

IDA AT WORK

Nicaragua: Supporting Progress in Latin America's Second-Poorest Country

Over the last two decades, the Central American country of Nicaragua experienced a remarkable economic turnaround. In the late 1970s and the entire 1980s, natural and man-made disasters resulted in Nicaragua's economic output shrinking by almost 40 percent and debt soaring to 400 percent of GDP. In 1990 Nicaragua was one of the most highly indebted and economically unstable countries in the world, and by 1993 half of all Nicaraguans were living in poverty. The International Development Association (IDA), the World Bank's fund for the world's poorest countries, resumed operations in Nicaragua in 1991 after the country's civil war. Since then, IDA has been a steady partner and, in recent years, has provided about one-fifth of all donor financial support.

Country Indicators	1995	2007
Atlas GNI per capita (US\$)	674	980
Inequality (GINI coefficient)	50 (1993)	40 (2005) ^a
Average inflation (%)	11.2	16.9
Combined total public debt (% of GDP)	331.9	78.8
External debt (% of GDP)	321.1	59.1
Fiscal deficit (% of GDP) ^a	3.7	1.2
Foreign direct investment (\$US millions)	75	335
Poverty incidence (%)	50.3 (1993)	46.2 (2005) ^a
Extreme poverty incidence (%)	19.4 (1993)	14.9 (2005) ^a
Net primary school enrollment rate (%)	72.6 (1991)	87.3 (2008) ^c
Under-five child mortality (per 1,000)	53	35
Maternal mortality (per 100,000 live births)	250	87 (2005)
Population (millions)	4.5	5.6

Sources: *World Development Indicators*, IMF estimates, government census and statistics, WHO, UNICEF and UNFPA.

a. 2005 figures will be updated in 2010, after completion of National Standard of Living Survey

b. Overall balance after grants. c. Administrative records.

By 2005, income per capita was up by a third, the number of people living in extreme poverty was cut by 25 percent, and inequality was significantly reduced. Economic progress continued after the change of government in early 2007; exports continued to increase at an average annual rate of 12 percent and foreign direct investment increased dramatically. However a new series of external shocks is threatening Nicaragua's momentum again. The country felt the effects of hurricane Felix, rising oil and food prices in 2007-2008, only to be hit again by the international financial crisis of 2009.

IDA's challenge over the next few years will be to help the people of Nicaragua prevent a return to the situation of the early 1990s and to continue to support them in their effort to promote sustainable development. IDA's long-term engagement will be important to ensure that all Nicaraguans reap the benefits of stability and growth



COUNTRY ACHIEVEMENTS

During the 1950s and 1960s, Nicaragua boasted one of the region's fastest growing economies. Over the years, natural disasters, economic mismanagement, political strife, and civil war (which left over 50,000 dead), transformed the nation of 5.5 million people from a star performer into the slowest growing country in the region. By the early 1990s, Nicaragua had become one of the most highly indebted and economically unstable countries in the world. Half of the population was living in poverty and one-fifth in extreme poverty.

During the first half of the 1990s, Nicaragua made rapid strides towards becoming a market-based economy. It lowered trade barriers, reduced the size of its bloated public sector and began modernizing government. More public spending was aimed at the poor. The education and health sectors were reformed and extreme poverty declined quickly.

But after the devastation of Hurricane Mitch, the government was overwhelmed by the short-term emergency needs of its people

and lost its focus on long-term development. When the huge flow of emergency aid money slowed, the government failed to reduce its spending, and budget deficits spiraled out of control. Nicaragua abandoned its program with the International Monetary Fund (IMF) and by 2002; economic growth had fallen to less than 1 percent. Hurricane Mitch, in effect, flattened the gains from Nicaragua's return to a market-based economy.

Building the foundation for sustained poverty reduction.

