IEO
Independent Evaluation Office
of the International Monetary Fund

BACKGROUND PAPER

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The IMF's Engagement with Latin America During the Pandemic

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ABBREVIATIONS

BANDESAL	*Banco de Desarrollo de El Salvador* (El Salvador)
BOP	Balance of Payments
CABEI	Caribbean and the Central American Bank for Economic Integration
CAF	Corporación Andina de Fomento
EF	Emergency Financing
EFF	Extended Fund Facility
EMDE	Emerging Markets and Developing Economy
ENACAL	*Empresa Nicaragüense de Acueductos y Alcantarillados* (Nicaragua)
ENATEL	*Empresa Nacional de Transmisión Eléctrica* (Nicaragua)
ENEL	*Empresa Nicaragüense de Electricidad* (Nicaragua)
EPN	*Empresa Portuaria Nacional* (Nicaragua)
FCL	Flexible Credit Line
IDB	Inter-American Development Bank
IFI	International Financial Institution
LOI	Letter of Intent
NPI	Non-Pharmaceutical Interventions
PETRONIC	*Empresa Nicaraguense de Petróleo* (Nicaragua)
RCF	Rapid Concessional Facility
RFI	Rapid Financing Instrument
SLL	Short-Term Liquidity Line
SME	Small and Medium-Sized Enterprises
SPR	Strategy, Policy, and Review (IMF)
UCT	Upper Credit Tranche
UNOPS	United Nations Office for Project Services
WEO	World Economic Outlook
WFP	World Food Program
WHD	Western Hemisphere Department (IMF)

EXECUTIVE SUMMARY

Coverage. In this paper, we assess the IMF's engagement with the Latin American region in the emergency phase of the COVID-19 pandemic (January 2020–April 2021), with a more detailed examination in four country cases, namely Bolivia, El Salvador, Nicaragua, and Paraguay.

A brutal shock. As in the rest of the world, the COVID-19 pandemic inflicted considerable pain in Latin America, both economically and socially. As cases climbed in 2020 Q2, Latin American governments, hoping to flatten the pandemic curve, introduced a series of non-pharmaceutical interventions (NPIs) that restricted mobility and economic activity on a large scale. These interventions, among the strictest globally, compounded by the fall in oil prices, international financial markets volatility, disruptions to global value chains, and weakening business confidence, led to a regional collapse in retail sales as well as in employment. As a result, Latin America experienced a 7 percent economic contraction in 2020 (IMF, 2021), which left the region 8.7 percent below the projected pre-pandemic trend (or in per-capita terms, more than 10 percent below projections).

Countries' policy response. Governments in the region quickly increased health spending to confront the crisis and implemented a wide range of fiscal stimulus programs to limit the magnitude of the economic contraction from lockdowns and to provide support for the eventual recovery. Measures varied by country ranging from increased social protection to temporary tax cuts and deferments to credit and guarantees. Alongside fiscal measures, Latin America's central banks implemented easy monetary policies and macroprudential measures to limit the economic and financial fallout of the pandemic. Prospects of reduced inflationary pressures during the remainder of 2020, helped by the collapse in oil prices and weak demand, provided room for policy easing efforts in many countries. Furthermore, central banks in some countries embarked on asset purchase programs.

Fund's agile and effective response. Interviews with various stakeholders in Latin America suggest that country authorities found the IMF's response to the pandemic in the region both agile and effective. Fund policy advice largely endorsed the authorities' own plans and was generally useful, although on occasions disagreements emerged with respect to either the magnitude of fiscal support or the timing of support withdrawal. Economic projections were broadly unbiased, although in a few cases, GDP and fiscal projections, as well as forecasts of the current account balance, turned out to be extremely pessimistic relative to outcomes, while in other cases Fund projections turned out to be too sanguine.

Evenhandedness. There was concern about the lack of evenhandedness in the case of Nicaragua compared to other countries in Latin America (and elsewhere) related to conditionality, expediency, and the channeling of disbursements. In the other Latin American countries that received Fund emergency financing (EF) and were examined here, prior actions were not required and commitments to strengthen governance safeguards were in line with requests across the majority of other members to which the Fund provided emergency financing in 2020. In the case

of Nicaragua, serious governance concerns delayed approval of the funds as the hurdle for governance standards was tightened over time, leaving the authorities to chase a moving target. Without reaching a definitive judgement, this experience leaves the impression that governance issues in Nicaragua were treated more stringently than in some other countries that also posed governance concerns.

Unpurchased or returned financing. In some cases, Fund approved financing was either returned or not purchased (for example, in the cases of Bolivia and Paraguay discussed in this paper). This raises questions about the implication for the ultimate effectiveness of the Fund's financing framework amidst countries' different legislative frameworks and how best can the Fund interact and assist countries during crises which require early and reliable mechanisms for financial support.

I. INTRODUCTION

1. **Purpose.** This paper assesses the IMF's engagement with countries in Latin America during the COVID-19 pandemic. It concentrates on the experience of four countries that received IMF financing: Bolivia, El Salvador, Nicaragua and Paraguay. Three of these countries received emergency financing (EF) while one was approved for it but eventually decided not to draw. The focus of the assessment is on the period from February 2020 to April 2021. The paper also briefly describes the Fund's overall engagement with the region, including WHD's policy advice over the course of the pandemic and the department's strategy for helping the region.[1]

2. **Sources.** For the four country cases, the narrative provided in this paper is based on interviews with the IMF mission chiefs during 2020–21, several country team members (including resident representatives), senior reviewers within Western Hemisphere Department (WHD) and in the Strategy, Policy and Review (SPR) Department, and the country authorities. Internal documents provided by WHD for the country cases were also consulted. In addition, WHD senior staff involved in crafting the department's strategy and financing decisions were interviewed alongside staff who put together WHD's *Regional Economic Outlook* reports, Executive Directors and their advisors, and outside experts.

3. **Structure.** Section II briefly summarizes developments in the region during the pandemic and WHD's response to help countries through policy advice and financing.[2] Sections III to VI present the case studies, including our assessment of IMF performance in each case. Section VII draws some conclusions.

II. IMF'S ENGAGEMENT WITH THE REGION

A. Developments and Policy Advice

The COVID-19 Economic Shock in Latin America

4. **A shock like no other**. As in the rest of the world, the COVID-19 pandemic inflicted considerable pain in Latin America, both economically and socially. Although the first case of Sars-Cov-2 infection in the region was detected later than in Asia and other regions of the world, by end-2020 the region had confirmed 13.2 million cases of COVID-19, equal to 16 percent of total global cases.[3] As cases climbed in 2020 Q2, Latin American governments, hoping to flatten the pandemic curve, introduced a series of non-pharmaceutical interventions (NPIs) that

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[1] Experience with EF for small countries in the Caribbean during the pandemic was evaluated in the evaluation of IMF engagement with SDS (IEO, 2022a).

[2] The Fund's capacity development and technical assistance work during the pandemic are covered in a separate IEO evaluation (IEO, 2022b) and summarized in a background paper for this evaluation (Loungani and others, 2023).

[3] See https://ourworldindata.org/covid-cases.

restricted mobility and economic activity on a large scale. These interventions, among the strictest globally, compounded by the fall in oil prices, international financial markets volatility, disruptions to global value chains, and weakening business confidence, led to a regional collapse in retail sales as well as in employment. As a result, Latin America experienced a 7 percent economic contraction in 2020 (IMF 2021), which left the region 8.7 percent below the projected pre-pandemic trend (or in per-capita terms, more than 10 percent below projections).

5. **Unfavorable initial conditions**. The COVID-19 pandemic struck Latin America after years of slow economic growth, at a time when the earlier gains in terms of poverty and inequality had been tapering and governments were finding social expectations increasingly hard to meet, as indicated by repeated episodes of social unrest in several countries in the region in the years predating the COVID-19 pandemic.

6. **Global underperformance.** At the regional level, Latin America's expected economic performance in response to the pandemic compares unfavorably with that of other emerging markets (Table 1). Not only was the downturn in 2020 more pronounced than in emerging regions of Asia, Eastern Europe, the Middle East, and Africa, but the recovery in 2021, adjusted for base effects, was somewhat weaker than in other regions, further widening relative income gaps with implications for poverty rates and living standards. These economic losses were compounded by additional and potentially more long-lasting socio-economic damages from education loss and job destruction, especially among the region's most vulnerable countries and lower income households within countries (Panagiotou and others, 2021).[4]

Table 1. EMDEs Real GDP Growth, by Region

	2019	2020	2021
Latin America	0.1	-7.0	6.8
Asia	5.3	-0.8	7.3
Europe	2.5	-1.8	6.7
Middle East	2.2	-2.9	5.7
Sub-Saharan Africa	3.1	-1.7	4.5

Source: IMF WEO, April 2022.
War Sets Back the Global Recovery, available at:
https://www.imf.org/en/Publications/WEO/Issues/2022/04/19/world-economic-outlook-april-2022

7. **Drivers of underperformance.** This regional underperformance reflects the combination of several factors. First, NPIs were particularly severe, extensive and prolonged in most Latin American countries relative to other regions where measures were more targeted and/or not as

[4] As of mid-October, Latin American children had on average lost more than 170 days of school, more than four times the global mean, according to UNICEF ("COVID-19: Schools for more than 168 million children globally have been completely closed for almost a full year, says UNICEF", at https://www.unicef.org/turkiye/en/press-releases/covid-19-schools-more-168-million-children-globally-have-been-completely-closed).

protracted;[5] in fact, no region was more home-bound in 2020 than Latin America, with restrictions in movement 70 percent greater than in North America.[6] As large shares of workers (informal and not) and companies in the region rely on face-to-face interactions and struggled to adjust, these policies threw immediately a vast portion of people into poverty and food insecurity and brought output to a screeching halt (Busso and Messina 2020; Bakker and Goncalves, 2021). Second, several Latin America countries lacked fiscal space and/or access to financing, either domestically or in international financial markets and so could not effectively support household and firms as economies' private sector engines were switched off (Filippini and Levy Yeyati, 2021). Third, even when funds were available to spend, often weak safety nets and limited government capacity to reach the most affected population complicated public support—in the form of cash transfers, sick leave, subsidized health coverage, aggravating income instability (Goldfajn and Levy Yeyati, 2021)[7].

8. **Impact heterogeneities.** Similarities aside, the economic damage from the pandemic differed widely by country. Among the region's six largest economies, those most severely hit by the pandemic were Argentina, Mexico, and Peru. In the year of the outbreak, these experienced real GDP year-on-year contractions of 9.9 percent, 9.0 percent, and 13.9 percent respectively, followed by Chile (6.0 percent), Colombia (8.2 percent), and Brazil (3.6 percent). Beyond having had more extended and stricter NPIs, the underperformance in the former three countries reflects their considerably greater trade exposure to the United States, which was hit severely by the pandemic. Conversely, countries with stronger trade ties to China, like Brazil, recovered faster despite being initially at the epicenter of the crisis. Sustained copper prices helped Chile to keep export revenues elevated, while exports of soybean from Argentina did not increase as they did in Brazil, because of dry weather conditions affecting yields but also reflecting Argentina's export taxes and a less competitive exchange rate. Elsewhere, some countries in Central America and the South American subregion also experienced relatively minor effects on their economies.

9. **Sectoral differences.** Countries with strong hospitality and/or contact-intensive sectors as well as strong oil exporters also suffered more. Tourist arrivals to Latin America collapsed in the first half of 2020 alongside widespread international border closures and travel restrictions implemented by countries in the region themselves. Countries that rely heavily on tourism such as Costa Rica, Ecuador, Peru, (and in the Caribbean, Aruba, the Bahamas, Barbados, and Jamaica) faced large declines in services activity, particularly in hospitality, food, entertainment, and retail services and, as a result, suffered deeper falls in GDP relative to other countries in the region.

