

INTERNATIONAL MONETARY FUND
AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

NICARAGUA

**Preliminary Document on the Initiative for
Heavily Indebted Poor Countries (HIPC)**

Prepared by the Staffs of the International Monetary Fund and
the International Development Association¹

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ABBREVIATIONS AND ACRONYMS

BANADES	National Development Bank
BANIC	Commercial and Industrial Bank of Nicaragua
CABEI	Central American Bank for Economic Integration
CBT	Negotiable Tax Certificate
CENIS	Exchange Rate Indexed Liabilities
CIRR	Commercial Interest Reference Rates
CORNAP	State-owned Holding Corporation
DSA	Debt Sustainability Analysis
ENABAS	State Supply Agency
ENACAL	National Water and Sewerage Company
ENEL	National Electricity Company
ENITEL	National Telecommunications Company
ESAF	Enhanced Structural Adjustment Facility
FISE	Emergency Social Investment Fund
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IDR	Rural Development Institute
IMF	International Monetary Fund
INISER	Public Insurance Company
INSS	Social Security Agency
INTA	National Agricultural Technology Institute
LSMS	Living Standards Measurement Survey
MINSA	Ministry of Health
NDA	Net Domestic Assets
NIR	Net International Reserves
NPV	Net Present Value
PETRONIC	Nicaragua Petroleum Company
PHC	Primary Health Care Model
PRD	Previously Rescheduled Debt
SIGFA	Integrated Financial Management System
SILAIS	Decentralized Health Management Units
SNIP	National System of Public Investment
SSF	Supplementary Social Fund

I. INTRODUCTION

1. This paper presents a preliminary assessment of Nicaragua's eligibility for assistance under the Initiative for Heavily Indebted Poor Countries (HIPC). Based on the analysis in this preliminary document, the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA) are of the opinion that, even with the full use of all traditional debt relief mechanisms, Nicaragua would still face an unsustainable level of external debt over the medium term. Section II assesses Nicaragua's eligibility under the Initiative by presenting the country's adjustment record since 1990, including macro-economic performance, and structural and social reforms. Section III details the policy outlook over the medium term. Section IV presents the debt sustainability analysis (DSA) agreed by the staffs of the IMF, IDA, and the Inter-American Development Bank (IDB), in consultation with the Nicaraguan authorities,² and summarizes the options for possible assistance under the Initiative (including the proposed enhancement of the HIPC Initiative framework) and the views of the authorities. Section V concludes with the staffs' recommendations and issues for discussion by the Executive Directors.

II. ASSESSMENT OF ELIGIBILITY

A. ESAF and IDA Status

2. Nicaragua is currently an Enhanced Structural Adjustment Facility (ESAF)-eligible and IDA-only country. Nicaragua, with a per capita GNP of US\$410 in 1998, is among the poorest countries in the Western Hemisphere. Twenty-year projections indicate that Nicaragua's per capita GNP would increase by 170 percent, to US\$1,120 in 2018. These projections assume GDP growth of 6.5 percent in 1999–01, gradually declining to 5 percent for the remainder of the period, and population growth declining gradually from more than 3 percent in 1999–00 to 2 percent by 2018. This outlook implies that Nicaragua will continue to need substantial international concessional assistance over the medium term, and to remain an ESAF-eligible and IDA-only country for the foreseeable future.

3. Nicaragua's social indicators are among the weakest in the region, partly reflecting its low income per capita (Table 1). Social indicators, including life expectancy, infant mortality, illiteracy, and the share of the population with access to sanitation and safe water,

² The DSA was prepared jointly with the authorities during missions in February and March 1999, with further consultation in Washington. The Fund staff team involved in its preparation comprised Mr. Cardemil (head), Messrs. Gudac, Justiniano, and Terrones (all WHD), Mr. Mendonca (PDR), and Mr. Ruiz (FAD), and the IMF resident representatives, Messrs. Gil-Diaz and Harnack. The IDA staff team comprised Messrs. Bannon (LCC2C), Lächler (LCCNI) and Kim (AFTD1). The IDB staff team included Mr. Brachowicz and Ms. Zavala.

are considerably poorer than the regional average. However, Nicaragua's social indicators are better than the average for other HIPC's.

Table 1. Nicaragua: Social Sector Indicators

(In units indicated)

Nicaragua	Indicator	HIPC's 1/	L. A. and the Caribbean
410	GNP per capita in 1998 (US\$) 2/	388	3,960
57	Infant mortality (per 1,000 live births)	97	31
68	Life expectancy (years)	52	70
62	Population with access to safe water (percent)	49	73
59	Population with access to sanitation (percent)	36	63
37	Overall illiteracy rate (percent)	47	15
37	Female illiteracy rate (percent)	57	16

Source: World Development Indicators Database.

1/ Excluding Nigeria from the original HIPC's.

2/ Preliminary.

4. In terms of poverty, the 1999 World Development Indicators show that 44 percent of the population live on less than US\$1 per day and about 75 percent live on less than US\$2 per day. IDA's poverty assessment estimated that in 1993 half of the population was poor and one-fourth extremely poor. Poverty is more extensive and deeper in the rural areas, with three out of four rural inhabitants living in poverty, compared with one out of three in urban areas, and close to four-fifths of all the extreme poor living in rural areas.

B. Adjustment Record

5. At the end of the 1980s, following a decade of civil war and inefficient and distortionary policies, Nicaragua's economy was in disarray. The country was afflicted by hyperinflation, an overextended public sector, and an underdeveloped, overregulated private sector. Widespread price and foreign exchange controls, multiple exchange rates, and inappropriate fiscal and monetary policies resulted in large macroeconomic imbalances that stifled economic growth. By 1990 real GDP had dropped to two-thirds and export volume to one-half of pre-1980 levels, while external debt had multiplied tenfold to US\$11 billion (700 percent of GDP). The extent of the deterioration was reflected in the country's social indicators, with infant and maternal mortality among the highest in the Western Hemisphere.

6. Beginning in 1990, Nicaragua changed its course drastically. Peace was re-established and the government began a transition to democracy and the transformation to a market-based economy. With the support of Fund arrangements (including a Stand-By Arrangement in 1991-92 and the first ESAF in 1994-97), and structural lending programs with the World Bank and the IDB, substantial progress was made in reducing macroeconomic imbalances and advancing the process of structural reforms. Financial

policies were strengthened, price controls eliminated, and the foreign exchange and trade systems liberalized. Considerable progress was made in strengthening government revenue, which in terms of GDP, about 25 percent in 1999, is among the highest within the group of HIPCs. A program of public asset divestment was implemented, and public employment and military outlays were reduced substantially. Private banks were allowed to operate again, public banks were liquidated or sold, and a superintendency of banks was created, all of which resulted in a significant improvement in private sector confidence.