The administration of President Bolaños, which took office in 2002, focused on establishing fiscal discipline and attacking corruption. Its efforts paid off when Nicaragua became the 10th country in the world to comply with conditions for debt relief under the Highly Indebted Poor Country (HIPC) initiative. Over US\$3 billion of public debt were forgiven instantly in early 2004. Investors returned and economic growth jumped to 5.1 percent in 2004, and remained at about 4 percent until the end of the Bolaños administration in early 2007.

President Daniel Ortega, who was sworn into office in January 2007, has also placed great importance on macroeconomic stability. One of the first achievements of the new government was to successfully negotiate a three-year Poverty Reduction and Growth Facility (PRGF) Program with the International Monetary Fund (IMF) as an important policy tool to continue to strengthen the healthy macro situation inherited from the previous administration.

Hurricane Felix and subsequent heavy rains which destroyed much of the crops ready to harvest, provoked a spike in inflation that reached almost 17 percent at the end of 2007. Rising oil and food prices continued to fuel an inflation rate of 14 percent in 2008.

Two and a half years into its mandate, the Ortega administration continues to implement an ambitious public investment program. The administration proposes a “National Human Development Plan,” which builds on many of the successes of the previous administration but gives more focus to basic infrastructure, especially energy, roads, and water, increased access to health and education, and more of a focus on small and medium producers in both towns and the countryside. The administration is also committed to reducing poverty by increasing the human capital of the poor through strengthening programs in health, education and special programs targeted towards at risk children.

Nicaragua’s ambitious anti-poverty agenda is being threatened however, by the current international economic crisis.

Although in 2009, high inflation is no longer an issue, growth has come to a halt. The latest estimates for 2009 from the IMF predict a negative growth rate of at least 1.0

percent. Unemployment is up, tax revenues are decreasing as are remittances coming from the United States and Costa Rica. A 10 percent reduction on imports is projected for 2009 while the volume of exports is expected to remain at same level of 2008 given the country’s efforts to find new markets. The impact of the crisis is reflected in the high level of liquidity available in the banking system (currently at over 30 percent). This represents a major obstacle for the reactivation of the economy.

IDA CONTRIBUTIONS

IDA’s partnership with Nicaragua has evolved over the years and become more effective.

Investment projects are now more closely monitored and assessed than ever before. More emphasis has been placed on country-driven poverty reduction strategies and support for policy reform. To help jump-start economic reconstruction in the early 1990s, IDA financed two large, quick-disbursing loans. From 1996 to 2002, IDA lent US\$656 million for 20 operations—mostly investment projects covering health, education, social development, natural disaster management, rural economic assets, local government strengthening, natural resource management, and business-climate improvements.

However in late 2002, IDA began to shift the nature of its relationship with Nicaragua, providing about half of its financial resources—US\$135 million—through budget support operations and associated technical assistance, on top of debt relief designed to support Nicaragua’s homegrown Poverty Reduction Strategy Paper (PRSP). The PRSP established national development goals, poverty spending targets, and a mechanism for

strong donor coordination, which was linked to the PRSP targets. The strategy was fine-tuned during the second half of the Bolaños administration and by the Ortega administration over the last two years. Nicaragua's development plans during this decade have shared a common vision of more infrastructure, more and better services in health and education, more economic growth and better incomes for the poor.

IDA's Country Partnership Strategy (CPS) for Nicaragua for FY2008-2012 reflects these priorities. A preliminary IDA allocation of approximately US\$240 million—to be used in an annual series of budgetary support operations and new investment operations in water and sanitation, public sector management, land administration, and rural roads—was quickly amended to include a \$17 million Emergency Relief Credit after the country was hit by Hurricane Felix

IDA is preparing a progress report to be presented to the World Bank's Board of Directors in December of 2009. The report will outline the major changes proposed in the CPS as a result of the internal and external shocks and crises of the last two years. It is likely to propose new investment operations to address challenges posed by the prevailing economic crisis and the spread of the H1N1 flu virus. The report will also suggest alternative investment operations to replace budget support in case internal political problems continue to weaken international support for budgetary lending.

