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Economic Commission for Latin America and the Caribbean

NICARAGUA: RECENT ECONOMIC EVOLUTION AND INTERNATIONAL
CO-OPERATION

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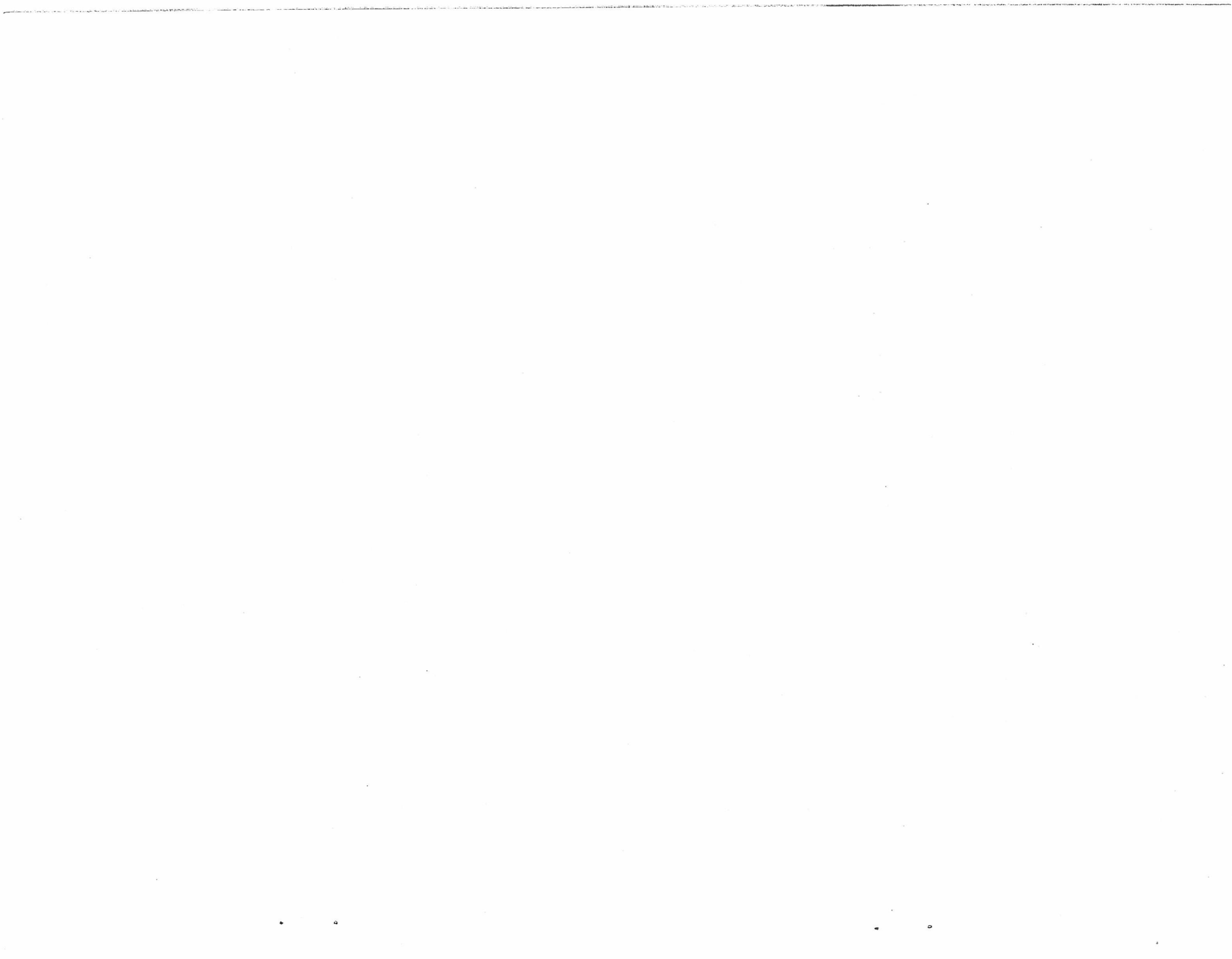
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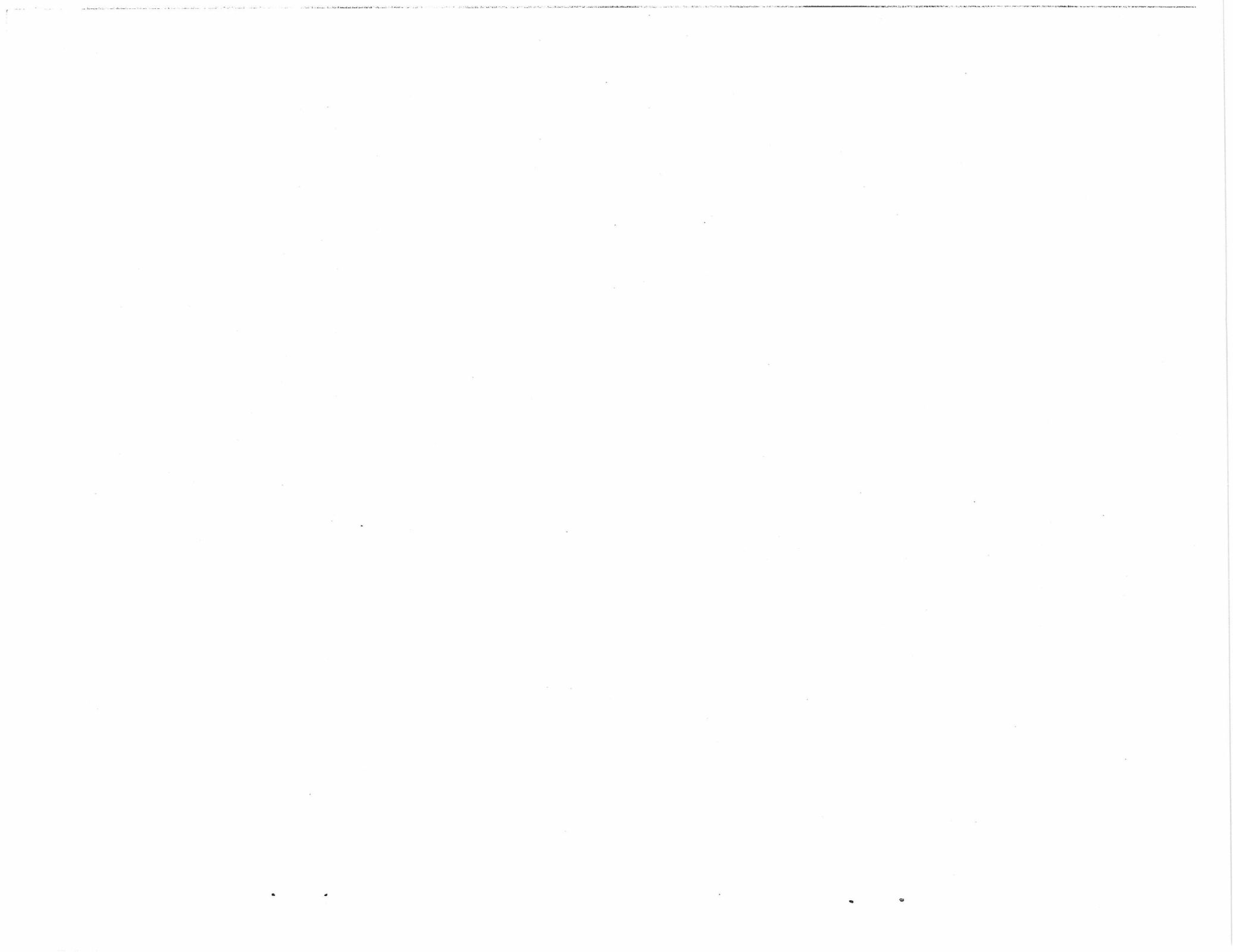
General aspects