7. Nicaragua's macroeconomic performance improved markedly during 1991–96. Inflation was reduced drastically and output growth (after more than a decade of negative rates) gained momentum beginning in 1993, reaching an annual average of about 4 percent during 1994–96. Investment began to recover in 1993 and rose rapidly during 1994–96 because of higher public and private capital formation, aided by a marked increase in private and official capital inflows. National saving, which had been negative for many years, started to recover in 1993, and became positive. The rate of open unemployment rose in the early 1990s to a peak of 22 percent, but declined to about 14 percent in 1996. The authorities' program under the first ESAF arrangement (approved in June 1994) had a satisfactory overall performance in the period through March 1995. The program weakened for a short period, before strengthening again in late 1995 and early 1996 under a staff-monitored program. However, in the period leading up to the presidential elections at the end of 1996, there was a loss of momentum in the reform process, and the arrangement became inoperative.

8. In early 1997, a new administration took office. The change of administration provided an opportunity for Nicaragua to resume the path toward economic stabilization and structural reform, in order to sustain high rates of economic growth and improve social conditions. In this context, the government prepared and started to implement a medium-term economic and structural reform program covering the 1997–00 period, which was subsequently supported by a new three-year ESAF arrangement, approved in March 1998.

9. The authorities' program supported by the three-year ESAF focuses on attaining further progress toward sustainability of the public finances and the external sector, intensifying structural reforms, and improving governance. Policies were strengthened beginning in 1997 and performance under the program in 1998 was broadly satisfactory. In 1998, fiscal performance was better than envisaged, despite serious adverse effects resulting from Hurricane Mitch, credit policy was tightened, and important progress was made in structural reforms and in governance improvements. In February 1999, the IMF Executive Board completed a midterm review and approved the augmentation of resources under the ESAF to help Nicaragua cover additional financing needs resulting from the devastation caused by Hurricane Mitch.

10. Under a preliminary program for 1999, prepared by the government in the wake of Hurricane Mitch, policies have continued to be on the right course, albeit there have been some deviations from the fiscal and structural targets. Preliminary indicators for the first half of 1999 point to the initiation of economic recovery, with a pick up in agriculture, including the hurricane-affected basic grains output, and a strong increase in domestic demand, driven by reconstruction activities and continuing private investment. Inflation fell to a 12-month

rate of 10 percent in July from 18.5 percent in December 1998, while international reserves have increased and unemployment has continued to drop.

11. As regards the programs with IDA, eighteen credits and five Fifth-Dimension supplementary credits totaling US\$693 million have been approved since 1991 when IDA support to Nicaragua was resumed. In addition to reviving economic growth and alleviating poverty, IDA's assistance has been directed at: (i) reforming the public sector and strengthening institutional capacity; (ii) investing in human capital; and (iii) improving environmental and natural resource management. Four operations have been successfully implemented and fully disbursed: two adjustment credits with their respective Fifth-Dimension supplementary credits, and the first and second Social Investment Fund Credits. The current portfolio consists of twelve projects aimed at: developing human capital (Health Sector Credits I and II and Basic Education, including a Supplementary Emergency Credit); reviving agriculture and strengthening natural resource management (Agricultural Technology and Land Management Credit, Rural Municipalities Credit and Forestry Credit); rehabilitating road infrastructure (Road Rehabilitation Credits I and II); intensifying institutional reform and strengthening the public sector (Institutional Development Credit); reforming state banks and improving prudential regulation and supervision of the financial sector (Financial Sector Adjustment Credit); supporting the social safety net (Third Social Investment Fund Credit); and emergency balance of payments support in the wake of Hurricane Mitch (Hurricane Emergency Project). In addition, Nicaragua prepared and successfully completed a commercial buyback operation with support from the IDA Debt Reduction Facility, the IDB and other donors.

12. The IDB has supported Nicaragua's stabilization and structural adjustment programs, focusing on the rehabilitation of the productive and physical infrastructure, the social safety net, the improvement of the policy environment and the strengthening of key institutions. Over the years, several important programs addressed key areas, starting with structural adjustment credits in the Trade and Finance Sector (1991) followed by an Agriculture Adjustment Credit (1992), Public Enterprise Reform (1994), Public Administration Reform (1996), and the Social Investment Fund (1992 and 1994). At present, the IDB has 23 operations (loans amounting to \$576.4 million) under supervision including two quick-disbursing credits approved in 1998 in the financial and energy sectors, and two projects in the social sector (Social Investment Fund Phase III and Hospital Modernization).

13. Other multilateral institutions and bilateral donors have also provided substantial financial and technical assistance in support of Nicaragua's stabilization and adjustment programs.

C. Structural Reforms

14. Since 1990, the Government of Nicaragua has implemented a wide range of structural reforms. The underlying objectives were to support macroeconomic stabilization, enhance the conditions for faster and sustained growth by transforming the economy from a state-controlled into a market-based system, and to alleviate the country's widespread poverty. Key elements in this reform process were the public sector downsizing while redirecting

expenditure toward the social areas, and the creation of an appropriate incentive and regulatory framework to foster private investment (Box 1).

Box 1. Nicaragua: Key Structural Indicators, 1990–98			
	1990	1995	1998
Size of the public sector (%)			
Public sector employment/total labor force	23.9	6.6	5.3
Central government current expenditures/GDP	33.0	22.5	21.0
Size of public sector banking system (%)			
Share of total deposits	100	43	2
Share of total assets	100	57	2
Overall economic performance(%)			
GDP per capita growth (three-year averages)	-7.6	-0.7	1.5
Annual inflation rate (CPI)	>1,000	11.2	13.0
Exports, goods and nonfinancial services/GDP	25.0	35.6	39.1
Sources: World Bank and Fund staff estimates.			

15. **Public sector reform.** The restructuring of the public sector over the past eight years has been remarkable. It included a significant reduction in public sector employment, the privatization of public enterprises, and a significant reduction in defense outlays. The public sector, which employed around 285,000 people (or 24 percent of the labor force) in 1990, was reduced to about 100,000 employees by 1998.³ In 1990, the government owned and managed 351 commercial enterprises through a holding company (CORNAP), with production accounting for about 30 percent of GDP. By 1996, nearly all these enterprises either had been sold to the private sector, returned to former owners, or liquidated. In 1998, the national assembly approved the Law on Organization of the Executive Branch, which reduced the number of central government ministries from 15 to 12, the number of decentralized entities from 25 to 22, and the total number of high level public officials (department director or higher) by 25 percent.