Poverty-linked debt relief

Nicaragua's huge external debt was the greatest burden it had to bear as a result of the economic mismanagement of the 1980s. Through the 1990s, Nicaragua paid the same

amount to its creditors as it was spending on education—about 12 percent of its annual budget.

The debt relief granted to Nicaragua has been the largest of all the debt relief operations granted under the HIPC initiative, including US\$382.6 million from IDA. Nicaragua has been able to use the funds that it would otherwise have paid in servicing debt to increase spending on anti-poverty programs from 10 percent of GDP in 2002 to 13.4 percent in 2008.

IDA continued to assist the government in reducing its foreign debt. In 2007, IDA and Nicaragua signed a Grant Agreement for the Commercial Debt Reduction Program in the amount of up to US\$61 million. In concrete terms, this has meant that approximately US\$1.3 billion of foreign debt was erased from Nicaragua's books by the end of 2008.

IDA's contribution to reducing poverty in Nicaragua spans many sectors.

IDA's contribution has been most notable in the following areas: education, rural infrastructure, public sector management, and the development of a more competitive business environment. Gains in these areas reflect improvements in IDA's approach to aid delivery.

Education—Rising enrollment and completion rates

As a result of initial IDA support to education, preschool enrollment more than doubled from 14.5 percent of young children in 1993 to about 31 percent in 2004. IDA financed the construction and establishment of community preschools nationally with a focus on poor rural areas, marginalized urban neighborhoods, and isolated indigenous populations. IDA also

Development Assistance Has Made an Impact in Nicaragua

Indicator	Baseline	Progress
Preschool enrollment (%)	14.5 (1993)	31 (2008)
Net primary school enrollment (%)	74.4 (1998)	87.3 (2008)
Share of rural roads in good or fair conditions (%)	17 (1999)	21 (2009)
Share of small rural towns connected to public telephone (%)	24.5 (2003)	90 (2008)
Spending on poverty reduction (% of GDP)	10 (2002)	13.4 (2008)
Days required to start a business	71 days (2003)	39 days (2009)

Sources: Ministry of Education, *World Development Indicators*, Ministry of Transport and Infrastructure, Telecommunications Regulatory Agency, Ministry of Finance and Public Credit, *Doing Business*.

trained both teachers and parents in project areas. Over this period, preschool drop-out rates fell by one-third. IDA also succeeded in better preparing children for primary school, helping to cut drop-out rates nearly in half to just 6 percent.

In 2007, the incoming Minister of Education reaffirmed the country's desire to achieve the education Millennium Development and Education for All (EFA) goals by 2015. In March 2008, the Ministry of Education presented its new education strategy 2008-2011, organized along the themes of education for all children; improved educational quality; local participation management and decentralization; and education as part of the life cycle.

More recent IDA operations have focused on primary schooling. Thanks to large contributions from IDA and other donors, more Nicaraguan children, especially among the poor, are attending and finishing primary school in more suitable classrooms equipped with better educational materials. Net primary enrollment in Nicaragua rose from 76 percent in 1996 to 87.3 percent in 2008, and the primary school completion rate climbed from

27 percent in 1997 to 67.2 percent in 2008. Notably, the share of students aged 7 to 13 living in extreme poverty that did not attend school was slashed from 45 percent in 1993 to just 20 percent in 2005. IDA is also working on improving the quality of education and for all primary school children will be using new textbooks financed by IDA and the Education for All Trust Fund managed by IDA.

IDA is also supporting the National Integral School Nutrition Program for the 2009-2010 school years; the program will provide lunches for 38,000 pre-school children and has been cited by the FAO as one of the top four school feeding programs in the world.

Rural infrastructure—Increasing access and connectivity

IDA has played a major role in helping to develop the rural sector by extending road and telecommunications networks, which connect people to markets and social services, and expanding the use of land titles, which help the poor access financing and build productive assets.

