Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 17-May-2022 | Report No: PIDA34085

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Paraguay	P178285	Paraguay Green and Resilient DPL (P178285)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	05-Jul-2022	Environment, Natural Resources & the Blue Economy	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of Paraguay	Ministry of Finance		

Proposed Development Objective(s)

The Program Development Objective is to (i) mobilize private capital for climate resilience and mitigation, (ii) promote climate resilience and mitigation in select sectors of the economy, and (iii) enhance fiscal transparency for climate action.

Financing (in US$, Millions)

SUMMARY

Total Financing	240.00

DETAILS

Total World Bank Group Financing	240.00
World Bank Lending	240.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Favorable external conditions and good macroeconomic policies have helped Paraguay achieve respectable growth and poverty reduction for the past two decades, however much of this growth has relied on the exploitation of natural resources, which are vulnerable to the effects of climate change. From 2003 to 2019, Paraguay grew 4.1 percent per annum on average, and poverty rates – measured at US$5.50 a day in 2011 PPP terms – fell from 39.3 to 15.4 percent over the same period. This growth has been largely based on Paraguay's rich endowment of natural resources, turning the country into an important producer of soybeans, beef, and hydroelectric energy. Together, the agriculture, livestock, forestry, fishing, electricity, and water sectors account for a fifth of GDP and of total employment. However, the success of the agribusiness sector has largely been fueled by the conversion of natural ecosystems, especially forests. Partly reflecting the depletion of these natural resources, Paraguay is increasingly vulnerable to the effects of climate change. More recently, external shocks, especially those associated with climate change, have suppressed the pace of growth and poverty reduction. Paraguay's economic growth has been highly volatile, driven by weather-induced swings in agricultural and hydroelectric production. In 2009, 2012 and 2019, 2020, and 2021/22, successive droughts and floods variously led to poor harvests, higher transport costs, and record forest fires, resulting in negative real GDP growth, reducing incomes, and resulting in inflationary pressures. Droughts, extreme heat, and flooding events are projected to increase, putting poor and vulnerable communities at risk.

Paraguay's macroeconomic policy framework is considered adequate. Although the economy has been exposed to climate and market shocks, a flexible exchange rate regime has helped Paraguay keep external imbalances under control. Fiscal and external imbalances are expected to remain below 4 and 2 percent of GDP respectively despite the projected slowdown in growth in 2022. Foreign reserves remain at prudent levels, covering 9.6 months of imports. A sound inflation targeting framework from an independent central bank has been a solid pillar of macroeconomic success. Since 2011, inflation has averaged 3.9 percent. Similarly, fiscal management has been sound, enhanced by a fiscal responsibility law that limits the central government deficit to 1.5 percent of GDP and the real growth of primary current expenditure to 4 percent of GDP.

Relationship to CPF

The proposed DPL supports the World Bank Group's FY19-23 Country Partnership Framework (CPF) for Paraguay, discussed by the Board on January 22, 2019. The CPF presented a shift in WBG engagement relative to previous strategies, with support to governance and institutional reforms at the center and a move towards environmental governance. With this background, and in the context of an acute climate-related crisis with visible impacts and the resulting government dialogue, this DPL supports a shift in the approach to recognizing the importance of and addressing climate change in key development areas. The DPL is primarily linked to the second CPF Focus Area, "Reducing volatility, natural capital management and integration into sustainable value chains", in particular Objective 6, "Strengthen environmental governance for NDC implementation and natural capital preservation", thereby also contributing to Objective 5: "Improve resilience to macroeconomic volatility". Select PAs also contribute to CPF Focus Area One, "Promoting Accountable Institutions and Improving the Business Climate", in particular Objective 3: "Improve governance in the water and electricity sectors" and Objective 4: "Create an investor friendly business climate". The Performance and Learning Review added a focus on climate mitigation and adaptation to the CPF, which this DPL directly supports.

C. Proposed Development Objective(s)

The Program Development Objective is to (i) mobilize private capital for climate resilience and mitigation, (ii) promote climate resilience and mitigation in select sectors of the economy, and (iii) enhance fiscal transparency for climate action.

Key Results

The proposed DPL supports an initial package of policy and institutional reforms that aim to set Paraguay's development trajectory on a more sustainable pathway. The program supports a shift in the government's approach to climate change policymaking toward a more proactive stance, especially in light of recent spate of severe droughts. Pillar 1 is expected to mobilize private capital for climate resilience and mitigation, in particular for energy efficiency and renewable biomass energy projects in the small and medium enterprise sector, and for forest plantation investments. Pillar 2 will support climate resilience and mitigation in select sectors of the economy, including by increasing the resilience of water and sanitation supply in rural and peri-urban areas, increasing the resilience of transactions, and improving the government's ability to manage wildfires. Pillar 3 is designed to enhance fiscal transparency in the face of climate change. The program aligns with the government's reform agenda as laid out in the *Plan del Gobierno 2018-2023*, as well as with Paraguay's updated Nationally Determined Contribution (NDC).

D. Project Description

A first set of reforms aims to mobilize private capital for climate resilience and mitigation. This includes the establishment of a credit line to finance energy efficiency improvements, including in the biomass energy sector, to incentivize small and medium enterprises to reduce their greenhouse gas emissions (Prior Action (PA1)). To facilitate financial institution lending to forestry businesses in the plantation sector, the government has also taken additional steps to regulate the valuation of standing timber for use as loan collateral (PA2).

