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Statement by Juan L. Cariaga

Nicaragua - Country Assistance Strategy

Introduction

We are pleased to be able to consider this well prepared and detailed Country Assistance Strategy (CAS) for Nicaragua and appreciate the positive cooperation by management and staff at IDA and IFC to produce it.

This is the second CAS exercise for Nicaragua since the end of the upheaval and displacement caused by a civil war that reflected both serious internal divisions and global concerns affecting to one degree or another the entire Central American region. Civil wars, by their very nature, leave the most difficult effects to overcome, as we have seen in several recent CAS presentations. In Nicaragua's case, exports and GDP fell to 40 percent of their mid-70's levels after the civil war and years of inappropriate and divisive policies.

Nicaragua is aided in its recovery efforts by a civil society that has survived and is re-emerging as an important contributor to the country's progress

Previous Economic Development Results

It seems clear that the results of the 1994 CAS have generally been positive. This seems especially so when compared with the situation at the end of the civil war. That earlier CAS sought revival of economic growth as its priority.

We think that this decision has proven generally correct. It was the Nicaraguan private sector whose efforts brought the country back to growth after the devastating 1972 Managua earthquake. Many observers believe it was the government's inadequate approach at that time to disaster relief and reconstruction which then brought about widespread discontent at all levels of society, eventually ending that government, but also resulting in new political, economic and social problems.

In addition to a renewed private sector, in the last three years we have seen that inflation has fallen, with steady economic growth including the re-emergence of new private financial intermediaries and growing private domestic and foreign investment. Other CAS goals including reform of the public sector, alleviating poverty, building human capacity and improving resource and environmental management have also seen some progress, although perhaps not as much as had been hoped.
Nicaragua has had to stabilize, privatize, liberalize, restructure and often rehabilitate or rebuild, all at the same time. There has been much progress and this should be recognized.

However, in spite of many positive indicators, there is also much that remains for attention. Nicaragua has fallen behind the rest of Central America and is now the second poorest country in the hemisphere. Poverty remains an overwhelming issue, with over half the population under the poverty line, with perhaps half of those persons in extreme poverty.

Moreover, the country has not yet resolved a number of the political and economic questions that remain, although it is seeking to do so through its democratic processes.

Continuation of Strategies That Are Working

This CAS proposes as its basic strategy to further what was begun in 1994 through a continuation of private sector development, attention to the rural economy and human capital development. Overall we endorse this strategy as offering the best possibility for continued progress. We recognize that there are numerous risks involved, but at the same time Nicaragua has advantages not available to all countries. We hope the following comments and questions are useful.

Private Sector Development

Growth areas for private activities include banking, tourism, agribusiness, mining, fishing, small and medium enterprises and maquiladora manufacturing. However, the CAS describes a situation in which "...although there are an even-increasing number of private sector actors, economic activity is still relatively highly concentrated among a few powerful groups." We would appreciate some clarification of the role played by these groups and whether they contribute to the enabling environment for private activity that is sought or are they an obstacle? If the latter, are there steps that can be taken to ameliorate any negative effects and harness their energy and capabilities?

Other uncertainties remain about the near-term political environment and the legal and institutional framework needed to underpin a market economy. These constitute major constraints to increasing investment. Private sector development is critical for success and at the same time difficult to ensure, as described by Annex C of the CAS. We support the efforts proposed to encourage emergence and consolidation of an enabling environment.

Advances in legal reforms have included passage of a Tax Reform Law, private participation in infrastructure development (power generation, port stevedoring services and road maintenance) as well as new legislation in commercial, financial and labor relations. In spite of this, much still needs to be done. The still ineffective legal framework is probably one of the most crucial impediments to private sector participation. In this context, we fully support the Financial Sector Adjustment Credit, co-financed with the IDB, and welcome the Government's structural adjustment program which aims to support reforms of the state banking sector, improve financial intermediation and improve the regulatory framework for private banking.

In past years, Nicaraguan authorities have made efforts to begin privatization of ENITEL (the state telecommunications enterprise) but the process could not be completed due to lack of substantial interest among potential foreign buyers. Sales of ENITEL and PETRONIC (the state petroleum company) are now programmed to be completed by the second half of 1998.
The Nicaragua: Policy Framework Paper 1998 to 2000 describes other initiatives that have been or will be presented for restructuring the public sector, the judiciary and legal systems; to privatize public enterprises and utilities; to reform social security, to resolve outstanding problems of property rights, to modernize the financial system, and to improve the functioning of the labor market. We are pleased to see that an important element of public sector reform is the need to address questions of transparency and accountability.

