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PD-ACC-200

**AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT**



**FIELD BUDGET SUBMISSION  
FY 1975**

**PARAGUAY ANNEX**

**DEPARTMENT  
OF  
STATE**

JULY 1973



BEST AVAILABLE

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PL 480 TITLE I PROGRAM

The Mission strongly supports the GOP request for a 35,000 metric ton PL 480 Title I Agreement for the following reasons:

1. The rapid expansion of wheat plantings in Paraguay during the late 1960's was supported by the GOP and encouraged by the external credit and technical assistance provided by ourselves and others. The Paraguayan Government and Paraguayan farmers over-reacted to this encouragement and wheat plantings and production expanded too rapidly. The 1972 wheat crop failure caused financial losses to farmers resulting in an impaired ability on the part of the National Development Bank to support the wheat program and an adverse psychological impact on everyone concerned. Domestic Paraguayan wheat planting has been reduced from 53,000 hectares (1972) to 11,000 hectares (1973), and production in 1973 will approximate 12-15,000 metric tons as compared with 55,000 metric tons in 1971. The shortfall in production constitutes a very sizeable financial loss.

2. The GOP has agreed to take initial steps toward integral fiscal reform. The provision of crucial external credit assistance to Paraguay at this time should elicit greater GOP cooperation in this and other efforts and will not relieve the overall long-term pressures on the GOP to generate greater revenues.

3. A Title I Agreement will provide counterpart resources badly needed for agricultural development. While we expect some significant improvement in the fiscal situation in 1973 and 1974 due to internal efforts, the supply of domestic resources for agricultural programs to which we supply technical assistance will be impaired without Title I counterpart proceeds in two ways: (a) from the lack of such counterpart to our projects, and (b) from the loss of leverage on the GOP to maintain adequate funding of the GOP's total program in the agricultural sector. Apart from the wheat debacle, efforts of the GOP to modernize her agriculture have had a significant pay-off in recent years. Most of the Paraguayan economy relies upon and is strongly linked to agricultural production. Her exports are almost entirely processed and unprocessed commodities produced by her agricultural sector. The volume of Paraguay's exports (as measured by a broadly-based index in constant US dollars prepared by the Mission) increased at an average annual rate of 5.0 percent in the years 1968-1972 as compared with an average annual growth of only 1.6 percent for the years 1962-1967. With the provision of adequate resources, we would expect that the agricultural sector would respond as favorably in the future.

4. There are compelling USG foreign policy considerations in support of a Title I Agreement. These considerations are amply covered in ASUNCION 1322 (April 5, 1973).

The GOP requested a new Title I Agreement on October 25, 1972, for wheat to be shipped as early as possible in FY 1973 for 35,000 metric tons of wheat. This request is still operative. The Mission has forwarded to AID/W several messages in support of the GOP's request. (See, in particular, Airgram TCAID A-39, April 2, 1973.)

Wheat and wheat products are Paraguay's most significant food import, accounting for approximately 65% of all food imports. The most important factor in assessing Paraguay's present requirement to import wheat has been a decline in domestic wheat production. Domestic wheat production approximated 55,000 metric tons in 1971 and 48,000 metric tons in 1970. Due to adverse climatic conditions, the 1972 wheat crop approximated 18,000 metric tons while plantings of 53,400 hectares should have produced over 50,000 metric tons with normal yields. The 1972 crop failure has had adverse psychological and financial repercussions. The National Development Bank (NDB) decided to reduce financing for plantings in 1973 to 15,000 hectares. However, farmers have planted 5,530 hectares to date with the financial support of the NDB and total plantings are estimated at 11,000 hectares. This constitutes a substantial reduction in total plantings from 1972 and in those financed by the NDB and is due, perhaps, more to the psychological impact of the 1972 crop failure than to lack of financing. Even if weather conditions are exceptionally favorable, the 1973 crop could not exceed 15,000 metric tons.

The Mission estimates that domestic wheat consumption will reach a level of 136,600 metric tons in CY 1973 and 140,700 metric tons in CY 1974. Stocks on hand at the beginning of CY 1973 were 2,000 metric tons. The GOP has indicated plans to purchase 70,000 metric tons of wheat or wheat flour equivalent in CY 1973 from Argentina, her traditional supplier. With reasonable allowance for stock and feed/seed/waste, at the end of CY 1973 there would be a shortfall of 66,000 metric tons, which would probably be met by unregistered flour imports. (See Table A). This shortfall will have to be covered prior to the possible arrival in Paraguay of wheat from a new Title I Agreement inasmuch as shipments are not likely to arrive before the end of CY 1973 if such an agreement were not signed prior to the last quarter of CY 1973 (second quarter FY 1974).