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[5] Disentangling empirically the marginal impact of NIPs is complex as they have generally been implemented simultaneously or following the same sequence (Hsiang and others, 2020) with the low quality of data on infections being an additional challenge (Bonacini and others, 2021). That said, most studies show that untargeted measures like school and public transport closures had a high economic cost but a limited effect on the outbreak. https://voxeu.org/article/best-policies-fight-pandemics-five-lessons-literature-so-far

[6] In 2020, Argentina, Chile and Peru have been the world's most restricted countries, according to both the Oxford Stringency Index and Goldman Sachs' Effective Lockdown Index.

[7] https://voxeu.org/article/latin-american-pandemic.

In these countries, jobs in industries such as restaurants, shops or public transport account for over 40 percent of total employment, compared with about a third in emerging markets and developing economies (EMDEs) as a whole. Likewise, major oil exporters, like Brazil, Mexico and Venezuela, saw big losses in oil export revenues as the price of oil plunged in 2020 and the global economy went into recession.[8]

Countries' Macroeconomic Policy Responses

10. **Fiscal stimulus.** Governments in the region quickly implemented a wide range of fiscal stimulus programs to confront the immediate health crisis, as well as to limit the magnitude of the economic contraction from lockdowns and to provide support for the eventual recovery. The average fiscal package in 2020 was about 8.5 percent of GDP,[9] implying a near doubling of the region's median fiscal deficit. On average public debt rose from 58 percent of GDP in 2019 to 72 percent of GDP in 2020. However, that figure includes a few large packages (for example, in Brazil, Chile, and Peru), while more than a third of countries implemented fiscal packages comprising 3 percent of GDP or less as originally elevated debt-to-GDP ratios constrained their room to aggressively ease fiscal policy. All in all, this means that, while Latin America implemented more generous fiscal stimulus than in past recessions, it stimulated less than EMDEs (The Economist, 2021), with countries like Mexico opting for even less support (equivalent to about a tenth of the median of the other five largest Latin American countries (Fig 1.1, IMF, 2020a)).

11. **Stimulus' focus.** Measures varied by country ranging from increased social protection to temporary tax cuts and deferments to credit and guarantees. Fiscal measures in the region targeted a range of areas, including health spending (Argentina, Chile, Guatemala), income support for vulnerable groups (Argentina, Brazil, Peru), tax payment deferrals (Brazil, Chile), tax cuts (Jamaica), loans or credit guarantees to small and medium-sized enterprises (SMEs) (Argentina, Chile), and enhanced employment protection (Argentina, Chile, Guatemala). Governments in Mexico, Paraguay, and Honduras, and Uruguay provided support for SMEs, including through the provision of additional resources to their development banks and other financial institutions. Fiscal support also included the expansion of social protection coverage (Argentina, Brazil, Peru).

12. **Monetary easing.** Alongside fiscal measures, Latin America's central banks implemented easy monetary policies and macroprudential measures to limit the economic and financial fallout of the pandemic. Prospects of reduced inflationary pressures during the remainder of 2020, helped by the collapse in oil prices and weak demand, provided room for policy easing efforts in many countries. Several economies in Latin America aggressively cut their monetary policy interest rates (Brazil, Chile, Mexico, Paraguay, Peru). Brazil's central bank reduced the policy

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[8] In 2020, oil exports from Latin America reached the lowest figure in at least ten years, amounting to 4.71 million barrels per day. This represents a decrease of nearly 15 percent in comparison to 2016, when the region's exports registered the peak of the decade, at over 5.5 million daily barrels.

[9] In contrast, advanced economies put together fiscal packages of about 19 percent of GDP on average.

interest rate by 225 bps in 2020, to a historic low of 2 percent, while also easing capital conservation buffers, reserve requirements, and provisioning rules to increase liquidity in the banking system. Mexico's central bank established several new liquidity facilities for banks to ease constraints and enable lending to firms.

13. **Unconventional monetary accommodation.** Furthermore, central banks in some countries embarked on asset purchase programs. After the experience of the 1980s with quasi-fiscal activities, central banks in Latin America and the Caribbean tend to have tight legal restrictions on asset purchasing, implying that their balance sheets expanded less than their counterparts in advanced economies. Brazil and Mexico also benefited from a newly established temporary swap line with the U.S. Federal Reserve that provided dollar liquidity equivalent to 17 percent and 32 percent of their international reserves, respectively.

IMF Policy Advice

14. **A call for spending but with caveats**. Throughout the pandemic, WHD staff continued its engagement with the region on policy advice and capacity development in line with the Fund's overall message. The key message for governments as they lived with the pandemic, to the membership, was that governments should use available fiscal room to support economies against unexpected shocks but do so in a way that was agile and pave the way for the eventual recovery. For large Latin American countries like Chile, Colombia and Peru with lower fiscal deficits and public debt and secure financing (including large backstops in the context of Fund precautionary arrangements), well developed capital markets, and comfortable level of international reserves, staff supported significant government spending and multi-year stimulus plans. In the case of Brazil, staff advice reflected greater concerns about debt sustainability: while supporting the very large fiscal stimulus provided in 2020, staff endorsed the authorities' commitment to substantial consolidation and preserving the expenditure ceiling in 2021. Staff also suggested, however, that if economic conditions were to turn out worse than expected by the authorities, they should be prepared to provide additional fiscal support. This latter advice created tensions between staff and the authorities who emphasized their commitment to fiscal responsibility and were concerned that the Fund was adding to public pressure to back away from fiscal prudence although eventually Brazil decided to provide further fiscal support in 2021 as it was faced by a second pandemic wave.[10]

15. **Cautionary notes.** Policy advice came with cautionary notes. First, countries should prepare for an eventual shift in policies—when the time comes to help workers transition back to employment. Second, they should ensure that the financial system is solid and reliable and can support the future recovery. Third, they should use the fiscal stimulus wisely—not only to help boost growth and employment but to create a more resilient post-pandemic world. And fourth, as disruptions fade way, fiscal soundness and debt sustainability should become a policy priority.

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[10] Brazil's policy response was among the largest for G20 countries and raised the primary fiscal deficit to 12 percent of GDP. An important and effective element of the government support was in the form of cash transfers, in addition to extra health spending.

16. **Liquidity measures welcome.** Fund staff generally welcomed and encouraged monetary accommodation in the region and documented the effectiveness of these measures in a number of EMDEs (Fratto and others, 2021), but also warned about the potential impact of unconventional accommodation on fiscal sustainability and other potential risks (Adrian and others, 2021).[11]

17. **Staff forecasting in 2020**. Outlook projections in the region in April 2020 were generally accurate, considering the large uncertainties. However, growth forecast errors were large for Brazil, which complained publicly about the pessimism in Fund forecasts, although the private *Consensus Forecasts* were also pessimistic about growth in Brazil (Loungani and others, 2023). Forecasts for some other countries (for example, Bolivia, El Salvador, Nicaragua) were also considerably off, even if less so. For the case of Brazil, WHD staff acknowledged that they had "not [been] sufficiently critical of what functional and other departments were saying" at the time, especially with regard to expectations that growth in Brazil would be highly correlated with that in other large, advanced economies like the United States, which ended up not being the case.

B. Strategy and Financing Decisions

18. **WHD and the Fund's overall strategy**. Early on in 2020, the Fund decided on a strategy with four elements: (i) recourse to EF—the Rapid Financing Instrument (RFI) and the Rapid Concessional Facility (RCF)—as the main source of financing instead of new upper credit tranche (UCT) arrangements; (ii) urging use of precautionary facilities and launching a new short-term liquidity line (SLL); (iii) pushing for an SDR allocation; and (iv) helping countries through debt relief and debt restructuring where needed (Ocampo and others, 2023). Following guidance from Management, WHD's senior staff operated with the intent of providing prompt access to financing to all members in need.

19. **Precautionary lending**. More so than in other regions, countries in the WHD region made use of the Fund's precautionary lending instruments, benefitting from preexisting contingent instruments at the start of the pandemic and a track record of use of these facilities during the Global Financial Crisis (Figure 1, left panel).[12] With additional countries stepping forward during the pandemic, the Fund expanded its precautionary lending commitments to the region to US$107 billion in 2020, by approving new flexible credit line (FCL) arrangements to Chile and Peru and renewing Colombia's line for a cumulative amount of US$16.9 billion

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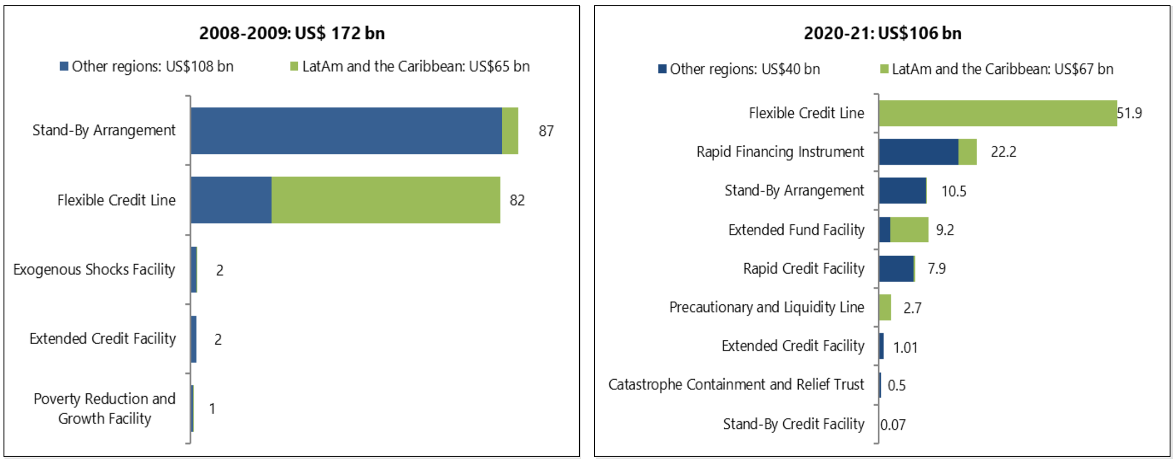
[11] https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2021/10/08/Asset-Purchases-and-Direct-Financing-Guiding-Principles-for-Emerging-Markets-and-Developing-464660

[12] Notably the Flexible Credit Line (FCL)—a form of Fund financial assistance available to countries with very strong policy frameworks and track records that do not have a current BOP need but could have one in the future, and the Precautionary and Liquidity Line—an instrument designed to flexibly meet the liquidity needs of member countries with sound economic fundamentals but with some remaining vulnerabilities that preclude them from using the FCL.

(Figure 1, right panel).[13] Mexico also had an FCL at the onset of the COVID-19 crisis, which was re-approved in November 2019. All in all, in 2020, the IMF approved assistance for 19 out of 42 Latin American countries (45 percent of countries, though not all of them purchased).

Figure 1. IMF Assistance to Latin America vs. Other Regions: 2008–09 and 2020–21



Source: IMF MONA Database.

20. **Emergency Financing or Upper Credit Tranche?** In terms of EF, as part of its overall strategic response, the Fund doubled the ceiling on access to emergency funding as; and, in 2020 alone, approved about US$5.5 billion of total financing to 15 countries in the Caribbean, Central America and South America, including 9 RFIs and 6 RCFs.[14, 15] There was much more limited use of new UCT arrangements. Only one country, Ecuador, opted for a (new) program in addition to an RFI, namely an Extended Fund Facility (EFF), for US$6.5 billion, while Barbados and Honduras augmented the amounts available under their existing EFF and Stand-By Arrangement.

21. **Reasons for limited UCT programs.** According to WHD senior staff, several reasons explain the limited recourse in 2020 to UCT programs. First, assessing the viability of UCT-based programs was particularly difficult during the pandemic because the shock was global and not idiosyncratic. Second, as major central banks around the world pumped unprecedented amounts

[13] Chile's FCL expired on May 19, 2022 and was followed by the approval of a US$3.3 billion SLL on May 20, 2022. By the end of August 2022, Chile canceled the SLL as the Board approved a new two-year FCL, to be treated as precautionary, for US$18.5 billion to augment buffers and provide insurance against adverse scenarios.

