> Neither the LOD nor the LOM specifies the criteria for the distribution of these resources among departmental and municipal governments.

<sup>14</sup> The legal framework regulating the distribution of royalties includes the main law (Law 1309/1998), which provides for the distribution of the royalties as compensation payments for flooded territories, as well as annual laws (e.g., 1829/02, 2391/03, 2442/04, 2148/03, 2419/04) which define the list of entitled jurisdictions.

<sup>15</sup> The LOD states that the distribution of appropriations to the departments must take into account the department's socioeconomic level, as measured by infant mortality, unemployment rate, degree of poverty, per capita income, health, education, and environmental quality. The territorial status of the department must also be considered, as determined by the dispersion of the population, rural component, ecological degradation, and distance from urban areas.

<sup>16</sup> The LOM states that municipalities may obtain loans for projects and services whose cost requires extraordinary resources, such as the purchase of capital goods, the establishment of municipal enterprises to provide services for which it is responsible, feasibility studies, and other investments (Articles 78 and 79).

<sup>17</sup> Under Article 163 of the Constitution, the functions of the departmental government include organizing services that affect more than one *municipio*, promoting cooperation among municipalities, and coordinating its

(continued)

services. For instance, the share of VAT collected in a department must be used for health, education, and public works and 80 percent of the revenue from royalties and compensation payments must be used for capital expenditure.<sup>18</sup> On this subject, the LOD also states that if a departmental government so requests, the national government may transfer the provision of public services to it as well as the revenue necessary for providing them. To date, no departmental government has made such a request.<sup>19</sup> The constitution grants municipalities authority on several matters (including urban planning, the environment, education, culture, sports, tourism, health and social assistance, and public safety), but does not specify the scope of such authority (i.e., whether it is exclusive, concurrent, or shared), nor whether it is merely executive or also normative. The LOM goes into somewhat greater detail concerning this authority and breaks it down according to the size and income level of the municipality. The municipalities generally do not carry out these functions or do so only partially.<sup>20</sup>

#### Fiscal management relations across different branches of government

### **6. The current definition of roles and responsibilities among different branches of government hinders the effectiveness of the budget as a key fiscal management tool and undermines transparency and accountability.**

1.1.2

The LAFE regulates the congress's powers to amend the budget proposal but it does not make the congress accountable for the realism of such amendments.<sup>21</sup> The executive uses the veto power as a negotiating tool only, and ultimately resorts to the *financial plan* to “budget” based on more realistic revenues, but its maneuvering ability is limited by high budget rigidities. The judicial branch enjoys budgetary autonomy and its budget—submitted directly

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activities with those of the central government and the municipalities. The LOD provides no clarification and, again, mentions coordination and organization instead of management and supply.

<sup>18</sup> Accordingly, 15 days before the end of each quarter, the recipient municipalities and departments must submit to the MoF, specifically the decentralization coordination unit, a report on execution of the income and expenditure budgets of programs financed with resources coming from royalties and compensation payments. The municipalities generally do not fulfill their reporting obligation.

<sup>19</sup> The LOD states that when a department believes that it can take over the provision of a service, it may forward a request to that effect to the executive branch, which will submit within a period of three months the request for consideration by congress. Following approval, the executive branch will transfer the assets and staff of the entity in question, together with the resources allocated for the provision of said service.

<sup>20</sup> The departments have requested, albeit informally, that the national government transfer responsibility to them for health matters and for the collection of taxes on agriculture and small businesses.

<sup>21</sup> Article 17 of LAFE establishes that congress cannot reassign resources from capital to current spending and that only capital spending can be increased if financing is identified. However, the law does not establish any incentive mechanisms to limit the room for expansions of the budget envelope through unrealistic upward revision of revenue projections, and accountability is limited by the lack of disclosure of the budget discussions in congress.

to congress—does not face any legal limits nor is it subject to the general criteria established by the executive branch in preparing the PGN.<sup>22</sup> If the PGN is not approved by the start of the budget year, the previous year's budget remains in force.<sup>23</sup>

**7. There are virtually no extrabudgetary activities, although a large percentage of taxes are earmarked.** *1.1.3*

The PGN covers all public sector activities, excluding municipalities. However, a sizable portion of the revenue is legally set aside for certain purposes: education, judicial branch, municipalities, delegations, universities, and airport services.

Relations between the government and the Central Bank of Paraguay

**8. Legally, the Central Bank of Paraguay (BCP) enjoys autonomy only for the implementation of the monetary policy. In practice, however, the BCP is also solely responsible for the design of the monetary policy.** *1.1.4*

The BCP is a decentralized entity whose relations with the government are clearly defined by law.<sup>24</sup> It provides treasury services to the government and is its fiscal agency for the issuance, placement, servicing, and redemption of public debt instruments and other national securities. It cannot provide loans to the government, either directly or indirectly, except in the form of short-term advances amounting to not more than 10 percent of tax revenue budgeted for the respective fiscal year. In national emergencies, it can exceed this ceiling in accordance with a well-founded resolution of the executive branch and subject to prior senate agreement.<sup>25</sup> It may provide guarantees and backing for the national government and other public institutions when specifically authorized to do so by law. It is responsible for supervising financial sector institutions through the Superintendency of Banks (SB). It is required to transfer 75 percent of its earnings to the national treasury and to allocate the remainder to reserves. Losses are to be charged to the reserves established in prior years, and if this is not possible, to the bank's capital.<sup>26</sup> The management and administration of the BCP is entrusted to a board of directors made up of a chair and four regular directors, appointed by the executive branch subject to

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<sup>22</sup> The result is usually an annual budget increase that is well above the average.

<sup>23</sup> The budget for the previous year will also remain in force while a total or partial objection by the executive branch to the PGN approved by congress is being discussed, or when congress, having accepted the partial objection, decides not to approve the disputed portion. In the event of total objection, neither chamber will confirm the initial approval of congress (Article 19 of the LAPE).

<sup>24</sup> Constitution (Articles 285, 286, and 287) and Law on the Central Bank of Paraguay (Law 489).

<sup>25</sup> Article 286 of the Constitution and Article 58 of Law 489.

<sup>26</sup> The law authorizes the deferral of losses, a practice currently adopted by the BCP, in which case losses are included in the BCP's balance sheet as nonperforming assets to be amortized with future profits; these losses are also provisioned. Profits or losses resulting from the revaluation of international reserves are not included in the BCP's income statement.

senate approval. Although its charter<sup>27</sup> states that the BCP is responsible of “executing” a monetary policy formulated “together with other technical organisms of the state,” in practice the BCP first adopts the monetary program by internal resolution and only subsequently communicates it to the national economic team (EEN).<sup>28</sup> The chair of the BCP board is appointed for the government’s term of office (five years), and one regular director is appointed each year to a five-year term.<sup>29</sup> The board approves the BCP’s annual budget proposal and forwards it to the MoF for inclusion in the PGN.

