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Report No. P-5598-NI

REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL DEVELOPMENT ASSOCIATION

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED ECONOMIC RECOVERY CREDIT

OF SDR 83.5 MILLION

(US$110 MILLION EQUIVALENT)

TO THE

REPUBLIC OF NICARAGUA

September 3, 1991

CURRENCY EQUIVALENTS

(as of August 30, 1991)

Currency Unit - Cordoba

US$1.0 = C$5
US$0.20 = C$1

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS

AGROEXCO	=	Agriculture State Export Company
AFA	=	Rice, Beans and Sugar Food Package
APP	=	People's Property Area
BANIC	=	Nicaraguan Industry and Commerce Bank
BIN	=	Nicaraguan Mortgage Bank
BND	=	Nicaraguan Development Bank
BP	=	People's Bank
CAFENIC	=	Nicaraguan Coffee State Trading Company
CIT	=	Corporate Income Tax
CO	=	Cordoba Oro
CORFIN	=	Nicaraguan Financial Corporation
CORNAP	=	State-owned Corporations Holding Company
CPAR	=	Country Procurement Assessment Report
ENABAS	=	State Agricultural Marketing Company
ERC	=	Economic Recovery Credit
FASO	=	Fund for Assistance to the Oppressed
FISE	=	Social Emergency Investment Fund
FNI	=	Nicaraguan Investment Fund
GVT	=	General Value Tax
ICB	=	International Competitive Bidding
IDB	=	Inter-American Development Bank
INAA	=	Nicaraguan Institute for Water and Sewerage
HATONIC	=	Nicaraguan Cattle/Slaughtering Holding Company
MDP	=	UNDP Management Development Program
OECD	=	Organization for Economic Cooperation and Development
PMA	=	Mother-Children Nutrition Program
PTI	=	Personal Income Tax
RUTA	=	UNDP/IBRD Regional Unit for Technical Assistance
SCT	=	Selective Consumption Tax
SOE	=	Statement of Expenses
UNDP	=	United Nations Development Program
USAID	=	United States Agency for International Development

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NICARAGUA

ECONOMIC RECOVERY CREDIT

PRESIDENT'S REPORT

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NICARAGUA

ECONOMIC RECOVERY CREDIT

CREDIT AND PROGRAM SUMMARY

Borrower:	Republic of Nicaragua
Amount:	SDR 83.5 million (equivalent to US$110 million)
Executing Agencies:	Ministry of Finance and Ministry of Economy and Development
Terms:	Standard IDA terms with repayment in 40 years, and ten years of grace.
Description:	The proposed loan would support the Government's structural adjustment program, which is designed to (i) downsize and restructure the public sector, including the privatization of state-owned companies; (ii) reform the financial system to improve resource allocation/ mobilization through establishment of a competitive environment with private sector participation; and (iii) reform the incentives systems by eliminating barriers to private sector entry to production and trade, liberalizing trade, domestic price controls and other regulations.
Benefits:	The implementation of the structural adjustment program would promote growth through increased private sector participation, improved incentives for production and a more efficient allocation of domestic resources. It would also increase employment opportunities and help alleviate poverty. In addition, it would facilitate the flow of external financing and foreign investment.
Risks:	The principal risks are weaknesses in institutional capacity to carry out the program, resistance on the part of organized groups to fiscal and financial restructuring, slow private sector response due to uncertainty regarding the property rights, and shortfalls in timely donor support.

<u>Disbursements</u>: The proceeds of the loan would be disbursed in two equal tranches of SDR 41.75 million (US$55 million equivalent) each: the first tranche upon effectiveness (with retroactive financing of up to SDR 41.75 million), the second tranche after a satisfactory performance review expected around March 1992.

REPORT AND RECOMMENDATION OF THE PRESIDENT
OF THE
INTERNATIONAL DEVELOPMENT ASSOCIATION
TO THE EXECUTIVE DIRECTORS ON
A PROPOSED ECONOMIC RECOVERY CREDIT
OF SDR 83.5 MILLION
TO THE REPUBLIC OF NICARAGUA

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1. I submit this report and recommendation on a proposed credit in the amount of SDR 83.5 million (US$110 million) to the Republic of Nicaragua. The credit would be on standard IDA terms, with repayment in 40 years, including a 10 year grace period. The credit would support an economic recovery program aiming to achieve economic stabilization and renewed sustainable economic growth, as well as an improvement in living standards. The credit proposal follows the recent decision to declare Nicaragua eligible for IDA credits (IDA/Sec. M 91-131, dated April 16, 1991). The proposed operation would be co-financed with concessionary funds from the Inter-American Development Bank (IDB), the Japanese Government, the German Government, and the Swiss Government (para. 103).

2. The IDA credit would be the first to Nicaragua since 1980. Following the past decade of Sandinista rule, the February 1990 elections brought the Chamorro Government to power. The new Administration approached the Bank and IDA to support its stabilization and recovery efforts after a six-year interruption in relations between the two institutions. Since April 1990, Bank staff visited Nicaragua on several occasions, assessed the economic situation, and discussed with the authorities the elements of a program for stabilization and adjustment. The Bank and IDA also coordinated donor support, including Consultative Group meetings in Paris on December 3-4, 1990, and May 16-17, 1991. In the latter meeting, the donors agreed on a financial package to clear the arrears to the World Bank and the IDB. The Government resumed debt service payments and froze the World Bank arrears at the May 1991 level. The International Monetary Fund (IMF) is helping the Government to monitor a Stabilization Program launched on March 3, 1991. A stand-by arrangement, based on a track record of program implementation, is expected to be presented to the IMF Board during the first half of September 1991. The Government is also requesting Paris Club assistance for debt relief.

I. ECONOMIC ISSUES, POLICIES, AND IDA ASSISTANCE STRATEGY

Background

3. The Chamorro administration inherited from the Sandinistas a devastated economy. Production was well below 1980 levels, exports ran at

about half of the pre-1980 level, hyperinflation was about 4,700 percent in 1989, international reserves were depleted, and debt had accumulated to around US$9 billion by late 1989. The administration has also inherited an oversized and extremely inefficient public sector which has crowded out private sector participation through a deep involvement in economic activities, and ownership of productive means. Many skilled technicians and managers had left the country. The tasks of achieving stability, economic revival, and the other prerequisites for sustained growth appeared daunting. Moreover, the economic agenda had to be pursued in the environment of a fragile political peace.

4. During the preceding decade, the Sandinista government tried to establish a centrally controlled economy. Many privately-owned undertakings were confiscated or expropriated. The financial and external trade sectors were nationalized. The small remaining private sector was heavily regulated. Inappropriate macroeconomic policies and price controls distorted resource allocation. Gross inefficiencies in resource use resulted. Public sector expenditures trebled over the decade, reaching an average of 57 percent of GDP in 1983-87. The Government's resort to Central Bank financing fueled an inflation level which reached 14,300 percent in 1988. The contra war and a United States trade embargo compounded problems. Consequently, the GDP grew only moderately at the beginning of the 1980s, and declined every year beginning in 1984. Table 1 illustrates the economic deterioration of the 1980s.

Table 1: NICARAGUA - GENERAL MACROECONOMIC INDICATORS, 1979-1990

	1979-83 1/	1984	1985	1986	1987	1988	1989	1990
Annual Real Growth Rates:								
GDP	-2.5	-1.6	-4.1	-1.0	-0.7	-15.0	-2.8	-4.4
Total Consumption per capita	-6.2	0.2	-4.9	-5.7	-2.6	-19.1	-9.9	-6.2
Average Domestic Inflation Index	33	35	220	682	912	14,316	4,770	7,485
Dec. to Dec. Domestic Inflation Index	35	50	335	747	1,347	33,657	1,689	13,490
Imports of Goods & NFS	-9.6	-1.5	0.6	-14.3	3.5	-5.7	-15.2	3.0
Exports of Goods & NFS	-2.4	-20.8	-11.7	-17.6	-1.0	-10.6	7.5	9.9
Ratios to GDP (%):								
BOP Current Account (incl. off. grants)	-15.2	-21.1	-25.9	-20.6	-22.1	-51.9	-32.8	-33.3
Resource Balance	-12.2	-15.0	-20.7	-19.4	-19.6	-47.7	-29.5	-31.1
Debt Indicators, excl. Interest Arrears (US$Mls):								
Debt Outstanding	2,644	4,546	5,255	5,945	6,984	7,488	8,267	8,819
Medium Long-Term DOD	2,151	3,900	4,618	5,321	6,262	6,773	7,546	8,064
Short-Term DOD 2/	493	646	637	624	722	715	722	755
Total DOD/Exports GNFS (percent)	520	986	1,526	2,070	2,152	2,378	2,427	2,358
Total DOD/Current GDP (percent)	109	161	188	210	240	659	752	796
Non-Financial Public Sector (As % of Curr. GDP): 3/								
Total Revenues	26.2	40.8	37.0	36.5	29.8	23.3	24.6	17.2
Total Expenditures 4/	38.8	62.6	59.8	51.6	47.9	49.8	29.9	42.8

Sources: BCN, IMF and Bank staff estimates
Notes:
1/ Annual average.
2/ Includes US$185 Million of estimated commercial debt.
3/ Consolidated nonfinancial public sector (NFPS) includes general government and public utility enterprises.
Figure for 1979 includes Central Govt. only.
4/ In 1990 extrabudgetary expenditures equivalent to 12 percent of GDP are included.

Recent Economic Developments

5. The Sandinista Government launched an emergency stabilization package to curb hyperinflation in 1989. The program significantly reduced the public sector deficit by halving Central Government expenditures, dramatically cutting credit to the public sector, and frequently devaluing to create a 90

percent real depreciation of the Cordoba in 1989. The program failed, although inflation was temporarily reduced to 4700 percent in 1989 and the current account deficit was slightly narrowed. In early 1990, a lame duck government abandoned the program and pursued highly expansionary policies. In only three months, public sector wages were increased by 800 percent in nominal terms, while public sector prices remained fixed. The Central Bank financed resulting deficits and the Cordoba appreciated by 45 percent in real terms, as inflation accelerated.

6. The Chamorro administration has emphasized the importance of stabilization through a combination of fiscal and monetary policies, and the reduction of the size and role of the government as well as reliance on market forces. Central Government expenditures rose only by 2 percentage points of GDP in 1990 despite a doubling of the wage bill, mainly due to the Sandinista-inspired wage increases prior to the new Government's term. The financial performance of the public utilities improved dramatically after prices were increased and then indexed to the US dollar. However, the measures taken in 1990 by the Chamorro government fell significantly short of achieving stabilization. Mainly due to a decline in government revenue by 7 percentage points of GDP, the overall public sector deficit widened to 43 percent of GDP. Domestic bank credit increased rapidly because of deficits in state enterprises.

7. In May 1990, the Government introduced a second currency, the Cordoba Oro (CO). It was pegged to the US dollar. Initially, the CO was used as a unit of account. However, subsequently it was used to pay a part of public sector wages. Loans and deposit rates were indexed to the CO and interest rates became less negative in real terms because the Cordoba continued devaluing against the US dollar (and the CO) on a weekly basis. Nonetheless, non-market criteria continued to determine credit allocation. The introduction of the CO in an inflationary environment also complicated monetary management. The fact that transactions were denominated in CO and effected in Cordobas, sped circulation of the Cordoba. Lax financial policies combined with enforcement of parity to the US dollar also depleted scarce international reserves.

8. Economic performance continued to worsen throughout 1990. This was exacerbated by political volatilities and persisting macroeconomic imbalances. The GDP dropped further by 4.4 percent. Inflation accelerated to over 7,400 percent due to unchecked monetary expansion and a large fiscal deficit. Despite improvement in export performance, the current account deficit remained high.

9. The most significant achievements of the Government in 1990 were the moves toward establishing peace and reaching broad national consensus on the main thrust of its economic policies, after an initial period of prolonged strikes. The consensus-building efforts culminated with an October 1990 agreement. The "Concertación Económica y Social" between the Government and representatives of workers and employees secured a formal consensus on the need to implement structural reforms, including: liberalizing trade, removing state monopolies in the financial and foreign trade sectors, and returning expropriated properties to their rightful owners. The Chamorro administration

demobilized and worked to reintegrate armed groups. In addition, the Government enacted significant policy changes in the areas of tax reform, tariff reform, and deregulation of the economy.

10. In 1991, the Government focused on stabilization and structural change. An extensive stabilization program was initiated on March 3. The Government sharply devalued the exchange rate and placed strict ceilings on expenditures and credit expansion (paras. 22-24). The early results of the stabilization program are encouraging in terms of drastic declines in the rate of inflation (para. 26). The scanty available figures regarding output levels indicate that the economic decline has been arrested and that moderate growth may have ensued in 1991, though no trend can be confirmed yet.

Need for Adjustment and Constraints

11. The severely distorted economy requires rapid transformation of the whole economic system away from centralized management, regulations, public ownership and resource use, and controls to a free-market orientation with increased private sector participation. This economic transformation has to occur under the restraint of a major stabilization effort. Before structural adjustment efforts can bear fruit, sustainable relative price stability has to be established.

12. While the Government demonstrates commitment to stabilization and adjustment through the March 3, 1991 program and a number of steps toward structural adjustment, the economic agenda continues to face strong challenges. Some of these challenges are not in the domain of straightforward economic policy. The effort to maintain consensus behind economic policies has consumed the Government's attention and required concessions by all economic actors regarding the content of policies. The Government, however, has achieved consensus to date in support of the main thrust of its economic policies.

13. The Government faces many constraints which will continuously test its political will and capability to implement its program for reforms. In an environment of hyperinflation, the restoration of macroeconomic stability necessitates drastic fiscal and monetary measures. Major expenditure cuts are required in the public sector. This will necessitate a decline in the wage bill with consequences for real wages and the level of public sector employment. Also, special care has to be taken that essential government services and social sector needs are not adversely affected. The government's revenue raising capability has to be improved significantly. Moreover, credit for all types of activities will have to be severely constrained. The authorities are working to achieve the stabilization targets without curtailing the supply response and worsening the position of poverty-ridden groups. Failure in this respect would erode support for Government policies and disturb the recently acquired social and political peace.

14. Reducing the role and share of the public sector in the economy constitutes a major challenge to the Government's adjustment efforts. First, the central government spends almost one third of GDP. This exceeds public

revenues, resulting in a fiscal imbalance. Second, government ownership of economic assets in all sectors and heavy public sector use of resources crowds out the private sector. The public sector monopolizes the financial system, owns a majority of the manufacturing firms, and participates in agricultural production by owning state farms. State enterprises operate inefficiently, are afflicted by highly politicized excess labor, and depend on financial resource transfer to cover operational deficits. Third, little room for private initiatives remains because the government heavily controls and regulates the economy, as well as monopolizes trade and services. Public sector cutbacks meet resistance from strong pressure groups opposing change.

15. Although the central government pervades the economy, its <u>policy formulation, implementation and monitoring capabilities</u> are limited. The deteriorated political climate has caused significant personnel losses in key areas over the last several years. Similarly, institutional capabilities have eroded. Implementing demanding stabilization and structural adjustment programs will strain public sector capabilities. Without substantial and immediate technical assistance, program implementation could fail.

16. The absence of a functioning <u>financial system</u> presents a major challenge to adjustment. The ineffective publicly owned financial institutions serve merely to channel Central Bank credit to the state. Formerly, the lack of credit discipline led to unchecked credit expansion and almost complete noncompliance with repayment requirements. The Central Bank has ineffectively used traditional monetary policy instruments. In addition, there is no effective supervisory agency nor prudential regulations. While a program to restructure the financial sector has been initiated recently, establishment of a functioning financial sector will take time.

17. The uncertainty surrounding <u>property rights</u>, land ownership, and land tenure, unless remedied quickly, could endanger the Government's ability to implement an adjustment program to obtain the necessary supply response. Since sympathizers of the previous regime retain control of many law enforcing offices, including the police, settling existing conflicts and enforcing property ownership rights may prove to be difficult. The privatization of properties confiscated or expropriated under the previous regime and agricultural production are especially sensitive to the property rights issue.

18. High <u>unemployment</u> and strained <u>labor relations</u> also cause concern. While economic adjustment and restored sustained growth would increase employment in the medium to long-term, stabilization and adjustment will require reduced public sector employment in the short-term. Decreased employment levels and declining real wages could meet with strong resistance from the highly politicized organized labor groups. This would cause interruptions in production and a slowing down of economic recovery.

<u>The Government's Strategy and Program for Stabilization and Adjustment</u>

19. <u>Strategy for Renewed Growth</u>. The Government's strategy, recognizing the interrelation between stabilization and structural adjustment,

requires carefully coordinated and sequenced actions to achieve the two goals. Achieving macroeconomic stability in an unstable macroeconomic environment is a precondition for successful adjustment, the authorities realize. In turn, economic stabilization, without a significant supply response through structural adjustment, would be short-lived.

20. The authorities recognize that structural adjustment entails immediate and simultaneous actions in several areas. However, proper policy sequencing is essential not to overextend the weak administrative capability of the Government across many areas. The authorities have sequenced their adjustment policies such that measures which can be implemented immediately with a relatively quick pay-off are given priority. Some examples are deregulating the economy, removing government monopolies in domestic and international trade, and abolishing intricate licensing practices. These changes, coupled with the maintenance of competitive interest and exchange rates, will encourage private sector participation.

21. Policy measures eventually will have to be supplemented by investment projects in productive and infrastructural sectors such as energy and communications. Meanwhile, the Government has initiated programs to cushion the impact of adjustment on the most vulnerable low-income groups (para. 91) and to address the immediate needs of the poor segments of the population.

22. The Stabilization Program. With IMF staff assistance, the authorities prepared a stabilization program to reduce inflation drastically. Implementation began on March 3,1991. In the area of fiscal policy, the program aimed to reduce the public sector deficit to a level that can be financed by external grants and concessionary assistance, without recourse to domestic credit. This required deep cuts in the recurrent expenditures from the budget compared to 1990, and a major increase in the tax effort. No extra-budgetary spending would be allowed in 1991. According to the program, all public entities are denied access to net domestic bank credit in 1991.

23. The stabilization program calls for strict constraints on domestic bank credit. The Government has instructed the Central Bank not to extend net domestic credit to the economy beyond available loanable funds. Monthly ceilings on Central Bank credit have been established. Also, the program aims to simplify the interest rate structure and indexes deposit and lending rates to the dollar.

24. The March 3, 1991 program devalued the exchange rate of the Cordoba Oro by 400 percent, from 1CO$ per US$ to 5CO$ per US$. The Government also announced increases in: (i) public utility tariffs ranging from 150 percent for telephone services to 350 percent for electricity; (ii) prices of petroleum products by about 350 percent; liquor, cigarette, and soda water prices by 300 percent; and (iii) prices of primary food products (rice, beans, corn, sugar, oil, milk) and soap, produced and marketed by state enterprises, by about 300 percent. An average 200 percent wage and salary increase was granted to public sector employees to partially offset the impact of price increases.

25. The ultimate success of the stabilization program will depend on the authorities' ability to achieve demanding expenditure and revenue targets. Through May 1991, expenditures have been limited to the targeted levels, which are compatible with current revenue and foreign grants. Tax receipts increased by more than 40 percent during the first five months of 1991 and will reach the target for 1991 easily. Thus, the drop in the tax revenue in 1990 proved a transitional phenomenon, resulting from the unusual political circumstances.

26. During the first five months of 1991, total Central Bank credit to the public sector and domestic financial institutions- the key factor behind high inflation in recent years- declined. This fact and the disbursements of foreign loans and grants led to a net increase in international reserves of US$93 million. In addition, the consumer price index dropped by 6 percent in May 1991 compared to April, indicating a moderation in price levels since the initial post-devaluation upsurge of March.

27. <u>The Structural Adjustment Program</u>. Section II details the Government's structural adjustment program. However, a broad outline of the program is given in this section. The comprehensive program for structural adjustment was finalized recently in consultation with IDA staff. The program aims at a radical reorientation of the economy toward competitive markets and improving incentives to the private sector.

28. <u>Fiscal policy</u> aims to balance revenue and expenditures through selective current expenditure cuts and improved revenue gathering by the tax administration. To avoid fiscal account imbalances, the authorities will continue to use cash budgeting, continuously adjusting monthly expenditures to revenue. To achieve price and external reserve targets, <u>monetary policy</u> will try to balance money supply with demand for real money balances. The authorities will continue to constrain the Central Bank's stock of net domestic credit. Both deposit and lending interest rates will be kept positive in real terms. After the primary objectives of stabilization are achieved, interest rates will be approximated to market rates (para. 76). The Government <u>exchange rate policy</u> will be flexible in order to maintain competitiveness in the tradeable sector and to stimulate export diversification. To ensure a competitive exchange rate, while adhering to tight monetary, fiscal, and wage policies, the authorities will monitor developments closely in order to act immediately due to changes in domestic and external factors.

29. The Government's program highlights reforms for the public sector, the financial sector, and the incentives system. <u>Public sector reforms</u> aim to reduce the government's size and economic involvement, while increasing efficiency in public services. Regarding <u>public sector expenditures</u>, the Government has controlled 1991 budgetary expenditures after an unsuccessful attempt in 1990. The authorities have targeted to cover all non-interest current expenditure with current revenue by FY93. To this end, the Government intends to reduce non-interest current expenditures by around 7 percent in FY92. Military expenditures are marked to bear the biggest burden

of adjustment, since they are perceived to be excessive. In addressing the public sector employment issue, the program initiated for employment reduction through voluntary retirement in 1991, will be continued in 1992 along with external assistance. The Government targets the privatization of some 350 state-owned companies. Already, several companies have been privatized mostly by returning them to their legal owners. The Government has a time-bound action plan to privatize about 90 percent of state-owned companies by end 1993.

30. The Government is moving to improve the tax administration, in order to enhance the buoyancy of the tax system and to ensure the reliability of tax revenues. Some measures, such as those against tax evasion, would produce short-term results. Other measures target long-term institutional improvements, including the training of staff.

31. Financial sector reforms comprise a major share of the adjustment program. The authorities are planning to introduce competition into the financial system by including the private sector. The state-owned banks will be either liquidated, merged, restructured or rechartered as institutions providing services and credit to small agricultural producers and micro enterprises. In addition, a modern and comprehensive Law of Banking and Financial Institutions is going to be drafted to establish prudential regulations and facilitate the use of modern banking and financial instruments.

32. The third component of the adjustment program aims to restore a system of incentives conducive to private sector participation in a market-oriented environment. Trade liberalization measures include the gradual lowering of nominal tariff protection to a range of 10-20 percent by end 1993. Steps are being taken to completely open foreign trade to the private sector, and remaining restrictions on imports are being removed and the foreign exchange allocation mechanism is being liberalized. The discretionary, complex, and distorted tax system was changed significantly in the second half of 1990. Distorting domestic regulatory practices would be erased by reducing the extent of the government's involvement in the economy and changing the regulatory framework for state-owned enterprises. Moreover, the authorities will eliminate the remaining agricultural support prices.