The second set of reforms will promote climate resilience and mitigation in select sectors of the economy. First, to increase climate resilience and generate economies of scale among rural and peri-urban water and sanitation service providers, the government has reformed the subsidy regime for water and sanitation boards (PA3). Second, to promote enhanced efficiency, security and resilience in transactions, the government is promoting the digital verification of relevant processes (PA4). And finally, to maintain resilience to climate change and conserve natural ecosystems, the government has reformed the institutional environment for fire use, management, and control, and the prevention of wildfires (PA5).

The DPL's third set of reforms is to enhance fiscal transparency for climate action. This includes the introduction of a fiscal risk report to estimate, among others, the impacts of potential climate shocks on macroeconomic variables, with the aim of identifying and mitigating their impact on macro-fiscal projections and to improve the Ministry of Finance's capacity to provision for climate shocks (PA6). To better align the central government budget with climate change policy priorities, the Ministry of Finance will also promote the identification and measurement of public expenditures focused on climate change adaptation and mitigation, starting with the Ministry of Agriculture and Livestock and eventually branching out to additional government entities overseeing the vast majority of the economy's greenhouse gas emissions (PA7).

E. Implementation

Institutional and Implementation Arrangements

The Ministry of Finance will be responsible for overall coordination and implementation of the proposed operation, as well as for reporting progress and coordinating actions among other concerned ministries and agencies. The monitoring, evaluation, and results framework has been agreed with the Ministry of Finance. The agencies responsible for the implementation of the prior actions of the operation include the Ministry of Finance; the Agency for Development Finance; the Ministry of Health and Social Wellbeing; the Ministry of Public Works and Communications; the Ministry of Industry and Commerce; the National Forestry Institute; and the Central Bank of Paraguay. Monitoring and coordination capacity in general is weak, and the participation of multiple agencies constitutes a risk. The World Bank will maintain close dialogue with the Ministry of Finance and line ministries and agencies for the monitoring of indicators. The indicators selected for monitoring the operation's implementation are part of the government's regular monitoring activities and/or the relevant information can easily be collected.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The poverty and social impacts of the policies supported by this DPL are expected to be mostly neutral in the short term and positive in the medium- and long term. The operation's poverty and social impact analysis focuses on the potential impact of the prior actions on promoting climate policies and resiliency, access to credit, employment, and informality. The qualitative and quantitative analysis relies on available data and a literature review. Overall, the set of policies included in this DPL is expected to strengthen the country's capability to prepare, adapt, and mitigate the effects of climate change, therefore benefiting the overall population in the medium and long term, particularly the poor and vulnerable. Policies aimed at mobilizing private capital to reduce GHG emissions and to transition to energy-efficient technologies supported by measures in Pillar 1 are expected to benefit the vulnerable middle class by improving SMEs' productivity and competitiveness and encouraging more formalization of SMEs (PA1) and facilitating and increasing financial access to forest producers (PA2). These measures may also promote job creation through business expansion and productivity gains, benefiting the poor and vulnerable. Prior actions under Pillar 2 will have neutral or positive impacts on poverty and inequality in the short term. In the long term, these measures should affect poverty and inequality positively as they are expected to improve the country's capability to manage the effects of climate change by improving sanitation services for rural populations (PA3), enhancing the efficiency of transactions at the same time as increasing digital financial inclusion (PA4), and improving the management of wildfires (PA5). Finally, the set of policies in Pillar 3 are not expected to impact poverty and inequality directly; however, they are expected to help build the foundations towards an adequate risk management framework to tackle climate-related shocks.

Environmental, Forests, and Other Natural Resource Aspects

The policies supported under this DPL are expected to have broadly positive impacts on Paraguay's environment and natural resources sectors by embedding an enhanced policy approach to climate change and promoting climate action in key economic sectors. None of the prior actions are expected to negatively affect Paraguay's environment, forests, or other natural resources. This assessment is based on the substance and expected result of supported prior actions across the three policy pillars and an assessment of the governance framework for environmental management in Paraguay. Pillar 1 aims to mobilize private capital for climate resilience and mitigation through the provision of an energy line of credit and regulation enabling the use of standing timber as loan collateral. These actions are expected to result in mitigation outcomes with local and global benefits, particularly reducing pressure on native forests through greater availability of plantation wood and increased resource efficiency for energy use by SMEs. Pillar 2 promotes climate resilience and mitigation in key economic sectors – specifically in rural water supply and sanitation, leading to greater resource use efficiency; electronic transactions, leading to reduced paper use and emissions from transportation; and improved ability to manage wildfires, with expected benefits for conservation, ecosystem services, and public health. Finally, Pillar 3 seeks to enhance fiscal transparency to support climate action and centers on assessing, monitoring, and disclosing fiscal risks arising from climate shocks as well as better aligning the national budget to promote climate priorities. These actions are expected to result in enhanced mitigation and adaptation outcomes to safeguard environmental assets at risk by projected climate change impacts.

G. Risks and Mitigation

The overall risk to achieving the DPL's development objective is Substantial. The primary risks identified include: (i) institutional capacity for implementation and sustainability due to challenges with interinstitutional coordination and overall limited resources; (ii) sector strategies and policies, where discrepancies between the legal and policy framework, the supporting ecosystem, communications and the sector leadership may reduce reform effectiveness pose risks; (iii) technical design, where the innovative nature of several policy instruments presents a risk to implementation; and (iv) political and governance, considering that next year's elections could impact the implementation of the proposed policies. Risks will be monitored throughout the preparation and implementation of the DPL. The World Bank, along with several other development partners, is providing technical assistance to mitigate these risks pertaining to several of the policy reforms targeted by this operation.

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APPROVAL

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