Nicaragua is the largest country of the Central American Isthmus in geographic terms. Its area covers a total of 139,000 km². In 1987, it had a total of 3.5 million inhabitants, of which 58.7% were located in urban areas. The population does not exert great pressure on the land, since there are only 25 inhabitants per square kilometer.

A mountain system running from northeast to southeast divides the country and forms two defined watershed systems, one towards the Atlantic and the other towards the Pacific. The principal agricultural and industrial activities are concentrated in the Pacific region, and the population is quite small in the Atlantic region. The climate is warm and humid in the eastern region, with an average temperature of 25° C; the western region is warm and dry and has an average temperature of approximately 28° C. It has a rainy season from May to November and a dry season from December to April. Owing to its ecological conditions, it has special characteristics both for the development of agriculture and for livestock raising and forestry.

As in the rest of the countries of the Isthmus, agriculture produces the main share of GDP (24%), with the manufacturing industry in second place (21%) and commerce in third (18%). The main export products are coffee, cotton, meat and bananas. Of these commodities, coffee accounts for the greatest share of the total value of exports (39%).

Nicaragua has characteristically shown high population growth rates in the past. In the 1980-1985 period, the rate reached an annual average of 3.5%. The social situation in Nicaragua for that same period, expressed in terms of basic indicators, is quite similar to that of most of the countries in the Central American region, with the continuation of relatively high infant mortality rates of 61.7 for every 1,000 live births. Life expectancy, however, rose to 59.8 years of age. Improvement in education may be noted, although 26% of the population was illiterate in 1986.



1. General economic overview of the 1980s

During most of the 1980s, the Nicaraguan economy operated in an extremely adverse international context. It experienced a progressive crisis that resulted in considerable contraction in economic activity and in the people's standard of living. At the end of the decade, production was 30% less than in 1978, which meant that the per capita product fell sharply by 50%. (See table 1.)

In fact, economic imbalances progressively became more acute and, in the second half of the decade, great economic disturbances arose: supply crisis, hyperinflation, exchange overvaluation, enormous fiscal imbalances, monetary- financial disorders and considerable distortions throughout the economy, particularly in the structure of prices and the system of incentives for production.

The costs of the war should be added to the economic disturbances mentioned above: the destruction of physical infrastructure and material goods, nearly 60,000 victims - including the dead, the mutilated and the wounded- the displacement of people from places of armed conflict and the loss of high-level technical and professional human resources caused by emigration.

Some of the main factors that caused these trends were: a) the macro-economic policy adopted, based on highly deficit public spending; b) the accumulative, destabilizing effects of the low-intensity war and the trade block imposed by the United States, Nicaragua's most important trading partner; c) the suspension of external financing from multilateral international organizations; and d) the unfavourable development, both in the production of marketable goods and in the international markets for the principal export commodities.

In parallel with the accumulation of imbalances, the Nicaraguan economy underwent important structural changes. The public sector increased its size and, consequently, its participation in economic activity; in the external sector, trade ties were modified and decreasing external sales were concentrated in only a few commodities; the subsector of informal activities expanded considerably to compete significantly with the formal subsector of the economy; and, finally, the enormous spending on military defence limited formulation of the economic policy.

Table 1
NICARAGUA: PRINCIPAL ECONOMIC INDICATORS

	1983	1984	1985	1986	1987	1988	1989 ^{a/}
1980 Index = 100							
A. Basic economic indicators							
Gross domestic production at market prices	109.3	107.6	103.2	102.2	101.4	90.3	87.7
Population (in millions of inhabitants)	3.1	3.2	3.3	3.4	3.5	3.6	3.7
Per capita gross domestic product	99.1	94.3	87.4	83.7	80.3	69.5	65.9
Fiscal deficit/GDP ^{b/}	30.0	24.8	23.4	18.0	16.4	25.8	5.2
Money (M1)/GDP	0.22	0.09
Underutilization rate ^{c/}	18.9	20.6	20.9	22.1	24.4	26.5	32.1
Growth rates							
B. Short-term economic indicators							
Gross domestic product	4.6	-1.6	-4.1	-1.0	-0.7	-10.9	-2.9
Per capita gross domestic product	1.2	-4.9	-7.0	-3.9	-3.5	-13.4	-5.2
Consumer prices							
December to December ^{d/}	32.9	50.2	334.3	747.4	1 347.3	33 602.6	1 689.9
Real wages and salaries ^{d/}	-12.9	-5.9	-30.0	-63.9	-31.4	-64.7	26.1
Current value of goods and services exports	5.4	-8.5	-18.5	-16.3	10.8	-15.6	24.9
Current value of goods and services imports	9.1	2.3	1.8	-8.7	4.4	-4.3	-11.2
Terms of trade in prices of goods and services	-3.2	26.2	-4.9	10.0	-9.1	5.8	-5.8
Millions of dollars							
C. External sector							
Trade balance of goods and services	-430	-491	-587	-563	-568	-581	-418
Net payment of earnings and interest	209	239	257	245	208	151	67
Current account balance	-635	-727	-827	-799	-766	-732	-485
Capital account balance	654	974	846	605	504	562	425
Change in net international reserves	93	129	16	-196	-262	-170	-60
Public external debt disbursed ^{e/}	3 788	4 362	4 936	5 760	6 270	7 220	7 570

Source: ECLAC, based on official figures.