Medium Term Prospects

33. The Nicaraguan economy has the potential to achieve fairly rapid economic growth over the next decade. This expectation is supported by Nicaragua's rich agricultural resources and considerable unused capacity, indicated by a much lower than recent historical average overall output. Also, the external markets of the last decade can be regained, particularly in the US, now that the embargo has been lifted. Successful implementation of the stabilization and structural adjustment policies, to be supported under the proposed credit, would achieve recovery and sustained growth. Another prerequisite of resumed growth is the maintenance of national peace and the resolution of the property rights issue. The Government has intensified efforts to resolve the potentially explosive property rights issue. With

private sector confidence, price stability, competitive exchange rates, and reformed fiscal, financial and incentives systems, quick recovery and respectable economic growth are attainable.

34. A base case scenario has been developed which assumes that structural adjustment measures would be implemented fully. GDP growth is expected to turn positive in 1991 and then gradually increase to reach 5 percent annual levels by 1995 and then stabilize at around 4.5 percent annually for the remainder of the decade. Despite positive per capita GDP growth rates by 1993, however, private consumption per capita would recuperate more slowly. In the transition from stabilization to the resumption of sustained growth, public investment would play the dual role of buffering initial slow growth and of improving infrastructural activities to encourage private investment. Even with this growth performance, real GDP would only reach early 1970s levels by 1996. More strikingly, GDP per capita levels would not reach 1950s levels before 2000. Table 2 shows the projected macroeconomic scenario.

Table 2: NICARAGUA - KEY INDICATORS, 1991-2000

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Annual Real Growth Rates:										
GDP	1.0	3.0	4.0	4.5	5.0	5.0	4.5	4.5	4.5	4.5
GDP per capita	-2.0	-0.1	1.0	1.5	1.9	2.0	1.7	1.7	1.7	1.7
National Accounts (As % of Curr. GDP):										
Total Consumption	113.2	107.7	105.7	104.5	102.5	100.5	98.8	97.4	96.1	94.7
Public Consumption	21.8	20.7	16.6	15.9	15.1	14.4	13.8	13.5	13.1	13.1
Private Consumption	91.4	87.0	89.1	88.6	87.3	86.1	85.0	83.9	83.0	81.6
Total Investment	12.0	15.0	16.0	16.0	16.5	16.5	16.3	16.0	16.0	16.0
Public Investment 1/	8.0	9.3	7.4	7.5	6.5	5.5	4.7	4.6	4.6	4.5
Private Investment	4.0	5.7	8.6	8.5	10.0	11.0	11.6	11.4	11.4	11.5
Exports of Goods & NFS	28.0	30.7	32.1	32.6	33.7	35.1	36.6	37.8	38.7	39.6
Imports of Goods & NFS	53.2	53.4	53.7	53.1	52.6	52.1	51.7	51.2	50.7	50.3
Gross Domestic Savings	-13.2	-7.7	-5.7	-4.5	-2.5	-0.5	1.2	2.6	3.9	5.3
Non Financial Public Sector (As % of Curr. GDP):										
Total Current Revenues	22.4	23.5	23.7	23.9	23.3	23.0	22.7	22.5	22.0	22.0
Total Current Expenditures	27.8	24.9	21.7	20.8	19.8	18.8	18.0	17.5	17.0	16.8
Capital Expenditures	7.0	7.7	7.6	7.7	6.7	5.7	4.9	4.8	4.8	4.7
Overall Balance	-12.2	-8.9	-5.4	-4.4	-2.9	-1.3	0.0	0.3	0.5	0.7
Balance of Payments:										
(Real Growth Rates)										
Exports of Goods & NFS	2.9	8.7	8.0	8.9	8.5	8.8	7.7	7.6	6.4	6.4
Imports of Goods & NFS	2.6	6.1	3.9	3.0	3.9	3.3	3.0	3.0	3.0	3.0
(As % of Current GDP)										
Resource Balance	-25.2	-22.7	-21.6	-20.5	-18.9	-16.9	-15.0	-13.3	-12.0	-10.7
Current Account - interest paymts 2/	13.0	-18.2	-17.5	-16.7	-15.5	-13.9	-12.3	-11.0	-10.0	-9.0
MEMO: GDP in US$ Mln.	1,421	1,489	1,578	1,714	1,888	2,065	2,236	2,444	2,666	2,909

1/ Includes APP enterprises.
2/ Includes official grants in 1991.
Source: WB staff estimates.

35. As shown in the table, modest growth is expected for 1991. This growth estimate is based on the predicted rapid reduction in inflation, existence of significant excess capacity, and new opportunities in the external sector. The stabilization program launched in early March 1991, has produced positive results already. The public sector carries the burden of adjustment, leaving room for increasing credit to the private sector even in the short run. Structural policy measures encouraging private sector participation in production and trade have been initiated. Foreign trade was

opened to the private sector in early 1991, and currently private traders are participating. Moreover, a full year's effect of the removal of the US trade embargo in 1990 will be felt in 1991. The agricultural frontier has grown since the end of the war, and there has been a massive transfer of idle agricultural land to ex-military personnel and former resistance fighters. The authorities expect a 25 percent increase in the production of basic grains this year.

36. The effects of structural reforms to improve resource allocation/mobilization and increase production of tradeables will take time. Moreover, private investment is expected to grow slowly. Although Nicaragua, a small economy, can be integrated rapidly into world markets, structural reform implementation will cause a lag in growth. Structural change will occur quickly in the trade and domestic deregulation areas because the main task there is to eliminate policy imposed barriers to production and trade. These reforms are expected to be installed by the end of 1993. However, financial sector reform will be more complex. It involves the difficult task of restructuring the state-owned banks. Similarly, the supervisory institutions and the privately-owned banks require time to be fully functional. Therefore, relatively high, stable GDP growth is not expected until 1995.

37. Maintaining a competitive exchange rate, in addition to far reaching trade liberalization and elimination of entry barriers to the private sector, will alleviate the anti-export bias and allow for a significant increase in exports in the medium-term. Overall exports of goods and non-factor services are expected to reach approximately US$660 million by 1996, growing at an real average annual rate of 8.6 percent between 1992 and 1996. This would be realized mostly through an increase in traditional exports, mainly coffee, cotton, and beef, products that will account for nearly half of total exports throughout the nineties. Coffee exports are expected to grow 10 percent annually, as a consequence of a slight increase in the cultivated area, and considerable increases in yields, reaching levels observed in other countries of the region. However, only in 1996 will the export volumes of the seventies be reached again. Cotton exports are expected to grow at high rates due to an increase in the cultivated area. Even with these favorable prospects, by the year 2000, export volumes would still be 20 percent below the 1970s' levels. Beef exports should grow steadily at a slow pace, given the small number of cattle for slaughter. On account of less favorable outlook in world markets, sugar will lose its 14 percent share of exports in 1992 to 11 percent in 1996. Export volumes of bananas will grow fast, due to favorable price prospects and the possibility of entering the American and European markets. An expansion in the cultivated area for banana is expected both in the short and long run. The seafood sector has good export prospects, since almost all exports are based on fishing rather than on shrimp and lobster aquaculture. However, because of overexploitation in some areas, export volumes will continue to be below levels twenty years earlier. With measures to increase profitability, non-traditional exports, especially agro-industrial products, are expected to increase at an annual rate of nearly 10 percent. In the case of imports, trade liberalization will not imply a massive increase, provided that the Government maintains a competitive exchange rate.

IDA Assistance Strategy

38. The present crisis, with its political, economic and social roots, presents formidable challenges to the implementation of a viable economic recovery and adjustment program. Like most IDA only countries, Nicaragua faces extreme poverty, a host of policy shortcomings, and weak institutions as it attempts to pre-condition sustained growth. However, Nicaragua faces three additional problems that compound the difficulty of its reform effort and argue for an exceptionally high level of concessionary support from multi- and bilateral donors. The first is that Nicaragua is emerging from a ten year military conflict that destroyed the country's physical and institutional infrastructure, diverted a high percentage of government expenditures to military uses, and contributed to a significant brain drain - amounting to some 10 percent of the population - mostly of professional and skilled labor. The war left large numbers of displaced and handicapped people that will strain government services for many years. The second additional difficulty is that the Chamorro Government is trying to dismantle completely the command economy from the 1980s. This means breaking down the state monopolies in internal and external commerce, rebuilding the insolvent financial sector, restoring property rights, returning businesses and agricultural holdings to the private sector, enacting major legislative and judicial reforms, and reducing the size of the state. Finally, the Government faces an extraordinarily high external debt burden and financing requirements over the next decade. Also, as of early 1991, Nicaragua's accumulated total arrears stood at $3.2 billion, more than twice the 1990 GDP. Though the Government has taken important steps to renegotiate its debt, this debt overhang remains constraining.

39. IDA must play a decisive role in both providing direct assistance and in mobilizing and coordinating adequate levels of donor support. Drawing on its comparative advantage, IDA will focus its assistance on: (i) helping first to address key macroeconomic and structural policy issues through quick disbursing operations; (ii) consolidating the reform process through a gradual shift to sector operations to support the Government's objectives of increasing the efficiency of resource use in the public sector, rehabilitating physical infrastructure and human resource development, and strengthening the private sector; and (iii) using the special IDA facilities to help improve creditworthiness and thereby contribute to restoring private capital flows. In leading the Consultative Group, IDA will seek to complement its financial support by: (i) helping organize and direct urgently needed technical assistance to support the Government's adjustment efforts; and (ii) assisting the Government to mobilize additional concessional resources. In order to enhance both these efforts, a Resident Mission will be established in Nicaragua later in 1991. This will back the Government in its implementation of the program and provide a direct line of communication in Nicaragua for the donor community.

40. This assistance addresses strategic issues critical to the realization of the government's economic development goals. Most importantly, there is a need to: (i) develop and implement an appropriate mix and sequence of adjustment and investment actions, including those for urgent infrastructure rehabilitation; (ii) strengthen the enabling environment for

private sector activities to ensure progress in the ongoing process of privatization; (iii) define and implement policies to address the structural causes of poverty; (iv) overcome the limited implementation capacity of the public administration through efficient use of external technical assistance and measures to attract qualified expatriates back to Nicaragua; and (v) promote the efficiency and effectiveness of external resource mobilization, given the likely dependence of Nicaragua on external aid in the medium term.

41. Given the need for profound structural reforms and to ensure a rapid transfer of resources, the bulk of the IDA funds initially will be made available through quick disbursing, policy-based credits. These policy-based operations will be designed to attract cofinancing or parallel financing in order to maximize external resource mobilization. The magnitude of the base case IDA lending program is determined by the amount of available IDA resources. In consideration of the special circumstances facing the country, Nicaragua has obtained a special allocation from IDA under the Ninth Replenishment, for the three year period FY92 - FY94. For FY95 and FY96, the requirement for IDA funds would be reduced, as the external balance of the country is expected to improve.

42. Upon successful implementation of the proposed Economic Recovery Credit (ERC), a follow-up structural adjustment credit is proposed for early FY93 to help the Government to deepen the adjustment process. Like the proposed ERC, this second IDA credit is expected to be supported through cofinancing and/or parallel lending from other donors on concessionary terms. Based on an intensive and well-focussed economic and sector work program (see para. 44), sectoral operations also would be prepared for Board presentation as soon as basic macroeconomic reform had occurred and the adjustment process was in place. Depending on the size of the available IDA resources, pivotal operations in the social sector, agriculture and infrastructure are being considered for the period FY92-FY94. The former is essential to poverty alleviation and human resource development, and the latter two credits are critical to achieving sustained growth and a resurgent private sector. For FY95 or FY96, an environmental project is envisaged. Both the "fifth and sixth dimension" IDA facilities could be utilized to broaden the assistance program, encourage greater concessionary flows from other donors, and strengthen burden sharing.

43. This IDA credit strategy is designed both to support the Government's objective of economic reform and to marshall the external resources needed to carry out this demanding agenda. It is critical, however, that the program "stay on track." Should significant policy slippages occur, a reassessment would be made of IDA's assistance role in Nicaragua. Under such circumstances, IDA might be able to consider a much reduced level of core credit operations focussing on the alleviation of poverty and on the environment.

44. To establish a sound analytical framework for the proposed future operations and continuation of the policy dialogue, an expanded economic and sector work program will restore the Bank's knowledge of the Nicaraguan economy following the lapse in relations in the early 1980s. A Public Sector Expenditure Review is currently being undertaken which will be followed later

in FY92 by reviews of the social sector, agriculture and infrastructure issues. In FY92-FY96, work would focus on (i) the mix and sequence of adjustment actions (through studies on the financial sector, public sector decentralization and the regulatory framework); (ii) reactivation of the private sector; (iii) poverty issues; and (iv) the environment.

45. For the past year, the Consultative Group has focussed on emergency assistance, the government's economic recovery effort, and mechanisms for clearing arrears to the International Financial Institutions. In the medium-term, the donor community faces the difficult tasks of supporting the reform effort, and helping to close the financing gap of about US$425 million per year (see para. 123). Recent bilateral support has focussed on balance of payment support, but will shift in the future to areas such as private sector development, education, municipal development, and natural resources.

46. Currently, IFC has two investments in Nicaragua, a sugar plantation and a hotel in Managua. The corporation is exploring, with both local and foreign private sector sponsors, the possibility of developing projects primarily in mining, aquaculture, and private energy generation.

II. THE GOVERNMENT'S STRUCTURAL ADJUSTMENT PROGRAM

47. The proposed ERC would support the Government's policies contained in the Structural Adjustment Program, which was designed in close cooperation with IDA. The program aims to reorient the economy toward competitive markets and improving incentives for private sector participation. The policies to be supported under the ERC are mainly in three specific areas, including: (i) public sector size and efficiency, (ii) the financial system; and (iii) the system of incentives. The program is described in the Government's Letter of Development Policy (Annex C). The details of the program in each general area are given below.

Public Sector Reforms

48. The Government's overall strategy toward organizing the economy and economic growth necessitates a major change in the public sector's role. While the state sector is expected to reduce its involvement in the economy in terms of ownership and regulatory responsibilities, the resources channeled through the public sector also must be reduced. Under the public sector reform, the program addresses issues that relate to public expenditures and revenue, public sector employment, and privatization.

49. The resources used in public sector expenditures are considerably higher than international and regional norms and are inconsistent with the Government's adjustment strategy. In 1990, for example, central government expenditures, excluding interest payments and activities of public utilities and other public enterprises, were around one third of GDP. As a result, the

potential growth of the private sector was crowded out, the public sector was burdened by large management responsibilities, and the resulting fiscal balances were unsustainable due to shortfalls in revenue performance.

50. The distribution of public expenditures between current and capital expenditures raises additional issues. For 1991, approximately 88 percent of projected budgetary expenditures are recurrent, leaving only about 12 percent for capital expenditures. Personnel-related expenditures comprise nearly 50 percent of current expenditures.

51. The authorities already have reduced the size of current budget expenditures. Cuts were effected in the 1991 budget compared to the (budgeted and non-budgeted) expenditures of the central government in 1990 (para. 22). The objective is to establish a balance between the revenue and non-interest current expenditures of the Central Government by 1993. Beginning in 1994, the central government is expected to be a net saver in its non-interest current account transactions. As a first step, the authorities have prepared, prior to Board presentation, a FY92 budget which reduces current expenditures to US$325 million equivalent in 1992 (para. 97 A.(i)). This corresponds to a current expenditure budget which is about 7 percent lower in current dollar terms in 1992. The level of current expenditures will be reduced by another 9 percent in 1993. The implied deficit of the central government is entirely consistent with anticipated donor grants and balance of payments assistance. Therefore, the envisaged fiscal adjustment would support the objective of price stability. The authorities are prepared to make further downward adjustments in expenditures to maintain the fiscal balance if there is a downfall in anticipated resources.

52. In the FY92 budget to be adopted by the Government, non-interest current expenditures would not exceed US$325 million equivalent (<u>second tranche release condition</u>; para. 97 B.(i)), compared with US$338 million equivalent in FY91. (This latter figure represents a major reduction in the FY91 budget adopted by the Assembly, and is in line with the targets of the stabilization program.) The budget reductions should be through carefully targeted expenditure cuts rather than across-the-board cuts. Therefore, savings will have to come through selected reductions in government activities. In the current budget, the projected expenditures in 1991 indicate a 45 percent decline in real terms in military spending and a 25 percent reduction in spending on internal security, compared to 1990. In the FY92 budget, with further cuts in the military expenditures, the share of civilian expenditures is expected to be around 87 percent of the non-interest current expenditures. While this corresponds to a 1 percent increase in the relative share of civilian expenditures, these are being reduced by the equivalent of US$16 million between 1991 and 1992. Expenditure reductions on vehicle maintenance and operation, water and utilities, and other areas will affect all spending units. Also, certain transfers from the budget, such as salary supplements, will be reduced. To achieve a more comprehensive expenditure restructuring, the authorities are undertaking a public expenditure review, with IDA assistance. The size, sectoral composition and distribution, and the institutional aspects of public expenditures will be reviewed. Agreement on implementing the recommendations of the public

expenditure review will provide the basis for the further restructuring of public expenditures (second tranche release condition; para. 97 B. (i)).

53. The Government will also undertake medium-term measures to strengthen the institutional capabilities of the line ministries and central ministries for better expenditure planning. Shortcomings exist in the current expenditure planning and monitoring practices. For example, links between the Ministry of Finance and the spending ministries in budget collaboration are unclear. A relevant macroeconomic framework for the preparation of a given year's budget is also missing. Moreover, the Ministry of Finance does not sufficiently monitor expenditures, except for *ad hoc* decisions on cuts. Other institutional issues involve the inadequacy of budgetary formats, the lack of public expenditures coverage other than of the central government, and the process of project selection in the public sector. These issues will be addressed in the context of the public expenditure review (para. 44).

54. Public sector employment requires particular attention. Without a significant reduction in employees, expenditure restructuring objectives cannot be fully met. As a result of political pressures stemming from strong unionization under the previous administration, public sector employment swelled, particularly in low skill areas. As of end 1990, approximately 69,000 people were employed by the central government and more than 75,000 workers were employed in state enterprises. Public sector salaries are high for unskilled workers and relatively low for technical levels. This has induced a substantial outflow of skilled workers, leaving the public sector with an extremely large over-paid and unskilled labor force. Though unionization is illegal for public employees, this restriction was circumvented by the previous Government with the formation of the National Association of Employees, a *de facto* union. This Association obtained extremely generous wage increases in the last months of the former regime and exerts strong political pressure for wage increases. The Association has also extracted a concession in the Concertacion Agreement which restricts the dismissal of government employees (para. 9).

55. To surmount labor market rigidities, the Government has introduced an Employment Reconversion Program (with direct funding from the USAID) to release about 9,000 of the 69,000 central government employees, with an additional reduction of 3,000 in the defense sector during 1991. A reduction of this size would reduce the share of the central government budget in GDP by about two percent. The initial reaction of the employees to this voluntary retirement program has been encouraging. The processing of voluntary employment reduction in the public sector for 8,000 personnel has been completed prior to Board presentation (para. 97 A. (ii)). The Government has now agreed with USAID to include the general public sector, including the banking sector, in the Employment Reconversion Program. The Government plans to continue the Employment Reconversion Program in 1992, with a stronger focus on state-owned financial institutions, public utility companies, and state enterprises. This second phase of the program to be implemented in 1992, which is also expected to be funded by the USAID, aims to reduce public sector employment by an additional 10,000 people. At the same time, the Government will implement a freeze on hiring new employees to replace those who leave the

services through retirement and resignation. It will continue also to gradually raise the work day to eight hours in the public sector.

56. The recovery and maintenance of government revenue will play a key role in the feasibility of attaining the stabilization targets, as well as in assuring non-inflationary financing of the government programs. Major improvements are necessary to overcome the weakness of tax administration. The General Directorate of Revenues and the General Directorate of Customs lack the organizational structure and the human capital base to implement a much-needed modernization program for tax administration. The high concentration of tax collections demonstrates tax administration weakness. In 1989, 84 percent of total tax collection was concentrated in 125 taxpayers. 92 percent of Selective Consumption Tax (SCT) collection was from 10 taxpayers mainly in fiscal industries, such as cigarettes and liquor. Tax collection is still heavily dependent on ad-hoc applications of SCT and the General Value Tax (GVT).

57. The Government has been working on a program to improve tax administration which will include organizational and procedural changes, as well as the formation of a team of well-trained specialists in tax administration, improving the judiciary process, and raising penalties for tax evasion. The Government has initiated an action plan, satisfactory to IDA, to improve tax administration (para. 97 A. (iii)). The Government has set up a separate unit within the General Directorate of Revenue to administer closely the taxes collected from the 280 largest taxpayers. This separate unit, will serve as a pilot project for the development of a modernized tax administration system. The experience from this operation will be extended to the entire system. Also, several customs posts recently have been relocated closer to the frontiers in order to improve collection.

58. The program for improving tax administration and enforcement includes both short and long-term steps. The authorities are planning by October 1991 to distribute and implement simplified tax declaration/payment forms and procedures, decree stricter sanctions for tax evasion and delinquent practices of businesses, and to revise the penalty structure for tax evasion and delayed tax payments based on the fiscal cost of the infraction and the lateness of payments. All tax administration and enforcement measures, as well as the full operation of the unit for large taxpayers, form a second tranche release condition (para. 97 B. (ii)). The customs valuation lists will be revised to reflect the changes in value, and will be updated on a monthly basis.

59. The above measures will provide a more reliable basis for tax assessment and enforcement. These short to medium-term measures will be supplemented by measures addressing the main institutional weaknesses in tax administration. To this end, the authorities are trying to develop automated management control systems and a computerized taxpayer identification system. Also, programs are being designed to train Internal Revenue and Customs personnel. A project for technical assistance is under negotiation with the IDB. The Government will finalize the arrangements for technical assistance by March 1992, hire consultants, and start implementing the project to improve

tax administration. Initiation of these long-term programs is a second tranche release condition (para. 97 B. (ii)).

60. In addition to 15 public utilities, the new Government inherited approximately 350 companies engaged in various activities ranging from agricultural production to manufacturing, and from mining to trade services. These companies are collectively known as the Area de Propiedad del Pueblo (APP). The larger enterprises in APP were expropriated from the Somoza family while others were acquired as a result of the agrarian reform, the confiscation of assets "abandoned" by their owners, and through other means. The Government's strategy is to privatize APP companies, but retain ownership of public utilities.

61. There is considerable scope for improvement in the performance of public utilities. Since they lack an overall regulatory framework, piecemeal distortional interventions are the norm. Public utilities have been given autonomy to set the tariffs for the services they provide, without having a framework to define their operation as natural monopolies. This allows them to pass on their inefficiencies and to realize monopoly rents at the expense of consumers and producers. They are also exempted from income taxes and from taxes on goods and services, including trade taxes. Organized power structures and political agendas in these enterprises still remain highly influential. In addition, management capabilities and technical skills are scarce and capital stock is run-down.

62. The necessary major restructuring of the public utilities will be based on the recommendations of a study to be conducted by the Government with grant funding and IDA support. The recommendations would help establish a regulatory framework defining the relations between the government and enterprises based on the principles of autonomy and accountability. The review would cover the establishment of efficient pricing practices for natural monopolies and would investigate the possibilities of competitive contracting-out alternatives to improve accountability in the operation of public utilities. Other areas include upgrading of management capabilities, improving the human capital base of public utilities, assessing production capabilities to create a minimum investment program for upgrading them, and preparing action plans for implementation. The study is expected to be initiated before March 1992. Its conclusions and recommendations may be included in the follow-up structural adjustment credit (para. 42).