**9. The BCP engages in several QFAs whose size is difficult to quantify. 1.1.4**

Quasi-fiscal costs are incurred routinely in the implementation of monetary policy and when the BCP absorbs losses generated by nonperforming public sector assets and bank intervention operations. The latter are significant but their exact amount cannot be ascertained at present, pending a full assessment and consolidation of the debts and credits between the BCP and the MoF. In addition, the BCP’s portfolio includes significant contingent liabilities in the form of guarantees granted to financial and nonfinancial public sector (NFPS) institutions. The BCP does not remunerate the deposits of the national treasury but receives compensation and reimbursement for all the expenditures it incurs as financial agent of the government. Finally, the BCP offers mortgages and personal lines of credit to its employees.

Relations between the government and NFPEs

**10. Although some important QFAs carried out through NFPEs<sup>30</sup> have been reduced, the line between commercial and fiscal activities remains blurred in some cases. 1.1.4**

All the traditional public services in Paraguay are provided by the public sector. Most operate as monopolies, as in the case of the manufacture of cement, the marketing of diesel fuel, local and international fixed telephone service, and electricity. In other sectors, such as water,

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<sup>27</sup> Article 4.

<sup>28</sup> The EEN, created by Decree 89 of August 19, 2003, is chaired by the minister of finance, and comprises the minister of agriculture, the minister of public works and communications, the minister of industry and commerce, and the president of the BCP (the economic advisor of the President of the Republic also participates in the meetings). Its determinations have advisory and/or binding power on a wide variety of economic, financial, and social matters. It is required to meet at least twice a month and whenever requested by its chair.

<sup>29</sup> There is an informal understanding that four members of the board will belong to the party in power and one to the opposition party.

<sup>30</sup> The public enterprises are the following: *Administración Nacional de Electricidad* (ANDE), *Administración Nacional de Navegación y Puertos* (ANNP), *Dirección Nacional de Aeronáutica Civil* (DINAC), *Petróleos Paraguayos* (PETROPAR), *Industria Nacional de Cemento* (INC), *Compañía Paraguaya de Comunicaciones* (COPACO), and *Empresa de Servicios Sanitarios del Paraguay Sociedad Anónima* (ESSAP). The last two, in application of Law 1615 of 2000 on the Reorganization and Conversion of Decentralized Public Entities and the Reform and Modernization of Central Government Agencies (OAC), and with a view to being privatized, were incorporated and are now governed by private law.

gasoline sales, and mobile telephone service and national long-distance service, they compete under the same regulations as the private sector. Some NFPEs are required to provide coverage for which they receive no government transfers, such as ESSAP in outlying districts and COPACO in rural areas. Recently, significant tariff adjustments aiming at covering an increased share of the costs in electricity (National Electricity Administration (ANDE)) and petroleum-related products (PETROPAR) have reduced QFAs.<sup>31</sup> In the case of ANDE, the implicit government transfer to cover the cost of the social tariff has been transparently incorporated in the budget as a result of an executive decree, which mandates a move to a gross-basis recording of financial flows between the government and ANDE.

**11. Despite a (somewhat confusing) recent spur of legal activity, a stable and predictable legal framework for promotion of private sector participation in public services remains elusive.**

1.1.5

The government has pursued a case-by-case approach—and not always consistently<sup>32</sup>—to identify the most convenient form of private sector participation in sectors thus far reserved to public enterprises. Thus, there is no general framework law ensuring basic transparency requirements, including competition among bidders, adequate valuation of businesses (to be either privatized or given in concession), and independent audits.

Relations between the government and the PFIs

**12. The PFIs<sup>33</sup> engage in QFAs and carry sizable contingent liabilities.** 1.1.4

The *Banco Nacional de Fomento* (BNF) is required to carry out operations in the agricultural and industrial sectors on preferential terms, and manages exclusively the deposits from all the

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<sup>31</sup> PETROPAR's finances remain precarious, as QFAs are still substantial, in large part as a result of the recent steep increases in international oil prices. A draft law, currently in congress, would liberalize the market for fuel oil products and enable PETROPAR to compete with the private sector by exempting it from the new procurement law, granting greater budget autonomy, discontinuing existent compulsory transfers to the treasury and allowing the private sector to flexibly participate in its operations. The draft law also requires the submission within 60 days of a draft restructuring law for PETROPAR.

<sup>32</sup> Law 126 of 1991 (governing privatization processes in the early 1990s) was repealed by Law 1615 of 2000, which established the legal framework for the privatization of three public enterprises: ANTELCO, CORPOSANA (*Corporación de Obras Sanitarias* (public sanitary projects), and *Ferrocarriles Presidente Carlos Antonio López*. Pursuant to this law, these companies were incorporated and renamed COPACO, ESSAP and FEPASA, respectively. Subsequently, irregularities in the process for privatizing COPACO prompted congress to pass Law 1932/02, which suspended the application of Law 1615.

<sup>33</sup> The first-tier public banks are the BNF, *Crédito Agrícola de Habilitación* (CAH), and *Banco Nacional de Ahorro y Préstamo para la Vivienda* (BNAPV). The second-tier financial institutions are the *Fondo de Desarrollo Campesino* (FDC—rural development fund) and the *Fondo Ganadero* (FG—livestock fund). There is also a *Fondo de Desarrollo Industrial* (FDI—industrial development fund) and a *Consejo Nacional de la Vivienda* (CONAVI—national housing council), which grant loans on preferential terms and are not supervised by the SB, although they are not financial institutions but rather central government units attached to the MoF, grant loans on preferential terms and are not supervised by the SB.

OACs. In recent years, some PFIs were required by law to forgive their customers' debts, especially in the agricultural sector, in exchange for government bonds, which eroded their financial positions and created a culture of arrears. Most PFIs capture resources in foreign currency and lend in domestic currency without managing adequately exchange rate risk. The financial statements of the public banks are monitored by the BCP through the SB, but they do not identify their QFAs, or whether they are compensated by the government for these activities. The financial system restructuring programs administered by the BCP are insufficiently documented in its reports and financial statements. The public banks offer highly concessional mortgages and personal lines of credit to their employees. Recent legal reforms in second-tier public banks holds promise to reduce the risk of mismanagement of their funds,<sup>34</sup> but attempts by the executive to reform the BNF, which would be more needed, have thus far been frustrated in congress.

#### Regulation of the nonbank private sector

### **13. The few regulatory entities that do exist are not independent of the executive branch.**

1.1.5

The existing regulatory committees and agencies<sup>35</sup> are self-sufficient public law entities endowed with legal status and attached to a sectoral ministry. Consequently, they are organized as technical agencies endowed with their own assets and with administrative and technical independence, and are financed in part with contributions from the regulated entities. They set rates, monitor the quality of services provided, deal with other regulatory matters (environmental, technical, the granting of operating permits, security, etc.) and have the authority to impose penalties. The independence of the regulatory commissions and agencies is compromised by the fact that the members of their boards are appointed by the executive branch, although in the case of the water company, prior Senate approval is required. The term of office of the chairman of the board of CONATEL (which administers radio activities and awards concessions) must coincide with that of the President of the Republic. No advance notice is required for changes in the regulatory framework, the public is not consulted, and no assessment of the regulatory impact is performed. General regulations are subject to legal appeal, whereas special regulations are subject to administrative appeal.