16. **Public utilities reform.** Following the divestiture of commercial enterprises, attention shifted toward improving the efficiency of the public utilities, which had been operating as loss-making institutions. The first step consisted of the introduction of harder budget constraints, and the separation of operational and regulatory functions. Regulatory

³ With the introduction of voluntary retirement programs in 1993, a major effort was made to obtain an accurate count of all persons employed in the public sector, their occupational category and their remuneration levels. Also, public administrative procedures were reformed to prohibit any new hires that did not correspond to available positions included in the budget.

agencies were established in 1995 for the telecommunications and energy sectors, and in November 1997 for the water and sanitation sector. The structure of public utility tariffs was also revised and formulas were introduced in 1997 to adjust these tariffs gradually toward long-run marginal cost levels. Finally, privatization efforts are underway for the telecommunications and energy sectors, in parallel with efforts to strengthen the regulatory agencies in each sector. The national assembly approved several laws in 1998 that improved conditions for the privatization of the telephone company (ENITEL), and liberalized the exploration and sale of hydrocarbons. The state-owned petroleum company, PETRONIC, has been leased to the private sector. The legal charter of the power utility, ENEL, was changed in 1997 to permit private sector participation in electricity generation and distribution. Three private sector generation projects came on line in 1998.

17. The **tax system** was progressively simplified and the tax base broadened through a series of tax reform packages that reduced top tax rates while reducing exemptions. Also, tax administration has been improved by updating and modernizing the registry of large contributors, improved audit control of industries subject to excise taxes (so-called “fiscal” industries), and better enforcement through the courts.

18. **Labor market and social security reform.** Commodity-based remuneration practices were phased out in 1991–92, and a new labor code (1994) introduced greater flexibility in the contracting of labor. The reform of the social security system started in 1995 by separating the pension and health insurance system (INSS) from social welfare operations.

19. **Financial sector reform.** The financial sector has experienced a profound transformation since 1990, when state-owned banks and the insurance companies monopolized financial intermediation, which resulted in a gross misallocation of resources. In 1991, an independent banking superintendency was established and the commercial banking system was opened to private sector participation, and currently there are 14 private banks with more than 98 percent of total banking sector assets. At the same time, the conduct of monetary policy became progressively more market-oriented, including the abolition of most interest rate controls and directed lending statutes by 1994, and the unification of reserve requirements in 1997. To correct continuing problems with the public sector banks, the government closed and liquidated the largest state-owned bank, the National Development Bank (BANADES), during 1997–98 and awarded a majority share of the second largest state bank, the Commercial and Industrial Bank of Nicaragua (BANIC), to private investors in early 1999. Complementing these actions, the banking regulatory system was strengthened through revisions of the prudential norms (in 1994 and 1998) and a program of training for bank regulators. The **insurance market** was opened up to private firms in 1997 and there are currently five private companies competing with the public insurance firm (INISER).

20. **Trade and pricing policy reform.** In the early 1990s, state import and export monopolies were eliminated, and the nominal tariff rate ceiling was progressively reduced from 60 percent to 10 percent in July 1999. Import duties above 10 percent still apply to a limited number of commodities, which are being reduced under an established schedule. Most price controls were eliminated in 1991–93. The use of negotiable tax certificates

(CBTs) was phased out in 1997, with export promotion efforts refocused toward less distortionary temporary importation and export-processing zone regimes.

21. **Reforms to improve governance** have focused on two broad areas. First, ensuring the **rule of law**. This includes strengthening the judicial system through a program of court house construction and training of judicial system officials, and measures to strengthen property rights and accelerate the resolution of property claims. Between 1992 and 1993, several official agencies were established with the aim of solving outstanding property disputes through administrative means: the National Review Commission (to review property claims and recommend compensation or return of properties), the Office of Territorial Ordinance (to review the legality of past land reform allocations) and the Office of Compensation (to determine fair compensation for confiscated properties). These efforts to resolve outstanding property claims received a further boost with the approval by the national assembly in November 1997 of a law governing urban and rural properties. This law resulted in an acceleration of property conflict resolutions; the number of property conflicts settled in 1998 was 31 percent higher than the annual average in 1995–97.

22. The second focus area refers to **greater accountability and transparency in the management of public finances**, through the introduction of an Integrated Financial Management System (SIGFA) in core ministries over 1995–98, and the implementation in 1997–99 of a comprehensive fiscal budgeting approach that includes all revenue sources.

D. Social Policies

23. Nicaragua's strategy for poverty alleviation and social development focuses on: (i) promoting economic growth with equity, (ii) investing in human capital, (iii) establishing a social safety net to protect the most vulnerable, and (iv) fostering rural development to stimulate growth and reduce rural poverty. Efforts have been underway since the early 1990s to increase equity, effectiveness and accountability in the delivery of education and health services, and in the provision of social infrastructure. Special emphasis has been given to the provision of primary education and basic health services targeted at rural municipalities, where most of the poor are concentrated. In line with its poverty alleviation strategy, the government has made considerable efforts to shift current expenditures toward the social sectors. As shown below in Table 2, Nicaragua allocates a relatively high share of GDP to the social sectors, averaging over 12 percent during 1993–99, although given the country's low income level, annual social expenditure per capita remain extremely low (equivalent to US\$17 per capita in health and US\$50 per student in education). A Supplementary Social Fund was created in 1998 with funding from bilateral and multilateral sources to facilitate the expansion of public spending on selected social programs.

Table 2. Nicaragua: Social Expenditures as a Share of GDP (Percentage)

	1993	1994	1995	1996	1997	1998 ¹	1999 ²
Total social expenditures	10.9	12.1	12.7	12.4	11.8	11.3	14.8
Education	4.4	5.1	4.6	4.7	5.1	4.9	5.9
Health	3.9	4.4	4.8	4.6	4.0	3.7	5.5
Other	2.5	2.6	3.3	3.1	2.7	2.7	3.3

Source: Table 6.

1/ Preliminary.

2/ Budgeted.