63. In addition to public utilities, the core economic activities in the country were nationalized by the former government, and put under APP. State control of production led to heavy political intervention, contraction of production, technological backwardness and excessive employment in both manufacturing and agriculture. By conservative estimates, more than 30 percent of GDP was produced by state enterprises, excluding those in the financial sector. The state controlled 45 percent of value added in manufacturing, 70 percent in mining, and a smaller portion in agriculture.

64. The privatization of the APP enterprises is a major component of the Government's strategy for structural adjustment. Privatization involves the sale of companies legally owned by the government, the return of

confiscated companies to their legal owners, and liquidation. By divesting these entities, the Government aims to reduce the share of the public sector in the economy, lessen its administration and management responsibilities, and earn additional revenue for the budget. The combination of a smaller role for the state and a reinvigorated private sector in a competitive framework is expected to create efficiency gains and employment. One of the earlier steps taken by the new Government was to set up Junta General de Corporaciones Nacionales del Area Pública (CORNAP) and charge it with carrying out the privatization process.

65. The process of preparing these companies for privatization has proven to be difficult and time consuming due to legal, technical, political, and financial considerations. A major obstacle to privatizing the non-agricultural companies has been the procedure for determining whether the Government legitimately owns a company. The former administration established de facto ownership of a number of companies without going through channels that are now regarded as legitimate. Consequently, the legal ownership status of each company has to be determined before CORNAP can either dispose it or return it to its former owner. This task, together with the work required to establish a data base on the companies under its umbrella, have occupied most of CORNAP's management time and resources. In addition, the Government's sensitivity to the demands of the labor employed by these companies has been a factor slowing down the process.

66. After a lengthy preparation period, CORNAP has developed a broad privatization strategy which has been adopted by the Government (para. 97 A. (v)). Out of about 350 companies covered by this strategy, 152 are candidates for privatization through sale to private parties. Of the remaining companies, around 70 are to be returned to their legal owners, 50 are to be liquidated, more than 30 are to be assigned to some government departments, and the rest are to be partly privatized and partly returned to private owners. To date, 86 companies have been divested, of which, 23 given back to previous owners, 34 partly privatized and partly returned to owners, 26 either liquidated or assigned to ministries, and 3 fully privatized. The most important action completed involved privatization of three large-scale agricultural corporations, including the HATONIC (the largest cattle operation), AGROEXCO (agricultural export company), and CAFENIC (coffee growing and processing). The properties of these corporations were distributed among the previous owners, workers, army retirees, and the demobilized resistance forces, based on agreement between the parties involved and the Government.

67. The Government's program will include 90 percent of state-owned companies in the privatization process by end-1993. The authorities have identified interim targets for mid-March 1992. By that date the process of divestiture will be completed in an additional 75 companies, out of which 25 companies will be fully privatized, while devolution or liquidation will be completed in the remaining 50 companies. Finally, another 30 companies will also have been prepared for sale by the same date (second tranche release condition; para. 97 B. (iii)). Once these interim targets are achieved, the relative importance of the state-owned companies in total GDP will decline from about 30 percent to less than 10 percent.

Financial Sector Reform

68. The Government considers financial sector reform to be central to the adjustment process and the stabilization effort because it has implications for resource allocation and money creation. Changes in production incentives implemented through the structural adjustment polices will create a demand for financial services that the existing state owned financial system cannot meet. A stronger and more diversified financial system concentrated in the private sector must develop based on free-market principles.

69. By 1979, Nicaragua had one of the most advanced financial systems in Central America. A mix of state, private national, and foreign subsidiary banks offered many financial services, including sight deposits, term deposits, transfers, and insurance. Even the inefficient state institutions earned positive rents during the period, while barriers to entry in the financial system created high rents for the more efficient private sector. After taking power in July 1979, the Sandinista government progressively changed the structure of the financial system by eliminating private sector financial institutions, transferring control of state bank operations to a holding company (which evolved into the Corporación Financiera de Nicaragua, CORFIN), and progressively reducing to five, the number of financial institutions: Banco Nacional de Desarrollo (BND), Banco Nicaragüense de Industria y Comercio (BNIC), Banco Popular (BP), Banco Inmobiliario (BIN), and the investment lending institution Fondo Nicaragüense de Inversión (FNI).

70. The state-owned banks were also functioning in specific sectors. BND serviced the agriculture and livestock sectors, BNIC the industrial and commercial sectors, BP the small scale sector, and BIN the housing sector. The complete specialization of the banks in 1985 further reduced management incentives to improve the quality or efficiency of their operations. Managers rolled over poor or nonperforming loans to maintain the flow of financial resources to targeted sectors. Moreover, periodic Government forgiveness or rescheduling of overdue loans and persistently negative real interest rates on loans eliminated any incentive for management to seek high return projects for their investments.

71. A cornerstone of the Government's program to reform the financial system is a restructuring of the state owned banks, along with the cessation of Central Bank subsidies and discounts. The Government initiated an evaluation of the state banks to outline a restructuring program, which has been adopted (para. 97 A. (vii)). The plan includes the following objectives: (i) a rechartering of BND and BP to noncommercial institutions within two years; (ii) the liquidation or merger of BIN with BNIC (second tranche release condition; para. 97 B. (iv)); (iii) the downsizing and restructuring of BNIC as a commercial banking institution; (iv) the restoration of FNI to a second tier institution; and (v) the dissolution of CORFIN (second tranche release condition; para. 97 B. (iv)). The rechartered BND and BP institutions would be financed by external grants and domestic resources, and would deliver technical and financial services for agricultural development and small scale industry, respectively. Initiation of these steps is a second tranche release condition (para. 97 B. (iv)). The Government is aware of the importance of

eliminating special support to the public banks to attract competitive and universal private sector banks to Nicaragua in the short-term.

72. The Government has emphasized laying the legal and regulatory groundwork for a new Superintendency of the banking system. In April 1991 a law to create the Superintendency and Financial Institutions was passed. Regulations recently adopted address the shortcomings in that law by reducing the discretionary powers of the Superintendency. The regulations will also reduce potential political interference in the functions of the Superintendent stemming from the role of the Superintendency Board (mainly composed of Cabinet Ministers) in the decision-making process. A Superintendent was appointed and operations of the Superintendency were initiated, both satisfactory to IDA, prior to Board presentation (para. 97 A. (vi)). According to the Government's plans, by October 1991, the Superintendent will have issued normatives to initiate private banking operations, and by December 1991, the Superintendent will have approved at least two applications for private banks (<u>second tranche release condition</u>; para. 97 B. (iv)).

73. The legal framework to establish a private sector financial system will be completed by creating a modern and comprehensive Law of Banking and Financial Institutions. This law will replace the outdated 1963 banking law and will authorize the privatization of state-owned banks. Until the law is drafted and implemented, the Superintendent will have to issue provisional and partial prudential regulations in order to issue licenses in the financial sector. The Government recognizes the urgency of completing the law as soon as possible. A draft law will be presented to the national assembly early next year (<u>second tranche release condition</u>; para. 97 B. (iv)).

74. The Government recognizes that prolonging the current system of <u>interest rate</u> controls both precludes development of strong and diversified private sector banking institutions and major improvement in resource allocation. However, an immediate liberalization of interest rates while the economy is stabilizing, could disrupt economic activity and discourage the evolution of stable financial institutions. Therefore, the Government plans to pursue an interest rate reform with the following objectives: (i) maintenance of positive real interest rates in the short-term; (ii) introduction of a flexible interest rate policy by March of 1992; and (iii) gradual liberalization of interest rates for all financial institutions with the development of a multibank system under Superintendency supervision.

75. The Government introduced a new interest rate policy in April 1991. At that time, deposit rates were established at 12 percent and indexed to the US dollar. Short-term lending rates were unified and indexed to the dollar at 18 percent. A second 30-day deposit instrument was introduced without indexation at 25 percent interest. The rate of interest has been progressively reduced since that time. Between April 11 and April 30, 1991, the Government attracted 47 million cordobas oro through the 30-day deposit instrument. The interest rate on this window of operations will continue to be reduced on a monthly basis as the rate of inflation declines.

76. Until stabilization is achieved and a fully functioning system is completed, the authorities will continue to manage interest rates, but with

greater flexibility. By March of next year, the Government intends to implement the next stage of its interest liberalization policy. This stage includes completely freeing deposit rates, maintaining a band on lendir- -ates equivalent to interest rates on loans of similar maturity in the US adj... ad for country and currency risk, and pursuing a rediscount policy which maintains a uniform rate on rediscounts higher than the average financial system interest rate prevailing on deposits. These measures will encourage banks to compete for deposits and borrowers.

Reforms of System of Incentives

77. The Government strategy will also focus on the system of incentives. Policy changes in the areas of trade regime, tax structure, and the domestic regulatory framework are needed. The Government inherited a trade regime under which foreign trade was practically closed to the private sector. Incentives were significantly biased toward import substitution. The old incentives system, coupled with exchange controls and arbitrary variations in the real exchange rate, has caused a decrease in the production of tradeables and a reduction of exports to 50 percent of their 1978 level. During the past decade, most international trade was performed by the state trading companies. These companies monopolized exports of traditional products (coffee, cotton, sugar, bananas, cattle, precious metals, seafood and forestry products), and accounted for up to 98 percent of exports in some years.

78. On the import side, state-owned trading companies administered trade with the Eastern block and imports of international donations. In 1989, these companies accounted for 56 percent of total imports, including a monopoly on imports of oil and fertilizers. Import quotas and prohibitions existed only for basic grains and related products, while some export quotas and prohibitions applied to forestry, fisheries, and cattle. Private parties were marginally involved in foreign trade under discretionary allocation/retention of foreign exchange within a system of multiple exchange rates and arbitrary trade credit rationing. Private importers had to register officially at the Ministry of External Trade and had to get specific import permits from the Central Bank. Nominal import protection was nontransparent and widely differentiated. It ranged from 4 percent to 253 percent, averaging 48 percent.

79. The Government has moved boldly to liberalize and deregulate trade. After the drastic devaluation of the exchange rate, beginning March 3, 1991, foreign exchange allocation mechanisms were liberalized significantly. Importers need neither ministerial nor Central Bank permits to have access to foreign exchange. All exporters, except cotton and coffee exporters, have full access to the foreign exchange that they generate. The state trading monopolies, which controlled virtually all export and most import trade during the 1980s, were eliminated by a decree in January, 1991, opening trade to private sector participation.

80. The authorities have also reduced trade protectionism and increased trade regime transparency. The ceiling on tariffs was reduced to 20

percent, and most of the administratively granted import tariff exemptions were eliminated. Transparency was increased by eliminating the SCT for domestic production and keeping it as an import surcharge for most imports. These measures lowered the nominal protection range to 3-143 percent and the average protection to 18 percent, the second lowest in Central America. The dispersion was also lowered. Now 66 percent of tariff positions vary between 3 percent and 40 percent.

81. The Government recently announced the next steps for a coherent medium-term program of trade liberalization and deregulation. In accordance with this program, the Government has reduced nominal import protection to a 10-60 percent range, by a combination of changes in the SCT and tariffs prior to Board presentation (para. 97 A. (viii)). Only medicines, newsprint and books will be exempted from the 10 percent tax/tariff. Also, prior to Board presentation: (i) the Government has made a public announcement specifying that, by December 1993, nominal import protection will be reduced to 10-20 percent range, while the SCT and the stamp tax will be eliminated (para. 97 A. (viii)); (ii) the Government has approved regulations to ensure automatic registration for imports and exports (para. 97 A. (ix)). According to the program, by March 1992, nominal import protection will be further reduced to the range of 10-40 percent. This will be a second tranche release condition (para. 97 B. (v)); and (iii) to lower nominal import protection dispersion and increase tax collections, the Government has established a timetable, satisfactory to IDA, to eliminate indirect tax exemptions including import tax exemptions and has removed income tax exemptions (para. 97 A. (iv)).

82. Regarding agricultural trade liberalization, the authorities have designed a price-based mechanism with variable levies for rice, yellow corn, and white maize (para. 97 A. (x)). The mechanism will be implemented before March 1992. Simultaneously, all remaining quantitative restrictions on food and grain imports will be eliminated prior to second tranche release (para. 97 B. (vi)). The Government's trade liberalization program will establish free-trade status for exporters by exempting them from import and domestic indirect taxes through a decree on export promotion which will be fully applied by March 1992. To liberalize the foreign exchange market, the same decree will eliminate foreign exchange surrender requirements for exporters.

83. The new Government inherited a highly discretionary, complex, and severely distorted tax system that compounded distortions in the trade regime. The Corporate Income Tax (CIT) had highly differentiated and high marginal rates, ad hoc exemptions, and incentives. The Personal Income Tax (PIT) system compounded the above distortions through multiple bases, excessive brackets, extremely high marginal rates, double taxation of dividends, and exemptions for interest income. The GVT aimed to be a value added tax, but because of its multiple exemptions, multiple rates, and weak administration, arbitrary distortions throughout the economic system resulted. The SCT exacerbated distortions because it was applied to about 700 goods with differential (higher) rates for imports and extremely high rates for the fiscal industries (soft drinks, beers, rums, cigarettes, and oil derivatives).

84. During the second half of 1990, the new Government enacted a broad tax reform to address most of the above distortions. It rationalized the

income tax regime by eliminating some tax exemptions and most fiscal incentives. To do this, the Government unified the CIT rate and equalized it to the maximum PIT rate at 38.5 percent. The PIT was simplified and changed to a global base. To increase the income tax base, the Government implemented new presumptive income tax collection methods. The GVT base was extended to additional services and the rate was raised and unified at 15 percent. The SCT was eliminated for all but the fiscal industries and the tax on imports was retained as a temporary surcharge. Indexing the tax system to the Cordoba Oro was an appropriate transitory solution to avoid the impact of high inflation on tax yields. In addition, by the end of 1990, the Government improved the withholding and advancement system of income tax collection to minimize the lag between accruals and collections. This improvement aimed to avoid the possible negative effects of accelerated inflation on collections. In June 1991, the Government reduced the maximum rate of PIT and the flat rate of CIT to 35.5 percent. Gradually, the Government will continue lowering it to approximately 33 percent. This internationally competitive rate would not deter foreign investment nor the repatriation of capital from Nicaraguans abroad. The tax system currently conforms to international standards and has the basic safeguards to avoid lagging collections in the presence of accelerated inflation. Currently, no major additional change in the tax system is required.

85. The third aspect of the policies to improve incentives entails changes in domestic regulatory practices. Some state-owned enterprises have had a *de facto* monopoly in production and trade, for example, the sugar, bananas, and slaughtering house sectors. State-owned enterprises in natural resource sectors have regulatory powers to limit market entry and exports of private sector firms. The Government has also inherited a system of generalized price controls, closed markets, and interventions by the ENABAS in regulating agricultural products and derivatives. In addition to the measures to liberalize imports (para. 80), the Government has lifted domestic price controls, with the exception of fiscal industries, and petroleum and public utilities. However, for a reduced group of basic staples, the authorities set prices in government-owned retail outlets as part of the strategy to alleviate inflation.

86. Though ENABAS intervenes much less in the market, it still dominates the domestic and foreign trade of basic grains. ENABAS has privileged access to the import permits that regulate basic grains. This enables it to control the domestic supply of basic grains and to establish its price support policy for domestic grains producers. This intervention has caused wide fluctuations in nominal protection for basic grains. The Government is aware of the negative effects of ENABAS' market intervention. Policy changes being introduced are designed to encourage competition in the international and domestic trade of basic grains.

87. The Government will eliminate *de facto* state production and trade monopolies via the privatization of state-owned enterprises in sugar, bananas, and slaughtering houses. The state institutes for mining and fisheries will be transferred to the Ministry of Economy, after separating its production and trade activities. The Ministry of Economy is studying ways to regulate natural resources.

88. The Government plans to eliminate transitory price setting adopted for selected products in Government owned stores before March 1992. Prior to March 1992 the Government intends to present an action plan to phase out price controls of the fiscal industries and reformulate the SCT, thereby confining it to luxury and sin goods regardless of origin. The legal framework permitting generalized price controls will be abrogated by the same date.

89. As part of its overall development policy, the Government's plan to reduce and change the role of ENABAS calls for support prices for all to be eliminated by August 1991. ENABAS will buy grains at market prices and offer storage and related services to private traders and producers for a fee. It may also rent out part of its facilities. In addition, ENABAS will offer private traders the service of importing on their behalf (bundling orders). ENABAS will stop trading in all but basic grains. A program for privatizing its retail and wholesale outlets will be prepared by the end of 1991. According to the Government's plan, at least 20 percent of its assets will be sold to wholesalers or distributed as part of severance payments to ENABAS employees by March 1992. The remainder will be divested before the end of 1992. The Government is designing a medium-term strategy and an action plan for redefining the future role of ENABAS. ENABAS' intervention in regional grain markets will be restricted to markets where private competition is insufficient and ENABAS' facilities will be privatized and/or leased where competitive private participation is ensured.

Social Sector Requirements and Poverty Alleviation

90. The recent economic decline has caused sharp deterioration in nutrition standards and the provision of basic services. Since 1985, calorie and protein intake per capita fell by 30 percent. They were 14 percent and 25 percent, respectively, below minimum recommended levels in 1989. The infant mortality rate, at 61 per thousand, is high by Latin American standards. Education coverage also remains poor; 24 percent of the children 10 years or older are not enrolled in school. An even greater percentage attend school irregularly. The dropout rate is high, especially at the primary level.

91. Nicaragua, with one of the lowest per capita incomes in Latin America and years of deterioration in the provision of basic services, cannot afford to wait until the end of adjustment to address the needs of the vulnerable segments of the population. Moreover, these groups will be affected adversely by the implementation of the stabilization program, which includes cuts in public sector employment and spending, as well as price adjustments. The Government has already taken initial steps to attack poverty. In November 1990 it created the Social Emergency Investment Fund (FISE) as a mechanism to channel donor funds toward urgently needed social projects. FISE operates directly under the Office of the Presidency and serves as a financial intermediary with auditing responsibility, but not as a project executing agency. It channels resources for primary health care, primary nutrition, retraining and micro-enterprise credit. It tries to stimulate local governments, private sector grass-roots organizations, and NGOs to participate in projects.

92. FISE has identified areas of critical poverty and targeted resources toward these most critical areas. The fund started its operations, mobilizing US$15 million from the external and local donors. It has committed US$4.5 million in the first quarter of 1991; 32 projects are already underway with an additional 62 projects scheduled for the rest of 1991. For FISE to continue, additional donor funding is required once the available resources are exhausted.

93. The Fund for Assistance to Oppressed Sectors (FASO), a more recent government creation, will provide immediate relief to poverty groups. Some pledges have been made to FASO by nine OECD member governments, but no program has yet begun operations. For now, the Vice Ministry of Social Affairs, an integral part of the Office of the Presidency which is managing FASO during its initial phase, has received UNDP and bilateral assistance. This will help strengthen social sector management, monitoring, and evaluation to prepare for efficient use of donor assistance.

94. The Government also needs to address severe nutrition problems of the poorest segments of the population. In 1985, 31 percent of the population was classified as poor and 23 percent were living under extreme poverty. The poverty status is certainly worse today, after two failed attempts at stabilization and continuous deterioration in production and employment opportunities since 1985. The authorities are addressing nutrition needs by: (i) retargeting eligibility to AFA (a food delivery program) to reach the poorest segments of the population; (ii) gradually eliminating food distribution in the work place and increasing distribution through health centers, NGOs, and churches where the poor can be reached; (iii) improving the logistics of the World Food Program sponsored mother/child program (PMA); (iv) increasing the nutritional content and improving targeting of the "glass of milk program" by introducing a solid enriched food or cookie to accompany the glass of milk; and (v) developing a weaning food to replace the currently used food ("atole") that has very low nutritional content.

95. Despite relatively high public spending in the past on health and education, the quality of services remains low. IDA is preparing a social sector operation which would support social sector rehabilitation and improve sector management, human resource development, basic infrastructure needs for classrooms, health posts, and health equipment (para. 42).

XII. THE PROPOSED ECONOMIC RECOVERY CREDIT

Objective and Size of the Credit

96. The proposed ERC aims to support the Government of Nicaragua in its endeavors to arrest the ongoing decline in the economy, to achieve lasting price stability, and to revive economic growth on a sustained basis. This is to be achieved with deep structural reforms that would help reorient the economy toward a competitive free-market. This will necessitate changes in macroeconomic policies, the public sector, financial sector, and the system of

incentives. The proposed ERC focuses on the most important areas of reform as described in previous sections and summarized in the Matrix of Actions (Annex D). As shown in Annex D, the Government has taken considerable up front action to implement its program. The size of the Credit is relatively large at SDR 83.5 million (US$110 million equivalent) in order to respond to the Government's demonstrated initiative, play an important catalytic role in mobilizing external assistance for the clearance of arrears to the international financial institutions, and provide sufficient program support. The operation will also receive significant co-financing (para. 103).

Conditions for Tranche Release

97. The Credit proceeds will be disbursed in two tranches, each tranche being SDR 41.75 million (US$55 million equivalent). The closing date will be end-December 1992. The first tranche will be available for disbursement upon credit effectiveness (para. 98), and the second tranche will be available for disbursement after six to eight months and the completion of the second tranche conditions. A summary of the proposed actions to be supported by each tranche release is presented below. In addition to the monitorable actions specified below, the release of both tranches will be contingent upon the maintenance of an appropriate macroeconomic framework and satisfactory performance in overall program implementation as outlined in the Letter of Development Policy (Annex C) attached.

A. Policy actions taken before Board presentation:

(i) Central Government non-interest current expenditures in the proposed FY92 budget were reduced to US$325 million equivalent; agreement with IDA on the composition of the proposed budget of the Central Government for FY92 (paras. 51, 52);

(ii) The processing of voluntary employment reduction in the public sector was completed for 8,000 personnel (para. 55);

(iii) The Government initiated an action plan, satisfactory to IDA, to improve tax administration with specific emphasis on General Value Tax (GVT) and income tax collection (para. 57);

(iv) Income tax exemptions were removed, and a satisfactory timetable was approved to phase out indirect tax exemptions including import tax exemptions (para. 81);

(v) The Government has adopted an action plan satisfactory to IDA, to privatize CORNAP enterprises (para. 66);

(vi) Regulations for the implementation of the Superintendency Law were adopted, the Superintendent was appointed and the

Banking Superintendency activities have been initiated, all satisfactory to IDA (para. 72);

(vii) The Government adopted an action program, satisfactory to IDA, on restructuring of state-owned banks, along with cessation of Central Bank subsidies and discounts (para. 71);

(viii) The Government lowered nominal protection in the trade sector to a range of 10-60 percent through a combination of reductions in the levels of tariffs, SCT, and stamp tax; and it announced a target tariff range of 10-20 percent and elimination of SCT and stamp tax on imports by the end-1993 (para. 81);

(ix) Arrangements for automatic registration for importers and exporters were approved (para. 81); and

(x) A proposal was presented to IDA for a price-based mechanism with variable levies for rice, yellow corn and white maize (para. 82).