Nevertheless, with this CAS we should already have come to the start of a process for private participation that would create a self-reinforcing, positive dynamic process. This would be the case if investors perceived no potential risks (like reversibility or alteration of arrangements) and if institutions believed they were reasonably secure about long-term continuity of government policies to support them, including the legal framework. In spite of much effort, clearly more needs to be accomplished. We would appreciate staff comments on how the Bank’s proposed lending program compliments and reinforces this process.

Government expenditures now represent over 40 percent of GDP. External debt has been significantly reduced, but is still equivalent to three times GDP while foreign aid supports about one-fifth of GDP. Over the past five years a sharp fall in scheduled interest payments, increased private transfers and strong export growth have resulted in a significant reduction in the current account deficit. Strengthening macroeconomic stability will require further improvement on the fiscal front. To further reduce the fiscal deficit, we urge the government to strengthen its efforts to decrease the size of the public sector, eliminating financial sector subsidies by reforming and/or privatizing the state banks and improving finances of public utilities.

Nicaragua also faces the broader challenge of redefining the role of the state to focus on effective regulation of privately provided services and delivery of those services that cannot be competitively provided by the private sector. We support the Nicaraguan government’s efforts to quickly implement tough reforms that will reshape the economy and resume solid growth.

The need to address Nicaragua’s debt overhang is an important issue for the sustainability of the economy. The debt sustainability analysis (DSA) performed by IMF and IDA indicates that even with strong efforts, Nicaragua’s external debt will remain a major constraint. Successful implementation of an ESAF program and good performance is essential for consideration of reduction of Nicaragua’s debt burden through the HIPC Initiative. We look forward to progress in this area.

Rural Development

Nicaragua is a predominantly rural country, and while the private sector will provide the engine for economic growth, the Bank’s goals of poverty alleviation can best be realized through agricultural development. This is especially so because poverty and extreme poverty are more entrenched in the rural areas. Not only is it important to raise the productivity and incomes of the rural poor, but this will contribute to the country’s food security.

In the rural sector, Nicaragua enjoys some natural advantages that many others do not have. These include much fertile land, relatively low population density and diverse crops and products, (including coffee, bananas, cotton, rice, citrus, corn, beans, cattle and fishing), that mean it is not
dependent on one or two exports. Nevertheless, earthquakes, volcanoes and often difficult terrain conditions contribute to the difficulties Nicaragua faces.

The CAS identifies several areas for attention, including the need to maintain a competitive real exchange rate. For rural economic development the Government strategy includes resolving issues of property rights, taking the government out of rural banking, promoting innovations in the delivery of extension services and developing agricultural markets by improving communications. The government also plans to protect natural resources and the rights of indigenous groups by improving the legal framework by preparing laws governing forestry, fisheries, mining, bio-diversity, protected areas and indigenous land use. Particularly welcome, in our view, is the privatization proposed for the state-marketing enterprise.

We welcome this emphasis on rural development and particularly the plans for IFC to renew activities in the rural sector after many years of absence.

Developing Human Capital and Protecting the Poor

Improving delivery of health, education and water services is appropriate for Nicaragua and the CAS takes into account the resource constraints faced by the government. The goals are to expand access especially in rural areas, improve efficiency of service delivery, and focus on the most vulnerable groups. These improvements while also of benefit to urban dwellers are of crucial importance for alleviating poverty in rural areas.

We think it positive that the government plans to establish a technical secretariat under the office of the Presidency to improve coordination and monitor the effectiveness of these programs. We note, however, that the CAS foresees that short-run donor support for recurrent costs in the social sectors will be essential during the three years of the ESAF program. In that regard, we note the collaboration with IDB and would appreciate staff views on the effectiveness of that coordination as well as with other donors, and the prospects for the obtaining the needed short-run support that has been identified.

The emphasis on mainstreaming gender into social policy is a welcome initiative.

Conclusions

We find the Bank’s proposed strategies for private sector-led growth, revitalization of the agricultural sector and development of human capital to be comprehensive and positive. However, we would emphasize again our concern that private sector-led growth can only be successful when based on the establishment of a regulatory framework that will create a self-reinforcing and positive dynamic process. In addition, rural development should be focused on a food security framework, while property rights, extension services and developing agricultural markets are encouraged. Finally, development of human capital should underscore services delivery and focus on the most vulnerable groups.

In spite of the difficulties described by this CAS, we believe that there are many reasons for optimism, not the least of which is the hard work and abilities Nicaraguans have shown in pursuing the country’s recovery. Because of this we agree that the three core priorities proposed by this CAS are appropriate and wish the authorities well in their efforts to implement its ambitious proposals.