[14] Two distinct RCFs went to St. Vincent and the Grenadines on separate dates. The second RCF (in July 2021) was in response to economic and humanitarian damage from volcanic eruptions and not directly linked to the pandemic; which involved an augmentation of the disaster window. See https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker.

[15] In line with requirements under the Fund legal framework, each of the 16 staff reports supporting a request by Latin American countries for RCF/RFI assistance from March 2020 to December 2021 included information/table on the impact of the COVID pandemic on economic activity and on the external accounts. All these reports indicated that the member was experiencing an urgent BOP need, which if not addressed would result in an immediate and severe economic disruption, as well as specified explicitly which of the two clauses applied. See Kincaid and others (2023).

of dollars and euros into the global economy, countries were able to obtain sufficient external financing to meet their needs. Third, due to stigma—arising from conditionality associated with IMF programs during past financial crises—Latin America remains largely reluctant to negotiate programs with the IMF, even when the Fund is the most obvious lender of last resort, like at the onset of the COVID-19 crisis. In this regard, staff believes that having special "umbrella" vehicles for the region could perhaps have helped overcome this resistance, but WHD attempts to arrange these via SPR indicated no clear support from the Executive Board for such a step.

22. **Catastrophe Containment and Relief Trust (CCRT).** Under the IMF's revamped CCRT, on April 13, 2020, the Fund's Board approved immediate debt service relief to 25 countries, including Haiti in Latin America.

23. **"Problematic" cases**. WHD staff pointed to three particularly complex cases in the region, Antigua and Barbuda, Nicaragua, and Suriname, which required additional work. In the end, the Fund approved both an RFI and a RCF for Nicaragua on November 2020 for US$0.2 billion in total, and extended an EFF to Suriname one year later, in December 2021, for a total of US$0.7 billion. On the other hand, Antigua and Barbuda did not receive EF from the Fund because of concerns about debt sustainability, but it obtained a US$25 million loan in October 2021 from the Caribbean Development Bank to counter COVID-19 fallout and support economic recovery. In other cases, notably in the case of Bolivia, Guatemala and Paraguay, domestic legal issues arose following Fund approval of EF (the cases of Bolivia and Paraguay are examined at length in Section III). None of these countries drew Fund financing because their government did not get parliamentary approval for the loans, reflecting economic policy or political considerations related to external debt operations, and the actual (prior actions) or perceived ex-ante conditionality embedded in the EF agreements.

24. **Prior actions, letter of intent (LOI) commitments and governance safeguards**. According to Board documents, formal prior actions were required for 4 out of 16 requests for IMF emergency assistance in the region (Ecuador, Grenada, Haiti, Nicaragua) from March 2020 to December 2021.[16] The EF for Ecuador was the only case involving only the RFI. Nicaragua was the only case in which a prior action was requested for a country using a blend of the RCF and RFI. On the other hand, all LOIs contained extensive commitments to economic adjustment aimed at resolving the urgent BOP need within 12 months, as requested under the Fund's legal framework for the provision of EF (Kincaid, Cohen-Setton and Li, 2023). In terms of governance safeguards, the gradual shift of IMF attention to governance protections related to COVID-19-spending in connection with RFI/RCF disbursements meant that in the case of 9 requests (submitted between late March and mid-April 2020) staff reports supporting RCF/RFI either had no specific reference to COVID-related governance measures or only made very generalized expressions.[17] In interviews,

[16] After the evaluation period (April 2021), the Fund Board approved a joint RCF/RFI request (50 percent of quota in total) for Equatorial Guinea. Four prior actions were associated with this request related to better governance, enhanced transparency, and anti-corruption measures.

[17] These cases included Costa Rica, Dominica, the Dominican Republic, El Salvador, Granada, Panama, Paraguay, and St. Lucia.

WHD staff noted that in the remaining cases, as attention to safeguards increased as the Board appropriately wanted assurance that money was targeted at needs, on occasion this led to complications and delays in the approval of Fund financing since some of the measures, notably the beneficial ownership framework, required the passing and/or the abrogation of legislation.

25. **Relationship with partner agencies**. WHD senior staff stated that they met regularly through the pandemic with their counterparts at the World Bank and the Inter-American Development Bank (IDB), and this allowed significant coordination in the context of arranging EF. These interactions continued and set a good tone for collaboration between the institutions. Both IMF and World Bank staff interviewed as part of the Independent Evaluation Group's parallel evaluation, confirmed regular and beneficial interactions between Bank-Fund country teams. As noted in the case studies that follow, WHD also coordinated with other bilateral and multilateral donors, such as the IDB, the Canadian government in the case of the Caribbean and the Central American Bank for Economic Integration (CABEI) for countries in Central America, or the Caja Andina de Fomento (CAF) for countries in the Andean region.

III. BOLIVIA

26. **Overview.** Bolivia requested an RFI in March 2020, at first for 50 percent of the quota, then raised to 100 percent, to be complemented with assistance from other multilateral lenders to fill a US$1.5 billion total financing gap due to the global recession, the decline in export prices, and the pandemic-based need to import medical equipment and supplies. The disbursement of the funds was delayed after being blocked in Congress and the purchase was fully reversed a year later.

A. Background and Economic Developments

27. **Initial conditions.** Prior to the COVID-19 shock, Bolivia experienced civil unrest associated with the general elections on October 20, 2019, leading to the establishment of a transitional government. After a decade of strong real growth (averaging 4.9 percent during 2006–2018), bolstered by high global commodity prices and expansionary fiscal policy, growth slowed to 2.8 percent in 2019. Inflation was stable, thanks to the de facto fixed exchange rate regime. The current account deficit narrowed in 2019 with a significant decline in capital goods imports offsetting weakness in hydrocarbons, mining, and agricultural exports. However, declining inflows from multilateral loans, sovereign borrowing, and foreign direct investment resulted in reduction in international reserves (to US$6.3 billion by February 2020, 88 percent of the Assessing Reserve Adequacy metric and US$2.2 billion lower than in the same month the previous year). The banking system was well-capitalized, with a relatively low rate of nonperforming loans (1.9 percent), but loan restructurings had risen and there were concerns that previous directed lending practices had introduced some financial vulnerabilities. The banking system faced moderate deposit withdrawals during the October–November 2019 unrest, but half of that deposit outflow had returned to the banking system by the beginning of 2020.

28. **Pandemic developments and non-pharmaceutical policies.** The virus was confirmed to have spread to Bolivia on March 10, 2020, when its first two cases were confirmed in the departments of Oruro and Santa Cruz. By the end of 2020, Bolivia's COVID-19 cumulative confirmed deaths were 9149, equivalent to 758 deaths per million people. These numbers climbed to 19,530 and 1,621, respectively, by end 2021.[18] As a result of the early two cases, on March 17, 2020, the government announced a series of measures including immediate closure of all borders, suspension of all international flights and all interdepartmental and interprovincial land transport, a 14-day national quarantine and the closure of all schools. These measures were subsequently extended multiple times. At the same time, Bolivia's terms of trade and trade balance deteriorated with the sharp decline in commodity prices and capital outflow intensified, including a sudden stop of foreign direct investment, leading, together with the domestic measures, to an 8.7 percent contraction in GDP in 2020 (Table 2). The fiscal impact was substantial, pushing the fiscal balance to a primary deficit of around 7.3 percent of the GDP.

Table 2. Bolivia: Selected Economic Indicators

	2019	2020				2021
	Actual[3]	Projections Pre-COVID[1]	Projections COVID[2]	June WEO	Actual[4]	Actual[4]
GDP Growth (Percent)	2.2	3.0	-2.9	-5.6	-8.7	6.1
Inflation (Percent)	1.8	3.4	2.3	2.0	0.9	0.7
Fiscal balance (Percent of GDP)	-7.2	-7.7	-7.3	-8.0	-12.7	-9.3
Government debt (Percent of GDP)	59.3	60.7	64.9	68.4	78.1	82.6
Current account balance (Percent of GDP)	-3.3	-4.7	-4.6	-4.9	-0.4	0.5
External debt (Percent of GDP)	33.4	37.9	N/A	39.9	40.4	36.5
Official reserves (USD billions)	6.5	5.3	5.2	5.4	5.3	4.8

Source: IMF.
[1] IMF WEO, January 2020.
[2] IMF Country Report No. 20/182.
[3] IMF WEO, October 2019.
[4] IMF WEO, July 2022.

29. **Fiscal policy response.** Besides introducing extensive lockdowns, Bolivia addressed the health crisis by increasing health spending by 1.2 percent of GDP and introduced a multi-faceted fiscal relief package equivalent to circa 0.6 percent of GDP. This included a direct transfer ("*Bono Familia*") of US$70 per child to be paid to households with children in school; a direct cash transfer ("*Canasta Familiar*") of about US$50 to each household; a 50 percent reduction in the price of natural gas supplied to households; the postponement of the payment of taxes, and a 3-month suspension of electricity charges to households with modest incomes. The package was offset by accelerated cuts in capital expenditure by public enterprises.

30. **Monetary policy response.** To boost liquidity, the central bank purchased bonds from the pension funds (about 0.5 percent of GDP). In an effort to protect household and small business finances, the authorities declared a 2-month moratorium on loan repayments (principal)

[18] See OurWorldinData at https://ourworldindata.org/covid-deaths.

for natural persons and small companies. The exchange rate was kept fixed during 2020, thus preventing a depreciation that could have helped mitigate the fiscal deficit, albeit at the cost of greater price volatility. The authorities also took some measures to support the financial sector.

B. IMF Engagement

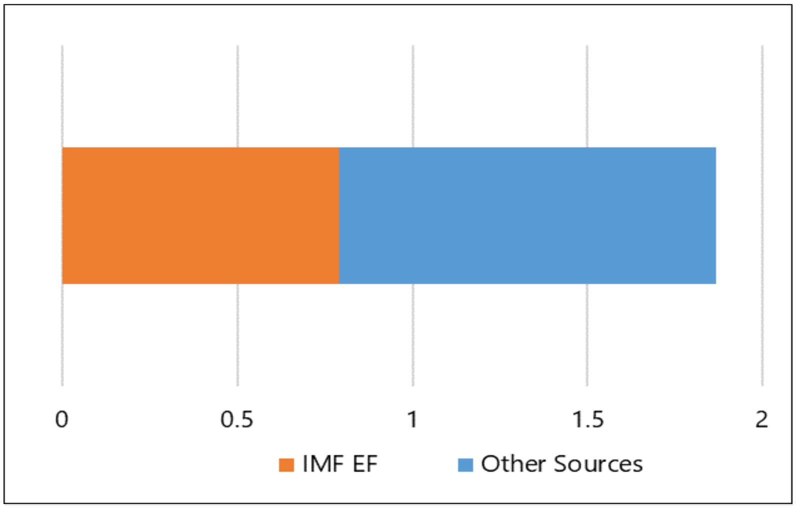
31. **Financing request.** During a staff visit that took place in March 2020, the Bolivian authorities expressed the intention to request Fund financing to help meet the country's urgent BOP and fiscal needs associated with increased pandemic-related health spending, weakened terms of trade, and a shutoff of international financing. The possibility of a large financing package based on a UCT program was immediately ruled out by staff on the grounds that Bolivia's transition government could not make longer-term policy commitments, and assistance through EF was suggested as an alternative. On April 17, 2020, the IMF approved Bolivia's request of Fund EF in the equivalent of SDR240.1 million (about US$332 million), corresponding to a purchase of 100 percent of quota under the RFI to combat the COVID-19 pandemic.

32. **Prior actions and governance safeguards.** Besides committing to ensuring continued macroeconomic stability and to avoiding any measures or policies that may compound economic difficulties, the LOI supporting the RFI request contained no prior actions. With respect to safeguards assessments, the authorities committed to undertake assessments of the Central Bank of Bolivia's practices, including provision of most recently completed external audit reports, in line with IMF requirements. On governance safeguards, they committed to adhere to best practices in procuring and awarding contracts related to the pandemic (including by publishing regularly documentation on procurement contracts on the government's website, together with ex post validation of delivery along with the name of awarded companies and the name of their beneficial owners) and to publishing an external independent audit report on virus-related expenditures once the crisis was over.