B. Policy actions to be taken before second tranche:

(i) Adoption of (a) FY92 budget with reduced Central Government non-interest current expenditures less than US$325 million equivalent and (b) agreement on implementing the recommendations of the joint Government-IDA public expenditure review (para. 52);

(ii) Implementation of measures to strengthen tax administration, including (a) full operation of unit for large taxpayers; (b) issuing of decrees on sanctions applying to delayed payment and non-compliance; and (c) initiating programs on automated management control system, computerized taxpayer identification system, and training programs for Internal Revenue and Customs personnel (paras. 58-59).

(iii) Implementation of privatization of CORNAP state-owned companies through (a) completion of privatization of additional 25 state-owned companies; (b) finalization of devolution, liquidation, or assignation of another 50 companies; and (c) initiation of concrete steps towards the preparation of an additional 30 companies for privatization (para. 67).

(iv) Carrying out financial sector reforms including, (a) liquidation or merger of Banco Inmobiliario with Banco Nicaragüense de Industria y Comercio, (b) dissolution of Corporación Financiera de Nicaragua (CORFIN), (c) initiation of steps towards the restructuring of Banco Nicaragüense de

Industria y Comercio, Banco Nacional de Desarrollo, and Banco Popular according to agreed action plan, (d) submission to the National Assembly of a draft law, satisfactory to IDA, on Banking and Financial Institutions, and (e) issuance of at least two licenses to private banks (paras. 71,72,73).

(v) The protection resulting from combined tariffs and taxes that apply to imports in Nicaragua will be reduced to a minimum of 10 percent and a maximum of 40 percent, except with respect to medicines, books and newsprint which may be exempt from such tariffs and taxes or subject to tariffs and taxes at a combined rate lower than the minimum rate referred to above (para. 81).

(vi) Replacement of import quotas on rice, yellow corn and white maize for a price based mechanism with variable levies, satisfactory to IDA, and elimination of remaining quantitative restrictions on food grain imports (para. 82).

Procurement, Disbursement and Auditing

98. The proposed ERC of US$110 million would be disbursed to reimburse the CIF cost of general imports (goods and services), excluding goods and services financed by other multilateral or bilateral sources, luxury goods, miliary equipment and other goods specifically prohibited in a negative list defined under the Standard International Trade Classification (SITC). In view of the large number of policy actions taken up front by the Government, and based on the financing requirements of the program, retroactive financing not exceeding SDR 41.75 million (US$55 million equivalent; 50 percent of the Credit amount) is recommended for eligible imports made after November 1, 1990, and before the date of the Agreement.

99. Because of the lack or inadequacy of procurement procedures, a conservative cut-off limit of US$3 million equivalent has been adopted for International Competitive Bidding (ICB). Therefore, imports made by public and private importers valued at the equivalent of US$3 million or more would be procured under simplified ICB procurement procedures in accordance with IDA's procurement guidelines. Public sector imports valued below US$3 million equivalent and above US$1 million equivalent would be procured on the basis of advertised competitive procedures satisfactory to the Association. Public sector imports valued at US$1 million equivalent or less may be procured through comparison of price quotations from at least two suppliers eligible under the Guidelines.

100. Import contracts by private importers, valued at below US$3 million equivalent, shall be awarded in accordance with established commercial practice, requiring comparison of price quotations obtained from at least two eligible suppliers, except in cases where direct contracting is considered appropriate under para. 3.5 of the Guidelines for procurement. Alternatively, such contracts will be subject to pre-shipment verification of quantity,

quality and price by an independent inspection firm acceptable to the Association.

101. Applications for disbursement corresponding to all import contracts paid after November 1, 1990 and before March 1, 1992, below US$3 million equivalent each, shall be supported by a certification by an independent inspection agency acceptable to IDA on the reasonability of the price paid. In the case of crude oil imports, expenditures under ongoing supply contracts entered into by Nicaragua would qualify for reimbursement under the Credit of an amount not to exceed, per unit, the reference price per unit established in commodity markets as reflected in Platt's Oilgram for the relevant shipping date and type of oil.

102. The Central Bank would administer the ERC and be responsible for the collection and review of relevant procurement documentation, ensuring that only imports that meet the eligibility criteria and agreed procurement procedures are included in withdrawal applications. To assist in this work, the Central Bank will retain an experienced procurement consultant. Disbursements against contracts valued under US$1.0 million would be made on the basis of statements of expenditure (SOE). The procurement documentation would be retained by the Central Bank for review by IDA as required and by the auditors to be appointed for the auditing of expenditures at the completion of each tranche. The submission to IDA of an audit report on the first tranche would be a condition of disbursement of the second tranche. Full procurement documentation would be required with withdrawal applications for individual contracts valued at US$1.0 million equivalent or more. Withdrawal applications would be consolidated and submitted in amounts not less than SDR 190,000 (US$250,000 equivalent). Contracts for imports valued under US$5,000 equivalent would be ineligible for financing under the loan.

Co-financing and Aid Coordination

103. As indicated in para. 2, since the new Government assumed office in April 1990, IDA has played a lead role in aid coordination for Nicaragua. Five donor meetings were convened, including the Consultative Group meeting in Paris on May 16-17, 1991. Seventeen bilateral donor representatives and eight international organizations attended the meeting in which agreement on arrears clearance was obtained. The IDB will co-finance the proposed ERC with a US$110 million credit to be disbursed in two tranches. The Governments of Japan (US$70 million), Germany (US$17 million) and Switzerland (US$ 5 million) will co-finance the program. The US Government has pledged more than US$500 million in 1990 for a two-year support, of which some US$300 million has already been disbursed. Other bilateral support will come from, among others, the Nordic countries, Germany, Canada, France, the Netherlands, and Austria. Mexico, Spain, Colombia, and Venezuela are supporting Nicaragua's reform program through bridge financing for arrears clearance.

<u>Relations with International Financial Organizations</u>

104. IDA has worked closely with the IMF and IDB staff in carrying out a policy dialogue with the authorities and toward the preparation of this credit. Regular meetings were held at Headquarters and joint field missions were organized. IDB staff participated in IDA missions for the preparation of ERC, including the June 1991, appraisal mission. IMF staff have also overlapped with IDA missions. The IMF has helped the authorities to design the new stabilization program and to monitor implementation. The track record established on implementation will provide the basis for a stand-by arrangement with the IMF to be presented to the IMF Board during the first half of September. The IMF has also been asked to consider Nicaragua for ESAF eligibility. The anticipated stand-by and ESAF arrangements would provide important additional financing for the Government's program.

<u>Technical Assistance</u>

105. Technical assistance for implementing the program is crucial. Though IDA will not finance the provision of technical assistance, through its leadership in the Consultative Group and its oversight of the adjustment process, it will help organize and direct technical assistance. To facilitate IDA's policy dialogue, ERC implementation, and technical assistance coordination, IDA will set up a Resident Mission in Nicaragua later this year. The Resident Mission will provide support as the Government implements its reform program and help identify institutional weaknesses and human resource requirements. A number of initiatives have already been underway, to address the immediate shortcomings in implementing and monitoring the reform programs and strengthening the institutional framework. To meet the short- term requirements of supporting the stabilization and adjustment program the Government has followed a two-track approach. It has been working through the Consultative Group to identify a minimum set of actions for which short term technical cooperation can provide a useful basis for decision making. Additionally, recognizing that this approach only addresses the immediate gaps, the Government has been working with the UNDP, IDB, selected bilateral agencies, and the international financial institutions to strengthen key ministries.

106. A number of critical tasks will be carried out using, to the extent feasible, the short-term resources that have been made available in recent months. To support the reconstruction of the financial sector, for example, technical cooperation funds will be used to design the banking regulatory framework, and organize the Superintendency of banks. An evaluation of the loan portfolios of the two major state owned banks, as an input for financial sector reform, has already been completed. An external debt management strategy and a related accounting system are being developed. The IDA Public Sector Expenditure Review is expected to recommend, <u>inter-alia</u>, reforms in the 1992 budget cycle. In agriculture, the UNDP/IBRD Regional Unit for Technical Assistance (RUTA) is tackling the issue of property rights by reviewing a cadastral system. It will also evaluate the Government's proposals for developing and disseminating agricultural technology. In the public utilities, a management audit has been completed in the water company

(INAA), where initial efforts in infrastructure rehabilitation are likely to take place.

107. The UNDP and USAID currently are providing longer term technical cooperation funds to staff key ministries. As the implementation of reform programs gets underway, however, ministries will need to add other functions and skills. The Government has entered into consultations with the UNDP Management Development Program (MDP) to provide funds for additional staff. It expects to have these staff in place within six months. In the Ministry of the Presidency, the staff would serve as a small secretariat to the Economic Cabinet to improve coordination across various ministries in the implementation of the program. Other staff would be assigned to the Ministry of Finance to implement budget reforms, and improve expenditure planning, disbursement controls and project evaluation. Other staff would be assigned to customs and revenue offices. In the Ministry of Economy and Development, additional staff are needed to improve the data collection and processing capabilities of key economic indicators, such as price indexes and other short-term indicators of economic activity. The Ministry also needs to strengthen its regulatory capabilities, in particular in the area of natural resources. In the Ministry of External Cooperation, staff are needed to coordinate the technical cooperation process, negotiate with donors, and ensure that conditionality on these grants is met. Finally, the IDB and the IMF have joined together to provide longer term technical cooperation resources to the Central Bank to support macroeconomic policy and to develop accounting and management information systems.

108. Over the longer term, the Government will need to deepen institutional strengthening by developing a merit-based civil service reform and more efficiently utilizing new analytical skills. This is essential to the recruitment and retention of a highly professional civil service, staffed by Nicaraguans. As a first step toward these goals, the Government plans to revitalize the Public Administration Institute under the proposed UNDP Management Development Program (MDP).

Benefits and Risks

109. Economic Benefits. The proposed ERC and the associated co-financing will enable the Government of Nicaragua to implement vital structural adjustment policies, at a time when domestic resource mobilization and foreign exchange to finance are inadequate. These international resources, the adjustment program of in Government, and the re-opening of the U.S. market will permit a rapid, but modest, supply response in the short-run. Without such recovery in supply, stabilizing prices would be impossible without recourse to massive external resource transfers.

110. Implementing the policies supported by the Credit can streamline resource mobilization and use in the medium-term. Reducing the size of the public sector, reforming of the financial system, and deepening trade reform, will reorient Nicaragua's productive structure toward activities with comparative advantage. Establishing an encouraging climate for investment

through sustained stabilization and deregulation/liberalization will induce large-scale private sector participation in the economy. Increased economic activity, coupled with properly functioning markets will alleviate unemployment. Finally, maintaining a sound macroeconomic environment and fully implementing structural adjustment measures would prompt external financing, and private foreign investment for long-term sustained growth.

111. Poverty Alleviation Effects. The Government's reform program should contribute significantly to reducing poverty. In the short-term, eradication of hyperinflation, would arrest the erosion and wild fluctuation of real incomes of the poor. The price stabilization since March has created according to preliminary estimates of the cost of living a relatively less expensive minimum consumption basket, in real terms than before the stabilization package. Land distribution to ex-militia, ex-contras, and workers will also improve the standard of living of these groups. FISE is targeting public work programs to the poorest segments of the population, easing the burden of adjustment.

112. In the medium-term, the structural adjustment program, will also alleviate poverty. The real devaluation, by impacting the profitability of agricultural production, will benefit many low-income rural groups. Trade liberalization and deregulation will reorient the productive structure toward labor intensive activities. Thus labor demand will rise. Moreover, an overall resumption of efficient growth in line with Nicaragua's comparative advantage, will create productive employment.

113. Environmental Effects. The main environmental issue in Nicaragua is the erosion of forests and woodlands. Erosion is rampant in the heavily populated Pacific slopes. The topography and the nature of the soil there make the land very vulnerable to inappropriate agricultural practices. Between 5 and 10 percent of all agricultural land is estimated to be "seriously eroded" or "degraded". The rate of deforestation is high, as forests and woodlands are disappearing at a rate of 2.2 percent per year, well above average for the Central America region. Primary tropical forest is being cleared at an even higher rate. In addition, widespread and uncontrolled use of pesticides, particularly in cotton production, and the serious chemical contamination of Lake Managua challenge the environment. The project will have an indirect positive impact on the environmental issues. The regulatory framework for the administration of natural resources will consider restrictions on the exploitation of natural resources, specifically of forests. Also, realigning relative prices to their international levels will avoid excess use of pesticides and damaging chemicals in agriculture.

114. Risks. Given the actions taken to date, little doubt remains about the Government's commitment to the program of stabilization and adjustment. A far-reaching stabilization effort has been in place since March 3, 1991, and important steps have been taken towards structural adjustment. Nonetheless, given the magnitude of problems, the Government's limited implementation capability, and the fragile nature of the peace among the opposing political forces, the proposed operation faces a number of serious risks. Politically strong groups, including the military, may resist deep

cuts in budgetary allocations and slow down fiscal adjustment. Organized labor, highly politicized by the opposition party, may resort to strikes and work stoppages to obtain higher salaries and resist cuts in public sector employment. If the issue of property rights is not resolved, the private sector may be slow in making new investments, or expanding and modernizing the existing capacities. In the area of privatization, domestic and foreign investors may prove reluctant to tender offers for state enterprises if employees continue to exercise effective control over them. Also, established political/economic interest groups and the employees working in state-owned banks may resist financial sector reforms.

115. However, the Government has established a consensus behind the program, as demonstrated by the statements of the ruling coalition and the opposition party representatives in recent donor meetings. This support is expected to continue, as long as the Government can demonstrate early success with the program. At the same time, the authorities have demonstrated their resolve to establish property rights and the rule of law. This would promote private sector trust in the economy and in the system of incentives.

116. The success of the program also depends on the timely availability of donor support. Given the large financing requirements and the huge external debt to be rescheduled, mobilization of donor assistance is challenging. Any major shortfall in the size and timing of this effort could prove extremely damaging to the program's success. However, the donors' response to Nicaragua's program in recent meetings has been encouraging. The authorities are now taking a very active posture in soliciting donor support. IDA will continue to play a key role in the coordination of such efforts.

117. Another potential risk to the timely implementation of a difficult program is weakness in the administration at a technical level. To alleviate shortcomings in the implementation capacity of the administration, technical assistance programs are being designed and put into place by bilateral and multilateral organizations (paras. 105-106). This will allow the authorities to implement the reforms more speedily and effectively. The Government is expected to assemble programs to alleviate managerial and administrative problems in the medium to long term, again with the help of technical assistance programs.

V. EXTERNAL FINANCING REQUIREMENTS

118. Nicaragua's economic recovery and medium-term growth will depend critically on adequate external financing. After having addressed the arrears problem (para. 119), Nicaragua needs to reduce its external debt overhang problem so that it can begin to manage its annual debt servicing and mobilize external financing for its program. The country's resource balance deficit as well as debt and debt servicing burden are expected to remain high by international standards through the remainder of the 1990s. Under the projected base case scenario (Table 2), Nicaragua's resource gap would be 20.1

percent of GDP during 1992-96, and then fall to an average 12.7 percent of GDP per annum in the 1997-2000 period.

IFI Arrears Clearance

119. Notwithstanding the magnitude of the debt burden, arrears to the World Bank, IDA and the IDB represent the immediate constraint to the flow of international assistance. As of April 1991, arrears to both institutions were approximately US$340 million. Beginning in May 1991, Nicaragua resumed debt service to both institutions. With the arrears effectively "frozen" as of May 1991, the clearance process is expected to be finalized by September 1991. Clearing the arrears to the international financial institutions is part of the overall financing program. The process will consist of three parts: (i) a relatively short-term bridge loan of approximately US$195 million, provided by Mexico, Colombia, Spain and Venezuela that would be repaid from the first tranche disbursements of the IDA, IMF, and IDB fast disbursing operations, and other cofinanciers (Japan, Switzerland, and Germany); (ii) some US$30 million in longer-term loans to be provided by Venezuela and Spain; and (iii) specific contributions made by bilateral donors for the purpose of arrears clearance for the remaining US$115 million from the USA, the Netherlands, Germany, France, Canada, Switzerland, Norway, Korea and Denmark.

External Debt Overhang

120. At the end of 1990, Nicaragua's total external debt amounted to US$10,585 million (including US$4,110 million in principal and interest arrears) of which US$7,081 million (67 percent) was owed to bilateral creditors, US$1,300 million (12 percent) to multilaterals, US$1,867 million (18 percent) to commercial banks, US$71 million (0.7 percent) to suppliers, and US$267 million (2.3 percent) to other creditors. To illustrate the gravity of the situation, if Nicaragua does not get debt relief on favorable terms, the outcome is illustrated in Tables 3 and 4. Under the assumptions that all arrears are cleared in 1991 and all debt service as due is paid to all creditors, the 1991 financing gap is projected at US$3.2 billion (Table 3); of this, US$2.5 billion is payment of non-multilateral arrears. Assuming further, that Nicaragua would service its external debt obligations as due throughout the 1990s, the country's external financing requirements would grow from US$887 million in 1992 to US$1.8 billion by the year 2000 (Table 3); the average annual financing gap would reach a staggering US$1.3 billion (63 percent of GDP on average) in the 1992-2000 period. The foreign debt would be on average five times the country's GDP for the remainder of the 1990s (Table 4). Gaps of this size are obviously unsustainable and cannot realistically be financed. Measures to significantly and drastically reduce Nicaragua's debt burden will have to be found.

121. The Government has taken a number of steps to address this situation. It has renegotiated its debt with Mexico and Venezuela (totalling some US$1.3b) on highly favorable terms (including substantial debt reduction) and hopes to reach a similar agreement with the USSR and Eastern Bloc countries (US$3.7b). It expects to begin negotiations with the Paris Club

donors later in 1991 as part of its debt management program. At this stage it is not possible to predict the outcome of these discussions. Commercial bank negotiations have also not yet begun and are unlikely to occur before 1992.

Table 3: Projected Financing Plan, 1991-2000
(US$ Millions)
(Debt Service as due)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Gross Financing Requirements	(3,962)	(1,035)	(1,010)	(1,330)	(1,290)	(1,492)	(1,544)	(1,692)	(1,854)	(2,026)
Resource Balance	(357)	(338)	(342)	(351)	(357)	(350)	(336)	(326)	(321)	(311)
Net Non-Interest Factor Income	10	16	16	15	14	13	11	8	4	(1)
Interest Payments a/	290	414	490	693	656	735	814	896	989	1,086
Amortization Payments a/	3,325	282	174	278	270	406	390	462	532	610
Buildup of Reserves	0	(18)	(21)	(24)	(22)	(14)	(13)	(16)	(17)	(18)
Sources	3,962	1,035	1,010	1,330	1,290	1,492	1,544	1,692	1,854	2,026
Private Transfers	50	50	50	50	50	50	50	50	50	50
Official Capital Grants	482	0	0	0	0	0	0	0	0	0
Net Direct Investment	10	30	40	50	60	75	90	105	120	135
Pipeline Disbursements	188	68	0	0	0	0	0	0	0	0
Financing Gap b/	3,232	887	920	1,230	1,180	1,367	1,404	1,537	1,684	1,841

a/ Includes debt service on arrears & existing debt, on pipeline disbursements, and on gap financing.
b/ Accounts for clearance of arrears to all creditors, except East Bloc and oil exporters, in 1991. Financing gap terms are 20 years maturity, 5 years grace, and 8% p.a. interest rate.

Table 4: FINANCING GAP AND CREDITWORTHINESS RATIOS, 1991-2000
(US$ Millions)
(Debt Service as due)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Financing Gap	3,232	887	920	1,230	1,180	1,367	1,404	1,537	1,684	1,841
Total Debt a/	6,275	6,948	7,694	8,646	9,557	10,518	11,531	12,606	13,738	14,990
Total Amortization Payments	3,325	282	174	278	270	406	390	462	532	610
Total Interest Payments	290	414	490	693	656	735	814	896	989	1,086
Total Debt Service Payments	3,615	696	664	970	926	1,141	1,205	1,357	1,521	1,696
Debt/GDP	442	466	487	505	506	509	516	516	516	515
Debt/Exports	1,539	1,462	1,464	1,491	1,447	1,398	1,360	1,317	1,289	1,260
Interest/GDP	20	28	31	40	35	36	36	37	37	37
Interest/Exports	71	87	93	119	99	98	96	94	93	91
Debt Service/GDP	234	47	42	57	49	55	54	56	57	58
Debt Service/Exports	886	147	126	167	140	152	142	142	142	142

a/ Excludes East Bloc and Oil Exporters.
Source: World Bank estimates.

External Resource Requirements

122. Two debt reduction and debt management scenarios have been developed to illustrate the impact of debt and debt servicing rescheduling/reduction on Nicaragua's external financing requirements during the 1990s. Both scenarios assume that arrears to the IFIs (IBRD, IDA, IDB) will be cleared and debt servicing to those institutions resumed in 1991. Under the "Toronto like" scenario, principal and interest on bilateral debts (excluding Mexico, Venezuela and the former Eastern Bloc countries for which negotiations have been completed or are nearing completion) are assumed to be

rescheduled approximating Toronto terms.[1/] The external financing gap is reduced to an average US$648 million per annum for the 1992-2000 period. While this is less than half of the "payment as due" scenario, it is extremely high considering the level of external finance likely.

Table 5: FINANCING GAP AND CREDITWORTHINESS RATIOS, 1991-2000
(US$ Millions)
("Toronto-like" Scenario)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Financing Gap	14	507	628	657	679	666	669	675	676	678
Total Debt a/	6,141	6,716	7,324	8,083	8,740	9,384	10,018	10,667	11,282	11,918
Total Amortization Payments	357	71	73	72	70	60	62	69	62	61
Total Interest Payments	40	245	299	325	354	380	408	427	450	471
Total Debt Service Payments	397	316	372	398	425	440	470	496	513	533
Debt/GDP	432	451	464	472	463	454	448	436	423	410
Debt/Exports	1,506	1,414	1,394	1,393	1,323	1,247	1,182	1,112	1,057	1,001
Interest/GDP	3	16	19	19	19	18	18	17	17	16
Interest/Exports	10	52	57	56	54	51	48	45	42	40
Debt Service/GDP	28	21	24	23	22	21	21	20	19	18
Debt Service/Exports	97	66	71	69	64	59	55	52	48	45

a/ Excludes East Bloc and Oil Exporters.
Source: World Bank estimates.

123. The second alternative debt reduction scenario (called "Beyond Toronto Terms") incorporates debt forgiveness on the order of two-thirds of the bilateral debt stock (again excluding Mexico, Venezuela and the former Eastern Block countries). That brings the projected financing gap down to some US$425 million per annum for the 1992-2000 period (from US$450 million in 1993 to US$405 million in 2000). Table 6 shows the details of this scenario. The debt forgiveness element lowers the debt/GDP ratio to some 210 percent on average in the 1992-2000 period. Interest payments are reduced drastically to some 10-20 percent of exports during the decade.