To date the GOP has purchased 34,000 metric tons of wheat equivalent of flour in CY 1973, and over half of this has already been imported.

GOP Wheat Commission sources indicate that the GOP is negotiating for a further 30,000 metric tons purchase of wheat from Argentina.<sup>1/</sup> Thus, if this negotiation is concluded successfully, the GOP would import, on a commercial registered basis, approximately 64,000 metric tons of wheat (and wheat flour equivalent) from Argentina in CY 1973. The precise quantity of unregistered flour imports which will occur in CY 1973 (from Argentina) is not known.

We assume that the 66,000 metric tons deficit will be covered by unregistered inputs of wheat flour from Argentina. This may depend upon the price of flour in Argentina, which has remained stable despite continued inflation. Inasmuch as the Guarani price of Argentine goods in contraband trade has risen substantially in the past year, deficit coverage from unregistered flour imports in the future may require some increase in the retail price of such flour in Paraguay.

In response to the Mission's request for information on UMR performance under the March 1971 Agreement, the GOP has stated that Paraguay imported under commercial terms 65,000 metric tons of wheat (and wheat flour equivalent) in 1971, 65,000 metric tons in 1972, and plans to import 70,000 metric tons in 1973. See airgram TOAID A-84 (July 2, 1973). The GOP further states that it does not object to the use of this information in any international event in which it would be necessary for the USG to consult other wheat suppliers regarding the operations of the PL 480 Title I program. While the data bases of the GOP statement are not confirmed from data on registered imports, and the Mission has come up somewhat different yearly estimates, the indicated total of commercial imports, both registered and unregistered, of wheat and wheat flour equivalent of 200,000 metric tons for CY's 1971-1973 is, if anything, conservative in terms of actual imports during these years.

The proposed 35,000 metric tons PL 480 Title I Agreement would be worth approximately \$3.05 million and would generate Gs.384.8 million for the use of the GOP. The Mission's proposal for uses is shown herein in Table B in Guaranies and US dollar equivalent.

The largest share of proposed uses, approximately 82 percent of the total, would be for the agriculture sector. A comprehensive discussion of specific programs within the Ministry of Agriculture

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<sup>1/</sup> This 30,000 metric tons is made up of a 20,000 metric tons purchase and a 10,000 metric ton donation. The donation is under consideration and is an attempt by the GOA to sell wheat at a price lower than that available to other commercial customers in order to honor a previous agreement with the GOP in regard to price.

(including the cooperative programs) was forwarded in Attachment A to TOAID A-39. All proceeds from the proposed PL 480 Agreement would be used in support of AID loan- or grant-assisted projects or the agricultural activities being assisted under the IDB's Integrated Program for Agricultural Development (PIDAP) loan. The Mission's grant assistance to agriculture amounts to some \$950,000 per year, and the \$14.7 million PIDAP loan is being disbursed over the period CY 1972-CY 1975. Airgram TOAID A-39 also includes a breakdown of ordinary budget funds and of PL 480 Title I proceeds for the financial support of the activities under jurisdiction of the Ministry of Agriculture for CY's 1971 and 1972 and estimated requirements for CY's 1973, 1974 and 1975. The estimate for CY's 1973-1975 represents the planning of the Ministry of Agriculture, and the Mission has made no commitments in regard to proceeds from the proposed Agreement. However, it is our opinion that without being able to count on a significant portion of the PL 480 proceeds in CY 1974 and CY 1975, the Ministry of Agriculture will not be able to meet its commitments to programs in adequate measure to make the best use of foreign resources being provided to it by the IDB and ourselves. Earlier this year, the Mission had hoped to have Gs.56.3 million of proceeds from a new Agreement to support CY 1973 expenditures of the Ministry of Agriculture. The lack of these funds is beginning to have a deleterious impact on the Ministry's program and Ministry officials have approached the Mission to seek a mechanism whereby funds could be advanced against a future Agreement. The Mission is not opposed, in principle, to an advance from the Central Bank of Paraguay to the Ministry for funding of the projects in CY 1973 contemplated in TOAID A-39 as soon as a PL 480 Title I Agreement is signed because the advance would be short-term and self-liquidating. Looking to CY 1974, Gs.130 million is the presently estimated requirement of the Ministry of Agriculture and this funding would also be jeopardized unless a PL 480 Title I Agreement is signed in the first half of FY 1974.