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<sup>34</sup> A brand new law unifies second-tier banking activities in a single institution (*Agencia Financiera de Desarrollo*) subject to banking supervision, allows lending (only through competitive bidding) exclusively to other financial institutions provided that these are supervised by the SB and do not extend loans to public entities, requires interest rates to cover administrative and financial costs, sets appropriate technical qualification for the board, and requires external audit by reputable international firms.

<sup>35</sup> *Comisión Nacional de Telecomunicaciones* (CONATEL) and *Ente Regulador de Servicios Sanitarios* (ERSSAN-regulatory agency for public sanitary services).

#### Fiscal framework for budget management

**14. The legal and administrative framework for budget management is fairly clear and complete, but in practice is not always thoroughly applied.**<sup>36</sup> 1.2.1

The LAFE applies to all levels of government, establishes some of the generally accepted budgeting principles,<sup>37</sup> and regulates all the aspects of public financial management.<sup>38</sup> The assignment of responsibilities for budgeting and finance are also formally well established in the law. The programming of execution is to be centralized, but operational execution is to be decentralized. The final financial statements and accounts are to be audited internally and externally, essentially to verify financial and legal compliance. However in practice, and as mentioned below, the PGN preparation and approval procedures do not guarantee a clear definition and a strict adherence to a budget envelope or the allocation of resources in accordance with the government's political priorities. The programming and monitoring of execution do not prevent the development of serious payments arrears problems. The general treasury is essentially a teller machine. The scope of internal and external audits is limited and accountability requirements are scarce.

#### Taxation, administrative application and taxpayers' rights

**15. As mandated by the constitution, all taxes are created and regulated by law. Recently enacted legislation has reduced the tax laws' traditional complexity and ambiguity.** 1.2.2

The tax code,<sup>39</sup> as amended by the recent Administrative Reorganization and Fiscal Adjustment Law (RAAF)<sup>40</sup> governs national taxes and sets maximum rates for some taxes (excises). There is also a new customs code<sup>41</sup> that governs duties. The PGN law can contain provisions that modify taxes. The law also establishes quasi-fiscal contributions or rates that make up the own resources of certain decentralized agencies, such as contributions to the *Instituto de Prevision Social*—social welfare institute (IPS). The RAAF, in the process of

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<sup>36</sup> The legal framework for fiscal management consists essentially of the Constitution, Law 1535/1999 on LAFE and its Regulatory Decree 8127/2000, as well as each year's PGN Law and its Regulatory Decree. The LAFE also establishes the legal system for fiscal management by the departments. The system for the municipalities is established in the LOM. According to Article 80 of this law, municipalities could apply provisions of LAFE as long as these provisions do not contradict their autonomy.

<sup>37</sup> These include universality, legality, unity, uniformity, annual basis, gross budget, and specialty. Important principles such as single treasury account, transparency, and non-earmarking are however not advocated.

<sup>38</sup> Including all stages of the budget process, as well as treasury, public credit, reporting, and information technology support.

<sup>39</sup> Law 125/1991.

<sup>40</sup> Law 1421/2004.

<sup>41</sup> Law 2422/2004.

being fully regulated, eliminated most of the tax exemptions introduced over time through 49 different laws.

**16. Accessibility and understandability of the tax code have improved as a result of recent legal reforms.** 1.2.2

In addition to the above-mentioned simplification of the tax code, the RAAF has increased accessibility, by complementing the traditional publication requirement of all laws on the *Gazeta Oficial de la República* with the requirement for the tax administration to post on its website updated information on laws and general norms, binding and not binding opinions, administrative resolutions, the agencies where taxes can be paid, the list of beneficiaries of tax exemptions, the tax deadlines, the forms to be used, and so on.

**17. The system for resolving tax disputes and taxpayers' rights have also been strengthened.** 1.2.2

The RAAF clarifies the tax administration's audit and supervisory powers,<sup>42</sup> the guidelines for interpretation of the tax code, the formal obligations of taxpayers, and the system of proofs and penalties. Both the tax administration and the taxpayer can request a reassessment from different auditors. After this recourse, the taxpayer can appeal directly to the authority with jurisdiction to review the final decisions of administrative bodies and courts (*summario*). If the dispute is not resolved, the taxpayer may lodge an appeal with the general courts.<sup>43</sup> The law has also modified the system for reporting infraction, and now allows the follow-up only of alleged infractions reported by tax officials, who can claim up to a 50 percent share of the proceeds of fines.<sup>44</sup> The new customs code has also improved taxpayers' rights, thanks to more modern operating procedures (more based on selectivity and ex-post controls rather than ex-ante massive controls), as well as those pertaining to disputes, penalties, and appeals involving duties. Finally, a taxpayer service department has been put in place, although it needs to be strengthened.

Ethical standards of behavior

**18. The law sets principles of ethical conduct for public officials but these in practice do not apply to the entire civil service.** 1.2.3

The Law 1626 on the civil service, which contains a general statement of the obligations of public officials, the system of incompatibilities, and the disciplinary and punitive regime, is

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<sup>42</sup> The RAAF limits to only two the types of admissible audits: an integral audit, whose targets must be chosen randomly, and a specific one, which must be clued by analysis of the tax returns and cross-checks between different sources of information.

<sup>43</sup> The appeal to the taxation board (*Consejo de Tributación*) of the MoF has been eliminated.

<sup>44</sup> The system previously allowed anyone to report an alleged tax infraction for a share of the proceeds of the audit, and this had given raise to substantial abuses.

not being uniformly applied, due to multiple challenges of unconstitutionality (as discussed further below).

## **B. Public Availability of Information**

### Coverage of the annual budget documents

**19. The PGN covers the entire public sector, except municipalities,<sup>45</sup> but the coverage of the periodic reports is much more limited.** 2.1.1

The monthly budget execution reports cover only the ACE agencies. Government agencies and entities are required by law to report monthly and annually to the MoF<sup>46</sup> on their budgetary, financial, and asset position. Monthly reports must be submitted within the first 15 days of the following month and annual reports no later than February 10 of the following year. However, only the ACE agencies comply with this legal requirement.<sup>47</sup> The CGR must audit the revenue, expenditures, assets, and operations and initiatives of the municipal agencies, and therefore is authorized to compile information on their budget execution.<sup>48</sup> However, only a very small number of municipalities comply with this provision.