^{a/} Preliminary figures.

^{b/} Percentages.

^{c/} Includes open unemployment and underemployment.

^{d/} Total annual average wage received by those belonging to the Nicaraguan Social Security and Welfare Institute.

^{e/} Short-, medium- and long-term.

In this context, the economic policy shifted from an initial project for reconstruction and reactivation of the economy (1980-1983) to a prolonged phase of crisis administration at an economic subsistence level. In the transition, the economy experienced the problems mentioned above: supply crisis, marked bias against exports and pronounced internal and external imbalances.

From the outset of the decade, following the chaos in production and destruction inherited from the 1979 revolution, the State assumed an expanding role in the economy. ^{1/} Social services for education and health expanded, domestic prices were controlled and basic consumption was heavily subsidized. Furthermore, following the sharp drop in private investment, the State took over capital formation. ^{2/} Public investment was aimed principally at ambitious macro projects of high capital density, which required enormous public resources, and, in some cases, would only reach maturity slowly. ^{3/}

Between 1980 and 1983, economic activity expanded at a rate slightly above population growth. Employment increased and the income of the population improved, owing to redistribution measures. Nevertheless, imbalances in public finances reached 16% of GDP on the average and substantial deficits were produced in external payments (520 million dollars on the average, equivalent to the value of annual exports). These imbalances were covered with relative ease through loans and donations received. (See table 1 again.)

Subsequently, defence expenditures gained greater importance in the governmental budget and consequently placed major constraints on economic activity. Between 1985 and 1988, approximately 40% of the total expenditures of the central government were allocated to the defence budget.

These expenditures proved to be incompatible with the social development policy, with major investments in the productive plant and with expansion of

^{1/} At the end of the war, the state of the economy was critical with economic paralysis, financial insolvency, internal depreciation of currency, high unemployment and depletion of inventories.

^{2/} During the initial year of government, important economic reforms were adopted, including agrarian reform and the nationalization of foreign trade and the banking and financial system.

^{3/} Some projects included the Tipitapa-Malcatoya sugar mill project; the Chiltepe dairy basin; the Cukrahill African palm and Nueva Guinea and Valle de Sébaco cacao projects.

the physical infrastructure, in a context of trade and external financing restrictions. Consequently, the previously indicated monumental macro-economic imbalances occurred. These, in turn, had significant impact on the micro-economic behaviour of the population.

In view of the progressive worsening of imbalances, partial adjustment measures were taken between 1984 and 1988. These measures basically included restrictions on public spending in areas other than defence, adjustments in public service rates, a reduction in the large subsidies plan, an increase in the tax load, and exchange and wage adjustments in line with growing inflation.

The reduction in government spending on social services infrastructure implied a decrease in the quality of public health, education and sanitary services in general. Furthermore, the communications and transport road network deteriorated significantly when expansion projects were cancelled and maintenance expenditures were limited.

In spite of the considerable increase in the tax load, the 1984-1988 public deficit almost doubled in relation to the 1980-1983 period, with an annual average of 21% of GDP. Faced with barred access to the financing of multilateral organizations, the Government sought financing from the Central Bank, fundamentally by issuing currency. ^{4/} The impact on the economic system in general was devastating.

Price levels rose and, from 1985 onward, took on characteristics of hyperinflation. Limitations on the supply of goods and services, the shortage of foreign exchange and the fiscal and monetary policies adopted contributed to pushing the annual growth rate of prices up from an average of 30% between 1980 and 1984 to 334% in 1985 and 33,600% in 1988. Inflation brought about great distortions in the relative price structures, with numerous effects on the economy. It discouraged production in general and reinforced the private sector's reluctance to invest in the production area; it substantially deteriorated the population's income; it stimulated the emergence of a strong informal economy (which was increasingly fed by human and material resources coming from the formal sector), and, finally, it had

^{4/} The World Bank and the IDB cut off Nicaragua's access to financing in 1983.

an outstanding impact on the exchange rate and encouraged the emergence of a significant parallel foreign exchange market. ^{5/}

In brief, the economic situation was becoming increasingly difficult and was consequently creating an atmosphere adverse to production. The prices and incentives structure, in particular, formed a considerable bias against exporters, which caused the production of marketable goods to fall steadily throughout the decade. Between 1984 and 1985, the gross domestic product contracted 15%, while the per capita product decreased 26%. Owing to the stabilization measures that significantly reduced real wages and subsidies, private consumption fell almost 20% while capital formation barely remained constant during this five-year period.