24. **Education.** Education indicators have improved somewhat but remain inadequate, especially in terms of high illiteracy and low primary enrollments (Table 3), and quality remains low throughout the education system. The education ministry has initiated a program of delegating school administrative functions to the local level, such that by 1998, 83 percent of secondary students and 52 percent of primary students were enrolled in autonomous schools. In addition, a number of important measures were taken to improve coverage in pre- and primary schools, and lower repetition and dropout rates, including: (i) the rehabilitation of two-thirds of all primary schools and the provision of revised textbooks and workbooks to all students in grades one through six from 1995 through 1998; (ii) the introduction of an incentive system for teachers supervised by parents, and teacher-training; (iii) the initiation of a community pre-school program that currently covers 30 percent of the age cohort; and (iv) the reform of education budgeting procedures, which are now based on a more transparent and equitable formula of per capita financing.

Table 3. Nicaragua: Main Education Indicators

1980-85	Indicator	1992-97
41	Illiteracy rate, adult female (% of females 15+)	37
40	Illiteracy rate adult male (% of males 15+)	37
40	Illiteracy rate, adult total (% of people 15+)	37
73	School enrollment, primary (% net)	78
75	School enrollment, primary, female (% net)	79
71	School enrollment, primary, male (% net)	77
19	School enrollment, secondary (% net)	27

Source: World Development Indicators Database.

25. **Health.** Since the early 1990s, Nicaragua has been making efforts to reform the health sector in order to improve quality and coverage, especially at the basic level. Health indicators show a marked improvement in a number of key areas (Table 4), including immunization coverage and access to safe water and sanitation in urban areas. There are important areas, however, where results have been limited, especially access to safe water and sanitation in rural areas, and maternal mortality. The government's reform process initiated in 1991 has concentrated on: (i) the rehabilitation of primary health and hospital infrastructure, especially in poor areas; (ii) the introduction of an integrated primary health care model (PHC); and (iii) the design of the main components of a decentralized health system. This design contemplates a deconcentration of the Ministry of Health (MINSA), the expansion of health insurance via the INSS and the purchase of health services by the INSS from both public and private providers. In response to the creation of a health insurance system, private health maintenance organizations have emerged to meet the INSS' growing demand to purchase health services for its beneficiaries.

Table 4. Nicaragua: Main Health Indicators

1985–89	Indicator	1992–97
13	Safe water, rural (% of rural population with access)	28
77	Safe water, urban (% of urban population with access)	93
50	Safe water (% of population with access)	62
35	Immunization, DPT (% of children under 12 months)	94
49	Immunization, measles (% of children under 12 months)	94
27	Sanitation (% of population with access)	59
35	Sanitation, urban (% of urban population with access)	88
143	Mortality rate, under-5 (per 1,000 live births)	57
189	Mortality rate, adult, female (per 1,000 female adults)	126
80	Mortality rate, infant (per 1,000 live births)	43
59	Life expectancy at birth, total (years)	68

Source: World Development Indicators Database.

26. **Social safety net.** The Emergency Social Investment Fund (FISE) and the Supplementary Social Fund (SSF) are the main social safety net programs in Nicaragua. FISE finances community infrastructure and targets its projects based on a poverty map derived from the 1993 Living Standards Measurement Survey (LSMS). Its projects have focused on construction and repair of primary schools and basic health facilities, water and sanitation infrastructure, including the rehabilitation and installation of safe water systems,

sewerage and latrines in rural and marginal urban areas. The SSF was created in 1998 to increase the level of social expenditures in the education and health sectors.

27. **Rural Development.** Priorities in rural development include improving land security, access to credit, developing rural infrastructure, strengthening technology and extension, and preserving the environment. Since 1991, the government has taken a number of measures to promote rural development, including: (i) creation of a national system of extension and agricultural technology—coordinated through the National Agricultural Technology Institute (INTA)—in 1993; (ii) the provision of rural infrastructure targeted on poor communities through FISE, and the Rural Development Institute (IDR); and (iii) the initiation in 1997 of a support program for small-scale basic grains farmers in poor regions of the country. To reduce insecurity in land ownership, a land management program, started in 1993, is modernizing the cadastre and property registries, and providing titles to rural land owners. Efforts are also underway to extend credit services to rural area.

III. POLICY OUTLOOK

28. The government's policies for 1999–01 have been framed in the context of a medium-term program which aims at advancing towards sustainability of the public finances and the public sector; strengthening the process of structural reform and implementation of social and poverty reduction reforms; and thereby enhancing the basis for sustained, high and equitable growth.

A. Macroeconomic Objectives and Policies

29. The agreed **macroeconomic objectives** for 1999–01 are to: (i) reduce the 12-months inflation rate from more than 18 percent in 1998 to 10 percent at end-1999 and to 7 percent by end-2001; and (ii) increase gross international reserves by end-2001 to about 3.5 months of imports and more than 200 percent of short-term debt due, while net international reserves (NIR) would cover about 80 percent of the monetary base. On average, the annual growth rate of real GDP growth is projected at about 6.5 percent (Table 5). In the long term, the authorities aim at maintaining the rate of output growth close to 5 percent a year, or about 2.5–3 percent in per capita terms.

30. **Reconstruction program and social expenditures.** The authorities' policies for 1999–01 will permit the implementation of the program of reconstruction, and an expansion of social and poverty reduction programs. Reconstruction outlays are projected at US\$190 million annually in both 1999 and 2000, which are to be covered with concessional foreign financing and executed according to satisfactory project evaluation by the World Bank. Social expenditure is projected to increase by close to 4 percentage points of GDP to reach more than 15 percent of GDP in 2000–01 (Table 6). The authorities will prepare an enhanced framework for poverty reduction by the decision point, based on the latest information available from the LSMS conducted with the support of the World Bank. This plan will include an evaluation of the appropriate level of social expenditure in 2000–01 taking into account possible assistance under the HIPC Initiative.

31. **Fiscal policy.** The fiscal program will seek to limit the public sector deficit to less than 14 percent of GDP in 1999, and to reduce it to 10 percent in 2000 and 8 percent in 2001, in a path of further fiscal consolidation. Public sector saving (excluding interest obligations) would increase from 10 percent of GDP in 1999 to 11 percent by 2001 (or 12 percent if one-time current expenditures are excluded). Central government revenue is expected to decline from over 26 percent of GDP in 1998 to about 24 percent in 2001 due to further trade liberalization, more than offsetting the increase in excises on cigarettes, beer and liquor. The government is committed to follow a cautious policy on expenditure, especially on nonreconstruction/nonsocial outlays. Expenditures on goods and services, transfers, and the wage bill are to be tightly controlled. As a result, noninterest current outlays will decline by close to 4 percentage points of GDP over 1999–01.