**20. The PGN contains no prior-year figures or estimates of the main budgetary aggregates for future years.** 2.1.2

The PGN contains only estimates on the current year's budget execution. Prior-year figures, which can serve as a reference for better identifying budgetary levels in the following fiscal year, do exist and are published in the annual budget execution report, but they are not included in the PGN. No estimates for future years are included either.

**21. Neither the budgetary documents nor the budget execution reports contain consolidated information on the central government and the public sector.** 2.1.2, 2.1.5

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<sup>45</sup> The municipalities are not required to submit their budgets to the MoF and, therefore, the only information included in the PGN is their share of the royalties transferred to them. The annual "*Informe Financiero*" prepared by the MoF does include some information on municipalities, but this is very limited. For example, only 19 municipalities were covered in the *informe* for 2004 (the capital city Asunción was not one of them).

<sup>46</sup> LAFE, Article 66, and LAFE Regulation, Articles 93 and 94.

<sup>47</sup> The monthly budget execution reports include (1) "*Informe de Coyuntura Fiscal. Situación financiera de la ACE*" (Report on the Fiscal Situation. Financial Position of the ACE), prepared by the MoF fiscal policy directorate, subsecretariat of state for economy and integration; (2) "*Informe Financiero de la ACE*" (ACE financial report), prepared by the MoF directorate-general of government accounting, subsecretariat of state for financial administration; and (3) "*Paraguay: Informe Económico*" (Paraguay: Economic Report), prepared by the BCP. These documents are published in the press and/or on the MoF and BCP web pages: [www.bcp.gov.py](http://www.bcp.gov.py) and [www.hacienda.gov.py](http://www.hacienda.gov.py).

<sup>48</sup> CGR Resolutions 173/1997 and 356/2000 require each municipality to submit its balance sheet, budget execution report, general inventory, list of acquisitions, and annual report to the CGR.

The annual financial report produced by the MoF directorate-general of government accounting contains the consolidated balance sheet and consolidated income statement for the ACE and for the decentralized agencies, but the two groups of institutions are not consolidated and there is no consolidated information for the central government, as defined in the *GFS*. This report, which includes individual accounting information on public entities, as well as their budget execution (initial budget, modifications, amended budget, and executed budget), is published on the MoF website, although there is no legal obligation to do so. The MoF directorate of fiscal policy produces financial statistics (but no analysis) on the consolidated position of the public sector, the NFPS and the central government. These are posted in the website of the MoF.<sup>49</sup>

#### Contingent liabilities, tax expenditures and QFAs

**22. No information on contingent liabilities, tax expenditures, or QFAs is published or estimated, even though these are significant.** 2.1.3

The subsecretariat of taxation has some calculations on tax expenditures, but these are quite incomplete and there is no systematic quantification and/or publication effort. QFAs, as mentioned above, are also significant, particularly in the BCP, the PFIs, and the NFPEs, but these activities are not quantified (except more recently those carried out by ANDE). The PGN neither analyzes nor provides information on the contingent liabilities of the NFPS, nor on the labor-related liabilities accrued by the pension systems of the ACE and the decentralized agencies.

#### Debt and financial assets

**23. Information is published monthly on external public debt and financial assets, and annually on total public debt.** 2.1.4

The balance of external public debt, disbursements, and service of this debt are published monthly in the BCP's monthly economic report, without any additional details such as classification by debtor, creditor, or term. Data on the ACE's financial assets are published monthly and annually in the consolidated balance sheet, which is included in the financial reports of the MoF directorate of government accounting. In addition, the annual financial report contains aggregate information on the financial assets of the decentralized agencies, the balance of ACE domestic and external public debt, and the amounts paid to service it. The external debt is disaggregated by groups of creditors, and domestic debt is broken down into direct debt and debt guaranteed by the national treasury.<sup>50</sup>

**24. Paraguay has subscribed to the General Data Dissemination System (GDSS), and publishes statistical data on the MoF website.** 2.2.2

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<sup>49</sup> [www.hacienda.gov.py/sseei/sectorfiscal/situacionfinanciera.htm](http://www.hacienda.gov.py/sseei/sectorfiscal/situacionfinanciera.htm)

<sup>50</sup> Reflecting the general lack of data for municipalities, there is no data on their debt either.

The purpose of this system is to disseminate statistics that comply with international standards. Paraguay releases in advance calendars for fiscal statistics in the GDSS (see <http://dsbb.imf.org>), although, as mentioned above, calendars are not followed systematically in practice.

### C. Open Budget Preparation, Execution, and Reporting

#### Budget documentation

25. **The budget document<sup>51</sup> does not contain a statement of the medium-term fiscal policy objectives or an analysis of their sustainability.** 3.1.1,3.1.2

Paraguay does not define medium-term macrofiscal objectives to assist in preparing the PGN. Budgetary programming covers only the budget year.<sup>52</sup> The sole fiscal rule established by law<sup>53</sup> prohibits government borrowing to finance current expenditure.

26. **The PGN does not contain an explanation of the macroeconomic framework and assumptions used in preparing the budget.** 3.1.3

The general guidelines for the preparation and programming of the PGN are approved and issued by a decree of the executive,<sup>54</sup> which does not include, as mandated by LAFE, an explanation of the macroeconomic assumptions to be used in preparing the budget. In practice, the macroeconomic information contained in this decree is quite minimal. Legally,<sup>55</sup> the draft PGN submitted to congress must be accompanied by an explanation of the fiscal policy objectives, as well as the methodology and the technical bases used to estimate revenue and determine budget appropriations, but in practice this precept is only partially followed.<sup>56</sup> The economic studies directorate of the MoF, according to the Charter Law of the MoF, is responsible for preparing the macroeconomic framework for the PGN in

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<sup>51</sup> Pursuant to Article 12 of the LAFE, the budget document, or PGN, comprises the revenue budget, the expenditure budget, the financing budget (which includes revenue generated by government borrowing and the recovery of loans and debt service expenditure), and a personnel annex, plus the budgets of public enterprises with attachments.

<sup>52</sup> Some preparatory ground has been laid out for the adoption of an indicative multi-annual budget framework

<sup>53</sup> Article 40, LAFE.

<sup>54</sup> This decree, as well as its attachments, instructions, and forms must, according to the law, be approved by April 30 of each year, and published in the *Gaceta Oficial de la República de Paraguay*.

<sup>55</sup> Article 16(a), LAFE.

<sup>56</sup> The presidential messages for 2005 and 2006 presented, however, some information related to macroeconomic indicators. The 2006 budget included a range for the inflation and presented for the first time estimates for the fiscal deficit, though only for the ACE.

coordination with the planning secretary.<sup>57</sup> Though this directorate provides inputs for the budget preparation process, final estimates for the submission of the budget to congress are guided by the official macroframework prepared by the BCP.