The policy to stimulate production was based on a variety of specific instruments, including particularly the control of prices, subsidized inputs and loans, and the selective allocation of foreign exchange for imports. However the fundamentally adverse macro-economic atmosphere caused by unfavourable prices and the shortage of imported inputs prevailed in general. These factors resulted in declining domestic supply and a widespread drop in productivity throughout the decade.

Both the production of exportable commodities and the production of goods intended for the domestic market fell significantly, although production for the domestic market dropped less because of the strong material support policy aimed at production for basic consumption. Between 1984 and 1988, in the agricultural sector, production of cotton fell 50%; coffee, 37%; sugarcane, 24%; and bananas, 35%. Basic grains, in contrast, underwent significant aggregate growth on the order of 20% between 1984 and 1988.

The industrial sector remained practically stagnant in the 1984-1988 five-year period as a result of deterioration in the productive plant caused by the effects of the trade block (which hindered access to parts, spare parts and inputs for its operations), and by the decrease in both the domestic market and the market of Central America.

Reorientation of public spending brought about a marked weakening in basic services, principally the transport and communications system. The

^{5/} For example, while the official exchange rate in 1987 was 70 córdobas per dollar, the rate in the parallel market reached 15,000 córdobas, that is, 200 times greater.

lack of maintenance and paralysis of expansion projects resulted in damage to the road infrastructure; in the case of the electric power sector, rationing even became necessary.

The problems observed in the sphere of production had an impact on employment. In general, during the decade, the creation of jobs was insufficient to meet labour force supply. Although open unemployment was insignificant, open unemployment and underemployment together reached more than 25% by the end of the decade. Nevertheless, owing to the armed conflict and the shift of the rural population, labour scarcity problems arose in agriculture during planting and harvesting seasons, principally for coffee. ^{6/}

In the context of stabilization measures, the wage policy was increasingly restrictive, which led to drastic reductions in the purchasing power of wages in the formal labour sector, in spite of schemes to subsidize consumption of basic goods and services. However, a considerable amount of remittances of Nicaraguans living abroad prevented greater contraction in private consumption, particularly of non-essential goods and services. But the enormous differences between real wages in the formal sectors and in the informal sectors encouraged the flight of human resources from the former to the latter.

The external sector remained in permanent deficit. In view of the unfavourable trend in international prices and demand, the export of goods fell throughout the decade, and more markedly during the second half. External sales fell from 720 million dollars in the 1977-1978 biennium to 400 million dollars on the average during the first five years of the 1980s and to an average of 270 million dollars during the second five-year period.

In contrast, the trend in imports of goods and services was more favourable. Faced with the trade embargo imposed by its traditional supplier of consumer and investment goods and services, the country changed its

^{6/} Certain factors that affected the evolution of the Nicaraguan labour market should be noted: a) military recruitment, principally among the young, rural population, and the shift of population in rural areas because of the war affected the availability of workers for the agricultural sector, b) it is estimated that between 1979 and 1989 nearly 500,000 people emigrated from the country, including a significant number of skilled technicians and professionals, and c) the deterioration in real wages in the formal sector of the economy caused people to leave it and join the ranks of the informal sector in search of greater income.

sources of supply. Obtaining lines of credit, principally from the countries in the communist bloc, allowed the acquisition of goods to remain relatively stable at about 800 million dollars between 1980 and 1989.

In this manner, decreasing income from exports, combined with a steady amount of imports, produced a growing deficit in the balance of payments, which averaged somewhat more than 800 million dollars between 1984 and 1988, which compares unfavourably with the average income from exports of 300 million during the same period. The lack of access to multilateral financial organizations prompted Nicaragua to make significant changes in its external financial relations. Financing was obtained from the socialist bloc and from European countries, which, in the former case, granted small loans tied to the purchase of machinery, equipment and intermediate goods. Although these mechanisms facilitated the acquisition of considerable amounts of the imports indicated, it also meant a great shortage of liquidity in foreign exchange during the entire past decade. However, outside the official financial circles a considerable amount of foreign currency (family remittances) fed both smuggling and informal sector activities.