Paraguay's current fiscal situation has been widely discussed and examined in recent months--at the May CIAP Sub-Committee Meeting on Paraguay and in several messages from the Mission (See TOAID A-39 and TOAID A-74)--and the fiscal situation is also discussed in Annex I to this document. A PL 480 Title I Agreement would make domestic resources available to the GOP. A counterpart generation from the proposed Agreement would constitute a net addition of 3.2 percent to GOP current revenues in 1974 (as targeted by the CIAP Sub-Committee). Thus, in terms of global magnitude, counterpart resources from the proposed Agreement would be relatively small. However, in terms of the CIAP target for the Central Government's domestic resource deficit in 1974, which is only Gs.399 million (not borrowing from the Central Bank), proceeds from a Title I Agreement are by no means insignificant.

As is stated in TOAID A-39, the Central Government deficit can be financed by higher use of Central Bank credit, reduction of government investment, greater use of short-term external credits, and some use of counterpart from a Title I Agreement. Inasmuch as counterpart generations are relatively small, the Mission prefers to guide counterpart allocations toward specific uses related to Mission technical assistance programs, particularly in the agricultural sector, rather than permit their utilization in generalized budgetary support. The strategy in this design is to induce greater GOP budgetary allocation to agricultural programs. Although this strategy may free some budgetary resources for other uses, procedure also effectively ties additional domestic resources to agricultural programs. In addition, "self-help" conditions attached to the Title I Agreement will be utilized to aid this allocative goal. For a new Agreement, the Mission proposes to negotiate more precise and quantitatively expressed measures than in previous agreements.

Inasmuch as discussion of the merits of a Title I Agreement have included consideration of Paraguay's 1973 balance of payments and the adequacy of her international reserves, a comprehensive projection of the likely outcome of her 1973 balance of payments is included in Annex I. The Mission now expects Paraguay's net international reserve position to improve by \$15 million to \$25 million in CY 1973, bringing her net reserve position to a level of \$29 million to \$39 million. Net reserves of this magnitude would be adequate to confront such adverse tendencies in her balance of payments as can be reasonably expected to arise during the next two years. Reserve coverage for imports at the end of CY 1973, would be in the range of 3.4 to 4.6 months.

Paraguay's export earnings increased by \$19 million in 1972 (on a B/P basis), and we project a further \$22 million increase in 1973. This contrasts with the weakness in Paraguay's export earnings in the period 1965-1971 and derives fundamentally from the boom in world food commodity prices in 1971 and 1972 and, in particular, to the prices of Paraguay's exports, although gains in export volume also explain part of the over-all increase in Paraguay's export earnings. We believe the near-term tendencies in the prices of Paraguay's exports are too difficult to predict with the degree of precision required for a valid assessment of the prospects for Paraguay's export earnings in 1974 and 1975. The economic processes presently operative in Paraguay suggest substantial increments in her import expenditures in 1974 and 1975. Even if Paraguay's export earnings remain near their present all-time high level (\$107 million projected for 1973), they may be little net growth in her net reserve position in CY's 1974 and 1975. If Paraguay's export earnings were to decline, for example, due to adverse climatic conditions or to lower prices for export commodities, both of which appear likely on the basis of historical evidence, we would expect significant erosion in her net reserve position.

TABLE A

PARAGUAY: SUPPLY AND DISTRIBUTION OF WHEAT  
(Metric Tons)

	Calendar Years		
	1972 (Actual)	1973 (Estimated)	1974 (Projected)
<u>SUPPLY</u>			
A. Beginning Stocks (Wheat)	30,800	2,000	(10,000)
B. Production	17,600	(15,000)	(25,000)
C. Imports			
1. Commercial			
a. Wheat	21,400	30,000	(50,000)
b. Wheat equivalent of flour	--	34,000	(20,000)
c. Wheat equivalent of unregistered flour imports <sup>1/</sup>	(42,700)	(66,000)	(16,500)
2. PL 480			
a. Sales (Title I)	22,200	--	35,000 <sup>3/</sup>
b. Donations (Title II, WFP)	700	(600)	(200)
3. Other concessional (Swiss Agreement)	6,800	5,000	--
D. Total Supply	142,200	152,600	156,700
<u>DISTRIBUTION</u>			
A. Consumption	(132,600)	(136,600)	(140,700)
B. Feed/Seed/Waste <sup>2/</sup>	(7,600)	(6,000)	(6,000)
C. Ending Stocks	(2,000)	(10,000)	(10,000)
D. Exports	--	--	--
E. Total Distribution	142,200	152,600	156,700

<sup>1/</sup> Represents residual after subtracting wheat milled into flour and registered imports from estimated total consumption.

<sup>2/</sup> Includes some border movement of wheat into Brazil.