32. **Monetary policy.** A prudent monetary policy will be maintained, consistent with the reserves and inflation targets. In case the fiscal position were to be stronger than envisaged, the central bank will have room to reduce the stock of its short-term exchange rate indexed liabilities (CENIS) to further reduce a source of debt vulnerability. The deepening of the financial sector reform, as described below, will improve the soundness of the banking system and is expected to reduce the spread between deposit and lending rates, fostering private savings and stimulating private investment.

33. **Exchange rate policy.** In July 1999, the authorities reduced the rate of the crawling peg to 9 percent a year, from 12 percent previously. A further reduction to 6 percent is expected in early 2000, while the exchange rate will be allowed to fluctuate within a band around the central crawling peg rate. These actions will help to sustain the reduction in inflation and introduce more flexibility in the current exchange system to respond to internal and external shocks.

B. Structural Policies

34. In the 1999–01 period, the government intends to consolidate its ambitious structural reform program and to introduce a series of “second generation” reforms. The second generation reforms will focus on the legislative and institutional framework necessary to promote financial savings and development of domestic capital markets, through the strengthening of the financial sector, a comprehensive social security reform and the improvement of governance. The scope for private sector activity will be broadened further through privatization of public utilities and contracting out to the private sector of government-provided services. To further improve the business environment, the government will strengthen protection of property rights and step up the resolution of pending property claims, improve transparency and accountability in public sector operations, and take further measures to strengthen the judicial process.

35. **Public sector and public enterprises.** Under its privatization program, the government has restarted the ENITEL privatization process, after taking cost cutting measures and raising tariffs to improve its financial situation, and it intends to bring the enterprise to the point of sale by January 2000. The distribution and generation units of

ENEL will be offered for sale or long-term leases, and several departmental units of the water and sewerage system (ENACAL) will be offered for long-term lease starting in December 1999. Also, the government will divest assets of the state food marketing enterprise (ENABAS) in 1999 and grant concession to the operation of major port facilities in 2000.

36. To improve the efficiency of public investment, the government plans to strengthen the legal status and mandate of the National System of Public Investment (SNIP), empowering the technical secretariat of the office of the presidency to review and oversee public investment across ministries, and thus provide greater cohesion to the country's public investment and development strategy. Also in the interest of economic efficiency, the government plans to continue implementation of periodic rate adjustments in the power, water, and telecommunications sectors, to align tariffs with long-run marginal costs.

37. Streamlining of the government will continue primarily through contracting out of services (road maintenance and other public works done by the operating units of the ministry of transportation, and the security, and catering services in the health facilities). The government also is considering a further reduction in the size of the military, and retraining some of the redundant military personnel into the police force. The reform of government ministries in line with the mandates set in the law approved in 1998 will continue through 2001.

38. **Financial sector.** The government intends to take important measures to improve soundness of the financial sector. The government has prepared three laws (in consultation with IDA, the IDB, and the Fund) to improve the legislative framework for the financial sector. A revised banking law would set clear rules for entry and exit from the system, permit consolidated supervision of financial groups, and provide a clearer base for enforcing prudential norms, including limits on lending to related parties. A new bank superintendency law will clarify the responsibilities of the superintendency and its regulatory council in bank regulation and supervision, and reduce room for discretion in the enforcement of prudential norms. Revisions of the central bank charter are expected to increase central bank autonomy, clarify financial and accounting relations between the bank and the treasury (leading to central bank recapitalization and elimination of quasi-fiscal operations), and permit open-market operations with treasury bills. The draft laws are being submitted to the assembly before the end of 1999.

39. As regards divestiture of public banks, as mentioned above, majority control of BANIC was awarded to the private sector in January 1999. A law permitting the privatization of the remaining state bank (*Banco de Crédito Popular*) is expected to be approved soon, so that the bank could be offered for sale in 1999.

40. Further steps to improve the soundness of the financial system will be based on a study supported by World Bank technical assistance, which will recommend criteria and procedures for bank exit, crisis resolution, and a deposit insurance scheme, including the structure of an agency to implement it. A program of further measures will be developed by December 1999 and implemented in 2000–01.

41. **Social security.** The government is committed to a comprehensive social security reform that will improve the position of the existing pension system and introduce a new system of individually funded accounts managed by the private sector (being prepared with IDA technical assistance). The first step was taken in April 1999 by separating the pension accounts and the health insurance accounts. The reform law, which has been prepared in consultation with IDA, the IDB, and the Fund, will be submitted shortly to the assembly. Changes in the contribution rates, retirement age, and at the parameters of the new system will be introduced following approval of the law. The implementation of the new system of individual account will start toward the end of 2000.

42. **Governance and public accountability.** Improvements in this area will be pursued through better transparency and accountability in the management of public finances, an accelerated resolution of outstanding property claims, continued modernization and strengthening of the judiciary, and greater decentralization, municipal development, and enhanced civil society participation. The government has submitted to the assembly a public sector procurement law along the lines recommended by the World Bank and the Fund. By end-September 1999, SIGFA is expected to be fully implemented in all core government ministries. The next steps to be implemented through end-2000 include extension of the system to all government entities and broadening of its coverage to include planning and execution of human resources, public investment and procurement policies. Also, the government will improve transparency of cash management of the treasury by putting all domestic operations under centralized cash management (*cuenta única*).

43. The Property Intendency in the ministry of finance has received funding (mostly from donors), and strengthened its implementation capacity to accelerate the resolution of property claims and land titling. Also, the 1999 plan of the ministry of agriculture envisages the activation of departmental cadastres and registries. A National Property Mediation Center is expected to be established by December 1999. The next steps in the strengthening of the judiciary would include approval by the assembly of an administrative process and dispute settlement law, a stepped-up modernization of public registries, and establishment of a Public Defender's Office in 1999–00. In 2000–01, the commercial, civil, and penal codes would be reformed and the law on public registries of real estate and other properties would be revised.

44. Decentralization will continue to be promoted through the school autonomy program in the education sector and the gradual delegation of powers to the local integrated health care systems (SILAIS) in the health sector. The roles of municipalities and civil society will be enhanced through contracting out road maintenance activities to private or communal microenterprises in the transport sector and the application of microplanning approaches emphasizing community participation in the provision and maintenance of social infrastructure by FISE.

