PARAGUAY

The limits of the economic model to meet the 2030 Agenda

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Paraguay faces strong challenges in meeting the Sustainable Development Goals (SDGs), with their focus on reducing inequalities and their complex links to production and growth. The right to health has not been met yet and social protection is still not a right for everyone. Even if there is a systematic improvement of the indicators of the past decade, these positive results were achieved only after years. After more than a decade of economic growth, lost opportunities in terms of welfare, the lack of productive transformation and tax justice place the country in an unfavourable position to meet the goals of reducing inequalities and ensuring socially and environmentally sustainable growth.

Economic model with little impact on poverty and inequality reduction

Paraguay faces strong challenges in meeting the Sustainable Development Goals (SDGs), with their focus on reducing inequalities and their complex links to production and growth. The right to health has not yet been met. Despite positive trends in many indicators such as the expansion of access to potable water and the reduction of maternal and infant mortality, Paraguay remains one of the countries with the most out-of-pocket expenses for health services, which implies that access to health services is mediated by the ability to pay.

Social protection is still a right to aspire to. Current contributory programmes are fragmented, incomplete and have a low level of coverage. The coverage of non-contributory programmes has increased significantly in recent years, but the lack of comprehensiveness hinders the possibility of substantial impact in reducing the risks that people face throughout their lives.

Even if there is a systematic improvement on the indicators of the past decade, these positive results were achieved only after years. The late start of state participation and the low level of public investment limited the scope and coverage of interventions. Added to this is the fact that policies were not implemented in a comprehensive way, which reduced impact, and the lack of equity in financing, which did not bridge the gaps by area of residence, ethnicity, gender and socioeconomic status.

In this context, Paraguay failed to meet most of the targets set in the Millennium Development Goals (MDGs), according to the Government's second official report in 2015.[1]

A multidimensional conceptualization is needed to reflect the complex relationship between tax policy and growth and inequalities.[2] Recent empirical evidence shows that tax policies in Latin America have positively affected income distribution through social spending and progressive taxation.[3] However, Paraguay is one of

1 Social Cabinet, Millennium Development Goals. Second Report of Government. Asuncion, 2015.

2 Ricardo Martner, Ivonne González and Andrea Podestá, "Politicas fiscales para el crecimiento y las igualdad," Macroeconomia de Desarrolo, CEPAL 2013; Hoeller, P. et al., "Less Income Inequality and More Growth – Are they Compatible? Part 1. Mapping Income Inequality. Across the OECD," OECD, 2012.

3 Giovanni Andrea Cornia and Bruno Martorano, "Development policies and income inequality in selected developing regions, 1980-2010,"Working Papers – Economics, Universita' degli Studi di Firenze, Dipartimento di Scienze per l'Economia e l'Impresa, 2013; Ivonne González and Ricardo Martner, "Superando el "Síndrome del Casillero Vacío" Determinantes de la Distribución del Ingreso en América Latina," CEPAL, 2012.

the countries with the lowest impact derived from the inequality of public spending and tax structure.

The current funding model sets limits on compliance with the SDGs

In this context of low and inequitable tax structure and failures in attempts to transform this situation due to the power exerted in policy decisions by affected sectors, especially those linked to the production of soybeans and livestock, indebtedness has been the strategy used by the last two governments, which generates future restrictions.

If the tax structure supported by indirect taxes is kept, debt repayment will disproportionately affect low and middle sectors, while profits from the expansion of the infrastructure will probably go more towards higher income sectors. In the infrastructure plans road work prevails over social work.

The fiscal space available to increase investment in the most disadvantaged sectors was due to the low level of indebtedness that enabled resources to be available for several years, a situation that began to reverse a couple of years ago. With the increasing debt, payment of commitments is added to other fixed costs such as wages and pensions in the public sector, thus the possibility of continuing to increase investment, particularly social investment, runs into restrictions.

In the absence of genuine resources, the Government proposes the implementation of public-private partnerships (PPPs) as a financing option. However, several international reports give an account of the risks involved, a path of failure with high costs for countries and lack of enough empirical evidence to ensure their advantages.

One of the main problems with public-private partnerships is that they end up generating obligations by the State that were not previously planned. The situation is compounded by the limited mechanisms of transparency, the problems in fiscal accounting records of government guarantees and the weak capacity to manage the initial contracts or renegotiations,[4] current situations in the country.

The second problem is the one related to final costs. The main criticism faced by PPPs lies in the higher cost of financing by comparing rates to be paid by a private entity to commercial banks compared with the rates that governments can get through sovereign guaranteed loans or by issuing bonds.[5] However, the price paid by the State for construction or services is similar to those the traditional model would demand. On the other hand, there is evidence of overruns. Nancy Alexander[6] presents a systematization of the main results found by Bent Flyvbjerg, Nils Bruzelius, Werner Rothengatter[7] about cost overruns incurred in megaprojects.