<sup>3/</sup> Current level of request for PL 480 Title I wheat.

(Figures in parentheses are estimates and projections of USAID/Paraguay).

TABLE B  
PROPOSED USES OF PL 480 PROCEEDS FROM 35,000 MT AGREEMENT  
IN FY 1974

	(Millions of Gs.)	(Thousands of US \$)
<u>Cooperatives' Program</u>	<u>16.67</u>	<u>132.26</u>
<u>Ministry of Agriculture</u>	<u>186.3</u>	<u>1,478.57</u>
AID Projects	25.7	203.97
PIDAP Projects	84.6	671.43
PIDAP Related Projects	20.1	159.52
Common AID/PIDAP Projects	55.9	443.65
<u>BNF Capitalization</u>	<u>113.0</u>	<u>896.83</u>
<u>Participant Travel</u>	<u>7.0</u>	<u>55.56</u>
<u>Population Program</u>	<u>22.5</u>	<u>178.57</u>
Additional Clinics	16.3	129.37
Operating Costs Now Being Paid with \$ Funds	6.2	49.20
<u>Current Loan Counterpart</u>	<u>6.37</u>	<u>50.56</u>
IDM (-022)	6.37	50.56
<u>Proposed Loan Counterpart</u>	<u>33.0</u>	<u>261.90</u>
Cadaster	25.2	200.00
Vocational Agriculture	7.8	61.90
<u>TOTAL</u>	<u>384.84</u>	<u>3,054.25</u>

TABLE IX

PL 480 TITLE I AGREEMENTS AND SHIPMENTS  
(All figures in thousands)

Paraguay

FY 1975 Request

FY 1974 Request

FY 1973 Estimate

Commodity	FY 1973 Estimate		FY 1974 Request		FY 1975 Request		Carryover Shipments To FY 1975	Carryover Shipments To FY 1976
	Agreements (MT)	Shipments (MT)	Agreements (MT)	Shipments (MT)	Agreements (MT)	Shipments (MT)		
Wheat	0	0	3,215	35	3,215	35	3,215	35

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Projection of 1973 Export Earnings

Projections of export earnings made by various authorities for 1973 are so far below present estimates that differences can only be described as staggering.<sup>1/</sup> The latest detailed GOP (CBP) estimate (\$118.0 million) is \$31.8 million above 1972 registered exports (\$86.18 million) and \$52.8 million above 1971 registered exports (\$65.19 million). At present, the Mission projects Paraguay's 1973 export earnings (FOB) at \$107.9 million. Based on detailed examination of prices and production of export commodities (and domestic consumption of some export commodities) we believe 1973 export earnings will be about \$22 million higher than in 1972 and \$43 million higher than in 1971.

The higher export earnings of 1973 do not arise from beef products; in fact the Mission projects that 1973 earnings from beef products will be \$4.7 million less than 1972 beef exports. A relatively short list of export commodities is likely to generate a \$25.8 million increase in export earnings over 1972 export earnings; they are as follows:

<sup>1/</sup> In October 1972 the IMF projected Paraguay's export earnings for 1973 at \$85 million (FOB), and in February 1973 the Central Bank estimated exports (FOB) at \$96.6 million and in March at \$92.3 million. In February the Mission estimated exports at \$82.2 million. In late May the Central Bank made a detailed estimate of \$118 million and in June a global estimate of \$100 million.

(Data in millions of U.S. dollars)

	<u>1972</u>	<u>1973</u>	<u>Increase</u>
Soybeans	3.84	9.00	5.16
Soybean meal and cake	2.20	8.10	5.90
Castor seeds	1.13	4.20	3.07
Tobacco	6.68	9.20	2.52
Cotton	3.82	6.90	3.08
Coconut oil	2.36	4.00	1.64
Essential oils	3.01	5.70	2.69
Other cake and expeller	<u>1.16</u>	<u>2.88</u>	<u>1.72</u>
	<u>24.20</u>	<u>49.98</u>	<u>25.78</u>

This set of commodities, whose export value was \$24.20 million in 1972, is projected to score a 106 percent gain in export value in 1973.