45. **Environment.** The government has submitted to the assembly a law to demarcate indigenous lands, which is expected to be approved following consultations with beneficiaries. Also, to rationalize the management of natural resources, a new law to regulate

the mining sector will be submitted to the national assembly by September 1999, and new laws to regulate the forestry and fisheries sectors will be submitted by January 2000.

C. Social Policies

46. **Social policies and poverty alleviation strategy.** The government's poverty alleviation and social development strategy is based on the poverty profile and analysis carried out with IDA support in 1993–94, which is being updated. The strategy has focused on the following four pillars: growth, investing in human capital, strengthening the social safety net, and promoting rural development. Owing to international donor support in the wake of Hurricane Mitch and support for the Supplementary Social Fund, total social expenditures are expected to reach about 14.8 percent of GDP in 1999, and rise to 15.4 percent over the next two years. The technical secretariat of the presidency has been assigned to coordinate priorities and improve the effectiveness of social policies. Together with line agencies and technical support from the IDB and IDA, the secretariat has identified a set of quantitative targets (Table 7)—aiming at approaching the OECD-DAC social development targets by the year 2015, monitoring execution of the government's social policies and programs, and ensuring accountability in the use of funds. The Secretariat, with continued support from IDA and the IDB, and in consultation with civil society, will prepare an enhanced framework for poverty reduction to underpin the HIPC process.

47. A redefinition of the role of the state and decentralization of management functions and responsibilities are also key elements of the strategy for the social sectors. The decentralization entails a gradual transfer of decisions on budget execution (except for the payroll) from the MINSA to the departmental health care units (SILAIS) and to municipalities, and on school administration and financial management from the ministry of education to local school councils. The ministries are being gradually transformed from service providers into policy setting, coordinating and regulatory agencies. In line with the decentralization objective, FISE and the PROTIERRA program will provide support to municipal governments to build their capacity to manage projects and maintain community infrastructure.

48. **Education.** The government will continue to implement education reforms which aim to raise primary school completion rates by improving the coverage, quality and relevance of primary education, rehabilitating education facilities, and improving student and teacher incentives. The government aims at increasing the allocation to the education sector, reaching over US\$70 per student in 2000–01, increasing the share of nonsalary current expenditures per student, and improving the administrative structure of the sector. Quality improvements would be sought through intensified teacher training and evaluation, improved curricula, more and better textbooks, and increasing the number of schooling days. Incentives for students to stay in school include the provisions of school materials (the school pack), scholarships for poor rural areas, as well as a school feeding program. The government will also continue efforts to expand coverage of pre-schools and improve secondary education. By end-1999, a procedure for selecting autonomous school directors will be agreed and adopted, and at least 95 percent of secondary schools and 65 percent of primary schools will be managed by local school boards as envisaged under the school autonomy program.

49. **Health.** Reforms will focus on strengthening primary and preventive care and epidemiological control by extending the integrated model for public care at the national level. The government aims at increasing allocations to the health sector, and reaching over US\$27 per capita in 2000–01. Primary health facilities are being rehabilitated to improve coverage, including the provision of essential pharmaceuticals and medical supplies. The government is also improving the availability of reproductive health services and introducing nutritional assistance for mothers and their young children. School feeding programs in poor areas will be extended, and a program of targeted delivery of nutritional supplements to the most needy will be implemented. An improved contracting system and performance-based incentives for medical personnel will be operational on a national basis by end-2001.

50. **Social safety nets.** FISE together with the SSF will remain the main vehicles to assist the building of social infrastructure in poor counties and complement current expenditures in the social sector. FISE will expand its efforts to strengthen institutional capacity in municipal governments and ensure that projects respond to priorities articulated by local communities. In addition, the government is developing, with the support of the IDB, a pilot safety net program targeted on the most needy, which is expected to begin operating in early 2000. The program will assist the poorest families by subsidizing their children's education and improving health care for pregnant/lactating women and children under two years of age.

51. **Poverty monitoring.** The government is aware that implementation of its poverty alleviation strategy requires an adequate data base to monitor poverty conditions. With support from IDA, the government carried out a second LSMS in 1999, including a detailed rural module and oversampling to permit an evaluation of the impact of FISE's interventions in poverty alleviation. The results of the LSMS will be used to prepare an update of the 1993 poverty profile, including an analysis of the determinants of rural poverty. The results will also be used to redraw the poverty map, which, coupled with an assessment of the poverty impact of FISE, will serve to improve the targeting of FISE and other social safety net programs. The data and analysis will also assist the government determine changes in the poverty situation as a result of Hurricane Mitch.

52. **Rural development.** Rural development will continue to be promoted through an accelerated program of land titling and registration, and improved technology. To increase agricultural yields and improve human capital, INTA will continue to expand coverage of agricultural extension services and implement its basic grains, crop diversification, and seed improvement programs. To remove distortions that hinder access of small-scale farmers to financial services, the government is providing temporary incentives to commercial banks to open branches in rural areas, taking steps to set prudential standards and minimum reporting requirements on nonbank financial intermediaries, and is preparing a revision of norms on bank guarantees to permit the use of movable property as collateral. A number of steps are being taken to improve land security. The government plans to accelerate its land titling program and to set up and activate departmental cadastres. The Supreme Court plans to modernize the property registry in Masaya in 1999 as a pilot project that would be expanded nationally during 2000–01. In developing local infrastructure, FISE plans to step up approval and execution of community-supported (participation and maintenance) water and sanitation

projects, and the reconstruction of schools and health centers targeting areas with highest poverty incidence.

IV. DEBT SUSTAINABILITY, SENSITIVITY, AND VULNERABILITY

A. Debt Sustainability Analysis

53. The DSA has been prepared jointly by the staffs of the IMF, the World Bank, and the IDB, in consultation with the Nicaraguan authorities, on the basis of loan-by-loan data provided by the authorities for debt outstanding at end-1998. The DSA evaluates Nicaragua's prospects for attaining external debt sustainability through an examination of debt levels in the context of a 20-year macroeconomic and balance of payments framework⁴.

54. The debt estimates and net present value (NPV) calculations⁵ are preliminary, pending the completion of the debt reconciliation exercise with creditors. Nicaragua has formally contacted its creditors regarding the reconciliation of its external debt and has now reconciled more than 85 percent of the total external debt stock outstanding at end-December 1998, as well as debt service payments falling due from these claims. The reconciliation of debt with all multilateral creditors has been completed. In relation to Paris Club creditors, all debts have been reconciled except for claims of the United States and Italy. In relation to other bilateral creditors, most of the debt has been reconciled but debt with some creditors, including Brazil, Honduras, India, and Iran, remains to be reconciled.⁶

55. At end-1998 the stock of Nicaragua's external debt is estimated to have been about US\$6 billion, including US\$2.1 billion in arrears to non-Paris Club bilateral official and commercial creditors. The NPV of this debt stock is estimated at US\$5.2 billion, of which 26 percent was owed to multilateral creditors, 26 percent to Paris Club official creditors, 43 percent to other official bilateral creditors, and 5 percent to commercial creditors (Table 9).