Roads. IDA's support for the development of rural roads in Nicaragua is an example where the combination of policy, investment, and technical assistance generated greater returns for all. Long-term IDA involvement has helped increase the share of the road network in good and fair condition from 17 percent of rural roads in 1999 to 21 percent in 2009). IDA-financed projects restored over 3,000 km of secondary roads destroyed by Hurricane Mitch, rehabilitated the Pan American highway between Managua and San Benito—restoring a key trade link with the rest of Central America—and more recently, has been working to improve 240 km of rural roads by using a type of concrete cobblestone (adoquines) as an intermediate solution, linking the poor to markets, health centers, and schools. IDA-financed projects have promoted the use of these lower-cost construction techniques, which represent an efficient allocation of resources and results in the provision of higher than traditional service levels for rural traffic, as the alternative to gravel-surfaced roads.

While IDA and other donors such as the United States, Japan, Denmark, the European Union and IADB, were financing the improvement of rural roads, analysis identified the need for better road maintenance. As a result, successive IDA budget support operations helped set up a road maintenance fund. By the end of 2008, the fund had contracts for maintaining 2,774 km of roads (85 percent of the country's maintainable road network), creating jobs for poor people, and lowering transport costs. Throughout this process, IDA has also promoted the creation of 38 local micro-enterprises for basic routine maintenance of roads (2,416 km by mid 2009), which also provide stable, productive work for some 430 very poor families.

IDA is also contributing to making the tourist sector one of the most dynamic in the country by rehabilitating two of the most important paved roads to touristic areas in the Pacific Coast of Nicaragua—San Juan del Sur and Diriamba-Casares.

Telecommunications. Prior to 2000, insufficient competition left Nicaragua with one of the lowest telephone connection rates in Latin America. IDA investment lending helped privatize the state monopoly and create a regulatory agency. IDA's budget support operations helped create a Telecom Investment Fund to extend services in rural areas. By putting this fund to work, an IDA-financed project helped provide telephone services to 500,000 citizens living in 365 small towns.

With IDA support, national coverage of fixed and mobile phones increased sevenfold from 194,000 in 1999 to more than 1.3 million in 2005, and mobile coverage in provincial capitals increased from 50 percent in 1999 to 100 percent in 2003. With continued IDA support, the majority of the municipal capitals of the country will have Internet connectivity by the end of 2008.

Almost all municipalities now have “telecentros” in which young people can learn computer skills and have access to unprecedented levels of information.

Land administration—Securing property rights for all

IDA's analytical work helped raise awareness of the importance of land titling in the battle against rural poverty. The IDA-financed pilot Land Administration project also assisted Nicaraguan authorities in preparing and implementing key legal and procedural

reforms that will be the basis of a massive national regularization program. With IDA's support, Nicaragua has designed a Registry Law and a state-of-the-art Cadastre Law; it also introduced a less costly and more effective systematic approach to regularize land rights and start clearing the backlog of titles and juridical services provision.

By mid 2009, cadastre surveys and new institutional procedures with national and municipal authorities were in place in four of the fifteen Departments of the country; more than 76,000 cases of rural land holdings are being analyzed as part of the new regularization process. 11 environmentally protected areas are also being studied. The average time it takes to title a property dropped from 65 days in 2003 to 10 days in 2005.

An important component of IDA's support to land administration in Nicaragua is the titling of indigenous territories in the Caribbean Coast of the country. Over the last two years, with strong support from the Government of Nicaragua, the Land Administration project has helped Nicaraguan institutions implement the Law on Indigenous Territories issued in 2002. By mid 2009, for the first time in Nicaraguan history, over 123 indigenous communities, home to more than 53,000 Miskito and Mayangna ethnic peoples, now live in territories that have been registered in the name of their communities. These nine areas represent 8 percent of national territory.

Public sector management— Improving governance

Over the years, IDA and other donors have begun to direct more resources through government channels (for example, through direct budget support). As a result, donors

have turned their attention to strengthening public sector management systems to promote greater transparency and accountability. IDA has been supporting the modernization of the public sector management as one of the pillars for the implementation of the country's development strategy, improving budget transparency and government accountability. In addition, the planning systems have been streamlined in order to improve the public policy effectiveness and monitor and evaluate their implementation. Finally, a reasonable civil service reform has been implemented with the goal of creating a professional and stable public sector.