Table 6: FINANCING GAP AND CREDITWORTHINESS RATIOS, 1991-2000
(US$ Millions)
("Beyond Toronto" Terms)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Financing Gap	14	326	450	463	468	441	431	426	415	405
Total Debt a/	6,141	2,837	3,233	3,683	4,098	4,493	4,872	5,237	5,596	5,947
Total Amortization Payments	357	89	92	91	89	79	81	88	81	80
Total Interest Payments	40	65	101	113	125	136	151	159	170	180
Total Debt Service Payments	397	154	193	204	214	215	232	247	252	260
Debt/GDP	432	190	205	215	217	218	218	214	210	204
Debt/Exports	1,506	597	615	635	620	597	575	547	524	500
Interest/GDP	3	4	6	7	7	7	7	6	6	6
Interest/Exports	10	14	19	19	19	18	18	17	16	15
Debt Service/GDP	28	10	12	12	11	10	10	10	9	9
Debt Service/Exports	97	32	37	35	32	29	27	26	24	22

a/ Excludes East Bloc and Oil Exporters.
Source: World Bank estimates.

1/ Bilateral debt is rescheduled, with 14 years maturity, 8 years grace and 3.5% interest p.a.. Nicaragua's interest payments would approximate those under an application of Toronto terms to all bilateral debt.

124. While the above two scenarios (particularly the last one) represent a significant improvement over the "debt service as due" case, it is evident that Nicaragua's economic program will depend heavily on additional external financial assistance for the foreseeable future. The donor community has already expressed a considerable interest in supporting Nicaragua. It has been demonstrated that aid flows of around US$400 million per annum realistically may be mobilized through the Consultative Group mechanism, if the Government stays on course with stabilization and adjustment program targets. Therefore, it appears possible to finance a gap on the order implied by the "beyond Toronto-terms". Since the first year's external financing requirements are basically met, timely efforts are needed to ensure the availability of external resources in 1992 and beyond. IDA will continue to play a key role in this process through the Consultative Group mechanism.

V. RECOMMENDATION

125. I am satisfied that the proposed credit would comply with the Articles of Agreement of IDA and recommend that the Executive Directors approve the proposed credit.

Lewis T. Preston
President

Attachments

Washington, D.C.
September 3, 1991

NICARAGUA -- Key Indicators

(In percentages unless otherwise noted)

Base Case Projection a./

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	Actual 1980	Actual 1987	Actual 1988	Actual 1989	Est. 1990	Projected 1991	Projected 1992	Projected 1993	Projected 1995	Projected 2000
Real Growth Rates:										
Gross Domestic Product (GDP)	4.6	-0.7	-15.0	-2.8	-6.4	1.0	3.0	4.0	5.0	4.5
Gross Domestic Income (GDY)	..	..	..	..	-6.7	1.3	5.0	3.9	4.9	4.4
Real per Capita Growth Rates:										
Gross Domestic Product (GDP)	1.2	-4.1	-17.8	-5.9	-7.3	-2.0	-0.1	1.0	1.9	1.7
Total Consumption	16.7	-2.6	-19.1	-9.9	-6.2	-0.9	-2.8	-1.2	-0.2	0.1
Private Consumption	13.9	-6.5	2.2	-10.7	-5.1	1.7	-2.8	3.1	0.3	-0.1
Debt and Debt Service (LT+IMF+ST): b./										
Total DOD (US$M)	1,964	6,984	7,488	8,267	8,819	6,275	6,948	7,694	9,557	14,993
DOD/GDP	163.7	464.7	546.3	624.9	658.4	441.7	466.5	487.5	506.3	515.3
Debt Service (US$M)	..	..	..	..	..	3,615	696	664	926	1,696
Debt Service/Exports	..	..	..	..	..	886.5	146.5	126.3	140.2	142.5
Debt Service/GDP	..	..	..	..	..	254.5	46.7	42.1	49.1	58.3
Interest Burden (LT+IMF+ST): b./										
Interest Paid (US$M)	..	..	..	..	..	290	414	490	656	1,086
Interest/Exports	..	..	..	..	..	71.2	87.2	93.3	99.4	91.3
Interest/GDP	..	..	..	..	..	20.4	27.8	31.0	34.8	37.3
Gross Investment/GDP c./	16.8	15.8	15.0	13.0	13.0	12.0	15.0	16.0	16.5	16.3
ICORs (one year lag)	..	..	..	..	..	..	..	3.7	3.2	3.6
Domestic Savings/GDP c./	-2.3	13.8	-24.6	-11.7	-12.8	-13.2	-7.7	-5.7	-2.5	5.3
BOP Resource Balance/GDP	-36.0	-37.9	-39.6	-24.7	-25.8	-25.2	-22.7	-21.6	-18.9	-10.7
National Savings/GDP	..	..	-28.1	-14.5	-16.7	2.8	-27.7	-28.8	-31.5	-28.5
BOP Current Account Balance/GDP d./	-46.2	-51.8	-56.9	-40.3	-42.7	-39.6	-39.3	-41.6	-45.3	-42.8
Government Investment/GDP e./	6.5	..	4.7	2.7	1.3	6.2	7.5	7.4	6.5	4.5
Government Savings/GDP	..	..	-36.8	-17.7	-29.9	-5.4	-1.4	2.0	3.6	5.2
Private Investment/GDP e./	10.1	..	10.3	10.3	11.7	5.8	7.5	8.6	10.0	11.5
Private Savings/GDP	..	..	-5.0	-9.5	0.2	-25.8	-26.3	-30.8	-35.1	-33.8
Government Revenues/GDP	..	29.8	23.3	24.6	17.2	22.6	23.7	23.9	23.5	22.2
Government Expenditures/GDP	..	47.9	49.8	29.9	42.8	34.8	32.6	29.3	26.5	21.5
Budget Deficit (-) or Surplus/GDP	..	-18.1	-26.5	-5.3	-25.6	-12.2	-8.9	-5.4	-2.9	0.7
Consumer Price Index (% growth rate)	35.0	912.0	14316.0	4770.0	7485.0	2850.1	40.9	20.3	11.2	10.0
GDP Deflator (% growth rate)	37.0	523.0	13233.0	5897.0	7485.0	2850.1	40.9	20.3	11.2	10.0
Real Exchange Rate (1989=100)	42	3,395	167	100	163	132	132	132	132	132
Terms of Trade Index (1989=100)	..	..	..	100	91	92	99	99	96	96
Exports (GNFS) Volume Growth Rate	-40.6	-1.0	-10.6	7.5	9.9	2.9	8.7	8.0	8.5	6.4
Exports (GNFS)/GDP	41.0	21.6	23.0	25.7	28.0	28.0	30.7	32.1	33.7	39.6
Imports (GNFS) Volume Growth Rate	81.6	3.5	-5.7	-15.2	0.3	2.6	6.1	3.9	3.9	3.0
Imports (GNFS)/GDP	77.0	59.5	62.6	50.4	53.8	53.2	53.4	53.7	52.6	50.3
BOP Current Account Balance (US$M) d./	-554.0	-778.1	-779.4	-532.7	-571.6	-562.8	-585.7	-656.4	-855.5	-1246.2
Net Reserves (US$M)	-208.5	-814.3	-800.9	-869.6	-1087.8	-1087.8	-1070.2	-1049.5	-1004.0	-925.9
Gross Reserves (months imports)	..	..	0.8	2.1	1.3	1.3	1.5	1.7	2.0	2.0

a./ Estimated and projected data are based on RMSM estimates, except for debt data.
b./ Figures for projected years based on Financing Scenario "As Due". This scenario excludes debt to former Eastern Bloc countries and Latin American Oil Exporters.
c./ Official data on gross domestic investment for 1988-90 were adjusted due to overestimation in the national accounts.
d./ Figures for projected years based on RMSM Financing Scenario (Annex A4). Excludes official grants.
e./ Public Investment refers to Non-Financial Public Sector only, i.e. excludes APP enterprises. Private Investment makes up for the difference.

NICARAGUA - NATIONAL ACCOUNTS

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Part A: Current Price Data
(As Percentage of GDP)

Base Case Projection
Per Capita GNP in US$: ca. 500 (1990)
Mid-year Population: 3.86 millions

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Imports (GNFS)	43.3	13.8	62.6	50.4	53.8	53.2	53.4	53.7	52.6	50.3
Exports (GNFS)	24.2	11.8	23.0	25.7	28.0	28.0	30.7	32.1	33.7	39.6
Resource Balance	-19.0	-2.0	-39.6	-24.7	-25.8	-25.2	-22.7	-21.6	-18.9	-10.7
Total Expenditures	119.0	102.0	139.6	124.7	125.8	125.2	122.7	121.6	118.9	110.7
Total Consumption	102.3	86.2	124.6	111.7	112.8	113.2	107.7	105.7	102.5	94.7
Government	19.7	34.2	35.3	23.3	24.0	21.8	20.7	16.6	15.1	13.1
Private	82.5	52.0	89.3	88.4	88.8	91.6	87.0	89.1	87.3	81.6
Gross Domestic Investment 1/	16.8	15.8	15.0	13.0	13.0	12.0	15.0	16.0	16.5	16.0
Government	..	..	19.4	16.9	6.1	8.0	9.3	7.4	6.5	4.5
Private	..	..	-4.4	-3.9	6.9	4.0	5.7	8.6	10.0	11.5
Memorandum Item:										
Domestic Saving	-2.3	13.8	-24.6	-11.7	-12.8	-13.2	-7.7	-5.7	-2.5	5.3

1/ Official data for 1988-90 were adjusted due to overestimation in the national accounts. Private investment includes increase in stocks for historical years.

Part B: Constant Price Data
(Millions of Cordobas, 1980=100)

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Gross Domestic Product	20,799	21,100	17,936	17,433	16,666	16,833	17,338	18,031	19,785	24,774
Imports (GNFS)	8,999	6,430	6,063	5,142	5,296	5,435	5,768	5,993	6,414	7,456
Exports (GNFS)	5,039	3,250	2,907	3,125	3,434	3,533	3,839	4,146	4,897	6,986
Resource Balance	(3,960)	(3,180)	(3,156)	(2,017)	(1,861)	(1,902)	(1,929)	(1,847)	(1,517)	(470)
Total Expenditures	24,759	24,280	21,092	19,450	18,528	18,735	19,267	19,879	21,302	25,244
Total Consumption Expenditures:	21,269	19,617	16,415	15,316	14,770	15,232	14,757	14,875	15,641	18,370
Government	4,103	10,222	6,480	6,156	5,811	5,377	5,376	4,472	4,421	4,756
Private	17,166	9,395	9,935	9,160	8,959	9,855	9,381	10,403	11,220	13,614
Total Investment Expenditures:	3,490	4,663	4,678	4,134	3,757	3,503	4,510	5,003	5,661	6,874
Government	..	..	..	..	..	..	..	..	..	..
Private	..	..	..	..	..	..	..	..	..	..
Terms of Trade (TT) Effect	..	..	..	..	..	..	..	..	..	..
Gross Domestic Income	..	..	..	..	..	..	..	..	..	..
Domestic Savings (TT Adjusted)	..	..	..	..	..	..	..	..	..	..

Note: Preliminary and projected data are based on RMSM estimates.

NICARAGUA - NATIONAL ACCOUNTS

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Part C: Value Added by Sector
(Sectoral Shares in Percent)

Base Case Projection

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Agriculture	23.2	28.9	29.1	31.0	31.3	..	..	..	..	..
Industry, of which:	29.3	22.2	21.9	20.4	20.2	..	..	..	..	..
Mining	0.7	0.4	0.5	1.1	0.8	..	..	..	..	..
Manufacturing	25.6	18.7	17.8	16.1	16.3	..	..	..	..	..
Services	47.5	48.9	49.0	48.6	48.5	..	..	..	..	..
Total	100	100	100	100	100	100	100	100	100	100

Part D: Long-Term Growth Rates
(Average Annual Growth Rates)

	Actual				Est.	Projected	
	1970-75	1975-80	1980-84	1984-89	1990	1990-95	1995-2000
B. National Accounts Growth (Constant Prices)							
Gross Domestic Product m.p.	5.1	-4.2	1.9	-4.3	-4.4	3.5	4.6
Agriculture	4.9	-4.7	3.0	-5.1	-3.4	..	..
Industry	6.0	-4.1	1.9	-6.3	-4.8	..	..
(of which Manufacturing)	5.9	-0.9	2.3	-7.3	-3.3	..	..
Services 1/	4.6	-3.9	1.2	-2.8	-4.7	..	..
Exports of GNFS	8.0	-5.6	-2.7	-9.5	9.9	7.4	7.4
Imports of GNFS	5.4	9.0	-5.4	-5.7	3.0	3.9	3.1
Total Expenditures	4.5	-0.1	0.3	-3.7	-4.7	2.6	3.0
Total Consumption	4.7	0.4	-1.2	-4.0	-3.6	1.8	2.8
Private Consumption	4.5	-1.9	-9.5	-4.6	-2.2	3.5	3.0
General Government	6.7	15.9	20.8	-3.1	-5.6	-5.3	1.5
Gross Domestic Investment	3.3	-2.8	8.4	-2.4	-9.1	8.5	4.0
Fixed Investment	8.6	-7.4	8.4	-2.3	-10.2	15.1	4.0
Capacity to Import	..	..	..	..	..	..	..
Gross Domestic Income	..	..	..	..	-6.7	3.7	4.6
Gross National Income	..	..	..	..	-8.6	0.5	3.0
Gross National Product 2/	..	..	..	..	-5.9	0.3	3.1

1/ Includes electricity, gas & water.
2/ Excludes current transfers.

NICARAGUA - NATIONAL ACCOUNTS

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Part E: Annual Growth Rate

Base Case Projection

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
GDP at Market Prices:	4.6	-0.7	-15.0	-2.8	-4.4	1.0	3.0	4.0	5.0	4.5
Agriculture	-19.0	-3.2	-10.5	2.7	-3.4	..	..	..	..	..
Industry	18.1	-0.8	-25.9	-7.2	-4.8	..	..	..	..	..
Services	12.8	0.5	-10.1	-3.1	-4.7	..	..	..	..	..
Gross Domestic Income	..	..	..	..	-6.7	1.3	5.0	3.9	6.9	4.4
Total Investment	-376.2	-1.5	0.3	-11.6	-9.1	-6.8	28.8	10.9	8.3	4.5
Total Consumption	20.7	0.9	-16.3	-6.7	-3.6	2.2	0.2	1.8	2.8	2.9
Population	3.4	3.6	3.4	3.3	3.1	3.1	3.1	3.0	3.0	2.8
Per Capita:										
GDP at Market Prices	1.2	-4.3	-18.4	-6.1	-7.5	-2.0	-0.1	1.0	1.9	1.7
Total Consumption	17.3	-2.7	-19.7	-10.0	-6.7	-0.9	-2.8	-1.2	-0.2	0.1
Private Consumption	14.4	-6.8	2.4	-11.1	-5.3	1.7	-2.8	3.1	0.3	-0.1

Part F: Price Indices
(National Accounts Deflators, 1989=100)

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
GDP Deflator	0.10	12.51	1.67	100	7585	223766	315298	379358	480495	775034
Imports (GNFS)	0.06	3.28	1.67	100	9403	220831	303230	367350	467697	775766
Exports (GNFS)	0.12	11.76	1.32	100	9201	205067	300421	363243	449840	767119
Total Expenditures	0.08	9.08	1.72	100	6631	227117	313755	378322	483989	785869
Consumption	0.08	9.24	1.65	100	6413	227548	313668	378332	484783	788117
Investment	0.09	8.13	2.00	100	7363	223117	314384	378258	479101	772786
Agriculture	0.08	12.95	1.65	100	7591	..	..	..	..	..
Industry, of which:	0.12	11.35	1.71	100	7539	..	..	..	..	..
Mining	0.07	8.23	1.20	100	7587	..	..	..	..	..
Manufacturing	0.13	11.68	1.77	100	7590	..	..	..	..	..
Services	0.10	13.28	1.68	100	7586	..	..	..	..	..

Part G: Other Economic Indicators

	1974-81	1981-90	1990-95	1995-2000	1976	1981	1990
Import Elasticity based on Imports (GNFS)	..	..	..	0.7	..	..	-0.1
Marginal Saving Rates:							
Gross Domestic Saving	..	..	..	..	..	..	..
Gross National Saving	..	..	..	..	..	..	..
ICOR (period averages)	..	..	..	3.5	..	..	..
Labor Force (%):							
Agriculture	..	..	..	..	..	..	..
Industry	..	..	..	..	..	..	..
Services	..	..	..	..	..	..	..
Total	100	100	100	100	100	100	100

NICARAGUA - EXTERNAL TRADE

A: Volume, Value, and Prices

Base Case Projection

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Volume Indices 1980=100										
Merchandise Exports:										
Coffee	100.0	81.4	67.4	73.2	81.6	66.9	76.9	84.6	102.3	153.1
Cotton	100.0	235.7	177.2	124.8	122.9	135.8	163.7	198.9	281.6	499.2
Sugar	100.0	81.0	55.7	125.6	187.8	225.1	225.1	225.1	229.7	253.6
Shrimp	100.0	29.2	30.7	40.7	28.5	41.1	47.2	54.3	69.9	119.9
Beef	100.0	33.6	46.6	99.0	144.4	143.2	147.5	151.9	161.1	186.8
Bananas	100.0	70.0	67.8	68.1	84.8	98.2	112.9	129.8	171.7	278.7
Gold	100.0	46.3	51.9	94.0	63.2	79.9	82.3	84.8	90.0	104.3
Non-Traditional & Other	100.0	..	..	..	..	..	..	..	..	..
Total Merch. Exports (FOB)	100.0	..	..	..	..	..	..	..	..	..
Value-Current Prices (US$ Millions)										
Merchandise Exports:										
Coffee	166	133	85	90	68	59	71	81	116	262
Cotton	30	46	53	28	37	41	50	63	95	200
Sugar	20	20	5	17	35	37	56	54	44	65
Shrimp	27	12	9	12	10	14	17	20	28	58
Beef	59	15	19	41	65	65	66	74	87	129
Bananas	8	[illegible]	15	21	23	27	31	36	48	86
Gold	32	12	13	21	14	18	19	20	24	34
Non-Traditional & Other	103	43	37	61	71	82	90	99	130	233
Total Merch. Exports (FOB)	445	295	236	290	321	342	400	447	572	1,071
Volume Indices 1988=100										
Merchandise Imports:										
Food	..	..	100.0	86.2	141.5	141.1	143.6	147.1	155.6	179.1
Other Consumer Goods	..	..	100.0	57.6	94.7	94.6	96.1	98.4	104.1	119.8
POL and Other Energy	..	..	100.0	77.2	90.5	107.3	109.2	111.8	118.3	136.1
Intermediate Goods n.e.i.	..	..	100.0	73.9	52.6	52.4	53.5	55.0	58.8	69.4
Capital Goods	..	..	100.0	76.2	67.8	67.6	81.2	87.4	95.4	110.0
Total Merch. Imports CIF	..	..	100.0	77.8	78.2	80.2	85.1	88.5	94.7	110.1
Value-Current Prices (US$ Millions)										
Merchandise Imports:										
Food	215	88	93	80	140	146	152	158	182	258
Other Consumer Goods	43	35	27	16	27	29	30	31	36	50
POL and Other Energy	174	123	109	84	114	120	103	113	135	231
Intermediate Goods n.e.i.	340	336	256	190	143	150	155	163	189	276
Capital Goods	110	242	234	178	168	176	215	236	280	398
Total Merch. Imports CIF 1/	881	824	720	548	592	620	655	700	823	1,213
Terms of Trade Indices 1989=100										
Merchandise Export Prices	..	..	..	100.0	97.7	100.5	107.1	109.8	116.9	148.7
Merchandise Import Prices	..	..	..	100.0	107.7	109.4	108.0	111.0	121.7	154.9
Merchandise Terms of Trade	..	..	..	100.0	90.6	91.9	99.2	99.0	96.0	96.0

1/ Imports valued at f.o.b. for 1988-2000

NICARAGUA - EXTERNAL TRADE

ANNEX A2
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B: Shares of Total, and Growth Rates

Base Case Projection

	Share of Merchandise Exports and Imports (in current prices)				Export and Import Volume Growth Rates			
	Actual	Est.	Projected		Actual	Est.	Projected	
	1980	1990	1995	2000	1980-89	1990	1990-95	1995-2000
Merchandise Exports (%, % p.a.):								
Coffee	37.2	21.0	20.2	24.5	-3.6	11.4	4.6	8.4
Cotton	6.8	11.4	16.7	18.7	2.5	-1.5	18.0	12.1
Sugar	4.6	10.8	7.7	6.1	2.6	49.5	4.1	2.0
Shrimp	6.0	3.1	4.8	5.4	-9.5	-30.0	19.7	11.4
Beef	13.2	20.1	15.2	12.0	-0.1	45.8	2.2	3.0
Bananas	1.9	7.2	8.4	8.0	-4.2	24.5	15.2	10.2
Gold	7.2	4.4	4.2	3.1	-0.7	-32.8	7.3	3.0
Non-Traditional & Other	23.1	22.0	22.8	22.2	..	12.7	10.1	8.3
Total Merch. Exports (FOB)	100.0	100.0	100.0	100.0	..	13.4	8.3	8.0
Merchandise Imports (%, % p.a.):								
Food	24.4	23.6	22.2	21.3	..	64.3	1.9	2.8
Other Consumer Goods	4.9	4.6	4.3	4.2	..	64.3	1.9	2.8
POL and Other Energy	19.8	19.3	16.4	19.0	..	17.3	5.5	2.8
Intermediate Goods n.e.i.	38.5	24.1	23.0	22.7	..	-28.9	2.2	3.4
Capital Goods	12.4	28.3	34.1	32.8	..	-11.0	7.1	2.9
Total Merch. Imports (CIF) 1/	100.0	100.0	100.0	100.0	..	0.4	4.2	3.0

1/ Imports valued at f.o.b. for 1990-2000

C: Trends in Nonfactor Services

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Volume Indices 1989=100:										
Exports of Nonfactor Services	..	..	..	100	100	102	106	110	119	145
Imports of Nonfactor Services	..	..	..	100	101	102	104	107	114	135
US$ Price Indices 1989=100:										
Exports of Nonfactor Services	..	..	..	100	106	111	113	115	126	155
Imports of Nonfactor Services	..	..	..	100	106	111	113	115	126	155

NICARAGUA - BALANCE OF PAYMENTS

(US$ Millions)

Base Case Projection

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
A. Exports of Goods & NFS:	492	325	315	341	375	398	457	506	637	1,15[illegible]
1. Merchandise (FOB)	445	295	236	290	321	342	400	447	572	1,07[illegible]
2. Non-Factor Services	47	30	79	51	53	56	57	59	64	81
B. Imports of Goods & NFS:	924	895	858	667	720	755	795	848	994	1,462
2. Merchandise (FOB)	816	734	720	548	592	620	655	700	823	1,213
3. Non-Factor Services	108	161	138	119	128	135	140	147	171	249
C. Resource Balance	(433)	(570)	(543)	(326)	(345)	(357)	(338)	(342)	(357)	(31[illegible]
D. Net Factor Income:	(122)	(208)	(237)	(206)	(226)	(255)	(298)	(365)	(549)	(985)
1. Factor Receipts	19	1	2	7	10	10	18	19	24	39
2. Factor Payments 1./	141	209	239	213	236	265	316	384	572	1,02[illegible]
a. Total Interest payments	120	209	239	213	236	265	314	381	563	98[illegible]
E. Net Current Transfers :	2	..	..	..	0	50	50	50	50	50
1. Current Receipts	..	..	..	..	..	..	..	..	..	..
a. Workers' Remittances	..	..	..	..	..	..	..	..	..	..
b. Other Current Transfers	..	..	..	..	..	..	..	..	..	..
2. Current Payments	..	..	..	..	..	..	..	..	...	..
F. Current Account Balance: 1./										
1. Before Official Grants	(552)	(778)	(779)	(533)	(572)	(563)	(586)	(656)	(856)	(1,246)
2. Official Capital Grants	122	135	189	169	202	482	0	0	0	0
3. After Official Grants	(430)	(643)	(590)	(364)	(370)	(81)	(586)	(656)	(856)	(1,246)
G. Long-Term Capital Inflows n.e.i.:	64	537	382	261	214	150	603	677	877	1,265
1. Net Direct Investment	(138)	76	106	(37)	(1)	10	30	40	60	135
2. Net LT Borrowing	94	90	2	(101)	(225)	(647)	573	637	817	1,130
a. Disbursements 2./	295	490	286	286	221	169	1,404	1,265	1,411	1,735
b. Repayments 1./	(201)	(400)	(284)	(387)	(446)	(816)	(831)	(627)	(594)	(605)
3. Other LT Inflows (net)	108	372	273	379	441	787	(0)	(0)	0	0
H. Total Other Items (net)	149	(14)	222	55	(63)	(69)	(0)	(0)	(0)	(0)
1. Net Short Term Capital n.e.i. 3./	13	193	227	206	226	(69)	(0)	(0)	(0)	(0)
a. Interest Arrears	..	..	..	..	..	..	..	..	..	..
b. Other Net ST Capital	..	..	..	..	..	..	..	..	..	..
2. Capital Flows n.e.i.	75	8	20	0	0	0	0	0	0	0
3. Errors and Omissions	61	(215)	(25)	(150)	(287)	0	0	0	0	0
I. Change in Net Reserves [() indicates increase]	217	120	(13)	68	218	0	(18)	(21)	(22)	(18)
1. Net Credit from the IMF	..	..	..	..	..	..	..	..	..	..
2. Reserve Changes n.e.i.	..	..	..	..	..	..	..	..	..	..
3. Escrow Account	..	..	..	..	..	..	..	..	..	..