56. Nicaragua has had three rescheduling agreements with the Paris Club. The first agreement, reached in December 1991, provided for flow reschedulings on London terms (50 percent NPV reduction). The second and third agreements were reached in March 1995

⁴ Changes from the earlier analysis undertaken jointly by the Fund and the Bank in March 1998 (EBS/98/7, Supplement 1) are primarily due to the updating of the balance of payments projections and discount rates.

⁵ The NPV of debt is calculated using the average currency-specific commercial interest reference rates (CIRRs) for the six-months period ending December 31, 1998 (Table 8).

⁶ These creditors reported claims outstanding at end-1998 of more than US\$100 million higher than the figures reported by Nicaragua (mostly due to differences in late interest charges). The authorities' figures were used in this document, pending a final reconciliation.

and April 1998, respectively, and provided for flow reschedulings on Naples terms (67 percent NPV reduction).⁷ The first tranche of the 1998 agreement has been implemented, while the second and third tranches are conditional on the Fund's approval of the second and the third annual ESAF arrangement, respectively. In December 1998, after Hurricane Mitch, Paris Club creditors provided a deferral on all debt service payments due during the remainder of the consolidation period. Several Paris Club creditors have forgiven, in whole or in part, their claims on Nicaragua, including some after Hurricane Mitch⁸.

57. Nicaragua also reached rescheduling agreements in 1995–96 with a number of non-Paris Club official bilateral creditors, including agreements with Mexico and the Czech Republic providing debt reductions in NPV terms of about 92 percent. A commercial debt buyback was concluded in December 1995 at a 92 percent discount, financed through a grant provided by the IDA debt reduction facility, a concessional loan from the IDB, and assistance from bilateral donors. In September 1997 Nicaragua reached a rescheduling agreement with the Central American Bank for Economic Integration (CABEI), in which some US\$104 million in arrears was forgiven (on the basis of it to be counted as part of CABEI's interim assistance under the HIPC Initiative).

58. **Baseline assumptions.** The medium-term scenario assumes a successful implementation of macroeconomic, structural and social policies under ESAF-supported programs, needed to sustain high rates of economic growth and reduce poverty. It also takes into account the implementation of the reconstruction program, financed mainly by official capital inflows that would help to rebuild the capital stock destroyed by Hurricane Mitch. The consequences of Hurricane Mitch have introduced additional uncertainties in the medium-term prospects, in particular with respect to GDP and export growth, and the projections are preliminary and subject to revisions. Key assumptions underlying the baseline scenario are quantified in Table 10 and described in Box 2.

⁷Nicaragua reached a rescheduling agreement with Russia in 1996, before Russia became a Paris Club member. When Russia joined the Paris Club this agreement was considered to be comparable to the Naples terms treatment that Nicaragua had received from Paris Club creditors.

⁸Also, through the Central American Emergency Trust Fund, bilateral donors are financing a significant part of the debt service payments of Nicaragua to multilateral institutions.

Box 2. Nicaragua: Main Assumptions in the Debt Sustainability Analysis

Growth

- The Nicaraguan economy is assumed to grow at an average rate of about 6.5 percent during 1999–01, and then to slowdown slightly with the growth rate stabilizing at 5 percent in the long run.
- The investment-to-GDP ratio is projected to increase from 33 percent in 1998 to 37 percent in 1999, reflecting the large investment in infrastructures related to the reconstruction program, and it is projected to decline gradually afterwards to about 24 percent by 2018, while the productivity of capital will increase steadily. National saving is projected to increase from 6 percent in 1998 to 17 percent in 2018.

Exports and imports

- After declining in 1998, the volume of exports of goods is projected to increase in the medium term slightly faster than the real GDP. Export growth is expected to be supported by the growth of nontraditional exports. A steady increase in services receipts, in particular tourism, is also projected. As a result, the ratio of exports of goods and services in relation to GDP would increase from 39 percent in 1998 to 40 percent on average in 1999–08 and 46 percent in 2009–18.
- The volume of imports is projected to increase strongly in 1999–00 with the reconstruction efforts. A rate of growth below real GDP is projected for the period 2002–05, and an income elasticity of one is assumed after 2005. Services payments are projected to increase at a lower rate than imports of goods, and the imports of goods and services in terms of GDP are projected to decline from 72 percent 1998 to 68 percent on average in 1999–08 and 61 percent in 2009–18.

Capital account

- It is assumed that Nicaragua will obtain official financing, both transfers and concessional loans, averaging US\$440 million in 1999–08 and US\$340 million in 2009–18.
- Private capital, mainly foreign direct investment, is assumed to remain on average at about US\$380–US\$420 million during this period.
- The residual financing gap is projected to be around US\$110 million during the first decade and US\$290 million in the second decade. The gap is assumed to be financed on concessional terms: 40-year maturity, 10-year grace, and 2 percent interest rate per annum.
- Gross official foreign reserves are projected to increase from one month of imports of goods and nonfactor services in 1998 to 3.5 months in 2001, and to slowly raise to 4 months of imports in the longer term.

59. **Balance of Payment projections.** The current account deficit, estimated at 33 percent of GDP in 1998, is projected to rise to 34 percent of GDP in 1999. In the medium term, the deficit is projected to decline steadily, to below 20 percent of GDP in 2005, and reaching 11 percent on average in 2009–18, as national saving (in particular, public sector savings) improves, helped by a gradual convergence toward fiscal consolidation. After an initial period of large official capital inflows associated with the post-Mitch reconstruction program, official transfers and loans are projected to decline over time. Gross official reserves are projected to increase to three and a half months of imports of goods and nonfactor services by 2001, and to increase to four months in the long term. After the full

application of traditional debt rescheduling mechanisms, a financing gap is projected to remain over the medium term (Table 11).