The external debt grew considerably from somewhat more than 1 billion dollars in 1977-1978 to 3.1 billion in 1983 and 7.2 million in 1988. Continuous problems in servicing the debt led to restrictions in medium and long-term debt servicing payments. Thus, indebtedness grew principally through capitalization of servicing overdue. (See again table 1.)

Faced with this increasingly critical panorama, in February 1988, thanks to the reduction in armed conflict, it was possible to adopt a number of adjustment and stabilization measures aimed at correcting the principal imbalances in the economy. Priority was given to slowing down hyperinflation, eliminating speculation and reordering the economy to reverse the bias against exporters. Some of the outstanding measures implemented were the monetary reform, the exchange rate adjustment with the unification of rates, restriction in demand, principally through public spending constraints and the contraction of credit, and the indexation of wages and interests rates. Later, in June, measures proceeded to include the deregulation of prices and wages.

These measures had favourable effects during 1989, but adversely affected the amount of economic activity and the average income of the population. In fact, the measures to cut back on public spending

(facilitated by the reduction in armed conflict), the monetary reform, exchange rate devaluation and unification, the deregulation of prices and the elimination of subsidies helped to reduce instability and tended to reform the relative price structure.

The fiscal deficit was decreased from 25% of GDP in 1988 to 5% in 1989 by reducing the current and capital spending of the Central Government by half. Significant progress in putting public finances on a sound footing had a favourable impact on the control of monetary-financial variables. The real interest rate tended to take on positive values in comparison with the situation that prevailed during most of the decade.

Furthermore, the policy to control hyperinflation had considerable success by reducing the price increase rate from 33,600% to 1,690% between 1988 and 1989. The improvement in relative prices and the free availability of foreign exchange from exporters stimulated the production of marketable goods. Domestic demand, in contrast, fell substantially, owing to the cutback in public spending and the reduction in real wages, and adversely affected production for domestic consumption.

The agricultural sector reacted to the improvement in general conditions for exportable production and to the incentive measures (deregulation of prices, debt forgiveness and subsidized loans) by increasing the supply of items for export (coffee, sugar and livestock). Domestic consumer production did not recover as rapidly, owing to the readjustment in production incentives and the drop in domestic demand. Reduced domestic demand also caused a contraction in the production of the manufacturing sector. The new scheme of relative prices, however, encouraged certain recovery in manufactured goods intended for external markets.

Unemployment became more serious because of the more compact public sector and contraction in the construction sector. However, these effects were, to some degree, compensated for by job increases in the agricultural sector. The deregulation of wages, by eliminating the National Work and Wages Organization System (SNOIS), implied readjustments in remuneration which, in general, tended to rise in the formal sector of the economy.

Finally, the external sector experienced a reduction in imbalances owing to the increase (24%) in exports and moderation in imports. Although the policy of keeping debt service payments to a minimum continued, fewer

resources from abroad made it necessary to use international reserves to cover the deficit in the current account.

2. International co-operation in the 1980s

International co-operation played a significant role in the Nicaraguan economy in the 1980s. In contrast with other countries of the region where external co-operation became a means of complementing national programmes, in Nicaragua, its importance was vital. It enabled the country to face an extremely adverse international trade and financial situation.

In fact, following the suspension of operations in the country by multilateral financial organizations at the beginning of the decade, the trade block and deterioration in the Nicaraguan external sector, international co-operation increased progressively. The traditional multilateral sources were replaced principally by bilateral sources and non-governmental organizations.

A precise estimate of the amount of resources channelled from these sources throughout the decade is not available, but, owing to the persistent financial gap with the exterior, it may be noted that the increase in these resources brought about a structural change in which the following sources were outstanding:

- a) The socialist countries
- b) Western Europe, particularly the Nordic countries
- c) NGOs, even of countries with which Nicaragua did not have formal relations
- d) United Nations

Although co-operation sources were expanded and diversified, great heterogeneity arose in the techniques and goods received. In fact, partly because of limited options and partly because of the weak institutional organization that established the criteria for priorities and policies, the co-operation received brought about significant problems in technical complementarity. Frequently it was incompatible with the infrastructure and the existing productive park, and resulted in less than optimum use of the channelled aid and the goods and equipment donated.

The efficiency of international co-operation was also affected by problems of a diverse nature, including those below:

a) The limitations in public financial resources required as national counterparts, due to the austerity imposed by the adjustment and stabilization programmes.

b) The lack of a portfolio of pre-investment and investment projects.

c) The lack of skilled human resources to formulate investment and pre-investment projects.