In this list, soybeans and related products stand out with an \$11.1 million increase in export earnings. For soybeans, the price per metric ton (FOB) was \$93 in 1972, but we estimate \$225 per MT for 1973 (and this is low for 1973 mainly due to dates of sale contracts against the 40,000 MT export quota). For soybean by-products (meal and cake) the average price in 1972 was \$76 per MT; we estimate \$270 per MT for 1973. For 1973, the Mission projects export of 40,000 MT of soybeans and 30,000 MT of meal and cake as compared with registered export in 1972 of 41,467 MT of soybeans and 28,895 MT of meal and cake. Even though one can quibble with the price estimates for soybeans in 1973 as either too low or too high, at this time it is a case of soybeans berserk. Although soybean plantings for 1973 in Paraguay should have yielded a crop in excess of 120 thousand MT, unfavorable weather conditions in late March and in April impeded harvest and spoiled some of the crop. Therefore, the 1973 harvest will probably be only slightly larger than the 97,100 MT harvest of 1972 (and some poor quality soybeans that would have been left unharvested in previous years are being harvested in 1973 and sold to the domestic vegetable oil industry).

Volume and price changes projected for castor seeds, tobacco, cotton, coconut oil, essential oils, and other cake and expeller are also favorable. Changes in volume, price, and export value for 1973 over 1972 are as follows (in percent):

	<u>Volume</u> <u>(%)</u>	<u>Price</u> <u>(%)</u>	<u>Value</u> <u>(%)</u>
Castor seeds	11.3	233.7	271.7
Tobacco	7.2	28.4	37.7
Cotton	77.8	1.5	80.6
Coconut oil	71.0	-0.8	69.4
Essential oils	17.2	61.8	89.4
Other cake and expeller	43.0	73.6	148.4

For castor seeds and essential oils, high prices have induced greater effort to pick castor seeds and sour orange leaves. The 1973 tobacco crop was somewhat larger than that of 1972 and is of good quality, so the effective price will be higher in 1973. The cotton crop was also substantially higher in 1973 than in 1972, an increase of 23 percent; however, the residual available after considering domestic consumption accounts for the extremely large gain in expected export value (13,500 MT in 1973 as compared with 7,593 MT in 1973). Export of coconut oil from pulp and kernel is estimated to increase substantially in 1973 with little overall change in export price. Other cake and expeller products are by-products from domestic crushing and refining of coconut, peanuts, and cotton seeds for vegetable oil. Projection of a significant volume increase results from a combination of higher price (which should yield higher export with reduced domestic use) and from higher volume of coconut, cotton, and peanut harvests.

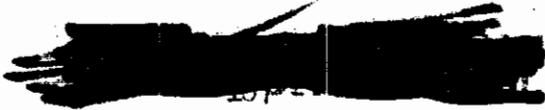
Export earnings of \$57.96 million are expected from all commodities not discussed above as compared with registered 1972 export value of \$62.01 million in 1972. A decrease in beef product exports from \$29.79 million in 1972 to \$25.06 million in 1973 accounts for most of this decline and is predicated on slaughter of 220,000 head of beef cattle for export in 1973 (as compared with 301,000 head in 1972) and on a 15 percent increase in average price per ton of beef product exports. Thus far in 1973, the GOP is standing by its decision to limit slaughter for export to the 220,000 head quota. (In fact most plants processing for export have now ceased operations, but politicking for an expansion in the quota will undoubtedly continue).

Apart from lumber products, whose export earnings are projected at \$10.5 million for 1973 (an increase of about \$1 million for total wood product exports), the remaining export products include other oilseeds, corn, fresh and prepared fruit and vegetables, coffee, yerba mate, palm hearts, other vegetable oils, quebracho extract, portland cement, wild animal skins, sugar, raw silk cocoons, and all other (n.i.e.). The more significant products of this list in terms of export earnings for 1973 are coffee beans (\$3.12 million), palm hearts (\$3.38 million), sugar (\$2.00 million) and quebracho extract (\$2.60 million); however, projected changes from 1972 export values are not large.

#### Projection of 1973 Import Expenditures

Apart from export earnings, the single most important item in a projection of Paraguay's balance of payments for 1973 is the level of import expenditures. At present, published customs data are available on commodities imported during the first four months of 1973. These data indicate a FOB value of imports of \$27.85 million. Based on the experience of recent years, imports of this magnitude during the first four months suggest an annual total in the range of \$85 to 101 million for the year as a whole. Supplementary evidence suggests that 1973 imports are likely to be near the high end of this range: (1) the increase in imports from the first four months of 1972 was 36.2 percent (if 1973 imports increase by the same percentage the total for the year would be \$107.2 million); (2) the value per metric ton was \$218.8 for the first four months as compared with \$206.1 per MT for the whole year 1972 and \$188.6 per MT for the whole year 1971; and (3) domestic liquidity has grown more rapidly in the past year, e.g. the stock of money grew by 28.2 percent from the first quarter of 1972 to the first quarter of 1973 as compared with 8.7 percent for the same period 1971-1972 and the stock of money and quasi-money grew by 28.4 percent in 1972-1973 as compared with 13.3 percent in 1971-1972.