**27. The budget documents make no distinction between existing policies and new policies, nor do they identify or quantify existing fiscal risks.** 3.1.4,3.1.5

The instructions for preparing the PGN require that the working drafts of institutional budgets differentiate between current policies and new policies, but no such distinction is made in the PGN ultimately approved. Nor is there any analysis of the sensitivity of the fiscal aggregates to possible changes in the macroeconomic assumptions or the fiscal risks posed by contingent liabilities.

Budget data

**28. The PGN contains gross figures, classified by institution and by programmatic, economic, and functional category.** 3.2.1

The LAFE establishes the guidelines to be followed in the revenue and expenditure budget classifier, which is approved annually as an annex to the PGN law.<sup>58</sup> The expenditure budget is classified by program, subprogram, responsible unit, purpose of expenditure, and source of financing.

**29. To date, the PGN has not included a description of the objectives of the various budgetary programs.** 3.2.2

The general guidelines for preparing and programming the 2005 PGN introduced, on an experimental basis in some agencies and entities, a reform of the budget preparation process, based on the formulation of annual operating plans containing a description of the objectives and targets of the various budget programs.

**30. The overall ACE balance is the indicator used to measure the government's fiscal position.** 3.2.3

The budget documentation contains no information on the indicator used to measure the central government's fiscal position, as defined in *GFS*. It does contain information on the ACE deficit, but no summary table explaining how this indicator is derived from the budgetary aggregates.

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<sup>57</sup> In the preparation of the macroeconomic framework for the budget, this directorate uses a financial programming model developed in EXCEL. The values of key macroeconomic variables are estimated using econometric models.

<sup>58</sup> Articles 11 and 14, LAFE. The PGN revenue and expenditure classifier contains the following classifications: institutional, expenditure (economic, by purpose of expenditure, by financing source, by purpose and function) and revenue (by source of revenue and economic).

### Procedures for budget execution

**31. An integrated financial administration system (SIAF) is being implemented. In spite of its major limitations, the SIAF has considerably improved budget preparation, execution, and control.** 3.3.1

The implementation of this system began in 1997. Although all central public sector agencies and entities are currently operating under SIAF regulations, at present only the ACE agencies and certain decentralized agencies are connected to the system. Most departmental governments have already implemented the accounting module of SIAF (SICO). Of the six modules envisaged, the budget, accounting, cash, and credit and public debt modules are in use, only the investment and supervision modules are pending.

**32. The SIAF accounting module provides a partially reliable basis for assessing payments arrears.** 3.3.1

Accounting is the responsibility of the financial administration units (UDAFs) established in each government agency or entity.<sup>59</sup> These units report to the institution's highest authority. In principle, the system provides information on obligations with pending payments but in practice this is not the case given that information on actual payments is not available in real time. Entities manage thousands of bank accounts<sup>60</sup> and often maintain parallel treasury systems as the use of SIAF for the issuance of checks is not compulsory. The financial plan is a first step to establish a commitment control system. However, this plan is not perfectly aligned with the cash plan at all times as existing legal<sup>61</sup> and technological restrictions of SIAF prevent an effective management of this plan along the year. The above said, the recently established link between the prevision stage and the procurement system is a good step, in preventing the occurrence of legally binding commitments outside the SIAF.<sup>62</sup>

**33. The implementation of the recently enacted procurement law<sup>63</sup> has substantially improved the transparency of public procurement and reduced the opportunities for corruption.** 3.3.2

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<sup>59</sup> The UDAFs' uniform regulation is contained in Title VIII of the LAFE Regulatory Decree (Articles 97–103). The UDAFs are responsible for those functions of the institution that relate to the budget, cash, accounting, human resources, and the procurement of goods and services.

<sup>60</sup> Currently there are about 4,000 accounts mainly deposited at the BNF.

<sup>61</sup> In fact, LAFE regulations set a yearly frequency for the financial plan while the cash plan is adjusted on a monthly basis.

<sup>62</sup> The problem of depletion of the budget may be exacerbated by the LAFE requirement that the prior year's floating debt must be settled within the first two months of the budget year, using, if necessary, the revenue collected during that period.

<sup>63</sup> Law 2051/2003.

The previous legal framework for procurement activities was highly fragmented<sup>64</sup> and did not include transparency requirements or mechanisms for third party appeals. The new law unified procurement procedures across the entire public sector, limiting acceptable procurement modalities to a well-defined few depending on the contract's amount. The law also obliges public entities to announce an annual purchasing program, disclose information related to all stages of the procurement process on the website of the procurement directorate of the MoF,<sup>65</sup> and set up consultative committees for the evaluation of offers. As a result of increased transparency, early warning systems to detect and correct irregularities are now in place. Simplified first recourse internal procedures have also been established to streamline the workload of administrative tribunals.

**34. Despite the progress represented by the completion of the first civil service census, considerable ambiguity remains in the current legal framework for public employment.**

3.3.2

The authorities recently completed the first civil service census for the years 2003 and 2004. The current civil service law<sup>66</sup> has raised some 1,500 challenges of unconstitutionality subjecting many public employees to a previous law enacted in the 70s. As a result, the current law that provides for fairly complete and transparent regulations of the civil service,<sup>67</sup> is not applied throughout the government. Hence, personnel selection and wage-setting systems in many entities continue to be essentially discretionary and do not safeguard the public sector human resources management policy from political interference.

**35. The internal control and internal audit systems are still weak.**<sup>68</sup> 3.3.3

Internal control includes the *ex ante* control exercised by government managers and the *ex post* control performed by the institutional internal audit office (AII) of each agency or entity and the executive branch general audit office (AGPE). The AIIs are organizationally attached to the highest authority of the agency or entity, but they report technically and functionally to the AGPE, which is responsible for coordinating, supervising, and assessing their operation, as well as making recommendations to improve their performance. The AIIs are required by law to focus generally on auditing budget execution and specifically on examining liabilities, payments, and purchases. A copy of the reports on audits performed must be sent to the

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<sup>64</sup> Before, each EEDD was governed by its own specific law or charter. Relevant regulations applicable to the ACE and the departmental governments dated back to 1909.

<sup>65</sup> [www.contratacionesparaguay.gov.py](http://www.contratacionesparaguay.gov.py)

<sup>66</sup> Law 1626/2000.

<sup>67</sup> Particularly in the following areas: administrative career stream, selection procedures based on merit and ability, classification, promotion and compensation, staff mobility, job stability, employee rights and obligations, and disciplinary measures.

<sup>68</sup> Internal control and internal audits are regulated by Articles 59–62 of the LAFE, Article 96 of the LAFE Regulatory Decree, and Decree 13245 of May 2001 governing the AGPE.

highest authority of the agency or entity and to the AGPE. The institutional capacity of the AIIs to fulfill these functions varies widely, depending on the willingness of the highest authority of the institution to assign human and material resources to them. The recently created AGPE, which reports to the Office of the President of the Republic, is responsible for conducting financial, management, and special audits of the agencies and entities and must submit a copy of the relevant reports to the audited institution and to the national President. In programming its activities, it must coordinate and remain in close communication with the CGR, whose internal government audit rules must be followed in its work with both AIIs and the AGPE. The conclusions and recommendations of the internal audit reports are not made public and there is no regulation governing how such recommendations are to be followed up to ensure effective implementation.