33. **Gap financing.** The RFI was estimated by staff to cover 42 percent (0.8 percent of GDP) of the country's 2020 financing gap projected by staff at around US$769 million (1.9 percent of GDP). Staff anticipated that other international financial institution (IFI) lenders would fill the residual gap with US$443million (1.1 percent of GDP) in additional finance (Figure 2). Staff did not exclude the possibility of a temporary reserve drawdown but did not factor it in the gap financing calculations and did not advocate it given that Bolivia's reserves—at US$6.3 billion at end February 2020, were already somewhat below (88 percent) of the Fund's Assessing Reserve Adequacy metric. In the LOI supporting their RFI request, the authorities anticipated even larger borrowing from other external lenders (US$1 billion, of which US$700 million would be provided by the Interamerican Development Bank and US$300 million by CAF during the coming year).[19]

[19] See IMF (2020d).

Figure 2. Bolivia: Ex Ante Balance of Payments Gap Financing
(In percent of GDP)



Sources: Staff Report; IEO staff calculations.
Note: The bar indicates the total estimated BOP gap.

34. **Financing outturn.** In April 2020, CAF granted a US$50 million loan to Bolivia in support of the national healthcare system; and in May 2020, the World Bank made US$170 million available to strengthen the capacity of the healthcare system's response to the COVID-19 pandemic through the restructuring of the Healthcare Service Network Project requested by Bolivia's Ministry of Development Planning. In 2020, IDB approved over US$1 billion to support the most vulnerable populations affected by the pandemic as well as to safeguard the productive fabric and employment in Bolivia. In addition, international reserves fell from US$6.5 billion to US$5.3 billion at end-2020, in line with the decline anticipated pre-pandemic as reserves had been on a downward trend since 2015 when they had reached a peak of over US$14 billion.

35. **Early repurchase of Fund financial assistance.** On the Fund's side the process of disbursement went smoothly, and the funds were released four days from approval. On the Bolivian side, disputes emerged whether Bolivia could draw on a RFI without parliamentary agreement and whether the RFI purchase, which is technically a currency swap, could be negotiated in the absence of a proper loan agreement. Many of those questioning the RFI's legal status claimed that the RFI also came with both fiscal and exchange rate conditionality that required parliamentary debate and ratification. The purchase was thus held up in parliament and held in a deposit at the Federal Reserve Bank in New York. When the transition government ended following new elections in November 2020, the new government returned the money to the Fund by reversing the purchase early, in February 2021. Other multilateral and bilateral loans provided to Bolivia by the IDB, the World Bank, and France also faced parliamentary hurdles but were eventually approved by parliament. When the next Article IV mission visited Bolivia in 2021, the issue of the RFI did not come up in discussions. No further request for Fund financing has been made since by the new government, although Bolivia did accept the distribution of the SDRs in 2021.

36. **Virtual environment.** The abrupt shift to a virtual environment had an impact on the quality and effectiveness of Fund surveillance according to staff. They commented that virtual interactions were "better than nothing but not nearly as good as the real thing." According to staff, the virtual meetings provided "no opportunity to develop relationships especially when interacting with authorities below the ministerial level," which impaired staff from developing a "sense of the economy [because staff] cannot interact with the private sector" due to remoteness and lack of good local connections. Staff also found "technical interactions with the central bank very constrained, especially for team members that have never been there." Noting that the difficulties related to interacting with the authorities only virtually "get deeper with time," staff expressed a clear preference for in-person missions, while recognizing the need for virtual arrangements under the circumstances.

C. Assessment

37. **Overall assessment.** Staff worked in a timely and organized manner despite large uncertainties in securing the rapid approval and disbursement of the RFI funds. The BOP need was calculated fairly on the basis of the economic impact of the pandemic, the negative terms of trade shock (although the shock turned out to be smaller than anticipated eventually) and the estimated extra financing need for health and social expenditure, conditioned on available forms of external financing. However, the debate about the legal nature of the RFI and the eventual reversal of the RFI purchase raises a more general question about how to ensure effective deployment of Fund financing in countries where government agreements with the Fund need parliamentary ratification and the domestic legal framework may provide a different interpretation of what constitutes "conditionality" in Fund EF. Staff expressed concern that Bolivia's experience related to these legal and definitional issues "may have had a negative impact on investors," producing an anti-catalytic effect on private capital flows.

38. **Staff analysis and projections.** The 2020 economic outcomes differed markedly from Fund projections (Table 2), with real GDP declining substantially more than projected (-8.7 percent rather than -2.9 percent) as the country went through a severe health crisis and Fund staff underestimated the impact of stringent lockdowns on a largely informal economy with limited state capacity and highly dependent on primary products. Actual fiscal and current account balances in 2020 also deviated from Fund forecasts: the former was significantly more negative than anticipated in April (-12.7 percent rather than the projected -7.3 percent) reflecting the much weaker than forecast GDP out-turn; while developments in the current account balance were more benign (-0.4 percent in GDP terms vis-à-vis a projection in April 2020 of -4.7 percent) despite the parallel deterioration in the terms of trade due to the import decline associated with a sharper contraction. The smaller-than-expected drop in the current account deficit, together with the strong support from the Fund and other official lenders implied that Bolivia was able to meet its external financing needs in 2020 without further depletion of international reserves beyond what had been anticipated pre-COVID.

39. **Debt sustainability.** Bolivia was judged by staff to have met the debt sustainability requirement for using IMF resources. At the time of the RFI request, the debt of the non-financial public sector net of public sector deposits at the central bank was projected to stay below 62 percent of GDP over the projection horizon, with gross financing needs averaging around 9.3 percent of GDP, neither breaching the market-access countries debt sustainability analysis thresholds. Total public debt, excluding the central bank's loans to the non-financial public sector, was projected to decline from 34.4 percent of GDP in 2019 to 29.7 percent of GDP in 2025. The debt profile was regarded as largely benign, since external debt was mostly held by multilaterals, most of it long-term, and with low average interest rates. On this basis, staff assessed that Bolivia met the eligibility requirements for accessing 100 percent of its quota through an RFI: since, in the staff's view, "Bolivia's debt remains sustainable over the medium term and, while the outlook remains highly uncertain, Bolivia maintains an adequate capacity to repay the IMF" (IMF, 2020c), while having no prior arrangement nor arrears with the Fund.

40. **Relations with partners.** Throughout 2020, staff stated that they worked closely with the other agencies in developing a comprehensive response to the pandemic, notably with the World Bank, the IDB and the CAF. No assessment letters were issued by the IMF for Bolivia.

IV. EL SALVADOR

41. **Overview.** El Salvador requested EF from the IMF in the form of an RFI for the equivalent of 100 percent of the quota. The RFI had three main objectives: help fill the BOP financing gap; provide budget support to facilitate fiscal measures to sustain the economy; and catalyze lending from other multilateral agencies. Fund financing, equivalent to 1½ percent of GDP, represented 10 percent of the international reserves and 20 percent of the country's net public sector borrowing requirement in 2020. This is the first disbursement from the Fund to El Salvador in over three decades.

A. Background and Economic Developments

42. **Initial conditions.** Pre-pandemic, the economy had a long stretch of inclusive growth that coincided with macroeconomic and financial stability. In the past two decades the economy grew on average 2¼ percent and inequality and poverty declined. However, growth remained below regional peers, primarily due to low investment rates, and it was insufficient to generate enough jobs in the formal sector. Banks maintained sound balance sheets and high liquidity buffers, but financial inclusion remained low. Despite a 2¾ percentage points of GDP improvement in the primary fiscal balance between 2013 and 2018, public debt continued to rise due to unfavorable debt dynamics and unaddressed fiscal structural issues. Fiscal deficits were financed increasingly by Eurobonds, with average coupon rates twice the nominal growth rate of the economy.

43. **Impact of the pandemic.** The virus was confirmed to have reached El Salvador on March 18, 2020 but the disease did not progress rapidly, and only around 1,300 COVID-related deaths were counted as of end-2020 (cumulating to 3,824 deaths by December 2021. This

corresponded to 210 deaths per million in 2020 and 605 in 2021).[20] Even before the first confirmed case, in the attempt to stop contagion, the government enacted strict and extensive restrictions including: a 30-day (then repeatedly extended) curfew; containment in mandatory quarantine centers;[21] a complete shutdown of schools, universities, and restaurants; a ban on all international travel; a ban on large public gathering; and a lockdown of prisons. The economy reopened on August 24, after the Supreme Court's decision rejected the government's executive decree that had established a scheme of measured reopening (IMF, 2022).[22] These containment measures—together with two consecutive tropical storms in late May–early June 2020—caused serious stress on the economy (IMF, 2020a),[23] and real GDP contracted by 7.9 percent in 2020, a 10.2 percentage point swing relative to staff's pre-COVID projections (Table 3). Moreover, the inflow of private capital dried up to a trickle, remittances plunged suddenly, and the country lost approximately a billion dollars (equal to about 3.7 percent of GDP) from the slowdown in tourism and lost exports.

44. **Fiscal policy response.** To cushion the negative impact of the pandemic containment measures on the economy, the authorities launched a package of fiscal measures of around 3½ percent of GDP including targeted cash transfers to vulnerable households and tax relief in the most affected economic sectors.[24] Key spending and tax measures comprised (i) a US$150 salary raise for all employees of the Ministry of Health and other public institutions affected by COVID-19; (ii) a one-time US$300 subsidy to approximately 75 percent of all households; (iii) the distribution of 2.7 food baskets to affected families worth US$56 each; (iv) a 3-month deferral of utility payments; (v) a 3-month extension for income tax payments for taxpayers operating in the tourism sector with a taxable income lower than US$25,000, taxpayers operating in the electricity and telecommunication provision sectors, and all taxpayers with a tax obligation below US$10,000; (vi) a 3-month exemption from the special tourism tax for companies operating in the tourism industry; (vii) a temporary elimination of import duties on essential medical and food imports (medical textiles, sanitizer, flour, rice, beans); (viii) and the conversion of a convention center into a hospital.

45. **Deteriorating fiscal balance.** As a result of these measures and the downturn, the fiscal deficit deteriorated sharply, hitting 8.2 percent of GDP in 2020, which remained at 5.7 percent of GDP in 2021. The deterioration of the fiscal position at the onset of the pandemic created a sizable financing gap. Delays in the Legislative Assembly's approval of the use of funds contracted from IFIs (IDB and CABEI) implied that the government had to rely on expensive market financing, which further elevated public debt. Overall, the government debt-to-GDP ratio

[20] Throughout the pandemic, El Salvador's rate of confirmed cases averaged only a tenth of that in the high-income countries and the death rate per million was only a third as high.

[21] Quarantine violations led to arrests, a provision that should have required congressional legislation according to Supreme Court of El Salvador (Reuters, 2020) and that was heavily criticized by human right groups.

[22] IMF Policy Responses to COVID-19, available at [https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.](https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19)

[23] IMF (2020b).

[24] IMF (2020b).

grew by 17 percentage points in the two years following the outbreak, reaching 83 percent of GDP (Table 3). In April 2020 the Legislative Assembly promptly approved a bill to authorize US$2 billion (about 8 percent of GDP) borrowing to finance all COVID-19 related spending and the recovery beyond 2020.

Table 3. El Salvador: Selected Economic Indicators

	2019	2020				2021
	Actual[3]	Projections Pre-COVID[1]	Projections COVID[2]	June WEO	Actual[4]	Actual[4]
GDP Growth (Percent)	2.6	2.3	-5.4	-9.4	-7.9	10.3
Inflation (Percent)	0.1	1.1	0.1	-0.2	-0.4	3.5
Fiscal balance (Percent of GDP)	-3.1	-3.2	-8.7	-11.6	-8.2	-5.7
Government debt (Percent of GDP)	71.3	69.1	82.2	87.8	89.2	83.6
Current account balance (Percent of GDP)	-0.6	-5.0	-4.1	-5.1	0.5	-4.3
External debt (Percent of GDP)	64.7	64.8	68.4	69.4	74.5	67.4
Official reserves (USD billions)	4.4	3.9	4.4	2.7	3.1	3.4

Source: IMF.
[1] IMF WEO, January 2020.
[2] IMF Country Report No. 20/106.
[3] IMF WEO, October 2019.
[4] IMF WEO, July, 2022.