1./ Based on RMSM financing scenario (Annex A6), thus may differ from Key Indicators table as well as text tables.
2./ Includes unidentified financing for projected years. Based on RMSM financing scenario.
3./ Includes US$315 Mls. of payment of multilateral arrears in 1991.

NICARAGUA - BALANCE OF PAYMENTS

(US$ Millions)

Base Case Projection

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
J. As Shares of GDP (current US$): 1./										
1. Resource Balance	-36.0%	-37.9%	-39.6%	-24.7%	-25.8%	-25.2%	-22.7%	-21.6%	-18.9%	-10.7%
2. MLT Interest Payments	10.0%	13.9%	17.5%	16.1%	17.6%	18.7%	21.1%	24.1%	29.8%	33.8%
3. Current Account Balance	-46.0%	-51.8%	-56.8%	-40.3%	-42.7%	-39.6%	-39.3%	-41.6%	-45.3%	-42.8%
4. LT Capital Inflow (line G)	5.3%	35.7%	27.9%	18.2%	16.0%	10.6%	40.5%	42.9%	46.5%	43.5%
5. Net Credit from the IMF	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
K. Foreign Exchange Reserves:										
1. Gross Reserves (excluding gold)	..	..	..	..	..	..	..	..	..	..
2. Gold (end-year London price)	..	..	..	..	..	..	..	..	..	..
3. Gross Reserves (including gold)	0.0	0.0	58.7	116.9	75.2	81.8	99.4	120.1	165.6	243.7
4. Net Res. in Months Imports	..	..	0.8	2.1	1.3	1.3	1.5	1.7	2.0	2.3
L. Exchange Rates:										
1. In Nominal Terms 2./ (C$/US$):										
a. Primary (Official) Rate										
Annual Average	0.01	0.07	191	15655	689819	4.33	7.50	8.86	10.29	13.49
End-of-Year	0.01	0.07	920	38150	3000000	..	..	..	..	..
b. GDP Conversion Factor	0.02	1.79	223	13463	964602	5.42	7.50	8.86	10.29	13.49
2. In Real Terms (base 1989=100):										
a. MUV (PAC estimates)	76	94	101	100	106	111	113	115	126	155
b. Index Real Exchange Rate (US$/C$) (increase = app.)	62	3395	167	100	163	132	132	132	132	132
M. Memorandum Item:										
GDP (US$ Million) 3./	1200	1503	1371	1323	1339	1421	1489	1578	1888	2909
GDP curr. cordobas 4./	0.021	2.696	306	17812	1291602	7697	11171	13978	19426	39235

1./ Based on RMSM financing scenario (Annex A4), thus may differ from Key Indicators table as well as text tables.
2./ Amounts in New Cordobas which were introduced with the monetary reform in 1988; and in Cordobas Oro for 1991-2000. The GDP conversion factor is set equal to the implicit nominal exchange rate.
3./ The 1980 US$ GDP was converted from the local currency with the parallel market exchange rate. In subsequent years, US dollar GDP is a product of that year's change in real GDP, the change in the G-5 MUV LDC weights for that year, and the previous year's US dollar GDP.
4./ In billion New Cordobas thru 1990; in million Cordobas Oro for 1991-2000.

NICARAGUA - EXTERNAL CAPITAL AND DEBT 1./

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Base Case Projection

(US$ Millions)

	Actual				Est.	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
A. Disbursements:										
1. Public & P.Guar. LT	..	..	285.9	286.3	221.0	188.0	67.9	0.0	0.0	0.0
Official Creditors	..	..	284.6	281.2	220.8	188.0	67.9	0.0	0.0	0.0
Multilateral	..	..	11.2	4.0	1.8	16.0	0.0	0.0	0.0	0.0
of which IBRD	..	..	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which IDA	..	..	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	..	..	273.4	277.2	219.0	172.0	67.9	0.0	0.0	0.0
Private Creditors	..	..	1.3	5.1	0.2	0.0	0.0	0.0	0.0	0.0
Suppliers	..	..	0.0	3.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial Markets	..	..	1.3	2.0	0.2	0.0	0.0	0.0	0.0	0.0
2. Private Non-Guar. LT	..	..	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Total LT Disbursements	..	..	285.9	286.3	221.0	188.0	67.9	0.0	0.0	0.0
4. IMF Purchases	..	..	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5. Net Short-Term Capital	..	..	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
6. Unidentified Sources	..	..	0.0	0.0	-0.0	-18.9	1336.1	1264.5	1611.4	1734.7
7. Total (all sources)	..	..	285.9	286.3	221.0	169.1	1,404.0	1,264.5	1,411.4	1,734.7
B. Repayments:										
1. Public & P.Guar. LT	..	..	283.8	387.0	438.1	809.0	826.6	623.2	590.0	228.4
Official Creditors	..	..	120.9	132.4	270.5	621.0	720.6	617.6	586.7	228.4
Multilateral	..	..	34.5	36.6	36.5	40.9	47.9	76.0	70.5	44.5
of which IBRD	..	..	13.1	8.6	7.4	11.1	11.3	11.4	9.6	4.5
of which IDA	..	..	0.3	0.2	0.3	0.7	0.7	1.1	1.1	1.7
Bilateral	..	..	86.4	115.7	234.0	580.1	672.7	541.6	516.1	183.9
Private Creditors	..	..	162.9	234.6	167.5	188.0	105.9	5.5	3.3	0.0
Suppliers	..	..	0.6	6.7	5.2	31.4	11.1	5.3	3.3	0.0
Financial Markets	..	..	162.3	227.9	162.4	156.6	94.8	0.3	0.0	0.3
2. Private Non-Guar. LT	..	..	0.0	0.0	8.3	6.7	4.2	4.2	4.3	0.4
3. Unidentified Sources	..	..	0	0	0	0	0	0	-0	376
4. Total LT Repayments	..	..	283.8	387.0	446.4	815.7	830.8	627.4	594.2	605.2
5. IMF Repurchases	..	..	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
6. Amortization Arrears	..	..	278.4	378.7	440.9	786.8	(0.0)	(0.0)	0.0	0.0
C. Interest:										
1. Public & P.Guar. LT	..	..	239.3	212.9	227.2	261.4	258.6	221.1	164.0	65.7
Official Creditors	..	..	126.1	118.3	165.0	230.1	245.2	219.5	163.4	65.7
Multilateral	..	..	44.4	36.9	37.0	23.9	22.5	43.8	32.6	13.3
of which IBRD	..	..	21.5	20.1	20.5	7.8	6.8	5.5	3.9	0.7
of which IDA	..	..	0.6	1.4	0.4	0.3	0.3	0.3	0.2	0.2
Bilateral	..	..	81.6	81.3	128.0	206.2	222.7	175.7	130.9	52.4
Private Creditors	..	..	113.2	94.6	62.2	31.4	13.4	1.5	0.5	0.0
Suppliers	..	..	1.0	5.6	2.4	7.9	5.4	1.5	0.5	0.0
Financial Markets	..	..	112.2	89.0	59.8	23.5	8.0	0.0	0.0	0.0
2. Private Non-Guar. LT	..	..	0.0	0.0	7.0	2.3	1.6	1.3	1.2	0.1
3. Total LT Interest	..	..	239.3	212.9	234.2	263.7	260.0	222.4	165.1	65.8
4. IMF Service Charges	..	..	0.0	0.0	1.9	2.4	2.4	2.4	2.4	2.4
5. Interest Paid on ST Debt	..	..	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
6. Unidentified Sources	..	..	0	0	0	-1	52	156	395	916
7. Total (all sources)	..	..	239.3	212.9	236.2	265.4	314.3	380.8	562.8	984.3
8. Interest Arrears	..	..	229.2	205.6	224.2	265.8	(0.0)	(0.0)	(0.0)	(0.0)
Memo: Tot. Arrears (Amort.+Int.):	..	..	507.6	584.3	665.1	1032.6	-0.0	-0.0	0.0	0.0

1./ Based on RMSM financing scenario. This scenario includes debt to all creditors, and assumes arrears clearance in 1991 to IBRD, IDA and IDB only, and debt service payments to all creditors for 1992 and beyond.

NICARAGUA - EXTERNAL CAPITAL AND DEBT 1./

(US$ Millions)

ANNEX A-
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Base Case Projection

	Actual				Est.	Projected				
D. External Debt (DOD)	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
1. Public & P.Guar. LT	..	..	6,705	7,479	7,999	7,378	6,619	5,996	4,565	3,0[illegible]
Official Creditors	..	..	5,370	6,130	6,632	6,199	5,544	4,929	3,506	1,95[illegible]
Multilateral	..	..	881	976	1,045	1,020	972	896	733	499
of which IBRD	..	..	159	159	159	148	136	125	104	71
of which IDA	..	..	59	59	59	58	57	56	54	48
Bilateral	..	..	4,489	5,154	5,587	5,179	4,574	4,032	2,734	1,452
Private Creditors	..	..	1,333	1,349	1,367	1,179	1,073	1,067	1,058	1,05[illegible]
Suppliers	..	..	30	43	61	29	18	13	4	([illegible])
Financial Markets	..	..	1,303	1,307	1,306	1,149	1,055	1,054	1,054	1,05[illegible]
2. Private Non-Guar. LT	..	..	68	67	65	59	54	50	42	29
3. Total Long-Term DOD	..	..	6,773	7,546	8,064	7,436	6,673	6,046	4,606	3,03[illegible]
4. IMF Credit	..	..	0	0	0	0	0	0	0	0
5. Short-Term Debt	..	..	715	722	735	735	735	735	735	735
6. Unidentified Sources	..	..	0	0	-0	-19	1317	2582	5646	12133
7. Total (all sources)	..	..	7,488	8,267	8,819	8,172	8,745	9,382	11,007	15,918
8. Accumulated Arrears	..	..	2,556	3,087	4,034	4,751	4,751	4,751	4,751	4,751
A. Interest	..	..	1,184	1,330	1,767	1,824	1,824	1,824	1,824	1,82[illegible]
B. Amortization	..	..	1,373	1,758	2,267	2,927	2,927	2,927	2,927	2,927
9. Total Debt + Acc. Arrears	..	..	8,671	9,597	10,586	9,996	10,570	11,207	12,831	17,743
Share of Public LT DOD:										
1. On Concessional Terms	..	..	..	..	..	..	..	..	..	..
2. With Variable Int. Rates	..	..	..	..	..	..	..	..	..	..
E. Bank and IDA Ratios										
1.IBRD to total LT DOD (line 3)	..	..	2.3%	2.1%	2.0%	2.0%	2.0%	2.1%	2.3%	2.3%
2.IDA to total LT DOD (line 3)	..	..	0.9%	0.8%	0.7%	0.8%	0.9%	0.9%	1.2%	1.6%
4.IBRD to total LT DS (line 3)	..	..	9.0%	9.4%	8.8%	2.9%	2.6%	2.5%	2.4%	1.0%
5.IDA to total LT DS (line 3)	..	..	0.2%	0.6%	0.2%	0.1%	0.1%	0.1%	0.2%	0.3%
F. DOD-to-Exports G&S										
1. Long-Term Debt	..	..	2136.3%	2171.9%	2096.0%	1823.7%	1404.6%	1150.7%	697.4%	523.0%
2. IMF Credit	..	..	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
3. Short-Term Debt	..	..	225.4%	207.7%	196.1%	185.1%	158.8%	143.6%	114.2%	130.1%
4. LT+IMF+ST DOD	..	..	2361.7%	2379.7%	2292.2%	2008.8%	1563.4%	1294.4%	811.6%	653.1%
5. Total Debt + Arrears	..	..	2735.0%	2762.4%	2751.4%	2451.6%	2224.7%	2133.0%	1942.6%	3058.7%
G. DOD-to-current GDP										
1. Long-Term Debt/GDP	..	..	494.0%	570.4%	602.2%	523.5%	448.0%	383.0%	244.0%	177.0%
2. IMF Credit/GDP	..	..	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
3. Short-Term Debt/GDP	..	..	52.1%	54.6%	56.4%	53.1%	50.7%	47.8%	40.0%	44.0%
4. LT+IMF+ST DOD/GDP	..	..	546.1%	624.9%	658.6%	576.6%	498.7%	430.8%	284.0%	221.0%
5. Total Debt + Arrears	..	..	632.5%	725.4%	790.6%	703.7%	709.6%	710.0%	679.7%	1035.3%
H. Debt Service/Exports G&S										
1. Public & Guaranteed LT	..	..	165.0%	172.7%	172.9%	262.5%	228.4%	160.7%	114.1%	50.7%
2. Private Non-Guaranteed LT	..	..	0.0%	0.0%	4.0%	2.2%	1.2%	1.1%	0.8%	0.1%
3. Total LT Debt Service	..	..	165.0%	172.7%	176.9%	264.7%	229.6%	161.7%	115.0%	115.7%
4. IMF Repurchases+Serv.Chgs..	..	..	0.0%	0.0%	0.5%	0.6%	0.5%	0.5%	0.4%	0.4%
5. Interest Only on ST Debt	..	..	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
6. Total (LT+IMF+ST Int.)	..	..	165.0%	172.7%	177.4%	265.3%	230.1%	162.2%	115.3%	116.1%
I. Interest Burden Ratios										
1. Total Interest/current GDP	..	..	17.5%	16.1%	17.6%	18.7%	21.1%	26.1%	29.8%	37.4%
2. Total Interest/Exports G&S	..	..	73.5%	61.3%	61.4%	65.1%	66.2%	72.5%	85.2%	169.7%

1./ Based on RMSM financing scenario. This scenario includes debt to all creditors, and assumes arrears clearance in 1991 to IBRD, IDA and IDB only, and debt service payments to all creditors for 1992 and beyond.

NICARAGUA - PUBLIC FINANCE

Base case Projection

ANNEX A5
Page 1 of 1

I. Consolidated Non-Financial Public Sector	Actual				Est.	Projected				
	1985	1987	1988	1989	1990	1991	1992	1993	1995	2000
As percent of Current GDP:										
A. Total Current Receipts	36.8	29.7	23.2	24.3	17.1	22.4	23.5	23.7	23.3	22.[illegible]
1. Tax Revenue	33.5	28.5	21.7	21.7	14.7	18.7	19.6	19.6	19.3	18.3
2. Non-Tax Current Receipts	2.5	2.1	1.4	2.4	1.2	2.1	2.1	2.1	2.1	2.[illegible]
3. Op. Surplus of Pub. Ent.	0.8	-0.9	0.1	0.2	1.2	1.6	1.8	2.0	2.0	1.6
B. Total Current Expenditures a./	47.7	41.5	42.6	26.0	41.3	27.8	24.9	21.7	19.8	16.9
1. Consumption	39.3	36.2	33.5	22.6	35.9	21.8	20.7	16.6	15.1	13.[illegible]
2. Transfers	..	..	..	..	5.4	6.0	4.2	5.1	4.6	3.7
3. Interest b./	..	..	..	..	..	..	..	..	..	..
C. Budgetary Savings	-10.9	-11.8	-19.4	-1.7	-24.2	-5.4	-1.4	2.0	3.6	5.2
D. Capital Exp. & Net Lending	12.1	6.5	7.2	3.9	1.4	7.0	7.7	7.6	6.7	4.7
1. Budgetary Investment	10.3	5.5	4.7	2.7	1.3	6.2	7.5	7.4	6.5	4.5
2. Capital Transfers	1.8	1.0	2.5	1.2	0.1	0.8	0.2	0.2	0.2	0.2
E. Capital Revenue	0.2	0.1	0.1	0.2	0.1	0.2	0.2	0.2	0.2	0.2
F. Overall Balance Financed by:	-22.8	-18.2	-26.5	-5.4	-25.5	-12.2	-8.9	-5.4	-2.9	0.7
1. Official Capital Grants	0.6	0.5	0.6	2.9	13.2	12.2	8.9	5.4	2.9	0.3
2. External Borrowing (net)	0.1	0.1	0.7	0.1	0.0	0.0	0.0	0.0	0.0	-0.7
3. Domestic Financing	22.0	17.5	25.2	2.2	12.6	0.0	0.0	0.0	0.0	0.0
G. GDP (curr. Cordobas) c./	0.115	2.696	326	17,810	1291602	7,697	11,171	13,978	19,426	39,235
II. Total Public Sector d./										
Overall Balance (deficit -)	-44.0	-37.2	-54.6	-38.9	-55.9	-28.2	..	..	..	..
Non-Financial Public Sector	-22.8	-18.2	-26.5	-5.4	-25.5	-12.2	-8.9	-5.4	-2.9	0.7
Rest of public sector	-13.1	-9.4	-3.2	-6.9	-16.8	-2.0	..	..	..	..
Central Bank losses	-2.8	-5.0	-8.5	-11.9	-1.8	-0.4	0.0	0.0	0.0	0.3
Unpaid foreign interest	-5.3	-4.6	-16.2	-16.7	-13.8	-13.6	..	..	..	..
Financing	44.0	37.2	54.4	38.9	55.9	28.2	..	..	..	..
External Financing e./	..	18.7	22.1	24.1	19.1	15.7	..	..	..	..
Domestic Financing	..	18.0	31.7	11.9	23.6	-1.1	..	..	..	..
Foreign Grants (civilian)	0.6	0.5	0.6	2.9	1.2	13.6	9.5	5.5	2.6	0.0
Foreign Grants (military)	..	..	..	..	12.0	0.0	0.0	0.0	0.0	0.0

./ In 1990 includes 12 percent of GDP in extrabudgetary military outlays financed with grants from Eastern European countries.
./ To be determined.
./ Amounts in billion New Cordobas which were introduced with the monetary reform in 88; and in million Cordobas Oro for 91-2000.
./ Excludes expropriated productive enterprises (APPs). Rest of the public sector includes the state oil company, foreign trade enterprises, and expenditures financed by external lines of credit.
./ Includes the counterpart of unpaid foreign interest.

NICARAGUA - MONEY AND CREDIT

Base case Projection

	Actual a./				Estimated
	1985	1987	1988	1989	1990
A.As percent of Current GDP:					
Money Supply (34)	47.5	3.3	62.6	21.8	21.1
Money + Quasi-Money (34+35)	64.5	3.8	65.7	24.7	26.1
Total Net Domestic Credit	77	3	86	52	91
To Government (net) (32an)	45.0	1.0	70.0	42.6	68.6
To Official Entities (32b)	..	..	..	..	..
To Private Sector (32d)	32.3	1.8	15.8	9.7	22.2
Net Foreign Assets (31n) b./	-56.9	-0.5	-826.0	-546.5	-598.2
All Other Items (net)	-39.1	-1.1	805.9	519.0	533.5
B.Offsets to expansion of MQM :					
Net Foreign Assets b./	-104.4%	-2.2%	..	-2256.2%	-2292.5%
Credit to Government	58.3%	22.4%	..	175.4%	264.2%
Credit to Official Entities	..	..	..	..	..
Credit to Private Sector	40.6%	48.1%	..	39.9%	85.6%
Net Other Assets & Liabilities	105.5%	31.7%	..	2141.0%	2042.8%
Increase in Money + Quasi-money	100.0%	100.0%	..	100.0%	100.0%

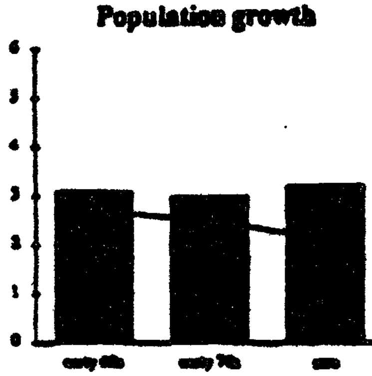
a./ Beginning 1988 there is a break in the comparability of the data.
b./ Includes Long-Term Foreign Liabilities.