Business climate—Easing the costs of doing business

Nicaragua continues to implement reforms to enhance its business climate. The 2010 *Doing Business* Report will take note of the establishment of the Central American Customs Union. An additional reform in the legislative arena is the approval of the Coastal Zone Development Law which should trigger important investments in the tourism and overall service sectors.

A recently approved US\$20 million operation to promote micro, small and medium businesses will continue to increase IDA's role in this sector. This operation encompasses a Partial Credit Guarantee Fund by which micro, small and medium enterprises with collateral limitations will have access to commercial loans from the local banking system.

The ongoing Broad Based Access to Finance Project has supported an increase in lending to small and medium producers, both urban and rural, by working with the government and the micro finance industry to expand their

services nationwide—increasing the points of financial services from 200 in 2005 to 253 in 2009.

Agriculture—Unlocking rural opportunities

In Nicaragua, agriculture represents 19 percent of GDP and provides 27 percent of total employment. Most of Nicaragua's poor are concentrated in rural areas where agriculture is the main source of food and income. Nicaraguan agriculture, mainly in hands of small landowners, shows strong potential. Improving the food supply in domestic markets and increasing exports of basic food products could make agriculture a driver of economic growth.

IDA is helping improve the sector's productivity and competitiveness by assisting the Ministry of Agriculture in adopting a two-pronged strategy that combines (i) actions to continue supporting the most vulnerable groups by delivering a package of agricultural inputs (certified seed of basic grains and fertilizers) and technical assistance, and (ii) actions aimed at expanding the supply of agricultural goods produced by small and medium farmers. To a large extent, such an approach is consistent with the recommendations issued for countries like Nicaragua by the World Development Report 2009 and under the Global Food Crisis Response Program.

CHALLENGES AHEAD

Nicaragua remains the second-poorest country in Latin America after Haiti. While economic gains have reduced the scale and severity of poverty in Nicaragua, it is still unacceptably high with 46 percent of the population living below the poverty line. To achieve the Millennium Development Goals,

Responding to Crisis

As a result of last year's food price increase crisis, IDA is supporting an emergency program that will give 31,000 poor farmers access to a package of certified seeds, fertilizers, technical assistance and training to improve their food security. In addition to this, IDA is helping the government to design and later implement a National Seeds Program that will address the chronic constraint of limited availability and use of quality seed in the planting cycles of the most important crops (maize, beans, rice and sorghum). This new operation will also promote the organization and business development of small and medium farmers as well as provide them with training and technical assistance. Financial services will be made available for seeds production, processing and commercialization, and the Ministry of Agriculture's technical assistance bureau (INTA) will see its capacity for research and seed certification strengthened.

the rate of progress will have to accelerate. Nicaragua's main challenges can be grouped into five areas.

Maintaining macroeconomic stability

Nicaragua has made significant progress since the start of the 1990s on improving and maintaining its macroeconomic stability. Until 2009, the country had experienced steady positive GDP growth averaging 3.2 percent between 2001 and 2008, low inflation rates, stable exchange rates, declining interest rates, and a high level of international reserves and foreign direct investment. However, the Nicaraguan economy has recently been affected by a number of external shocks including Hurricane Felix, the rising international prices of food and oil and the global financial crisis. All these factors, including the negative effects of continuing internal political strife, have undermined its current

performance resulting in the deterioration of the economic growth level, which in turn has a major impact on the reduction of poverty. Currently the government is in intense negotiations to maintain its program with the IMF and is designing and consulting the reforms necessary to maintain macro economic stability, while at the same time striving to maintain the gains in education and health of the past several years.

These are particularly difficult moments for the Nicaraguan economy given that several vulnerabilities persist due to the current financial gaps in the national budget, stemming from the level of public debt, fiscal and trade deficit, and governance matters, among other factors. In this sense IDA should continue to work with other donors on strengthening the macroeconomic framework by supporting sectors that foster socio-economic growth, promote fiscal consolidation and increase poverty reducing spending while at the same time promoting transparent and effective public administration.