46. **Monetary and macro-financial response.** Several monetary and financial measures flanked fiscal measures, including: (i) a 25 percent cut in banks' reserve requirements for newly issued loans; (ii) a cut in banks' statutory reserve requirements for various liabilities; (iii) weaker provisioning requirements for nonperforming loans; (iv) a temporary moratorium on credit risk ratings; (v) temporary easing of lending conditions through a grace period for loan repayments; and (vi) establishment of a US$650 million trust fund to be operated by the development bank BANDESAL to provide support to workers and SMEs.

B. IMF Engagement

47. **Early request.** In mid-March 2020, only days after the World Health Organization declared a pandemic, El Salvador's authorities approached the Fund with a request for financial assistance. The country had not borrowed from the IMF since the 2009 Stand-by-Arrangement, for which negotiations were quite protracted. In interviews, staff noted that EF was quickly identified as the only viable route to Fund financing because, although opting for a "UCT program would have allowed delivering more money, it would also have implied much more conditionality" and designing a program was difficult because any conditionality "could have become obsolete quickly" in highly uncertain circumstances. Moreover, although the authorities had been "extremely proactive and were one of the first countries to quantify their financing need," they did not have much recent experience with Fund programs and staff "thought a negotiation would take quite a lot of time." Thus, practical difficulties to quickly design and implement a UCT program clashed, in the staff view, with the urgent need for financial assistance and the authorities' focus on containing the pandemic and immediate recovery efforts.

48. **Emergency financing.** As the Legislative Assembly had already approved borrowing US$2 billion to finance the pandemic via the creation of a dedicated pandemic trust fund, and the Ministry of Finance entertained excellent relations with WHD senior staff, the Fund quickly "changed gears" from surveillance to lending (when the pandemic broke out staff was about to go on mission for an Article IV consultation) and began negotiations for EF under an RFI. Staff supported the approval of the RFI which could provide rapid funding, welcoming how "good at lockdowns and stimuli" the authorities were, including through their "decision to have more ICU beds and really ramp up public health." Staff noted the severity of the pandemic's economic impact from these containment and spending measures, the urgent BOP needs, and the authorities' swift engagement with other multilateral institutions, including the IDB, CABEI and World Bank, to address budgetary needs. Staff also assessed El Salvador as "having sustainable debt and adequate capacity to repay the Fund […] under the gradual fiscal adjustment strategy to which the authorities are committed in the LOI, even as the pandemic shock will raise the public debt ratio temporarily."[25]

49. **Approval of the RFI.** On April 14, 2020, the IMF's Executive Board approved El Salvador's request for emergency financial assistance of about US$389 million (SDR 287.2 million equivalent to 100 percent of quota) under the RFI—the first use of Fund resources in over three decades.

50. **Prior actions and governance safeguards.** No prior actions were envisaged in the request of the RFI. The LOI for supporting the RFI request contained the usual commitment to ensuring continued macroeconomic stability and to avoiding any measures or policies that may compound economic difficulties. It also included governance commitments to ensure the good use of EF, for which "the President of El Salvador called on the International Commission Against Impunity for El Salvador of the Organization of American States to join efforts with the Salvadorian Court of Audits to oversee accountability and the transparent use of financial resources allocated to fight COVID-19." Specifically, the government committed to transparency and accountability and to using effective mechanisms and controls for the disbursement of funds, including through the Recovery Fund. From an operational point of view, the purchase of the RFI was channeled to the Ministry of Finance for budget support. In the LOI the authorities also agreed to the standard safeguards assessment of the central bank, including providing Fund staff with the necessary central bank audit reports and authorizing the external auditors of the central bank to hold discussions with staff.

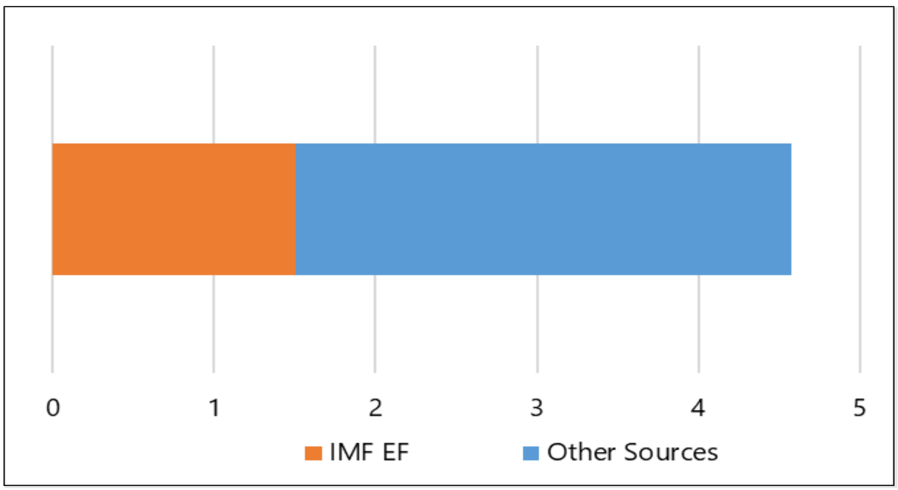
51. **Policy advice.** In the documents accompanying the request for the RFI, staff endorsed the authorities' containment measures and a temporary widening of the budget deficit to preserve public health and contain the economic impact of the pandemic. To preserve macroeconomic stability, staff recommended allowing these temporary measures to lapse and implementing a gradual fiscal adjustment of 3 percent of GDP through permanent measures over 2021–24 once the pandemic had subsided—a commitment in line with the proposed gradual fiscal adjustment strategy recommended by staff to reach a primary fiscal balance of 3½ percent of GDP by end-

[25] IMF (2020a).

2024 in line with requirements under the Fiscal Responsibility Law. Staff also called for "vigilance over financial stability" while providing relief and recovery measures. In this connection, staff noted that the temporary relaxation of the bank lending standards should be accompanied by close monitoring to ensure appropriate loan classification. In addition, staff recommended establishing strict criteria for acceptable loan restructuring, and ensuring that credit extension to firms undergoing loan restructuring was in line with prudent risk management.

52. **Gap financing.** At the time of the RFI request, the IMF projected El Salvador to have a financing gap of US$1.2 billion (4.7 percent of GDP), a third of which would be covered by the RFI and the rest from other official and market sources (Figure 3). No use of international reserves was envisaged in order to preserve the economic buffers given the large downside risks. Staff envisioned that the rest of the financing gap (estimated at US$793 million) would be filled by the World Bank, IDB and other multilaterals.

Figure 3. El Salvador: Ex Ante Balance of Payments Gap Financing
(In percent of GDP)



Sources: Staff Report; IEO staff calculations.
Note: The bar indicates the total estimated BOP gap. 'Other Sources' includes both official and private sector sources.

53. **Financing outcome.** Following the large initial shock, nominal exports recovered quickly, supported by external demand and a rapid reorientation of maquila exports towards demand from the health sector, while imports suffered a large contraction, leading to an overall small current account surplus in 2020. The implementation of two fiscal packages supported the fight against the pandemic and the economic recovery, but also led to a considerable increase in public debt (Table 3). Other multilateral loans were negotiated, notably the IDB (for US$250 million) and the World Bank (US$120 million), but were not ratified by the Parliament because clashes emerged between the ruling party and the opposition with regard to the strictness of the lockdowns; however, a loan by CABEI partly went through. As two key official loans failed to materialize, in the summer of 2020 El Salvador turned to local financial markets to finance the remainder of its financing gap—which had declined relative to the original estimates

as a result of spending restraint—at 9.5 percent rates. Nonetheless, El Salvador's net international reserves declined by about $1.4 billion as risks materialized, even though the current account performed much better than expected.

54. **Aftermath.** Persistent fiscal deficits and high debt service are leading to large and increasing gross fiscal financing needs. To address these, the authorities have opened negotiations with the Fund for a UCT program, but progress has been slow in part due to an intervening change in the government's technical team.

C. Assessment

55. **Overall assessment.** The Fund´s agility and the absence of ex post conditionality associated with the emergency assistance, coupled with the fact that the country already had updated figures for its macroeconomic framework from a recent Article IV consultation, enabled a quick delivery of financial assistance. Moreover, the authorities indicated that the RFI would pave the way to a UCT program, although this remains under negotiation. However, El Salvador was unable to close its 2020 financing gap, in part related to changes in technical teams and political tensions that made it difficult to get approval for loans by the IDB and the World Bank. To make up for the shortfall, the government switched investment spending from infrastructure to health and resorted to local market bond placements at a higher borrowing cost. The main concern that emerged in interviews with the authorities was that a 100 percent quota cap on Fund EF might was too limiting given the large size of the pandemic shock and high uncertainty surrounding the duration and persistence of the external balance crisis. In their view, a higher limit would have served El Salvador better in 2020 at a time when borrowing from other international lenders remained uncertain and the country struggled to manage the public health emergency.

56. **Staff projections.** Actual GDP growth in 2020 turned out to be worse than predicted in the April 2020 WEO but better than June 2020 WEO forecasts. Country teams stated that this partly reflected staff's adherence to top-down guidance from the Research Department and SPR on the likely effect of domestic infections on NPIs and fall in external demand on GDP, and at the departmental level, reliance on historical trends in macroeconomic correlations between economic developments in North and South America.[26] The 2020 current account balance recorded a small surplus, instead of the predicted large deficit, due to a stronger than expected export performance and an unanticipated dramatic drop in imports from a weaker-than-expected domestic demand.

57. **Concerns about debt sustainability.** At the time of the RFI request, staff's debt sustainability analysis concluded that, even as the pandemic shock would raise the public debt ratio temporarily, El Salvador's debt was sustainable, and that the country could thus repay the Fund provided that the authorities proceeded with the gradual fiscal adjustment strategy to

[26] Accordingly, forecast errors on the fiscal front derived from the fact that while staff closely approximated the effect on revenues and spending of pandemic fiscal measures, it calculated the overall impact of the shock by forecasting fiscal revenues based on the estimated historical revenue elasticity with respect to GDP, which turned out to be strongly overestimated.

which they had committed. Specifically, with unchanged policies, the pandemic shock was expected to raise the debt to GDP ratio to reach 85 percent of GDP in 2025, but under the gradual fiscal adjustment that the authorities had committed to implementing in the LOI, public debt was projected to peak in 2020 and decline to 74 percent of GDP in 2025 and 60 percent of GDP in 2030, in line with the authorities' Fiscal Responsibility Law target of a public debt (including pensions) of 60 percent of GDP. While risks arising from the relatively high public debt ratio were significant, staff considered these to be at least in part mitigated by the long maturity of the existing debt and a stable investor base. After the pandemic shock gross financing needs were expected to reach 14 percent of GDP in 2020 and abate thereafter to reach about 8 percent of GDP in 2025, due to reversing the temporary measures in 2021 and the medium-term adjustment. The 2022 Public Debt Sustainability Assessment,[27] however, revised these estimates pointing to emerging fiscal vulnerabilities, as persistent fiscal deficits and high debt service are leading to large and increasing financing needs. Staff concluded that under current policies, public debt is expected to rise to about 96 percent of GDP in 2026 on an unsustainable path.

58. **Relations with partners.** Throughout 2020, staff stated that they worked closely with the other agencies in developing a comprehensive response to the pandemic, notably with the World Bank, CABEI, and the IDB. Staff were kept abreast of the authorities' discussions with other IFIs from the onset with the hope that the Fund loan would help catalyze the approval of other official borrowing. There was no IMF assessment letter issued to El Salvador during the pandemic.