The Central Bank projects imports (in B/P) at \$101.4 million for 1973. Although this would be 29 percent higher than the \$78.7 million level of imports for 1972, it does not appear unreasonably high given the combination of increased domestic demand (as represented by growth in domestic liquidity originating from the export boom of 1972 and 1973) and increased prices of goods from Europe (which has supplied approximately 40 percent of Paraguay's imports in recent years) and from Japan. As an additional test for the validity of the \$101 million import level, the ratio of long-term credit utilization and direct investment inflow to imports for past years and 1973 is as follows (in percent):



1968	47.1
1969	42.7
1970	38.4
1971	40.7
1972	37.6
1973	43.8

This ratio has ranged from 38 to 47 percent. A \$101 million import level in 1973 would yield a ratio of 43.8 percent as compared with an average of 41.3 for the years 1968-1972 (applying this historical average would yield a 1973 import level of \$107.5 million).

#### 1973 Balance of Payments

Table XII presents the likely outcome of Paraguay's external transactions for 1973. Data for 1972 (identical with data presented in Table VI) are included only for comparative purposes. The Central Bank of Paraguay's (CBP) projection of June 13, 1973 is also included in Table XII. In order to broaden detail of presentation, a decomposition of capital account items was undertaken which goes somewhat beyond the CBP presentation.<sup>1/</sup>

Paraguay's net international reserve position at the end June 1973 is \$32.4 million, which indicates a \$15.8 million increase in net reserves since the end of 1972. While certain commodity exports have moved out rapidly in 1973, particularly beef products, the Mission expects that reserves will continue to rise. Although the second half of 1973 will probably not show an increase of the same magnitude as the first half, a reserve increase of \$20 million for 1973 as a whole appears probable, although one should allow an error factor of ± \$5 million.

In regard to projection of E/P current account items, the Mission accepts all CBP estimates except (1) export earnings and (2) net inflow on travel expenditures. Given the more favorable exchange rate for Argentina tourists, some rebound on net inflow on travel account should occur in 1973. The \$7.0 million estimated by the Mission is higher than the CBP estimate but lower than the net inflow in 1969-1971 (See Table VI).

<sup>1/</sup> The \$100 million export figure of the CBP does not coincide with detailed data also given to us by the CBP. Their detailed projection of commodity exports (May 1973) is \$110 million. This is \$10 million higher than the export estimate in the CBP's B/P projection and implies an increase in net international reserves of \$32.5 million.



[REDACTED]

TABLE XII

PROJECTION OF PARAGUAY'S 1973

BALANCE OF PAYMENTS (Millions of U.S. Dollars)

	1972 <u>a/</u>	1973 <u>b/</u>	1973
	—	<u>GDP</u>	<u>USAID</u>
<b>A. Current Account</b>			
I. Merchandise Trade	+ 6.8	- 1.4	+ 6.5
a. Exports (FOB)	+ 85.5	+100.0	+107.9
b. Imports (FOB)	- 78.7	-101.4	-101.4
II. Non-Factor Services	- 7.4	- 9.7	- 7.9
a. Freight and Insurance	- 6.9	-10.1	-10.1
b. Other Transportation	- 2.2	- 0.7	- 0.7
c. Travel	+ 3.2	+ 5.2	+ 7.0
d. Government	- 0.4	- 0.1	- 0.1
e. Other	- 1.1	- 4.0	- 4.0
III. Factor Services	-11.2	-12.7	-12.7
a. Profit (net outflow)	- 2.4	n.a.	n.a.
b. Interest	- 8.8	n.a.	n.a.
IV. Donations and Transfers	+ 6.5	+ 5.1	+ 5.1
a. Private Source	+ 2.4	+ 2.1	+ 2.1
b. Public Source	+ 4.1	+ 3.0	+ 3.0
V. Balance of Current Account	- 5.3	-18.7	- 9.0

a/ Preliminary estimate, Central Bank of Paraguay.

b/ Projection of Central Bank of Paraguay,  
June 13, 1973.