The institutions in charge of international co-operation were recently reorganized and the Ministry of External Co-operation was placed at the head of the sector. This meant considerable progress in the capability for administering and controlling projects and programmes. Nevertheless, the problem of limited capability in human resources for managing projects continued to be one of the most significant obstacles to materializing external aid.

3. The 1990-1996 government programme and the role of international co-operation

Nicaragua underwent almost a decade of armed conflict and serious deterioration in its productive and social infrastructure. In the current circumstances of political transition, the principal problems that monopolize the attention of the new governmental authorities (1990-1996) are particularly those of a political/military nature (including the demobilization of the irregular forces) and the continuation of stabilization and economic adjustment efforts.

In fact, in the short term, serious problems of macro-economic stabilization and adjustment persist. Even though the high rate of inflation and imbalances in public accounts were significantly reduced in 1989, they are still among the principal restrictions in formulating economic policy. In this context of financial restrictions, the task of reactivating production, principally the exportable supply, is being planned.

From a longer-term perspective, problems of numerous social and economic factors associated with reconstruction are presented, which, in general terms, may be highlighted in the following topics:

The revitalization of productive activity in general. In particular, the industrial plant shows significant deterioration related to problems of maintenance and obsolescence. In the agricultural sector, the recovery of activity faces problems of reorganization both in agricultural and livestock

production. However, this sector has the advantage of large investments made by the outgoing administration and the agrarian reform.

In the area of physical infrastructure for productive and social services, there are considerable deficiencies in the road network, communications and transport. Education health and basic social services also showed serious setbacks, particularly during the previous five-year period. In addition, note should be taken of the depletion of skilled human resources caused by a decade of intense emigration.

The Nicaraguan people have experienced a significant decrease in their standard of living, caused both by the effects of the war and by lower income associated with the stabilization and adjustment programmes. This sets limits on the economic policy to implement adjustments with additional costs that would lower the average income of the people.

Financial problems with the exterior persist. Nicaragua has the highest external debt in Central America (although under different terms), which points up the need to initiate negotiations to improve debt costs and time periods.

The end of the war also calls for reorganization of the State under new institutional arrangements. In this field, there is an outstanding need to strengthen public institutions through training human resources at different levels.

Even though a detailed economic programme is not yet available, the major guidelines of the provisional programme of the new Government (1990-1996) are as follows:

The programme establishes three transitional stages for economic efforts:

- a) immediate reactivation of productive activity;
- b) recovery of past production levels;
- c) sustained economic progress based on the modernization of the production structure and its participation in the international market.

In the first stage of reactivation, the economic and political stabilization policy will continue, based on measures for fiscal and monetary-financial constraint, together with the establishment of compensatory programmes for the population strata most affected by the crisis.

The principal measures being considered include tax and budget measures which underline austerity in the spending of the Central Government, a review of the subsidy system and reorientation of spending towards health services. Efforts will also be made to put decentralized entities and enterprises on a sound footing through a review of prices and rates.

In the financial area, plans call for monetary reform and reorganization of the operations of the nationalized banking system in which emergency loans for small and medium-sized industry and business will be promoted.

In the area of production, priority has been given to reactivation of agriculture, especially that intended for export, and to the repair of infrastructure in agricultural zones of high production potential.

In the social sector, a number of measures are being programmed, including particularly aid for war victims and the establishment of an emergency fund for employment.

The second stage envisages the transformation of the economic structure in the medium term. It involves adopting important economic reforms, including especially the deregulation of economic activity, the privatization of production resources owned by the State and the opening of financial intermediation to private and mixed institutions.

A number of programmes are also being projected to rebuild the physical infrastructure for roads, electricity, drinking water and telecommunications services.

The third stage, for the long term, establishes the modernization of the economy and its renewed participation in the international market in terms of greater productive efficiency. Some policy measures aimed at these objectives include the promotion of foreign investment, the modernization of agribusiness, industrial conversion, the promotion of non-traditional exports and the development of free areas.

In the social sphere, efforts will include reformulation of the education system, rehabilitation of the health system and the programming of regional and urban development.

To implement this economic and social programme, the new Government has assigned an important role to international co-operation. To date, however, it does not yet have detailed studies on co-operation requirements, in accordance with sectoral priorities. Furthermore, plans foresee the reorganization of institutions responsible for administering and controlling international co-operation.