V. NICARAGUA

59. **Overview.** In early 2020, Nicaragua requested emergency financial assistance from the IMF equivalent to 100 percent of quota to help the country support its health sector and meet an urgent BOP need stemming from the COVID-19 pandemic. Only half of that amount was approved, however, and with considerable delay, under a mixed RFI/RCF financing (about 16.7 percent of quota under the RCF, and 33.3 percent of quota under the RFI). The authorities did not officially request debt relief under the G20 debt service suspension initiative.

A. Background and Economic Developments

60. **Initial conditions.** Amid ongoing international sanctions which sharply limit Nicaragua's access to external financing,[28] Nicaragua's economy contracted on average by 3.7 percent in 2018 and 2019, following demonstrations in mid-2018 against a decree by President Ortega

[27] See IMF (2022), Annex I.

[28] Nicaragua is subject to certain international sanctions, which have sharply reduced Nicaragua's access to external financing. In December 2018, the U.S. government enacted the Nicaragua Human Rights and Anticorruption Act, which severely restricts Nicaragua's external funding. Canada also imposed sanctions on targeted Nicaraguan nationals. For European Union members, the Council of the European Union imposed targeted sanctions (October 2019) and then imposed sanctions on individuals (May 2020), which have been renewed in October 2020. The United Kingdom (May 2020) and Switzerland (June 2020) have also imposed similar sanctions as those of the European Union.

legislating higher taxes and reduced benefits in the country's pension system. The social unrest caused supply disruptions, a drop in consumer and investor confidence, and bank deposit outflows. The tourism, construction, and retail sectors were particularly affected, leading to higher unemployment and a deterioration in social indicators. At the same time, a steady growth in remittances, exports, and a drop in imports—due to lower disposable income—contributed to current account surpluses. Following some initial volatility in capital flows, overall net international reserves stabilized. Strong buffers, including low public debt, and the authorities' determined macroeconomic policy response to the difficult circumstances—including revenue-enhancing measures and reduced capital expenditure, as well as an easing of monetary and financial policies—helped avoid a downward economic and financial spiral.

61. **Impact of the pandemic.** After the first case was reported on March 18, 2020, Nicaragua suffered a temporary surge in confirmed cases around May 2020. Nevertheless, the country experienced one of the lowest number of cases in Latin America, with a mere 24 and 31 confirmed COVID-19 deaths per million in 2020 and 2021, respectively (OurWorldinData, 2022). Even before a single case was confirmed in the country, in January 2020, the Nicaraguan government declared a sanitary alert due to the threat of COVID-19, strengthening epidemiological surveillance prevention, diagnosis, and treatment in line with guidelines from the World Health Organization and the Pan-American Health Organization. As in Sweden, the Nicaraguan government regarded the use of lockdowns as both impractical—as most Nicaraguans need to leave home each day to earn enough to survive—and unnecessary given the observed demographic distribution of COVID-19 fatalities and the fact that 95 percent of Nicaraguans are below 65 years of age. The government's response focused instead on education about the virus via millions of house visits by "health brigades", the establishment of COVID-19 wards in 18 hospitals, health checks in place at the country's points of entry with mandatory quarantines and measures to tackle misinformation about the virus. Children returned to school after the Easter 2020 break as normal, government employees returned to work and most activity continued with minimal limitations. The combination of the relatively mild incidence of COVID-19, the limited recourse to lockdowns, the resilient remittance flows despite the serious economic contraction in the United States, and stable agricultural exports, implied that in 2020 the economy actually contracted by less than in 2018–19 (-2 percent), rebounding strongly already by 2020Q3 and Q4, and growing by over 10 percent in 2021 (Table 4).

Table 4. Nicaragua: Selected Economic Indicators						
	2019	2020				2021
	Actual[3]	Projections Pre-COVID[1]	Projections COVID[2]	June WEO	Actual[4]	Actual[4]
GDP Growth (Percent)	-3.7	-1.2	-5.5	-9.5	-2.0	10.3
Inflation (Percent)	5.4	5.0	3.9	4.7	3.7	4.9
Fiscal balance (Percent of GDP)	-0.3	-1.4	-6.2	-6.4	-2.1	-1.7
Government debt (Percent of GDP)	41.7	42.5	57.4	49.4	47.9	48.6
Current account balance (Percent of GDP)	6.0	1.2	0.5	-1.2	5.9	-2.6
External debt (Percent of GDP)	86.8	87.2	95.7	97.6	91.9	85.3
Official reserves (USD billions)	2.2	2.0	2.1	1.4	3.0	4.0

Source: IMF.
[1] January 2020 WEO.
[2] IMF (2020e).
[3] 2019 IMF WEO (October).
[4] 2022 IMF WEO (July).

62. **Fiscal policy response.** To mitigate the potential impact of the global pandemic, the authorities introduced fiscal measures of about 1.6 percent of GDP to cover additional health care expenses (1.3 percent of GDP) and targeted temporary social assistance measures (0.3 percent of GDP), including support to food production and deferred water payments. As a result of these measures, the mild pandemic and the country's economic resilience, the fiscal deficit in 2020, originally projected to widen to 4.2 percent of the GDP, ended up at a more modest 2 percent (see Table 4). In the LOI, the authorities announced plans to unwind the temporary pandemic-related fiscal measures and adopt corrective actions to rebuild fiscal buffers (in the form of government deposits) and ensure fiscal sustainability over the medium term. In doing so, the authorities underscored the importance of ensuring transparency and accountability while safeguarding spending on critical social programs and creating fiscal space for strengthening the social safety net.

63. **Monetary policy response.** The Central Bank of Nicaragua (CBN) implemented several policy measures in response to the shock to ensure adequate financial system liquidity and regular functioning of the payment system and critical supply chains. Specifically, since March 2020, the CBN cut the reference interest rates by 250 basis points and reduced reserve requirements contingent on private banks' actions to expand credit. In addition, in June 2020 the Superintendency of Banks and Other Financial Institutions introduced a new temporary financial regulation, effective until December 2020, allowing forbearance on loan-loss provisions by banks for loans granted before March 31, 2020.

B. IMF Engagement

64. **Early request, delayed answer.** Nicaragua first contacted the IMF for emergency financial assistance in March 2020 requesting access to 100 percent of quota to address urgent COVID-19-related health care and external financing needs. The request did not receive a formal answer until May 2020 when Fund staff requested a macro exercise to estimate the impact of the

pandemic, which elicited considerable back and forth due to the uncertainty surrounding the estimates and Fund staff insisting on a more pessimistic pandemic outlook than that of the authorities. The process was further delayed by staff's requests for a detailed account of how the IMF funds were going to be spent. In addition, staff anticipated a decline in fiscal revenues and wanted the RFI to be used for additional spending rather than to offset lost revenues. Reflecting these delays, agreement on a draft LOI was delayed until July 29 (based on the scenarios drawn in March). The dialogue with the Fund mission was described as tense but generally limited to technical discussions, with several iterations. Matters were further complicated particularly by concerns about how to address governance issues raised in the 2019 Article IV consultation concluded in February 2020 as the Fund gradually tightened governance standards amid rising general concerns about how countries receiving EF used these funds, so that late comers (or those with delayed negotiations like Nicaragua) faced stricter conditions. The authorities were frustrated by these new requirements, which they felt did not substantively add to the information already shared with the mission.

65. **RFI/RFC and funds' disintermediation.** The RFI was finally approved on November 20, 2020, for one half of Nicaragua's initial request (equivalent to 50 percent of quota). In interviews, staff rationalized the reduced amount as a necessary compromise to respond to concern about the use of IMF funds both by staff and by a major Fund stakeholder and the fact that "Nicaragua did not have the capacity to ensure they would be spent appropriately." Moreover, on these same grounds, the Fund requested that half of the RFI disbursement should be managed through two third parties: the United Nations Office for Project Services (UNOPS), based in the United States (for assistance in the execution of health care emergency spending), and the World Food Program (WFP) based in the United Kingdom (for assistance in the design of an emergency agricultural-support program to ensure adequate food supply), despite the good track record of execution displayed by Nicaragua. This entailed additional delays to coordinate with these two agencies, which led to a postponement in the availability of the actual IMF disbursement to 2021 (the funds were disbursed to Nicaragua on December 7, 2020, only to be retransferred to the third parties abroad). UNOPS was given until December 2021 to execute the program, but by September 6, 2021, they had spent only US$2.2 million out of the original US$70 million and had to request an extension to June 30, 2022. WFP also delayed execution considerably. By contrast, the 50 percent share of the loan that stayed under local official management was fully executed in 2020 and was allocated to public debt service, cancellation of an historical debt with the social security system, and a water program.

66. **Prior actions and governance safeguards.** As mentioned in Section II, Nicaragua was one of the four cases in Latin America in which prior actions were requested by staff to qualify for the RFI (Kincaid, Cohen-Setton and Li, 2023). Specifically, the LOI pointed to three prior actions all meant to strengthen transparency in the use of Fund resources that had been taken ahead of the submission of the RFI request. These involved (i) publishing all the contracts of the beneficial owners of all public procurement contracts; (ii) publishing all COVID-19-related public contracts;

and (iii) publishing the financial statements of the five largest state-owned enterprises, namely ENATREL, ENEL, PETRONIC, EPN, and ENACAL— covering the period 2015–19. In interviews, the authorities lamented the exceptionally burdensome treatment of Nicaragua on prior actions and ancillary requests, like the request by staff to hold mandatory periodic meetings with the authorities to monitor the execution of those contracts, since conditions so binding were not typically required to obtain Fund EF in other countries in the region. Staff also requested a written opinion from the Attorney General in support of the Ministry of Finance, which required the participation of the Procurement Office. In addition, Nicaragua committed to a safeguards assessment, in line with Fund requirements to provide the Central Bank of Nicaragua's most recently completed external audit reports and authorize its external auditors to hold discussions with IMF staff. Nicaragua also committed, upon receipt of the RCF/RFI funds, to transfer the US dollar equivalent to 40 percent of SDR 130 million to the UNOPS and 10 percent of SDR 130 million to the WFP. To strengthen governance safeguards, the authorities committed to hire an external, independent firm to audit all COVID-19 related expenditures through July 2021 and to publish the results of such audit on the government's website within two weeks of its finalization; to adhere to best practices in procuring and awarding contracts; and to facilitate the tracking and reporting of the use of resources by channeling externally sourced emergency assistance through a dedicated subaccount of the treasury single account. Finally, they renewed their commitment to implement swift reforms to enhance governance and combat corruption in line with pre-COVID staff recommendations and to strengthen the effectiveness of the anti-money laundering/combating the financing of terrorism framework in accordance with the action plan already agreed with the Financial Action Task Force.

67. **Record on governance safeguards.** The authorities followed through with commitments to strengthen governance safeguards. Specifically, in early 2021 the Ministry of Finance began to publish the details of all COVID-19 related spending and of all public procurement contracts on its website and provided that all COVID-19 related spending be subject to an independent external audit within a year. As per the Fund's request, the government transferred one half of the emergency funds received from the IMF to UNOPS and the WFPs, hired an independent auditor to audit pandemic-related spending, and published the financial statements of the main state-owned enterprises. In parallel, the central bank and the National Institute of Statistics revamped their online publication of economic statistics.