**36. The recent changes in tax legislation have improved tax administration and mandated regular publication of information on revenue collection activities. 3.3.4**

The RAAF has reduced opportunities for and increased the cost of corruption by introducing criteria for audits based on cross-checks of information systems, creating an internal audit division, mandating cabinet-based and in-house decisions on individual audits, and standardizing financial statements in tax filings. Collection and audit statistics, as well as lists of delinquent taxpayers are now posted on the website of the tax administration, as required by the RAAF. The undersecretariat of taxation has produced a first annual report covering its revenue collection activities during 2003–04.

Fiscal reporting

**37. The law requires that periodic reports on the execution of the PGN be submitted to congress. 3.4.1**

The MoF is required to submit to congress, no later than March 31 of each year, a report including consolidated financial statements reflecting the financial, economic, and asset position of government agencies and entities, as well as a comparative statement of amounts budgeted and executed in each fiscal year ended and closed.<sup>69</sup> For the first time, the annual budget law for 2002 introduced the requirement that agencies and entities submit to the MoF, and the latter to congress, a bimonthly budget execution report.

**38. The final accounts are presented to congress in the year following the budget year. 3.4.2**

By end-April of each year, based on the report mentioned in the preceding paragraph, the national president sends a report to the CGR on the execution of the previous year's budget. The CGR has four months to submit the president's report to congress as well as its opinion on the report, prepared in accordance with generally accepted audit standards. A bicameral

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<sup>69</sup> Article 67, LAFE. The LAFE Regulatory Decree specifies the statements to be included in the report: balance sheet and consolidated income statement for the public sector; statement on the sources and uses of funds; budget execution statements; consolidated saving, investment, and financing statement; balance sheet and income statement for the national treasury; updated statement of credit; and public debt.

commission made up of five senators and eight deputies has a maximum of one month to comment on the report. Then, each chamber of congress has another 30 days to approve or reject the report.

**39. No information is submitted to congress on the results achieved with the various budget programs.** 3.4.3

The annual PGN law and the charter law of the MoF require agencies and entities to report quarterly on the qualitative and quantitative results of the implementation of budget programs, specifying the activities carried out and the amount of resources used, to the MoF for submission to congress. Only some central agencies report this information to the MoF and not in a systematic manner.<sup>70</sup>

#### **D. Assurances of Integrity**

##### Data quality standards

**40. The PGN is a representative but not sufficient indicator of the budget actually executed.** 4.1.1

The revenue actually collected generally differs significantly from the amount budgeted. The average rate of revenue execution in the amended budget in the last three years is close to 86 percent. However, the rate of personnel expenditure execution, which accounts for half of the current expenditure, is nearly 100 percent, whereas the execution of capital expenditure is close to 50 percent. This situation is attributable, as mentioned above, to deficiencies in the procedures for the preparation and execution of the PGN that allow unrealistic increases on revenues to accommodate higher spending. Budget increases and modifications are frequent and sizable. The budget documentation does not include a historical study analyzing the differences between the budget estimates of the main fiscal aggregates and the outturn in recent years, nor are any efforts made to avoid significant deviations.

**41. Neither the budget nor the final accounts contains a statement of the government accounting policies.** 4.1.2

The accounting principles and policies are stated generally in the LAFE<sup>71</sup> and specifically in the “Integrated Accounting Manual,” which, however, is not published. The MoF is responsible for approving the general principles and rules of government accounting (accounting policy, principles, rules, chart of accounts, technical procedures, financial statements, and reports to be submitted), as well as any changes that were necessary.

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<sup>70</sup> The executive presents general reports, quarterly to the public and once a year (mid-year) to congress, but these have little information on the actual budget programs.

<sup>71</sup> Title VI of the LAFE establishes the government accounting system for all government agencies and entities. This system must be accrual-based, comprehensive, uniform, and used to record all budget operations, as well as flows of funds, credit, and public debt.

**42. The quality of the fiscal data is not sufficiently assured, as no regular and timely reconciliation of the public accounts is performed.** *4.1.3*

The data in the fiscal reports are consistent with each other but are not reconciled with pertinent data from other sources. The accounting reports are reconciled with the budget appropriations on an efficient and timely basis only for the ACE,<sup>72</sup> but their reconciliation with the bank accounts are neither timely nor efficient due to the proliferation of bank accounts managed directly by entities. Macro level aggregate reconciliations between fiscal and monetary data are usually not carried out.

Independent assessment

**43. The CGR is independent from the executive and the legislative branches.** *4.2.1*

The CGR enjoys a constitutionally established functional and administrative autonomy. The controller and the deputy controller are appointed by the chamber of deputies for a term of five years, which must not coincide with the term of the president, and they may be reappointed for an additional period. They cannot be removed from office and can be terminated only for committing crimes or for poor performance. The CGR, however, does not have budgetary autonomy.

**44. The CGR is responsible for conducting external audits of the public sector.**

*4.2.1*

The duties of the CGR include conducting financial, performance, and compliance audits in the public sector, including the municipalities. In this latter aspect its activities overlap with those of the audit office. It is also responsible for monitoring and inspecting the assets and property of the government and all public sector entities. The CGR is also responsible for monitoring the execution and closing of the PGN and must present an opinion on the closing of the previous year's budget to congress. In practice, its capacity to carry out the various functions assigned to it is limited. It conducts only compliance audits and half of them are carried out on the basis of citations, with no predetermined schedule.

**45. The CGR's recommendations are inadequate and are not followed up.** *4.2.1*

The CGR report is essentially descriptive, includes no substantive comments, and is not made public. Many of the decentralized agencies do not provide the required information, especially the municipalities, so that the coverage of the budget execution report is limited. If the CGR or a private external audit firm has important comments or recommendations, there are no institutional mechanisms to guarantee that they are acted on.

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<sup>72</sup> For the ACE, the accounting reports and budget appropriations are reconciled on a timely and efficient basis in the Integrated Accounting System (SICO), which is one of the SIAF systems. In the case of the EEDDs, the reconciliation is inadequate because these agencies are not included in the SIAF and do not report fiscal information on a timely basis.

46. **There is no independent assessment of the fiscal and macroeconomic estimates.**

4.2.2

As mentioned earlier, the assumptions used to prepare these estimates are not published and, except for some very limited and vague information, are not included in the decree approving the general guidelines for preparing and programming the PGN. The macroeconomic model, estimation methodologies and periodic macroeconomic reports prepared by the directorate of economic studies of the MoF are not publicly available. There are no private sector surveys or macroeconomic estimates that could be used as benchmarks.