Social Indicators of Development, 1990

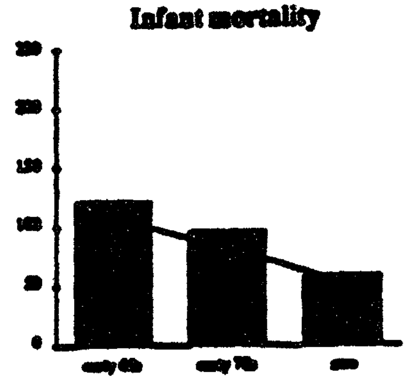
Nicaragua

	Unit of measure	25-30 years ago	15-20 years ago	Most recent estimate (mre)	Same region / income group: Latin America, Caribbean	Same region / income group: Lower-middle-income	Next higher income group
HUMAN RESOURCES							
Size, growth, structure of population							
Total population (mre = 1989)	thousands	1,750	2,408	3,740	422,417	666,815	422,994
14 and under	% of pop.	48.8	47.9	46.0	36.5	37.9	33.6
15-64	"	48.8	49.7	51.2	58.9	57.6	60.8
Age dependency ratio	unit	1.05	1.01	0.95	0.70	0.73	0.64
Percentage in urban areas	% of pop.	42.7	50.3	59.3	73.6	59.2	68.2
Females per 100 males							
Urban	number	..	116	..	104	..	..
Rural	"	..	94	..	..	..	..
Population growth rate	annual %	3.1	3.0	3.2	2.0	2.1	1.8
Urban	"	4.6	4.3	4.3	2.9	3.0	2.9
Urban/rural growth differential	difference	2.5	2.6	2.6	3.0	1.9	3.1
Projected population, 2000	thousands	..	..	5,148	514,043	831,021	510,348
Stationary population	"	..	..	13,908	..	..	..
Determinants of population growth							
Fertility							
Crude birth rate	per thou. pop.	49.2	46.1	40.0	27.9	30.0	25.5
Total fertility rate	births per woman	7.19	6.47	5.33	3.45	3.87	3.27
Contraceptive prevalence	% of women 15-49	..	..	27.0	..	..	..
Child (0-4) / woman (15-49) ratios							
Urban	per 100 women	..	64	..	..	..	..
Rural	"	..	91	..	..	..	..
Mortality							
Crude death rate	per thou. pop.	15.7	12.2	7.2	7.1	8.1	8.0
Infant mortality rate	per thou. live births	121.4	95.8	58.2	51.7	52.7	45.2
Under 5 mortality rate	"	..	..	69.5	61.6	81.5	54.4
Life expectancy at birth: overall	years	50.4	55.7	64.1	67.0	65.2	67.4
female	"	51.6	56.7	65.4	70.0	67.6	69.9
Labor force (15-64)							
Total labor force	thousands	535	722	1,162	148,480	243,588	159,186
Agriculture	% of labor force	56.7	49.1	..	..	..	..
Industry	"	15.7	15.6	..	..	..	..
Female	"	18.8	20.6	24.9	26.6	30.2	30.7
Females per 100 males							
Urban	number	..	128	..	106	..	..
Rural	"	..	94	..	88	..	..
Participation rate: overall	% of labor force	30.6	30.0	30.9	35.1	38.8	38.7
female	"	11.4	12.3	15.4	18.5	22.6	23.5
Educational attainment of labor force							
School years completed: overall	years	..	4.4	..	..	..	..
male	"	..	..	..	..	..	..
NATURAL RESOURCES							
Area	thou. sq. km	130	130	130	20,308	21,088	16,264
Density	pop. per sq. km	13	19	27	20	30	25
Agricultural land	% of land area	40.7	44.8	50.1	36.5	36.9	31.9
Agricultural density	pop. per sq. km	33	41	54	55	82	79
Forests and woodland	thou. sq. km	62	51	38	9,703	6,084	6,887
Deforestation rate (net)	annual %	-1.8	-2.1	-2.8	-0.5	-0.7	-0.4
Access to safe water	% of pop.	..	56.0	48.0	73.2	63.5	79.7
Urban	"	..	100.0	76.0	83.6	77.2	90.4
Rural	"	..	14.0	11.0	52.6	46.8	63.2

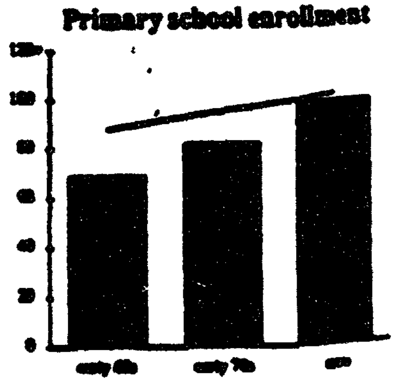
Population growth



Infant mortality



Primary school enrollment



Social Indicators of Development, 1990

Nicaragua

	Unit of measure	25-30 years ago	15-20 years ago	Most recent estimate (mre)	Same region / income group: Latin America, Caribbean	Same region / income group: Lower-middle-income	Next higher income group
INCOME AND POVERTY							
Income							
GNP per capita (mre = 1987)	US$	320	630		1,950	1,320	3,810
Total household income							
Share to top 10% of households	% of income	..	..	..	..	..	..
Share to top 20% of households	"	..	65	..	..	..	..
Share to bottom 40% of households	"	..	9	..	..	..	..
Share to bottom 20% of households	"	..	3	..	..	..	..
Poverty							
Absolute poverty income: urban	US$ per person	..	..	..	..	..	..
rural		..	..	..	..	..	..
Pop. in absolute poverty: urban	% of pop.	..	..	..	..	..	..
rural		..	..	..	..	..	..
Prevalence of malnutrition (under 5)	% of age group	..	..	22.1	..	..	..
EXPENDITURE							
Food	% of GDP	..	..	..	..	..	..
Staples	"	..	..	..	..	..	..
Meat, fish, milk, cheese, eggs		..	..	..	..	..	..
Cereal imports	thou. metric tonnes	54	58	129	17,357	40,386	36,788
Food aid in cereals	"	..	3	87	..	7,767	..
Food production per capita	1979-81=100	98.7	115.3	58.5	103.8	99.9	102.9
Share of agriculture in GDP	% of GDP	25.1	22.5	29.6	10.1	13.2	13.1
Daily calorie supply	calories per person	2,398	2,374	2,361	2,728	2,741	2,980
Daily protein supply	grams per person	69	69	57	69	71	77
Housing	% of GDP	..	..	..	..	..	
Average household size	persons per household	6	..	..	..	..	
Urban		6	..	..	..	..	.
Fixed investment: housing	% of GDP	..	..	..	..	..	
Fuel and power	% of GDP	..	..	..	..	..	..
Energy consumption per capita	kg of oil equivalent	172.1	293.4	255.8	967.1	843.7	1,537.7
Households with electricity							
Urban	% of households	..	..	..	..	..	..
Rural	"	..	..	..	..	..	..
Transport and communication	% of GDP	..	..	..	..	..	..
Population per passenger car	persons	135	66	84	17	30	15
Fixed investment: transport equipment	% of GDP	..	..	..	..	..	..
Total road length	km	..	..	..	..	..	..
Population per telephone	persons	..	67	61	12	17	8
INVESTMENT IN HUMAN CAPITAL							
Medical care	% of GDP	..	..	..	..	..	..
Population per: physician	persons	2,498	2,098	1,498	938	1,551	1,020
nurse	"	1,390	..	534	879	..	601
hospital bed	"	..	400	400	..	..	..
Access to health care	% of pop.	..	..	..	..	..	..
Immunized (under 12 months): measles	% of age group	..	..	44.0	52.7	62.9	..
DPT		..	..	43.0	62.4	63.2	..
Oral Rehydration Therapy use (under 5)	% of cases	..	..	23.0	33.6	27.5	..
Education	% of GDP	..	..	..	..	..	..
Gross enrollment ratios							
Primary: total	% of school-age group	69.0	82.0	99.0	106.8	102.0	102.6
female	"	69.0	85.0	104.0	105.4	101.1	99.7
Secondary: total	"	14.0	24.0	43.0	47.9	51.1	55.9
female	"	13.0	24.0	58.0	51.3	52.4	56.5
Tertiary: science/engineering	% of tertiary students	9.7	..	20.2	..	..	..
Pupil-teacher ratio: primary	pupils per teacher	34	39	32	24	26	23
secondary	"	17	41	35	..	17	..
Pupils reaching grade 4	% of cohort	..	47.9	60.9	69.3	..	75.4
Repeater rate: primary	% of total enrollment	..	13.7	14.6	19.6	8.6	
Illiteracy rate: overall	% of pop. (age 15+)	50.4	42.5	..	16.7	25.4	
female	% of females (age 15+)	..	..	..	19.0	31.6	..
Newspaper circulation	per thou. pop.	46.3	37.8	46.5	81.7	78.9	83.0

Source: World Bank International Economics Department, September 1990.

MINISTERIO DE LA PRESIDENCIA

LETTER OF DEVELOPMENT POLICY

Managua, July 25, 1991 (9:26am)

Mr. Barber B. Conable
President
The World Bank
Washington, D.C. 20433

Dear Mr. Conable,

1. After free elections in February 1990, the Chamorro Government took office in April 1990 inheriting a devastated economy which was performing at extremely depressed levels compared to a decade earlier. Private sector participation in the economy was minimal due to extensive public sector intervention through ownership, monopoly, and regulation of economic activities as well as heavy domestic and external resource use. This, coupled with mismanagement of economic policy, resulted in major inefficiencies of resource use and production, and reduced domestic savings and productive investment. Additionally, the economy was highly unstable, with hyper-inflation reaching about 34,000 percent p.a. in 1988.

2. From the beginning of its regime the new Government has pursued a reform strategy which emphasizes the importance of establishing and maintaining price stability and structural adjustment. The main focus of the strategy has been to reduce the size of the public sector, to realign relative prices, and to achieve the preconditions of a market economy. In line with this strategy, the Government has adopted a set of policies in the areas of expenditure reduction, tax reform, monetary and exchange rate policy, and trade liberalization.

3. After achieving some initial success in reducing the rate of inflation in 1990, the Government's economic policies came under pressure from extended strikes and other political difficulties. Under more relaxed fiscal and monetary practices, inflationary pressures increased and the year was closed with a decline in output and more than 7,000 percent annual rate of inflation. Nonetheless, the Government was successful in restoring peace to the country and in formally achieving a consensus among the different groups in the society. A "concertación" agreement was successfully concluded among the Government, labor, business, and the Sandinista opposition in October 1990, which would pave the way for successful implementation of the Government's economic policies.

I. THE STABILIZATION PROGRAM

4. After consultation with international organizations including the IMF and the World Bank, the Government announced a far reaching stabilization program on March 3, 1991. The main elements of the stabilization program included:

Changing the official parity of the córdoba (oro) from 1 C$ to 5 C$ per dollar. Convertibility at that rate for trade purposes will be progressively increased with the aim of achieving free convertibility by year's end. The old córdoba was taken out of circulation completely by April 30, 1991.

Committing, from March 4 onward, to refrain from emitting any new money that is not backed by international reserves. The Central Bank will not extend credit to finance the public sector deficit, and it will give credit to the banking system only to the extent that it is backed by corresponding foreign currency inflows.

Pursuing public sector wage policies which are consistent with reducing inflation and maintaining fiscal discipline. Revenues will be increased primarily by widening the tax base. Expenditures will be strictly limited to tax revenues plus actual receipts from foreign grants and loans, and the government payroll will be gradually reduced through a voluntary program of job reconversion.

5. This stabilization program has been closely scrutinized by the international community. In various fora the IMF, the World Bank, and the IDB, and bilateral donors have strongly endorsed the program and have acknowledged the Government's decisiveness in implementing such a program under strenuous economic, social, and political circumstances.

6. The results of the implementation of the stabilization program are very encouraging. After eleven months of weekly inflation rates ranging from 6 to 20 percent, the rate of inflation declined quickly after the corrective shock following the March 3 devaluation, and amounted to only 12 percent from end-March to end-April, becoming negative in May. Industrial sales recovered significantly from February to May and were at higher levels than a year before.

II. THE STRUCTURAL ADJUSTMENT PROGRAM

7. The Government considers that stabilization and structural adjustment are preconditions to economic recovery after many years of depression, and that they also pave the way to sustained growth with equity. It is our conviction that, without economic recovery, stabilization will not last very long, and without stabilization and establishment of a supporting macroeconomic environment, our adjustment efforts will be unproductive. Consequently, the Government is now poised to intensify its efforts toward structural adjustment. The main elements of this program have been discussed with the World Bank staff, and the final design of the program has benefitted from these discussions.

Medium Term Macroeconomic Framework

8. The Government attaches primary importance to maintaining macroeconomic policies which support the objectives of structural adjustment. To this end, we are committed to pursuing the following:

Fiscal policy which maintains the proper balance between revenues and expenditures, and which avoids recourse to Central Bank financing. While the need for external financing will continue in decreasing magnitudes, the objective is to achieve a balance between Government revenues and non-interest current expenditures by 1993 through expenditure rationalization and improvements in revenue performance.

Monetary policy which encourages financial resource mobilization and improves the efficiency of resource allocation. Together with financial sector reforms, this will be achieved through the maintenance of positive real interest rates and eventual interest rate liberalization. The Government will ensure the consistency of the monetary program with the objectives of stabilization and adjustment, which will put tight constraints on increases in the Central Bank stock of net domestic credit.

Exchange rate policy that helps to maintain competitiveness and profitability in the tradeables sector and encourages the diversification of the country's exports. While implementing tight fiscal, monetary and income policies, we will also monitor developments closely and take actions promptly, when warranted, to account for changes in domestic and external factors.

Public Sector Reform

9. The Government's structural adjustment policies will have a particular focus on public sector reforms, financial sector reform, and reforms in the system of incentives. In the area of public sector reform, the reduction of the size of the public sector is one of our priorities. During the previous decade, the public sector sharply expanded its share in resource use as the deficit of the public sector peaked at 54 percent of GDP in 1988.

10. Expenditures. In line with our stabilization objective, we plan to keep Central Government expenditures under US$ 390 million in 1991, with US$ 338 million represented by current expenditures. This represents 63.2 percent of the current expenditures of the previous year. This drastic cut is to be achieved through the continuous rationalization of the public sector, with particular emphasis on military expenditures. The Government's objective is to ensure that in the medium term the Central Government will be a net saver, in contrast with its performance during the previous decade. To this end:

Non-interest current expenditures will be reduced by another 7 percent in 1992 from the level programmed in 1991 at US$ 330 million. To ensure this outcome, the FY1992 budget will accommodate no more than US$ 315 million of non-interest current expenditures. This outcome will be partly achieved through an approximate 15 percent cut in military expenditures.

By FY93 we will target another restructuring in the budget which will aim at reducing non-interest current expenditures by an additional 9 percent in that year, a level which we expect will correspond to Government revenue.

Beyond 1993, we will aim to cover recurring interest payments expenditures from the current budget with domestic resources, and the Central Government to produce a net savings in funds.

The Government will carry out a public expenditures review in 1991-1992, jointly with the World Bank, which will provide a basis for the restructuring of the size and composition of public expenditures. We expect to incorporate some of the resulting recommendations in FY92.

11. As part of our public sector restructuring effort, the Government has implemented an employment reconversion program which aims at voluntarily reducing the size of public sector employment. With funds from USAID, we are targeting more than 10,000 public sector employees to be retired in 1991. The program has been very successful in that more than 8,000 employees applied to take advantage of the retirement scheme. During the year, we extended the program to cover the financial public sector and state economic enterprises. We plan to continue with the program, targeting an additional 10,000 employees in the public sector, if we can obtain additional external funds in 1992.

12. **Privatization**. Another important aspect of our public sector restructuring efforts is the privatization of state owned corporations and companies. There were some 350 such entities when this government came to office. Their activities ranged from agricultural farming, to manufacturing, and to trade and other services. Some of these companies were monopolies in their respective areas of operation, while others acted as regulatory agencies. The Government aims to drastically reduce public ownership in economic activities, dismantle state monopolies, and eliminate undue regulations. After having set up an umbrella organization (CORNAP) to assume the responsibility for privatization, we formulated a strategy for divestiture. Some 86 enterprises have already been either returned to previous owners whose properties were illegally confiscated under the previous regime, liquidated, or privatized. Our goal is to accomplish the objectives of privatization rapidly. The plan is to finalize divestiture or complete preparations for privatization for at least 90 percent of enterprises by the end of 1993. In line with this objective, the Government will complete the following by March 15, 1992:

Finalize the privatization of at least 25 additional companies.

Finalize devolution, liquidation or assignation of an additional 50 companies.

Take concrete steps toward the preparation of an additional 30 companies for privatization.

13. **Public Utilities**. During the previous year, the Government was successful in eliminating the deficits of the public utilities through adjustments in their tariffs and rates. There is still a need, however, to improve their overall efficiency in operations. This will require changes in areas such as organization, incentives, autonomy and accountability of management, and decision making. To provide a framework for such changes, the Government plans to undertake, with support from the World Bank, a comprehensive study covering the various aspects of public utilities operations. This study will commence before March 1, 1992.

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14. **Tax Administration.** The Government has already taken important steps to revise the overall tax rate structure. We believe that these rate adjustments will yield their full effects, in the form of higher revenues and improved incentives, as a result particularly of the implementation of major improvements in tax administration and enforcement. The Government, therefore, has prepared a plan of action to reform the customs and internal revenue services. In accordance with this plan, the Government has already created a separate unit within the General Directorate of Revenue to improve the administration of taxes collected from the 280 largest taxpayers. Several customs posts have been relocated to improve customs control. The separate taxation unit for large contributors will serve as a pilot project for the development of a modernized tax information system and streamlined tax administration procedures. It will be extended subsequently to the entire system, and it is expected to be fully operative by August 1, 1991. Other actions that will be completed before October 1991 include:

The distribution and implementation of simplified tax declaration/payment forms and procedures.

The publication of a decree establishing stricter sanctions for tax evasive or delinquent practices.

The publication of a second decree revising the penalty structure for tax evasion and delayed tax payments in accordance with the fiscal cost of the infraction and the lateness of payments.

The relocation of all customs posts identified in the action plan.

The revision of customs valuation lists, which will be updated on a monthly basis.

15. In addition to these short term measures, the Government aims to address the main institutional weaknesses in tax administration in the context of a medium to long term strategy. Toward this end, the Govenment is planning to take steps to: (i) develop automated management control systems and a computerized taxpayer identification system, and (ii) train Customs and Internal Revenue personnel, especially in the areas of auditing and the use of computers. By March 1992, the arrangements for technical assistance to implement actions in these areas will be finalized, consultants will have been hired, and program implementation will have started.

Financial Sector Reform

16. The plan for reform of the financial sector is consistent with the overall economic reform strategy in other sectors. Through a series of regulatory changes the role of the public sector in financial intermediation activities will diminish, in such a way as to create the conditions that allow a greater private sector participation in the financial sector. The ultimate goal of the plan is to improve the efficiency of financial intermediation and resource allocation through the establishment of a competitive, free entry, private sector oriented financial system.

17. **Restructuring the State Owned Banks.** A restructuring of the state owned banks will form the cornerstone of the reform program for the financial sector. This is not only essential to attract viable private sector financial institutions to the economy, but also to eliminate the enormous cost to the Government and the economy of the current state bank system. To initiate the restructuring program the Government will adopt an action program by July 15, 1991 which incorporates the following measures:

The recharter, within 24 months, of the Banco Nacional de Desarrollo and Banco Popular to provide financial and technical assistance services for rural and agricultural development and small scale enterprise. During the transition process, BND will be transferring its commercial operations to the private banks in step with the capacity of those banks to provide these services. Both BND and BP will be funded exclusively through foreign grants and domestic resources which have been budgeted for in the Central Government. During the transition process before adoption of the new charters, both institutions will operate under competitive conditions with private sector financial institutions.

The liquidation or merger of Banco Inmobiliario with Banco Nicaragüense de Industria y Comercio (BANIC) within 6 months.

The restructuring of BANIC as a public financial institution subject to exactly the same conditions as any competing private sector financial institution, including redimensioning it to be compatible with financial viability.

The measures required for the Fondo Nicaragüense de Inversiones (FNI) to become a second-tier banking institution.

And the dissolution of the Corporación Financiera de Nicaragua (CORFIN) by March 1992.

18. By March 1992, the Government will have completed all administrative and regulatory requirements needed to implement the action plan in its entirety. Additionally, financial sector employment will have been reduced to levels compatible with financial viability and the minimum investment required to restore solvency to BANIC will have been determined. All banking functions of CORFIN will have been consolidated into the appropriate state owned banking operation, with the elimination of CORFIN.

19. **The Superintendency.** Creating and implementing a strong Superintendency is a critical element of the plan to develop a well functioning private banking system. The Superintendency has the responsibility to society at large to monitor banking activities and to enforce their compliance with established norms. Owing to the importance of this aspect of the financial sector program, a law has already been passed for The Creation of Superintendency and Financial Institutions. By July 15, 1991, additional measures will be taken:

A qualified Superintendent will be designated.

The Superintendent will be housed and at least partially staffed and equipped to assume operations.

Regulations acceptable to IDA will be issued to execute the Superintendency Law.

A financing source for any technical assistance required to prepare normatives through the Superintendency will be identified.

By October 1991, the Superintendent will have issued normatives to permit the initiation of private banking operations, and by December 1, 1991, will have approved applications for private sector financial institutions.

20. Law of Banking and Financial Institutions. The Government recognizes that a modern and comprehensive Law of Banking and Financial Institutions is necessary, to complete the legal framework to establish a financial market with free access that encourages competition, to authorize the privatization of state owned banks, and to develop modern prudential regulations.

21. By end-July 1991, the Government will produce a terms of reference for developing and implementing the new Law of Banking and Financial Institutions. The terms of reference should identify a team, a technical assistance financing source, and a timetable for the development of the new law.

22. By March 1992, a modern Law of Banking and Financial Institutions will have been developed and submitted to the National Assembly.

23. Monetary and Interest Rate Policy. Appropriate monetary and interest rate policies are not only necessary to maintain price stability, they are also crucial for the development of domestic savings and an efficient and competitive financial system. The Government has already introduced a transitional interest rate structure which indexes deposit and lending rates to the US dollar. Interest rates on domestic lines of credit have been increased to 3 percentage points above the deposit rate, also indexed to the dollar. Monetary policy is conducted with an objective of achieving price stability and reserves targets, where corresponding ceilings established for net domestic assets are met.

24. By March 1992, the Government will have introduced a new interest rate policy which completely liberalizes deposit rates and maintains only a band of control around lending rates. The band of lending rates will be sufficiently wide to allow the possibility of lending interest rates equivalent to rates in the US adjusted for currency and country risk. The rediscount rate will be uniform for all borrowers, and will lie above the average deposit rate prevailing in the financial system.

Trade Liberalization and Market Reforms

25. Private-sector driven economic growth and Nicaragua's efficient insertion into world trade require not only the retreat of the state from direct control over GDP, but also the elimination of obstacles to the functioning of internal and external markets. The Government has launched a far-reaching program of liberalization and promotion of foreign trade across all products and sectors of the economy. Measures have already been taken, and will continue to be directed, toward the elimination of entry and exit barriers to economic activities and (domestic and foreign) markets, the achievement of a neutral

foreign-trade regime, and the provision of services necessary for market transparency.

26. State Trading Monopolies. The state trading monopolies that controlled virtually all of export and most of import trade during the 1980's have been eliminated by Legislative Decree in January 1991 and substituted by a system of commercial registration at the Ministry of Economic Affairs and Development. Regulations, passed in June 1991, ensure complete automaticity, non-discretionality and transparency of the registration process. Additionally:

De facto trading monopolies, due to the dominant position and forward-integration of state-owned enterprises in certain product markets (e.g. meat and sugar), will be dealt with in the context of the government's privatization plan. Specifically, CANSA's monopoly on domestic purchases and distribution of sugar will be eliminated by March 1, 1992.