The Organisation for Economic Co-operation and Development (OECD)[8] alerts us to the need to analyse the successes and failures of this method taking into account the experience of countries like Spain and Portugal, where the extensive use of PPPs led to overinvestment in domestic infrastructure, contributing to the financial crisis in these countries. To the high risks verified even in developed countries, the paucity of information on the impacts of PPPs must be added, especially in the field of social policy.

Regarding Paraguay, the recent report by the International Monetary Fund (IMF) noted the importance of ensuring transparency of contracts and prudent assessment of contingent liabilities as part of

4 Carola Pessino. “Treatment of contingent liabilities.” Presentation at the Seminar "Fiscal Space and Investment Projects. The Role of PPPs" InterAmerican Development Bank, Lima, Peru, June 3 – 5, 2014; http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=38838473; Germán Alarco Tosoni, “Fiscal risks of Public-private partnerships (PPPs) in Latin America. Hemispheric Group on Finance and Trade, 2014.

5 Paloma Alonso, et al., “General concepts and models. Series of technical notes on pubic-private partnerships in the health sector in Latin America.” Technical note # IDB-TN-714. IDB, Washington, 2014.

6 Nancy Alexander, Presentation at Regions Refocus. Washington, 2015

7 Bent Flyvbjerg, Nils Bruzelius, Werner Rothengatter, Megaprojects and Risk: An Anatomy of Ambition. Cambridge University Press, Cambridge, 2015.

8 OECD, “Official support for private investment in developing country infrastructure,” 2014.

the budget process. More broadly, it will be essential to have sufficient institutional capacity before managing projects in order to obtain adequate economic returns. This puts PPPs in a complicated place, as the common factor of successful PPPs in increasing coverage and efficiency has been the existence of a strong public sector regarding supervisory capacity and with a highly professional civil service. It is worth remembering that Paraguay is one of the last in the ranking in this regard[9].

The emphasis on foreign direct investment (FDI) as a funding mechanism also presents difficulties in creating a solid foundation for growth to ensure job creation in sufficient quantity and quality to achieve the transition from a model of selective growth towards one that views work as a mechanism for income generation, economic security and reduction of poverty and inequalities.

Paraguay has no studies assessing the impact of FDI as an engine for development through paid work. If unawareness about the impact on employment is added to the low tax rates and the existence of tax exemptions, the conclusion is that the country is betting on a mechanism that does not have enough empirical evidence to support its contribution to development. The United Nations Economic Commission for Latin America and the Caribbean (ECLAC) notes that it is necessary for countries to evidence the net profit, considering that the available data do not show clear advantages for them.

A study by ECLAC reveals that over the period studied (2003-2013), FDI in Latin America contributed only 5 percent of the net job creation. One factor that explains this result is the high proportion of investment channeled into projects in primary activities and in their early stages of industrial transformation, into relatively more capital-intensive sectors. For every million US dollars invested only one job is created in the case of extractive activities and two in natural resource intensive manufacturing-oriented investment. These sectors concentrated around 47 percent of the investment amounts, but only 25 percent of jobs announced in investment projects over the ten years studied. Paraguay is one of the countries in which FDI has less impact on employment. For every USD 1 million invested only 1.8 jobs are created, while in Costa Rica and Nicaragua 5.2 and 8.9 jobs, respectively, are created. It is worth noting that these are the peak levels.[10]

Conclusions

Paraguay is in an uncomfortable situation for compliance with the SDGs. After more than a decade of economic growth, lost opportunities in terms of welfare, productive transformation and tax justice place the country under unfavourable conditions to meet the SDGs, particularly those that relate to reducing inequalities and ensuring a socially and environmentally sustainable growth.

Faced with the slowdown in economic growth at the international level, the lack of structural reforms in the economic model to facilitate progress along the path of development and the challenges in terms of compliance with the indicators required by the SDG targets based on a relatively low floor, the main concern focuses on how to finance the SDGs.

The solutions proposed by the Government so far are not helping to increase the tax burden and reduce inequity in collections. To this must be added the incipient process of indebtedness to finance infrastructure and a commitment to PPPs and FDI with financing mechanisms that not only do not have enough empirical evidence to ensure their contribution to development, but also pose risks that may culminate in adverse effects on the objectives of equality.

9 Cortázar Velarde, Juan Carlos; Mariano Lafuente; Mario Sanginés (editores). Al servicio del ciudadano: una década de reformas del servicio civil en América Latina (2004-13). BID. Washington. 2016

10 ECLAC, "Foreign direct investment in Latin America and the Caribbean." Santiago de Chile, 2013, p.138