47. **Several different institutions are responsible for compiling, assessing, and publishing statistical data.**

4.2.3

The MoF is exclusively responsible for fiscal statistics;<sup>73</sup> the BCP is in charge of data on the monetary, real, and external sectors; and the directorate-general of statistics, surveys, and censuses publishes population data and socioeconomic indicators. In other words, there is no technically autonomous body (such as a national statistics office with institutional independence) responsible for the direction, coordination, and dissemination of economic and fiscal statistics for other official agencies and capable of verifying the quality of the data.

### III. IMF STAFF COMMENTARY

**In recent years, Paraguay has made important progress towards greater fiscal transparency by:**

Adopting a fairly comprehensive legal framework for fiscal management

48. The **financial administration law (1999)** provided a unified treatment of all aspects of public financial management, covering all levels of government and establishing many (though not all) of the generally accepted budgeting principles.

49. More recently, **the RAAF (2004)** has simplified the tax legislation by eliminating most tax exemptions and revamped revenue administration procedures, significantly limiting the discretion and power of tax officials in the interpretation and application of the laws, thus reducing the scope for corruption. Key elements include: system-based objective criteria to prompt audits, a new internal audit division, and the replacement of individual onsite decisions (where the scope for corruption is maximized) with team-based and in-house decisions. Besides increasing the predictability of tax obligations, the law aims at reducing the cost of compliance for taxpayers (including through comprehensive information dissemination requirements—ranging from interpretations and binding opinions to tax forms and calendars—and the creation of a taxpayer service department, though this is still in its

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<sup>73</sup> The legal framework for this responsibility of the MoF is governed by the budget laws, the financial administration laws, and the charter of the MoF (Law 109/92), which grant it technical independence in the management of fiscal statistics.

infancy). Finally, the RAAF strengthens taxpayers' rights to fast, fair and more independent appeals of adverse tax administration decisions.

50. In the same spirit, the new **Customs Code (2004)** aims at combating corruption and increasing efficiency through the introduction of modern procedures (e.g., greater reliance on green channels, ex-post verification and risk-based audits).

#### Clarifying the scope of government activities carried out by NFPEs and PFIs

51. The significant tariff adjustments in **electricity and petroleum-related products** aiming at reducing the dependence of important NFPEs from budget transfers, the transparent disclosure of the government transfers to cover the cost of the social tariff, and the launching of external audits of the finances of most NFPEs conducted by international firms are welcome first steps in the direction of clarifying and making more transparent the true extent of governmental activities in the economy.

52. As regards to the PFIs, the brand new **second-tier public bank** law has many features that reduce the room for nontransparent QFAs and the risk of possible mismanagement of funds and contingent liabilities for the government. Especially important are the requirements of subjecting the single public second-tier bank to banking supervision; prohibiting the extension of loans to public entities; requiring interest rates to cover administrative and financial costs; setting appropriate technical qualification for the board; and mandating external audits by reputable international firms.

#### Tightening control in budget execution

53. First steps toward a **control of commitments and arrears** have been taken with the incorporation of the commitment stage in SIAF and their subordination to the financial plan (although still in a static fashion—see below). Equally important in this area is the requirement introduced by the **new procurement law** that, in order to legally bind the government, all procurement activities must be registered and validated by the system, which checks for the availability of the resources. More generally, the new procurement law has introduced welcome standardized transparency and publication requirements in the evaluation and awarding of all public procurement contracts.

#### Increasing the disclosure of fiscal information

54. The adoption and extension of the government financial management information system (SIAF) has facilitated the provision of important amount of budget, fiscal and government debt information. In addition, a key gap has been filled with the completion of the first ever **civil service census** (2003/04). Finally, more information is being provided, although not systematically, including on the activities of the tax and customs administrations, the 2006 draft budget, and the size of the implicit subsidy provided by PETROPAR.

**However, in many areas Paraguay fails to meet several requirements (at times even basic ones) of the code.**

The transparency and effectiveness of the budget as key fiscal policy tool are low

55. The budget should convey the government's **fiscal objectives** and guide fiscal policy implementation. In Paraguay, the budget is far from exerting this key role. First, there is no clear announcement of fiscal targets nor is a full fledged consistent macroeconomic framework which both underpins and reflects the fiscal stance and highlights potential fiscal risks.<sup>74</sup> Second, the procedures for budget approval and execution do not allocate clearly roles and responsibilities to the executive and the legislative, and do not ensure discipline and even less accountability. The legislative, for example, typically escapes the formal restrictions to increase spending by revising upward the revenue or financing projections without being held in any way accountable for their realism and feasibility. The executive has no obligation to report to congress on the changes that it introduces to the budget as the execution progresses. In this context, the financial plan replaces the budget as a more realistic guide to fiscal policy thus undermining in a basic way fiscal transparency.

Control and transparency in budget execution need to be strengthened

56. As mentioned above, the **gap between the budget and a feasible fiscal policy** is bridged by the financial plan, which is designed once a year and is then implemented through a succession of cash plans, which are updated on a monthly basis. The financial plan is the legal maximum for entities to enter into commitments. Since the financial plan is not at all times aligned with the cash plans (that reflect more updated information on projected resource availability), the possibility exists that entities commit without receiving the necessary payment, thus generating arrears. In addition, the **proliferation of bank accounts** (some 4,000 presently) together with the lack of a legal requirement to use the SIAF to issue checks has greatly limited the possibility to have a real time tally of the amount of payments actually made, and therefore of the arrears.

The public employment framework is basically discretionary and nontransparent

57. A **civil service reform** law, which would have introduced standardized and transparent, merit-based procedures for selection, classification and promotion of civil servants has been challenged by multiple accounts of unconstitutionality, and is in practice not applicable. Even in those cases where the legal framework has been strengthened to address these concerns (i.e., in the tax and customs administration), the implementation has been slow.

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<sup>74</sup> Moreover, a key weakness in the budget preparation stage is that there is a virtual disconnect between the units in the MoF responsible for the design and analysis of the policies and those that actually oversee the compilation of the budget.

Ambiguity remains over the scope of the government

58. QFAs remain substantial and, with rare exceptions (ANDE's social tariff), are neither identified, nor quantified (let alone publicized). The BNF is a particular source of concern, as it extends subsidized credit, enjoys government guarantees and faces a culture of no repayment fostered, among other things, by past decreed debt forgiveness paid for with public resources. In this respect, it is regrettable that several reform attempts have floundered in the last few years.

59. While in some aspects the relations between the government and the NFPEs have been clarified, NFPEs continue to engage in substantial QFAs and are in some cases (most notably, PETROPAR) a source of major contingent liabilities and fiscal risks. The government is considering the full liberalization of the market for oil products and the placement of a restructured PETROPAR on a level playing field with the rest of the private sector. This would be welcome, but some legal impediments for PETROPAR to engage with private sector companies would have to be overcome. More generally, sending conflicting signals as to the degree to which the government is willing to open up reserved sectors to different forms of private capital participation (as has happened recently with the water, telecommunications and railways sectors) undermines the transparency of the framework for public-private interactions.