The government will take further steps to improve the legal basis of free private sector participation in foreign trade during the remainder of 1991.

27. Quantitative Restrictions. The 1980's were characterized by pervasive non-price restrictions on foreign trade. Over the past year, most of these restrictions have been eliminated. At present, and apart from currency convertibility, quantitative restrictions remain only on exports of some natural resources, basic grains, sugar and capital goods, and on imports of basic grains, sugar and products of the poultry industry. In addition:

Export permits for precious metals, timber, fish, crustacea and live cattle will be dealt with in the context of controls on exploitation (see below). Trade in basic grains will be subjected to a price band (see below).

In the case of products subject to quotas in international markets (currently: sugar), quota access conditions imply the necessity of distributing such quotas among exporters. By March 1, 1992, access to the quota will be based on a bidding system to exclude non-price rationing and minimize government discretionality.

All other quantitative restrictions on non-petroleum imports and exports (but those of basic grains) will be completely eliminated by March 1, 1992.

28. Tariff Reform. Trade liberalization and thus tariff reform is at the core of the Government of Nicaragua's program of structural adjustment and of the fundamental shift from an economic philosophy of import substitution toward incentive neutrality as the basis for Nicaragua's insertion into world markets. Even though substantial advances have already been made to reduce nominal protection and render it more uniform, a high rate dispersion and a certain lack of transparency persist.

29. Duties on imports to Nicaragua include the basic tariff (DAI) applied to imports from outside the Central American region as well as the Selective Consumption Tax (ISC) on selected imports and a flat 3 percent stamp tax on imports from all origins. Nominal protection currently ranges from 3 percent to 143 percent and averages 18 percent, the second lowest level in Central America.

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The Government of Nicaragua is committed to reduce nominal import protection and rate dispersion according to the following schedule:

By August 1991, nominal import protection (NIP) will be lowered by Decree and its dispersion reduced to a 10%-60% range. The Decrees -- and widely published public announcements to this effect -- will further include a timetable according to which, by December 1991, the NIP range will be reduced to 10%-50%, and progressively in well-defined steps to reach a tariffs-only range of 10%-20% by December of 1993. The only exceptions to this rule will be medicines and books.

By March 1992, according to the NIP reduction program, the NIP rates will have been lowered to a 10%-40% range.

So as to avoid exemptions to this regime and thus unnecessary distortions, the government will negotiate with the respective foreign agencies that in-kind donations should reach local markets under competitive conditions, and will remove income tax exemptions as well as prepare a program to phase out indirect tax exemptions, including import tax exemptions.

30. Decontrol of Foreign Exchange. Restrictions on access to foreign exchange for current account purposes are among the most damaging of quantitative restrictions. The Government of Nicaragua's move toward free trade and efficient markets therefore implies a rapid process of decontrol of foreign exchange.

Foreign exchange allocation under the Sandinista government was highly centralized and discretional. Exporters did not have guaranteed access to the foreign exchange generated by their operations. Foreign exchange retention of export proceeds by the government is not currently enforced, with the exception of the foreign exchange revenue generated by cotton and coffee exports.

Legally, the Export Promotion Decree, to be passed in August 1991, will provide exporters with unrestricted access to own-generated foreign exchange for current account operations. Similarly, the Investment Promotion Law, enacted in June 1991, guarantees foreign investors access to foreign exchange for transfers of dividends and profits as well as for the repatriation of principal.

Although the government is committed to achieve full current account convertibility of the Córdoba by March 1992, the allocation of foreign exchange from official external credit lines and donations will continue to be regulated by the Central Bank for reasons of compliance with donor and creditor restrictions. Nevertheless, the allocation process will be drastically simplified and its transparency increased, and steps will be taken to ensure that allocation will not entail rationing of eligible demand by means of non-price criteria by March 1992.

After July 1991, foreign exchange operations will be progressively transferred to the commercial banking sector.

31. Agricultural Trade. With the objectives of reducing Government intervention, barriers to private sector participation, and incentive distortions in the production and trade of basic food grains (rice, beans, maize and sorghum), an action plan has been approved that contains the following elements:

Support prices for all four products will be eliminated by August 1991. ENABAS will buy grains at prevailing market prices. ENABAS will also offer to private traders and producers storage and related services for a fee. It may also rent out part of its facilities.

Payments in kind to public sector employees (AFA package) will be monetized as part of the salary before October 1991.

A price band system with variable levies for rice, yellow corn, and white maize will be designed before August 1991, and implemented before March 1992.

Any remaining quantitative restrictions on food grain imports will be eliminated by March 1992. ENABAS will offer to private traders the service of importing on their behalf (bundling orders). An action plan for the elimination of quantitative restrictions on exports will be prepared by the same date.

ENABAS will refrain from trading in all but basic grains before March 1992. A program for privatizing its retail and wholesale outlets will be prepared by the end of 1991. At least 20 percent of its corresponding assets will be sold to wholesalers or distributed as part of severance payments to ENABAS employees, before March 1, 1992; the rest will be divested before the end of 1992.

A medium-term strategy and action plan for redefining the future role of ENABAS, restricting ENABAS intervention in regional grain markets to such markets where private competition is insufficient, and privatizing and/or leasing its facilities whenever competitive private participation can be ensured, will be prepared before March 1992.

32. **Export and Investment Promotion.** The thrust of the government's export and investment promotion policies is the elimination of the anti-export bias inherent in Nicaragua's history of controls and protection, and the provision of a clear legal framework for property rights, as illustrated by the following:

The new Export Promotion Decree, to be passed by September 1991, provides for the exemption of inputs for export production from import duties and indirect taxes. As part of the Decree, non-traditional exports will receive additional temporary incentives, in the form of negotiable tax credit certificates, to compensate for the economy's anti-export bias during the adjustment phase. The by-laws of the Decree will be elaborated by the same date and implementation is to be completed by March 1992.

The Foreign Investment Law, adopted by the National Assembly in June 1991, guarantees the foreign investor's right to profit and dividend transfers as well as the repatriation of his capital.

The Decree on Duty-Free Export Processing Zones, to be adopted before Board presentation, specifies further stimuli to exporters who meet certain minimum criteria.

Finally, one-stop administrative procedures will be in place by the end of 1991, simplifying current needs for the exporter to deal with a diverse array of government institutions.

33. Domestic Deregulation. A very significant reduction of government intervention in the economy, and the development of open and competitive markets, are necessary conditions both for a more efficient use of resources and for creating a favorable climate for the reactivation of private economic activity. Where government intervention is necessary on social or economic grounds, it will be done under transparent and equitable rules, while simplifying bureaucratic procedures to the greatest extent possible. In this context, the following actions will be taken:

The legal framework permitting price controls, except for natural monopolies, will be abrogated before March 1992.

Transitory price setting adopted for selected products in Government-owned stores will be eliminated before March 1992.

An action plan to phase out price controls of the fiscal industries and to reformulate the Selective Consumption Tax, confining it to luxury goods regardless of origin, will be prepared before March 1992.

The state institutes in charge of regulating exploitation in mining (INMINE) and fisheries (INPESCA), after separating from them their corresponding production and trade activities, will be transferred from CORNAP to MEDE before August 1991.

Terms of reference for studies to design the regulatory framework for the management of natural resources will be prepared by September 1991. This regulatory framework will be implemented before March 1992.

Any regulatory entry barriers to the private sector in other activities still remaining under CORNAP production monopolies (sugar mills, export slaughtering houses, bananas for export) will have been eliminated before August 1992.

Social Sector Programs

34. Two programs have been established to ensure that the burden of stabilization and structural adjustment does not fall most heavily on the poor.

The Emergency Job Creation program is administered by the Emergency Social Investment Fund (FISE) that was created in November, and a campaign for social protection of the most vulnerable groups (will be administered by the Fund for Attention to Oppressed Sectors (FASO):

Emergency Job Creation. The emergency job creation program (FISE) is expected to generate the equivalent of 30,000 man-years of temporary employment at a total cost of US$ 62 million in 1991, and 40,000 man-years at a cost of US$ 83 million in 1992.

Protection to Most Vulnerable Groups. The campaign for social protection (FASO), with a projected budget of US$ 87 million in 1991 and US$ 103 million in 1992, will create additional social safety nets for the most vulnerable of the society:

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Emergency feeding programs will be directed toward rural and urban child care centers, homes for invalids and the elderly indigent, and orphans of war victims. A total of 46,598 persons are expected to participate in the feeding program.

Occupational training for the unemployed will target 20,000 workers laid-off as of March 1991 and will provide them with training, free transportation and foodstuffs during the duration of the training.

A microenterprise credit program for 10,050 people will promote and protect micro-entrepreneurs working in the informal sector. The small business people will receive technical and managerial training programs and credit through the Micro-fund of the Banco Popular.

A special health support program will be added in 1992.

III. CONCLUSIONS

35. The Government of Nicaragua is committed to pursuing policies which lead to renewed and sustainable growth and an improvement in living standards for the citizens of Nicaragua. The actions and policies outlined in this letter of development policy will support both of these objectives. Since taking office in April 1990, the Government led by President Chamorro has demonstrated its commitment and political will to initiate both stabilization and adjustment measures under extremely difficult conditions. To ensure the successful completion of these programs, however, adequate financial and technical assistance from the international community are needed. In this context, we request the World Bank's fina' ial support for the implementation of our program for economic recovery and adj ıstment.

Ministro de Economía y Desarrollo

MACROECONOMIC POLICIES AND PROGRAM IMPLEMENTATION

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992 [1]
Achieve and maintain a macroeconomic policy framework consistent with the objectives of price stability, trade and exchange rate liberalization, and balance of payments equilibrium.	A stabilization program has been initiated; Cordoba was devalued by 400 percent. Expenditures targeted in line with expected revenue. Adopted cash-budgeting procedures for expenditures. Monthly credit ceilings for Central Bank credits established.	Maintenance of an appropriate macroeconomic framework, including fiscal deficit and domestic credit ceilings consistent with stabilization objectives (Board Presentation condition). Maintenance of exchange rate policy which is consistent with export competitiveness, and which reflects changes in monetary, balance of payments, and trade and foreign exchange reserve indicators. Satisfactory program implementation (Board Presentation Condition).	Maintenance of an appropriate macroeconomic framework (Second tranche condition). Satisfactory program implementation (Second tranche condition).

[1] Tentative date for second tranche release.

PUBLIC EXPENDITURES

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Large size of public sector with high total expenditures/GDP ratio and current expenditure/GDP ratio	Budgetary expenditures for FY91 have been restrained, including a significant reduction in military expenditures.	Reduction of Central Government non-interest current expenditures in the proposed FY92 budget to less than US$325 million equivalent (Board Presentation condition).	Adoption of: (a) FY92 Budget with reduced Central Government non-interest current expenditures less than US$325 million equivalent; (Second tranche condition) and (b) An action plan, satisfactory to IDA, based on recommendations of the joint Government-IDA public expenditure review (Second tranche condition).
Weak institutional capacity to plan and monitor public expenditures.			

PUBLIC SECTOR EMPLOYMENT

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Excessive public sector employment and large wage bill. Reduce public sector work force and facilitate reallocation of redundant labor to productive employment in the private sector, especially in tradeables.	Government demobilization of 35,000 military draftees and milita and retiring of 5,000 military officers. Institution of a hiring freeze in Central Government.		
	Introduction of an externally funded "employment reconversion program" to relocate 9,000 of 69,000 central government employees, including an additional 3,000 military personnel during 1991.	Completion of the processing of voluntary employment reduction in the public sector for 8,000 personnel (Board Presentation condition).	
		Preparation of an action plan to extend employment reconversion program to the entire public sector with a target of 10,000 employees including CORNAP, public utilities, and the banking sector.	Satisfactory progress in implementing the action plans for employment reconversion program.

PUBLIC UTILITIES

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Major restructuring of public utilities is needed to improve efficiency in their operations and responsiveness to the demands of a growing and competitive economy.	Elimination of indiscriminate price subsidies for the goods and services supplied by most state enterprises. Creation of an informal oversight central government committee for public utilities.		Initiation of a study, with IDA support, on Public Enterprise rationalization.

PRIVATIZATION

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Major reduction of the size of state enterprise sector. Quick sales of state enterprises to reduce the structural deficit of the public sector, to encourage private sector participation, and to generate revenue. Clarify and guarantee private property rights to remove uncertainty and foster private investment and growth.	Established CORNAP and endowed it with responsibility for both managing and privatizing about 350 state enterprises. Study completed on privatization strategy. Strategy for divestiture is worked out. 86 companies have already been returned to previous owners, liquidated or privatized, including one large group of agricultural enterprises -Hatonic-)	Adopt an action plan, satisfactory to IDA, to privatize CORNAP enterprises (<u>Board Presentation condition</u>).	Implementation of privatization plan including: completion of privatization of an additional 25 state-owned enterprises; devolution, liquidation or assignation of another 50 enterprises; and having already taken concrete steps toward the preparation of 30 additional enterprises for privatization (<u>Second tranche condition</u>).

PUBLIC REVENUE

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Increase and maintain tax revenue to ensure objectives of stabilization and non-inflationary finance of medium-term government program.	Tax reform measures were implemented, including reduction in the number of brackets in personal income tax, and reduction of top rates for personal and corporate income taxes.		
	Withholding provisions were improved, and new presumptive methods were introduced for both of above taxes.	Removal of income tax exemptions, and approval of a program to phase out indirect tax exemptions including import tax exemptions (Board Presentation condition).	Satisfactory progress in implementing the action plan to phase out indirect tax exemptions.
	The General Value Tax base was expanded and the rate increased to 15 percent.		
	Administratively granted tax exemptions were eliminated.		
Simplify and strengthen tax administration	Adoption of a plan, satisfactory to IDA, to improve tax administration with emphasis on GVT and Income Tax Collections. Preparation of a pilot project to register and collect taxes from large tax payers.	Initiation of an action plan, satisfactory to IDA, to improve tax administration with specific emphasis on GVT and income tax collections (Board Presentation condition).	Implementation of measures to strengthen tax administration including: (a) full operation of unit for large taxpayers; (b) issuance of decrees on sanctions applying to delayed payers and non-compliance; (c) relocation of customs posts indicated in the action plan; and (d) initiation of programs on automated management control, computerized taxpayer identification system, and training programs for Internal Revenue and Customs personnel (Second tranche condition).

FINANCIAL SECTOR

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Improve the allocation of financial resources by rationalizing regulations on banking activities and by strengthening instruments of monetary control	Established deposit interest rates at 12 percent and lending rates at 18 percent and tied both to dollar. Introduced a monthly deposit rate for non-indexed deposits.		Adoption of an interest rate policy which approximates rates to market rates, by setting up a band for lending rates and freeing the deposit interest rates.
Improve the efficiency of financial intermediation through the development of a profit oriented, private sector based financial system.	Assembly approved a bill for setting up a Superintendency.	Adoption of regulations, satisfactory to IDA, for the implementation of the Superintendency law. Appointment of a superintendent and start-up of Superintendency activities (Board Presentation condition). Adoption of an action program, satisfactory to IDA, for the restructuring of state-owned banks, along with cessation of Central Bank subsidies and discounts except for agriculture and micro enterprises (Board Presentation condition). Preparation of terms of reference for developing and implementing the new Law for Banking and Financial Institutions which identifies a team, a technical assistance financing source, and a timetable.	Preparation of transitory normatives to establish necessary prudential regulations. Carrying out of financial sector reforms including, (a) liquidation or merger of Banco Inmobiliario with Banco Nicaraguense de Industria y Comercio; (b) dissolution of Corporacion Financiera de Nicaragua (CORFIN); (c) demonstration of concrete steps toward the restructuring of Banco Nicaraguense de Industria y Comercio, Banco Nacional de Desarrollo, and Banco Popular according to agreed plan; (d) submission to the National Assembly of a bill, satisfactory to IDA, on Banking and Financial Institutions; and (e) issuance of three licenses to start-up private financial institutions (Second tranche condition).

TRADE REGIME

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Increase output and diversification of tradables by increasing private sector participation in trade.	Trade Deregulation Decree opens import and export trade to the private sector.		Consolidate the legal framework to ensure permanence of minimum government intervention in foreign trade.
	After the devaluation of the Cordoba, foreign exchange allocation mechanisms were significantly liberalized, eliminating ministerial and Central Bank permits for importers, and giving de-facto full access to foreign exchange to exporters (except cotton and coffee exporters).	Allow full foreign exchange retention for exporters under an Export Promotion Decree.	Achieve full current account convertibility of the Cordoba.
Move to a more uniform, transparent, and lower nominal protection structure.	Reduction in the dispersion and average "basic" tariff rates. Elimination of selective consumption tax on a number of imports. Conclusion of a free trade agreement with Mexico to become fully operational by 1996.	Lowering nominal protection in trade sector to a range of 10%-60% through a combination of reductions in the levels of tariffs, SCT, and stamp tax; and announcement of a target tariff range of 10%-20% and elimination of SCT and stamp tax on imports by the end of 1993; and approval of arrangements for automatic registration for imports and exports (<u>Board Presentation condition</u>).	Lowering of nominal protection in the trade sector, to a range of 10%-40% through a combination of reductions in levels of tariffs, SCT and stamp tax (<u>Second tranche condition</u>).
		Develop action plan to provide free trade status, i.e., exemption of tariffs and indirect taxes, for exporters.	Satisfactory progress in the implementation of the action plan for giving free trade status to exporters.
		Design a price-based mechanism with variable levies for rice, yellow corn and white maize (<u>Board Presentation condition</u>).	Replacement of import quotas on rice, yellow corn and white maize for a price based mechanism with variable levies, satisfactory to IDA, and elimination of remaining quantitative restrictions on food grain imports (<u>Second tranche condition</u>).

DEREGULATION

ISSUES AND OBJECTIVES	ACTIONS ADOPTED		ACTIONS TO BE ADOPTED
	BEFORE NEGOTIATIONS	BEFORE BOARD PRESENTATION	BEFORE MARCH 1992
Curb and eventually minimize static and dynamic welfare losses occasioned by pervasive state intervention	Elimination of most domestic price controls other than those of public utilities and the fiscal industries		Abrogation of the legal framework permitting price controls, except for natural monopolies. Removal of transitory price setting adopted for selected products in government-owned stores. Present an action plan, satisfactory to IDA, to remove price controls of the fiscal industries and to reformulate the ISC extending it to luxury goods.
	Abrogation of legal export monopolies for several products by allowing private sector access to export licenses.		
		Elimination of barriers to entry to natural resource exploitation by transferring licensing regulations from state enterprises to the Ministry of Economy. Prepare terms of reference for studies on the regulatory framework of natural resources.	Implementation of the study's findings on a regulatory framework for the management of natural resources.
		Elimination of support prices for basic grains. ENABAS to begin offering services (storage, bundling import orders) and to rent facilities to private entrepreneurs.	Disallow ENABAS to trade in all but basic grains. Present a program for privatizing ENABAS retail and wholesale outlets, such that at least 20% of its corresponding assets will be sold to private parties or to laborers by March 1992 and the remainder will be divested by the end of 1992. Present an action plan to redefine the future role of ENABAS.

NICARAGUA - Economic Recovery Credit

Supplementary Credit Data Sheet

Section I. Timetable of Key Events

(a) Time taken by the Country to prepare project: 7 months

(b) Project prepared by: Ministries of Economy, Finance, and the Central Bank.

(c) First Presentation to the Bank: January 1991

(d) Departure of Appraisal Mission: June 1991

(e) Completion of Negotiations: July 1991

(f) Planned date for Effectiveness: September 1991

Section II: Special Bank Implementation Action:

None

Section III: Special Conditions:

Release of the second tranche would be contingent on satisfactory progress in the implementation of the Government's structural adjustment program, including the maintenance of a supportive macroeconomic framework, and fulfilling the following conditions:

(i) Adoption of (a) FY92 budget with reduced Central Government non-interest current expenditures less than US$325 million equivalent, and (b) agreement on implementing the recommendations of the joint Government-IDA public expenditure review;

(ii) Implementation of measures to strengthen tax administration, including (a) full operation of unit for large taxpayers; (b) issuing of decrees on sanctions applying to delayed payment and non-compliance; and (c) initiating programs on automated management control system, computerized taxpayer identification system, and training programs for Internal Revenue and Customs personnel.

(iii) Implementation of privatization of CORNAP state-owned companies through (a) completion of privatization of additional 25 state-owned companies; (b) finalization of devolution, liquidation, or assignation of another 50 companies; and (c) initiation of concrete steps toward the preparation of an additional 30 companies for privatization.

(iv) Carrying out of financial sector reforms including, (a) liquidation or merger of Banco Inmobiliario with Banco Nicaragüense de Industria y Comercio, (b) dissolution of Corporación Financiera de Nicaragua (CORFIN), (c) initiation of steps toward the restructuring of Banco Nicaragüense de Industria y Comercio, Banco Nacional de Desarrollo, and Banco Popular according to agreed action plan, (d) submission to the National Assembly of a draft law, satisfactory to IDA, on Banking and Financial Institutions, and (e) issuance of at least two licenses to private banks.

(v) The protection resulting from combined tariffs and taxes that apply to imports in Nicaragua will be reduced to a minimum of 10 percent and a maximum of 40 percent, except with respect to medicines, books and newsprint which may be exempt from such tariffs and taxes or subject to tariffs and taxes at a combined rate lower than the minimum rate referred to above.

(vi) Replacement of import quotas on rice, yellow corn and white maize for a price based mechanism with variable levies, satisfactory to IDA, and elimination of remaining quantitative restrictions on food grain imports.

STATUS OF BANK GROUP OPERATIONS IN NICARAGUA

A. STATEMENT OF BANK LOANS AND IDA CREDITS

(As of March 31, 1991)

Credit/ Loan No.	Fiscal Year	Borrower	Purpose	Amount in US$ million (less cancellation) Bank	IDA	Undisbursed
28 loans and 5 credits fully disbursed				229.61	59.74	
Total				229.61	59.74	
Of which has been repaid				72.50	0.88	
Total now held by Bank and IDA				157.11	58.86	
Amount sold :	5.62					
Of which has been repaid:	5.62					
Total undisbursed				0.00	0.00	0.00

KBArevalo:LA2C2
File: NIC0391 (a1..c60)
May 09, 1991

NICARAGUA

B. Statement of IFC Investments
As of March 31, 1991
(US$ million)

Fiscal Year	Obligor	Type of Business	Original Approvals Loan	Original Approvals Equity	Original Approvals Total
1968	Textiles Fabricato de Nicaragua, S.A. (FABRITEX)	Textile Mill	1.00	1.07	2.07
1976	Nicaragua Sugar Estates Limited (NSEL)	Sugar Mill	6.50	0.00	6.50
1976	Posada del Sol	Hotel	0.70	0.20	0.90
	Total gross commitments		8.20	1.27	9.47
	Less cancellations, terminations, repayments and sales		8.20	1.27	9.47
	Total commitments now held by IFC		0.00	0.00	0.00

IFC Investments:NIC0391
EBArevalo:LA2C2
June 11, 1991