	1972	1973	1973
		<u>GOP</u>	<u>USAID</u>
<b>B. Capital Account</b>			
I. Private Sector, net	- 0.5	+13.6	+ 7.5
a. Private Direct Investment, net	+ 3.2	+ 5.0	+ 3.0
1. Inflow	(3.5)	(5.0)	(4.0)
2. Outflow	(0.3)	(---)	(1.0)
b. Long-term Credits, net	--	+ 6.6	+ 4.5
1. Inflow	(0.7)	(6.6)	(5.5)
2. Outflow	(0.7)	(---)	(1.0)
c. Short-term Movements, net	- 3.7	+ 2.0	---
II. Public Sector, net	+17.2	+23.1	+20.1
a. Central Government, net	+ 1.9	+ 7.3	4.3
1. Utilization	(3.8)	(12.6)	(9.6)
2. Amortization	(1.9)	(5.3)	(5.3)
b. Official Banks, net	+12.2	+ 5.0	+ 5.0
1. Utilization	(14.3)	(9.9)	(9.9)
2. Amortization	(2.1)	(4.9)	(4.9)
c. Other Gov. Agencies, net	+ 3.1	+10.8	+10.8
1. Utilization	(7.3)	(15.4)	(15.4)
2. Amortization	(4.2)	(4.6)	(4.6)
III. Other (Holdings by External Agencies of Guaranties)	- 0.1	+ 1.0	+ 1.0
IV. Balance on Capital Account	+15.6	+37.7	+28.6
C. SDR Allocation	+ 2.2	---	---
D. Non-Monetary Balance	+13.5	+19.0	+19.6
E. Errors and Omissions	+ 0.5	- 4.5	---
F. Change in International Reserve Position (- indicates increase)	-14.0	-14.5	-19.6

In regard to the net balance on capital account, the Mission's estimate is \$9.1 million lower than that of the CBP. The CBP projection of net inflow to the private sector appears large. Two items which are difficult to substantiate are net private direct investment and net short-term movements. In the absence of satisfactory evidence, 1972 performance would dictate lower net inflows for these items. The Mission's projection of the long-term credit (items B.I.b.1. and B.I.b.2) is, however, fully substantiated.

In terms of public sector credit utilization and amortization, the only adjustments made by the Mission are the most obvious. Gross credit utilization of central government was reduced by \$3.0 million to reflect lower pace of utilization of IDB Trans-Chaco highway loan and the IBRD highway maintenance loan. At present there are 29 active loans being utilized by Paraguay's public sector and the CBP projection was made in April, so some further shortfall in utilization may occur. It is expected that any shortfall in credit utilization which is not balanced by a corresponding reduction in imported commodities will be relatively small.

The Mission's projection of the non-monetary balance (see Table XII, item D) is \$ + 19.6 million. For methodological reasons, errors and omissions are not projected. The \$19.6 million increase in international reserves should be viewed as the average within a range from \$14.6 million to \$24.6 million. Allowance of a margin of error is due to the very preliminary data available at this time and several presently unknown factors which may yet influence the B/P, particularly imports, utilization of external credits, and private short-term movements.

### Fiscal Performance

Fiscal performance of the Central Government began a cycle of deterioration in 1970. The principal causes of this deterioration were lagging growth of current revenues, rates of growth of 3.3 percent in 1970, 1.5 percent in 1971, and 6.3 percent in 1972, and accelerating growth of current expenditures, rates of growth of 7.1 percent in 1970, 4.3 percent in 1971 and 12.4 percent in 1972. (See Table XIII). The major repercussions of the adverse trend in current revenues have been relatively low levels of capital expenditures and increased net utilization of Central Bank credit (which was unduly large in 1972, Gs.924 million). Although various elements of Paraguay's fiscal system have been defective for many years, including heavy reliance upon specific rather than ad valorem taxes (which imparts low elasticity to current revenues), defective tax administration, and lack of adequate budgetary and accounting procedures, the GOP succeeding in raising the ratio of current revenues to Gross Domestic Product in the 1960's. The fiscal problem of 1972 reflected the failure of the GOP to take timely action to increase current revenues significantly. In 1972, current revenue

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growth was 6.3 percent (as compared to a 16.4 percent CIAP target). The increasing of taxes and the reduction of fiscal expenditures involve political decisions and an assessment of the trade-offs between the unpopularity of higher taxes, negative political repercussions of reduced levels of expenditures, and the eventual inflationary impact of monetized fiscal deficits.