Pursuing good governance and state modernization

Because public investment and spending will always exceed limited public funds, careful planning is needed to ensure that what is spent, is spent well. Progress has been made as previously noted. The next steps could keep focusing on improving the professionalism of the civil service, expanding the use of financial management systems, providing freedom of information that would allow citizens to hold government more accountable, and strengthening the quality and targeting of public spending. IDA will be working closely with the Inter-American Development Bank and several bilateral donors to strengthen the

efficiency and transparency of the country's public financial management systems.

Building a competitive investment climate

Despite real progress in recent years on meeting the challenges of freer trade under the US-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), Nicaragua is still not taking full advantage of global markets because of infrastructure and regulatory bottlenecks. New investment is needed to provide a reliable electricity supply and to substantially increase the network of paved roads. Bureaucratic red tape still needs to be slashed to provide predictable and transparent regulatory processes, secure property rights, and deepen financial markets, with special attention to providing a level playing field to help small and medium enterprises thrive. IDA will play an important role in this strategic area through a new operation of US\$20 million to support the development of small and medium enterprises.

Tapping human potential

Nicaragua's people need access to quality education and adequate nutrition and health if they are to enjoy the benefits of a vibrant global economy. Primary school enrollment has increased significantly, but children must be taught what they need to advance. Investment in secondary education will be very important to Nicaragua's future.

In health, the big challenge is to continue to expand the coverage and quality of health services in affordable ways. Child malnutrition, which remains alarmingly high, needs immediate attention. Special efforts will be required to provide services to isolated populations along the Atlantic coast, includ-

ing investments in roads and clean water. IDA recently approved a \$20 million operation to provide water and sanitation services for the rural sector, including the Caribbean Coast, as well as \$40 million new operation to bring water and sanitation to Managua's poorest neighborhoods.

Expanding economic opportunities for the poor, predominately in rural areas and in the Caribbean Coast

To boost their productivity and income-earning potential, rural areas must be given the tools to compete globally. More funds are needed for roads, telephone connections, land titles, intensification of agriculture and agro industry, and promotion of rural non-farm economy. Although IDA was at the forefront of investment in the country's roads, nearly 80 percent of the network is still in poor condition. Energy and telecommunications improvements are still needed in Nicaragua's smallest towns and land-titling coverage remains limited to a few areas in Nicaragua's northeast. Poverty statistics are especially alarming in the country's Caribbean Coast, home to the majority of nation's indigenous citizens. IDA has increasingly targeted new investments to this area but much more is needed.

IDA's experience in Nicaragua underlines the importance of staying tuned to a country's political economy.

In retrospect, the success of IDA's involvement in Nicaragua has hinged on local political consensus and buy-in from all relevant government actors. When authorities are not

convinced of the value of reforms, no amount of financial or institutional leverage will ensure that activities proposed by IDA or other donors are carried out and sustained. Within this context, IDA analysis has played a critical role in identifying problems and solutions, building political consensus, and generating momentum for reform based on a common understanding of country challenges.

Going forward, IDA will carefully evaluate the country's political realities and take account of the limits to its influence. IDA is a strong and respected partner; however, elections and administration changes interrupt policy dialogue and continuity. IDA will continue to have to weigh and make trade-offs between what is considered optimal and what may be realistic and achievable in a fluid political environment. IDA's comparative advantage in drawing from and introducing best-practice programs from other countries is unparalleled. However, proposed activities based on international practice must be tailored to Nicaragua's political and social realities. There is no "one-size-fits-all" approach to development.

IDA's work in the education sector is evolving from a fragmented, project-driven approach to a coordinated effort supporting a government-led strategy.

IDA's support to government planning strategies for poverty reduction continue to be useful tools, and act as a catalyst for government planning especially in a time of crisis.

August 2009

<http://www.worldbank.org/ida>