60. There is some ambiguity as to the financial relations between the **central and subnational governments**. Specifically, the law leaves significant leeway to the central government in applying underdefined formulas for the interdepartmental allocation of discretionary transfers.

Few (if any) assurances of data quality are provided

61. Reconciliations at the level of the individual entity are not necessarily systematic and timely. A proliferation of bank accounts, managed directly by spending agencies, makes it difficult to carry out reconciliations at the macrolevel with bank accounts. Aggregate reconciliations at the macrolevel between **fiscal and monetary data** are also rare. Although the CGR presents a yearly audit report to congress, its assessment on the integrity of the fiscal information is essentially descriptive and usually does not provide substantive comments.

Disclosure of fiscal information is sparse and its coverage not comprehensive

62. Information provision still falls short of the LAFE's requirements (for example, with respect to budget documentation). There is almost no information on QFAs, contingent liabilities, and fiscal risks. Even the information that is indeed compiled is not consistently made available in the most user-friendly way. In addition, most budget execution reports focus on a narrow central administration concept.

**63. A broad and sustained effort is required to address the identified deficiencies and recommendations are offered below in order of importance.** Some measures address fundamental problems and therefore need to be carried out as a matter of short-term priority, although they may take time to complete, especially when changes in the legislation and/or in the information supporting system are involved. Others instead are more in the immediate purview of the executive and hence could and should be put in place promptly

**64. First, achieve the transparency and effectiveness of the budget as the main instrument of fiscal policy.** In the short term, essential steps in this direction would include:

- Clarify the roles and responsibilities on budget matters of the different government branches to ensure sustainability and higher accountability of fiscal policy. The executive and legislative branches should forge a consensus on possible mechanisms to define binding and sustainable fiscal policy objectives.<sup>75</sup> In addition, it would also be important to agree on a mechanism ensuring that the operating budgets of the various government branches grow, on average, at similar rates.<sup>76</sup>
- Review the budget preparation framework within the executive to ensure that responsibilities for the design of fiscal policy and targets are clear and that policies and targets are actually reflected in the draft budget submitted to congress.
- Strengthen the capacity for macrofiscal analysis of the MoF and create a technical office in congress to provide analytical support to congressmen on budget issues.
- Improve the transparency of budget execution to facilitate a better control of payment arrears, by creating a unified treasury account and revamping the commitment control system.
- Enhance within-year reporting to congress to promote higher awareness and commitment to fiscal policy objectives, as well as to instill discipline in the use by the executive of its powers to amend the approved budget.<sup>77,78</sup>

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<sup>75</sup> The definition of such objectives could be delegated to the MoF or to a consensus-building commission with representatives from the MoF, the central bank, and congress. Another alternative would be to informally agree with congress to divide the approval of the budget process in two stages to ensure that fiscal policy objectives and a budget envelope are clearly defined and maintained during the discussion of the detailed content of the budget in congress. A greater institutionalization of such coordination should be pursued but may take time as either the LAFE or congress's internal regulations may need amending. A fiscal responsibility law may be another alternative, but this should be considered only after a track record of adherence to budget targets and procedures has been well established.

<sup>76</sup> This would appear to be especially important to impose greater budget discipline on the judicial system.

<sup>77</sup> At a minimum, the mid-year budget report to congress should provide a comprehensive update on the implementation of the budget, including an updated forecast of the budget outcome for the current fiscal year, a  
(continued)

65. **Second, solidify recent transparency and efficiency gains in revenue administration.** Consolidate and generalize the application of new procedures, develop the functionality of the new taxpayer service department, and strengthen human resource management including by implementing the relative sections of the two codes. Especially in the tax agency, there is need to intensify the efforts aimed at modernizing the supporting information systems.

66. **Third, put in place a modern civil service law.** The current legal ambiguities should be resolved in favor of a framework that clearly specifies procedures governing employment in the public service, establishing recruitment and pay regulations on transparent merit-based criteria (which should be easily accessible), and introducing other basic transparency features such as a requirement for all vacancies to be advertised and filled through competition based on clearly defined selection criteria.

67. **Fourth, ensure that relations between the government and the rest of the public sector are clear and stable.** Contingent liabilities and quasi-fiscal costs should be clearly identified, quantified and publicized (to congress and to the public, both through the PGN and the annual reports of the individual NFPEs and PFIs). The approach adopted with the social tariff offered by ANDE in the electricity sector represents an interesting model, and the government should pursue its more generalized application. Those features of the second-tier bank law reducing the room for nontransparent QFAs, the risk of possible mismanagement of funds and, ultimately, contingent liabilities for the government should be extended to other PFIs, and in particular to the BNF, with greater systemic importance. Over time, the authorities could consider amending the BCP charter to grant the BCP sole responsibility in the design of the monetary policy and prohibiting it from extending guarantees to public entities (which would only formalize current practice in Paraguay). With respect to subnational governments, transparency would be increased by a more stable and self-contained legal framework for revenue and royalties sharing, as well as by a clearer definition of the allocation criteria (and of their relative importance) for discretionary transfers.

68. **Fifth, increase the assurances of data quality, reliability, and comprehensiveness.** In the short run, the government should conduct and publish systematically macrolevel reconciliation exercises between fiscal and monetary data. As progress continues toward a tighter commitment control system and a single treasury account, reconciliations could be conducted at a more microlevel. Additionally, these efforts should be complemented with a

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revision of the economic assumptions underlying the budget and their impact on the current budget, and an assessment of other government decisions, or other circumstances, that have had a material effect on the budget

<sup>78</sup> The efforts recently undertaken to adopt a multi-year budget and put in place pilots for output-based budgeting are praise-worthy but should not detract from higher priority goals described in this section which are in many cases a precondition for their full usefulness.

strengthening of the capacities of the CGR to conduct substantive audit assessments of the integrity of fiscal information. A consistent policy of prompt publication by the economic studies directorate of the MoF of the methodologies and assumptions underlying their fiscal and macroeconomic forecasts would facilitate independent assessments, better inform debates on the budget and on fiscal policy more generally, and perhaps even spur the formation of private sector consensus forecasts. Over time, it would be important to ensure that the fiscal activities of the municipalities are fully covered in the budget and in the fiscal reports, especially if they are handed over more expenditure responsibilities.

**69. Finally, the executive can take several measures in the very short run with a high yield in terms of transparency.** These include: completing the inventory of contingent liabilities, identifying and to the extent possible quantifying fiscal risks and QFAs, keeping updated the information collected through the first census of civil servants, further institutionalizing the provision of fiscal information and analysis, and extending the focus of fiscal policy and reporting to a GFS-consistent consolidated central government concept (and possibly include the key entities in the rest of the public sector that carry out substantial QFAs, such as PETROPAR and BNF).