The January 1972 CIAP Sub-Committee meeting decided to establish targets for 1972 and 1973 current revenues and current expenditures. These targets were set with the clear recognition of the difficulty in restraining growth in current expenditures, and the CIAP Sub-Committee proposed levels of current revenues which would facilitate reasonable levels of capital expenditures and minimum levels of net utilization of Central Bank credit. While the inability of the GOP to fulfill the fiscal targets agreed upon for 1972 may have been due in part to adverse economic factors, we and other CIAP agencies are inclined toward the supposition that the GOP has been unwilling to make the necessary political sacrifice. Attainment of the targeted level of current revenues would have required imposition of new taxes and upward revision of existing tax rates, and in 1972 the GOP did not take significant steps in this direction. In any event, the tenor of the May 1973 CIAP Sub-Committee meeting discussions reflected participating agency dissatisfaction with GOP fiscal performance and the belief that the GOP had ignored (1) the fiscal realities which were confronting it and (2) its promise to proceed with its request for external assistance for integral tax reform which was promised at the January 1972 CIAP Sub-Committee meeting. The more immediate, short-term problem is that of increasing current revenues; lack of progress on that front will signify ever-growing bail-outs from the Central Bank and an inability of the GOP to provide counterpart for projects financed with external credits. Integral tax reform would provide little immediate relief for the revenue problem but would aim to improve the flexibility, elasticity, and administration of the tax system, all of which are critical for longer-term growth of current revenues.

The GOP accepted new CIAP fiscal targets for 1973 and 1974 (established at the May 1973 CIAP Sub-Committee meeting, see Table XIII). Targeted growth of current revenues for 1973 is 16.0 percent, and targeted growth of current expenditures is 9.0 percent. Attainment of the 1973 revenue goal depends critically upon the revenue yield of tax measures adopted in 1973. Data on fiscal current revenues are not yet available for the first half of 1973; however, preliminary indications are encouraging. Attainment of current revenue and expenditure targets would permit a Gs.733 million increase in the 1973 current surplus and Gs.623 million increase in capital expenditures. A shortfall from the targeted level of current surplus would probably result in an even greater

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TABLE XIII

FINANCIAL SITUATION OF THE CENTRAL GOVERNMENT 1970 - 1972  
AND CIAP TARGETS FOR 1973 and 1974  
(Millions of Guaranies)

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974 <sup>a/</sup></u>
Current Revenues	8,790	8,918	9,478	10,992	12,070
Current Expenditures	<u>7,369</u>	<u>7,686</u>	<u>8,636</u>	<u>9,417</u>	<u>10,283</u>
Current Surplus	1,421	1,232	842	1,575	1,787
Capital Expenditures	1,503	1,661	2,165	2,910	3,076
Direct Investment	907	1,090	1,651	2,274	2,402
Transfers to Public Sector	553	468	454	510	508
Other	43	103	60	126	166
Deficit	- 82	- 429	-1,323	-1,335	-1,289
Financing	+ 82	+ 429	+1,323	+1,335	+1,289
Net External Resources	+ 284	+ 261	+ 604	+ 946	+ 890
Credit Utilization (+)	( 281)	( 230)	( 842)	(1,205)	(1,472)
PL 480 Utilization (+)	( 253)	( 233)	( 166)	( 153)	( 153)
Donations (+)	( 31)	( 28)	( 25)	( 70)	( 70)
Amortization (-)	( 281)	( 280)	( 429)	( 482)	( 582)
Net Domestic resources	- 202	+ 168	+ 719	+ 389	+ 399
Central Bank, net	(- 29)	(+460)	(+924)	(+ 389)	(+ 399)
Suppliers' Credits, net	(- 93)	(-245)	(-264)	(- 264)	(- 264)
Change in Deposits (& Other)	(- 90)	(- 47)	(+ 59)	(+ 59)	(+ 59)

<sup>a/</sup> All data for 1974 are expressed in 1973 prices. All other data are expressed on current prices.

SOURCE: For years 1970-1972, CIAP, El Esfuerzo Interno y las Necesidades de Financiamiento Externo para el Desarrollo del Paraguay, Vol. II (18 April 1973), Cuadro A-IV-10.

For years 1973-1974, data are from CIAP "Proyecto de Conclusiones y Recomendaciones" Cuadro 1.

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reduction of capital expenditures because disturbance of Gs.1,185 million in external credits from the IBRD, IDB, and A.I.D. requires Gs.460 million in domestic counterpart (see airgram TOAID A-74, June 13, 1973).

In regard to the fiscal reform activities, the GOP made a verbal request for technical assistance for integral tax reform to CIAP at the May meeting which was followed by a written request from the GOP, i.e. a letter from the Ministers of Finance and of Foreign Relations to the President of CIAP which included areas for priority consideration. The CIAP participating agencies agreed, in turn, to support and facilitate the GOP's request through the CIAP mechanism. The GOP also promised to reimpose the income tax law, legally suspended in late 1971 (after becoming law the same year). Probably the most noteworthy topic omission of the recent CIAP meeting was agency discussion of new credits. This was related to a tight fiscal situation and the inability of the GOP to make available counterpart needed for ongoing credits on a timely basis.