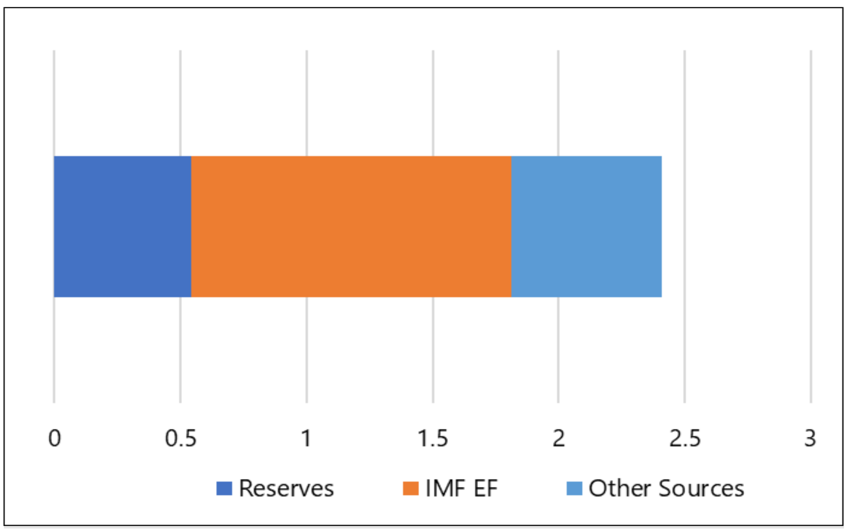
68. **Policy commitments.** In the LOI the authorities committed to unwind over 12 months the temporary fiscal programs implemented in response to COVID-19 and enact a multi-year fiscal consolidation of at least 3 percent of GDP in permanent measures over 2021–23 to bring the debt-to-GDP ratio to a firmly declining path over the medium term.

69. **Fund policy advice.** In the document supporting the RFI, staff endorsed a widening of the budget deficit in 2020 to preserve public health and contain the economic impact of the pandemic, and in fact pushed for more spending than advocated by the authorities in 2020, who wanted to avoid a large fiscal expansion since COVID-19 was not as prevalent as in other

countries. At the same time, staff stressed the importance of continued commitment to enhance transparency in public spending and ensure the good use of EF. Staff also endorsed and acknowledged the authorities' commitment to safeguard medium-term debt sustainability and rebuild buffers once the crisis dissipated, maintain the accommodative monetary policy stance and safeguard financial stability, and persevere on their structural reforms' path.

70. **Financing gap**. With no access to markets due to international sanctions and fearing a deterioration of its BOP as a result of the global pandemic shock, Nicaragua accompanied its public health pandemic response and wide-ranging demand policies with requests for financial assistance directed at several multilateral lenders including CABEI, the IDB and the World Bank, as well as the IMF. Staff estimated Nicaragua's BOP gap at around 2.4 percent of GDP, of which the IMF would cover 40 percent. One fourth of the gap would be financed by other donors and another one fourth by drawing reserves (Figure 4).

Figure 4. Nicaragua: Ex Ante Balance of Payments Gap Financing
(In percent of GDP)



Sources: Staff Report; IEO staff calculations.
Note: The bar indicates the total estimated BOP gap. Following Kincaid and others (2023), reserve drawdown is treated as financing.

71. **Financing outturn**. The first COVID-related funds to Nicaragua arrived in October 2020 from CABEI which allocated $50 million in support for the country's micro, small and medium enterprises. The IDB committed US$43 million and the World Bank $27 million in July and December 2020, respectively. While it is hard to map these loans precisely into COVID-19-related spending, they cumulatively added up to more than what staff had envisaged ex ante in terms of other lenders' external financial support. At the same time, the use of international reserves was not necessary ex post given the non-materialization of anticipated macroeconomic risks (reserves eventually increased between March 2021 and December 2021 by US$1.4 billion). In the end, IMF EF covered over half (55 percent) of the remaining financing gap, although the disintermediation of Fund financing via foreign third parties, meant that only 25 percent of quota was deposited

directly with the Nicaraguan authorities and could be spent in 2020 while the rest remained abroad in the hands of UNOPS and WFP until late 2021, with a part still unspent by mid-2022. The authorities did not officially request debt relief under the G20 bilateral debt suspension initiative (which would have suspended debt service payments of US$43.2 million according to World Bank estimates from 2022 Q1). Nicaragua met what remained of the financing gap in part by compressing imports.

C. Assessment

72. **Overall assessment.** Delays and uncertain prospects for the approval of the RFI detracted significantly from both the direct mitigating effect of Fund lending and its potential catalytic effect. The slowness and relative modesty of the Fund's emergency response reflected various problems. First, despite the urgency of the request given the nature of the shock, negotiations were not started at the time of the request and once initiated, were lengthy, due to extensive efforts to address governance concern including incremental staff requests that could have been delivered upfront and possibly more clearly. Second, the amount of financing provided was only half of what could be provided under EF. Given the strict safeguards imposed, the prudent plans of the government both in managing the pandemic and the macroeconomy at a time of great uncertainty, the fact that the country had no market access due to international sanctions, and the potential risks to the economy and the population from the pandemic shock—as anticipated in the staff documents accompanying Nicaragua's request for EF—more could have been considered and approved. Third, even if funds were modest relative to needs expected by staff, the Fund disintermediated the financing through third parties, which led to further delays both in the initial disbursement and in the deployment of the funds where needed.

73. **Staff analysis and projections.** Fund forecasts in 2020 substantially underestimated Nicaragua's GDP growth resilience while seriously overestimating the deterioration in both the fiscal and current account balance (Table 4). Specifically, in 2020 GDP contracted only by 2 percent, against staff's increasingly negative forecasts in the April and June 2020 WEO (-5.5 percent and -9.5 percent, respectively), despite a visible V-shaped recovery, in the economic activity index of the central bank already starting in May of 2020. Similarly, thanks to resilient remittances and strong agricultural exports, the current account balance registered a surplus of about 6 percent of GDP contrary to staff's projection of balance (0.5 percent of GDP) or a deficit (-1.2 percent) in the April and June 2020 WEO, respectively. At the same time, staff predicted a fiscal deficit in April 2020 that was twice, and then three times in June 2020, the size of the outcome and, consequently a steep increase in public debt that did not materialize. Staff noted that the errors arose because they calibrated their forecasts to U.S. forecasts, which turned out to be too pessimistic, and they thought that GDP and other macro variables, like external variables, in Nicaragua were on a deteriorating "nonlinear" path.

74. **Debt sustainability.** Under the updated low-income country debt sustainability assessment framework, Nicaragua's risk of external debt distress was assessed as "moderate" with limited space to absorb shocks. Over the 10-year projection horizon, all external debt

burden indicators under the baseline scenario remained below the threshold, though the present value of public and the publicly guaranteed external debt-to-GDP ratio breached the threshold under standardized stress scenarios. The overall risk of public debt distress was also assessed as moderate. The present value of the public debt-to-GDP ratio was projected to be below the threshold under the baseline scenario (assuming a multi-year fiscal consolidation with permanent measures of at least 3 percent of GDP and the unwinding of temporary programs implemented in response to COVID-19), but it was projected to surpass the threshold under most standardized stress scenarios, notably lower GDP growth and realization of contingent liability shocks.

75. **Relations with partners.** In interviews, Fund staff affirmed that it had worked closely with partner agencies (notably CABEI and the IDB) in 2020 to discuss Nicaragua's external financing needs and estimate its BOP residual financing gap. The share of the gap financed by non-Fund lenders ended up considerably smaller than staff had anticipated, although Nicaragua's needs also turned out to be smaller. The IMF did not issue any assessment letters for Nicaragua during the pandemic.

VI. PARAGUAY

76. **Overview.** On April 21, 2020, the Fund approved access to 100 percent of quota under the RFI to help the country address BOP pressures, boost confidence, and create fiscal space for essential pandemic-related expenditures and catalyze donor support.

A. Background and Economic Developments

77. **Initial conditions.** Sound macroeconomic policies have benefited Paraguay's economy over the past two decades. From the early 2000s, Paraguay grew strongly and managed to cut the poverty rate by more than half, reflecting sound macroeconomic policies and a favorable trend in agricultural commodity prices. During this time, public and external debt remained modest, and inflation was both low and stable. Weather shocks occasionally disrupted growth but on a temporary basis. In 2019, one such event affected the harvest, slowing growth to almost zero, but a recovery quickly took hold, with GDP accelerating by 7 percent in February 2020 relative to a year earlier.

78. **Impact of the pandemic.** The virus reached Paraguay on March 7, 2020. By the end of 2020, Paraguay's COVID-19 cumulative confirmed deaths were 2,242, equivalent to 337 deaths per million people.[29] These numbers climbed to 16,624 and 2,479, respectively, by end 2021. Already in response to the initial few cases, on March 10, 2020, the Paraguayan government introduced strict containment measures and suspended in-person education at all levels and all activities that involved groups of people, as well as public and private events. Other preventive measures included restrictions on commercial activity and on citizens' movement, the suspension of commercial flights, border closures, curfews, and the launch of a system of strict controls to

[29] That is about a half of Bolivia and Chile's cumulative deaths per million, a third of Argentina, Brazil and Mexico, and one-eighth of Peru, but 15 times the number of deaths in Nicaragua.

ensure compliance with these measures. In May of the same year the authorities allowed a gradual return to work and social activities conditional on additional social distancing and health-focused measures. However, borders remained closed and other domestic activities remained restricted. In the Fall of 2020 restrictions on most activities were relaxed, national borders were reopened, and some international flights were resumed. However, schools remained online, and the curfew was maintained until February 2022, when all restrictions were lifted.

79. **Fiscal policy response.** The government economic response to the pandemic was aggressive and timely. After cutting value-added tax and eliminating import tariffs on medical supplies, on March 23, 2020, the government launched an emergency fiscal package with spending measures of around 2½ percent of GDP including additional health-related spending measures to support the vulnerable population, and emergency funding for small enterprises, as well as a 3-month deferral in corporate income taxes. It then obtained congressional authorization to borrow an additional 4 percent of GDP from multilateral institutions and through sovereign dollar-denominated bond issuances. Against this background, an Economic Recovery Plan for (5¾ percent of GDP) was launched by end 2020, focusing on investment, social spending, and financing for the private sector. Strong safeguards were put in place to ensure effectiveness and proper targeting of the new programs. The Fiscal Responsibility Law was suspended temporarily to allow for that emergency spending.

80. **Monetary and macro financial policy response.** As the pandemic broke out, the central bank cut the policy rate by 325 basis points to ¾ percent, and the overnight rate by 200 basis points to 2½ percent. At the same time, it reduced the minimum reserve requirements on domestic and foreign currency deposits and created a National Emergency Special Credit Facility and a micro-, small- and medium-scale enterprise Guarantee Fund to support credit creation. Banks were allowed to renew, refinance and restructure loans without penalty. The exchange rate was allowed to float (it depreciated by about 7 percent in 2020 and foreign exchange (FX) interventions specifically aimed at preventing excessive volatility in the FX market amounted to US$133 million) to buffer the external shocks without compromising nominal stability given the high level of financial dollarization and exchange rate pass through.

81. **Economic impact of policy measures.** The impact of the pandemic and total associated lockdown measures on the economy and the public finances was severe, triggering an 11 percent contraction in 2020Q2. Children and women were particularly affected due to the protracted school closures, as were workers in the secondary and tertiary sectors, two-thirds of whom were informal and are not entitled to social protection. As restrictions were lifted and the government emergency economic package came into effect, GDP rebounded sharply, but for the year as a whole GDP declined contracting more than 2019 (Table 5). As a result of the recession and the government's emergency package, fiscal revenues collapsed, while spending accelerated, triggering a huge fiscal deficit in 2020 (-7.2 percent of GDP), and pushing the public debt-to-GDP up sharply to 37 percent. The economy recovered in 2021, growing by 4.2 percent in real terms. In both 2020 and 2021, the balance of payment profited from easy external financing conditions, a good harvest in 2020 and high soy prices in 2021; international reserves grew accordingly.

Table 5. Paraguay: Selected Economic Indicators

	2019	2020				2021
	Actual[3]	Projections Pre-COVID[1]	Projections COVID[2]	June WEO	Actual[4]	Actual[4]
GDP Growth (Percent)	-0.4	4.0	-1.0	-5.0	-0.8	4.2
Inflation (Percent)	2.8	3.7	2.9	3.0	2.2	6.8
Fiscal balance (Percent of GDP)	-3.8	-0.8	-5.1	-7.0	-7.2	-6.2
Government debt (Percent of GDP)	25.8	24.1	30.6	37.4	36.9	37.0
Current account balance (Percent of GDP)	-0.5	2.4	-0.1	-0.3	2.7	0.8
External debt (Percent of GDP)	43.1	38.3	44.7	51.6	51.6	47.5
Official reserves (USD billions)[2]	7.5	8.8	7.5	7.5	10.0	10.6

Source: IMF.
[1] IMF WEO, January 2020.
[2] IMF (2020c)
[3] IMF WEO, October 2019.
[4] IMF WEO, July 2022.

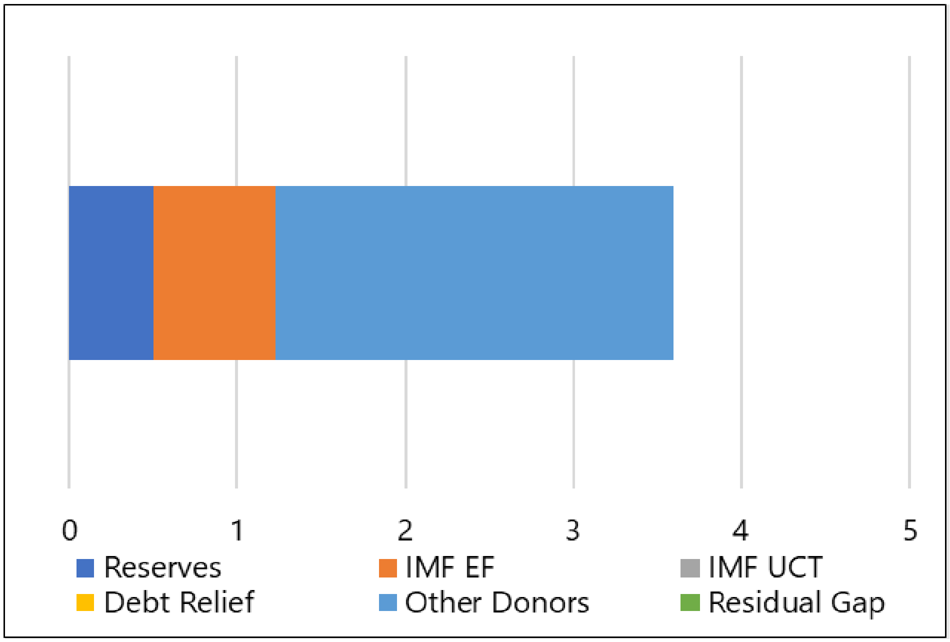
B. IMF Engagement

82. **RFI request.** Paraguay contacted the IMF for emergency financial assistance in March 2020. In consultation with SPR, WHD staff quickly decided that, considering the urgency of the request, EF was the best instrument with which to provide financial assistance. A fully-fledged UCT program would have taken considerably more time to put together, and the authorities felt that they were in a position to manage their medium-term BOP challenges via suitable adjustments. With public and external debt low, a track record of prudent policies, and a credible plan to bring back macroeconomic stability, staff assessed Paraguay to have sustainable debt and adequate capacity to repay the Fund. On April 21, 2020, the Fund's Executive Board approved the RFI for the country to address BOP pressures, boost confidence, and create fiscal space for essential pandemic-related expenditures and catalyze donor support.

83. **Financing gap.** Staff projected Paraguay's external financing gap at 3.2 percent of GDP (US$1.2 billion). They judged that an RFI for 100 percent of quota (SDR 201.4 million equivalent to approximately US$278 million) would cover around one-fourth of the BOP gap. Other multilaterals were expected to cover a total US$900 million (roughly 75 percent of the gap), of which US$500 million from the World Bank, US$300 million from the IDB and US$100 million from the CAF) (Figure 5). US$500 million of reserves (which amounted to about US$8 billion by end-2019) was envisaged to be used to help fill the BOP gap.

84. **Policy commitments**. In the LOI the authorities committed to moderate current expenditure growth and increase tax revenues via a revision of the Fiscal Responsibility Law and the introduction of a tax reform in the 2021 budget; they also committed to continue with the policy of letting the exchange rate absorb shocks, and have its value determined by market forces, while keeping monetary policy focused on the pursuit of the inflation target.

Figure 5. Paraguay: Ex Ante Balance of Payments Gap Financing
(In percent of GDP)



Sources: Staff Report; IEO staff calculations.
Note: The bar total value indicates the total estimated BOP gap. The portion of financing labeled as "reserves" mirrors the calculation in Table 4 of the IMF Country Report 20/127 where the external financing gap (US$-1.2 billion) was calculated as the residual from the projected overall balance (US$-1.7 billion) and the use of international reserves (0.5 billion).

85. **Financing outturn.** Two days after the RFI was approved, Paraguay also successfully issued US$1 billion worth of 10-year sovereign bonds yielding 4.95 percent in a deal that was more than seven times oversubscribed. On March 19, 2020, the World Bank approved a US$300 million loan in support of the Paraguayan economy although the funds were not additional to earlier, pre-COVID plans; an additional US$20 million was also disbursed on April 2, but with a specific health support target in mind.[30] On April 9, the IDB approved a US$90 million loan to Paraguay to further transparency in the use of funds in the public sector. This was followed in March 2021 by a second loan for an additional US$250 million in order to boost efficiency of public resource management, including for the design and launch of the digital platform *Rindiendo Cuenta*, which provides open information about the country's public spending during the COVID-19 pandemic. Likewise, in March 2021, CAF approved a US$250 million loan to support Paraguay in its post-pandemic revival efforts. Overall, with the current account surplus stronger than initially expected, Paraguay avoided any reserve drawdown, even though it never followed through with its RFI purchase.

[30] An assessment letter by the IMF on January 15, 2020, conveyed a benign picture of the outlook despite several shocks facing the economy even pre-COVID.

86. **Prior actions and governance safeguards.** Paraguay was not required to adopt any prior actions. The RFI purchase was to be disbursed to the central bank and on-lent to the government to provide financing for COVID-related spending. The authorities committed to undergo a safeguards assessment, to let staff access the central bank's most recently completed external audit reports and to authorize the central bank's external auditors to hold discussions with staff. The authorities also promised to establish a framework agreement between the central bank and the government on responsibilities for servicing financial obligations related to the RFI purchase. On the governance safeguards front, in line with staff recommendations, and aided by the IDB, in 2020 a new anti-corruption law was drafted (and submitted to Congress) which aimed to bolster the roles and investigative competences of the National Anti-corruption Secretariat and strengthen the anti-corruption and transparency units established within each government agency. In addition, a new Transparency and Anti-Corruption National Plan 2021–25 was developed with help from the U.S. Agency for International Development and approved in the same year. In line with advice from the IMF, the authorities also established formal registries for legal persons/arrangements and beneficial ownership information. A governance diagnostic report prepared by the IMF with IDB participation was published by the authorities in October 2022.

87. **Fund policy advice**. In the document supporting the RFI, staff welcomed the government's temporary widening of the budget deficit, the focus on increasing spending on health care and the social safety net, as well as the support to small businesses and workers. During the crisis, Fund emergency support under the RFI, staff noted, would help address BOP pressures, boost confidence, and create fiscal space for essential pandemic related expenditures and catalyze donor support. However, staff noted that after the crisis "to prevent the emergence of permanently high deficits, Paraguay should return to the deficit ceiling under the Fiscal Responsibility Law." Staff also stressed that the exchange rate should continue to function as shock absorber, and monetary policy should continue to target inflation. Staff also advocated improvements in governance, the business climate, and human capital to accelerate convergence with advanced countries.

C. Assessment

88. **Overall assessment.** Paraguayan authorities responded quickly to the COVID-19 pandemic, striving to mitigate the negative economic and social impact of their pandemic measures with forceful and targeted fiscal, monetary and macroprudential measures. The Fund's approval of financial assistance to Paraguay at a time of elevated economic and market access uncertainty was both timely and appropriate.

89. **Effectiveness of assistance**. While on the Fund side the negotiation of the RFI went smoothly, and the RFI was approved swiftly, Paraguay never purchased the funds. In interviews, staff explained that by the time the RFI was approved in mid-April, Paraguay's access to external finance was restored and the authorities had largely filled the financing gap, including through a large successful sovereign bond issuance. Since congressional authorization for additional

budgetary spending through external borrowing had been exhausted, authorizing additional external borrowing became problematic and was eventually unsuccessful. In interviews, the authorities confirmed that the key factors behind their decision included the rapid turnaround in Paraguay's economic outlook, especially on the external sector side, improved global liquidity by virtue of the large monetary expansion by the Federal Reserve and other major central banks, the normalization of capital flows to EMDEs which allowed Paraguay to issue a large amount of dollar-denominated sovereign bonds, and the successful negotiation with other IFIs that agreed to provide funds at convenient rates before and soon after the RFI approval. The authorities noted, however, that the rapid approval by the Fund of an RFI for 100 percent of quota without prior actions, even though not drawn upon, was likely instrumental in facilitating Paraguay's continuous securing of alternative external borrowing, by sending a positive signal about the country's debt sustainability and outlook.

90. **Staff analysis and projections.** Staff projections of key macro variables for Paraguay oscillated considerably during 2020, with a peak in pessimism in June's forecasts (Table 5). GDP growth came in close to April 2020 projections, at 0.8 percent vs. 1 percent, but was much stronger than staff expectations in June (-5 percent). Projections of the current account in percent of GDP were also on the low side both in the RFI documents and in June, forecasting a balance (-0.1 percent and -0.3 percent) instead of the actual surplus (2.7 percent). Inflation was expected higher throughout the year but remained stable and close to 2 percent. Reflecting the better-than-expected GDP turnout, the fiscal balance ended up higher than staff's initial and RFI forecasts.

91. **Relations with partners.** Staff coordinated with other agencies from the beginning, ascertaining lending plans to Paraguay by other multilaterals which were then reported in the official documents supporting Paraguay's request for the RFI. In the end financial support from the World Bank, the IDB and CAF was revised down relative to initial plans. The IMF issued two country assessment letters for Paraguay to the World Bank in January and November 2020.

VII. CONCLUSIONS

92. **Fund's agile and effective response.** Interviews with various stakeholders in Latin America suggest that country authorities found the IMF's response to the pandemic in the region both agile and effective. Policy advice largely endorsed the authorities' own plans and was generally useful, although on occasions disagreements emerged with respect to either the magnitude of fiscal support or the timing of support withdrawal. As indicated in Loungani and others (2023), economic projections were broadly unbiased, although a few cases, including Brazil, El Salvador, Nicaragua, Paraguay, GDP and fiscal projections, as well as forecasts of the current account balance, turned out to be extremely pessimistic relative to outcomes, while in other cases (for example, Bolivia) Fund projections turned out to be too sanguine. In part this may have been explained by strong, top-down guidance at the inter-departmental level. But it may also have reflected the impact on the quality of Fund work from the abrupt shift to a virtual environment which made it hard to interact with authorities below the ministerial level, and impaired staff from developing a first-hand sense of the economy.

93. **Evenhandedness.** There was concern about the lack of evenhandedness in the case of Nicaragua compared to other countries in Latin America (and elsewhere) related to conditionality, expediency, and the channeling of disbursements. In the other Latin American countries that received Fund EF and were examined here, prior actions were not required and commitments to strengthen governance safeguards were in line with requests across the majority of other members to which the Fund provided emergence financing in 2020. In the case of Nicaragua, serious governance concerns delayed approval of the funds as the hurdle for governance standards were tightened over time, leaving the authorities to chase a moving target. Without reaching a definitive judgement, this experience leaves the impression that governance issues in Nicaragua were treated more stringently than in some other countries that also posed governance concerns.

94. **Unpurchased or returned financing.** In some cases, Fund approved financing was either returned or not purchased (for example, in the cases of Bolivia and Paraguay discussed in this paper). This raises questions about the implication for the ultimate effectiveness of the Fund's financing framework amidst countries' different legislative frameworks and how best can the Fund interact and assist countries during crises which require early and reliable mechanisms for financial support.

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