60. **Debt rescheduling assumptions.** The baseline scenario assumes full use of traditional rescheduling mechanisms. It also assumes that the second and third tranches of the April 1998 Paris Club rescheduling agreement will be implemented. Subsequently, the baseline envisages a hypothetical stock-of-debt operation on Naples terms (67 percent NPV reduction) on pre-cutoff date Paris Club debt in March 2001, in accordance with the goodwill clause of the April 1998 agreement (no further treatment is assumed on debt to Russia, under traditional rescheduling mechanisms). This stock-of-debt operation is assumed to cover nonpreviously rescheduled pre-cutoff date debt and to include a topping up of previously rescheduled debt (PRD) on London terms.⁹ Comparable treatment is assumed from non-Paris Club creditors.¹⁰ It assumes also a buyback of eligible commercial debt in 1999, on the same terms as the 1995 buyback operation (92 percent reduction), which is expected to be financed through official grants and possibly IDA debt reduction facility.

61. Based on the assumptions and policies outlined above, Nicaragua's external debt ratios will remain at unsustainable levels. The NPV of debt-to-exports ratio (based on a three-year export average) would decline from 600 percent in 1998 to 440 percent in 2001, and would remain above 250 percent until 2008, and above 180 percent on average in 2009–18. The NPV of debt-to-central government revenue ratio would decline from 1000 percent in 1998 to above 500 percent in 2001 and it would remain above 280 percent until 2006 and at about 250 percent on average in 2009–18 (Tables 12 and 13). The debt-service ratio (after rescheduling) would decline from 32 percent in 1998 to 16 percent in 2000, and then would increase again reflecting the end of the deferral on debt service payments in 2001 and the start of the repayment of deferred amounts in 2002; only by the year 2008 would the debt service ratio decline again below 20 percent. The debt service-to-revenue ratio also will remain high throughout the period, peaking at more than 50 percent in the year 2002 and declining to 35 percent by 2008.

⁹ The topping up excludes short-term previously rescheduled debt on London terms, which the 1991 Agreed Minute stipulated that it would not be rescheduled again.

¹⁰ Previously rescheduled debt on terms at least comparable with Naples terms, is assumed not to be treated again under traditional rescheduling mechanisms. No assumption was made in the DSA in relation to a possible deferral of debt service payments on this debt, as well as on post-cutoff date debt due to non-Paris Club bilateral creditors; the Nicaraguan authorities are making best efforts to reach agreements on the deferral of these payments, while avoiding to damage their credit and trade relations with these creditors.

Summary Debt Indicators 1/

(In percentage)

	1998	1999	2000	2001	2002	2008	2009–18
NPV of debt-exports ratio	602	452	478	443	408	250	183
NPV of debt-revenue ratio	993	648	597	526	478	315	245
Debt service ratio	32.4	19.3	16.1	23.4	33.6	19.6	13.5
Debt service-to-revenue ratio	48.2	28.4	24.5	36.8	54.2	34.5	25.3

Sources: Tables 12 and 13.

1/ After rescheduling, assuming a stock-of-debt operation in 2001.

B. Sensitivity and Vulnerability Analysis

62. **Sensitivity analysis.** The Nicaraguan economy remains vulnerable to a wide variety of possible adverse shocks, including natural catastrophes, developments in international markets and availability of aid flows. Because of their importance, the sensitivity analysis presented here assesses the likely impact on the debt ratios of the following exogenous factors: a) lower export volumes of nontraditional exports; and b) higher interest rates and shorter maturities on the new borrowing required to close the financing gap. The alternative scenarios are based on the assumption that there are no policy adjustments to the shocks. On this basis, the current account deficit widens as a result of the shock, and is financed by additional external borrowing. The results of the sensitivity analysis are summarized in Table 14.

63. **Lower export volumes.** Nontraditional exports have increased significantly since the early 1990s, before dropping in 1998 as a result of Hurricane Mitch and the adverse effect of the elimination of a special tax incentive. The baseline assumes that nontraditional exports will increase at an annual rate of about 10 percent in U.S. dollar terms over the medium term, on the basis of recovery of agriculture and further increases in productivity and export capacity. If this rate were to be reduced, say, by one-third, the NPV of debt-to-export ratio would be on average 14 percentage points above the baseline during the next ten years and the debt-service ratio would be higher by approximately 1 percentage point a year.

64. **Less favorable external financing.** In the baseline scenario, the financing gap is assumed to be financed on terms similar to the IDB concessional loans (2 percent interest rate and 40-year maturity with 10-year grace). If this financing were to take place on less concessional terms (say 5 percent interest rate, with 20-year maturity and 5-year grace), the NPV of debt-to-export ratio would increase on average by 13 percentage points above the

baseline during the next ten years and the debt-service would on average be around 1 percentage point higher.

65. **Vulnerability.** The vulnerability of Nicaragua's economy relative to other HIPC, based on 1996 indicators, is illustrated in Table 15. The NPV of debt in relation to GDP is one of the highest, significantly above the average for other HIPCs. The fiscal indicators also reflect the high debt service burden, which are on average similar to the other HIPC countries, although higher than the average for countries that have received a stock-of-debt operation. Tax revenue and official grants are higher, as a percent of GDP, than the average of the HIPC group. The noninterest current account deficit is also almost double the average of the HIPCs as a group. The reserve coverage was also significantly below the average of other HIPCs.

66. A factor of strength is the relatively more diversified export base, with the main export, coffee, representing in 1996 only 14 percent of exports of goods and nonfactor services, significantly below other HIPCs. However, the variability of exports, defined as the standard deviation of export values over the 10-year period 1986–95, is higher than the average of other HIPCs; in addition, this indicator understates vulnerability when one takes into account the large fluctuation of export values observed since 1996. Another factor of strength is the large volume of private remittances into Nicaragua from emigrants living in Costa Rica and the United States.

67. **Domestic debt.** Another source of vulnerability in Nicaragua's economy is the large value of the U.S. dollar indexed public domestic debt outstanding, which represents an increasing fiscal and quasi-fiscal burden. Besides the short-term liabilities, CENIS, referred to in paragraph 32, with a value outstanding of about US\$200 million as of end-1998, indemnification bonds are being issued to compensate owners/investors of the assets expropriated in the 1980s, as an important part of making progress toward the resolution of property rights issues. These bonds have a 15-year maturity, with 10-year grace, and an interest rate of 3–5 percent. The principal of the first bonds issued starts falling due by 2004. As of end-1998, the nominal amount outstanding of these bonds was about US\$500 million.

C. Eligibility, Decision, and Completion Points

68. Based on the above analysis of an unsustainable debt burden under the baseline scenario, Nicaragua would qualify for assistance under the HIPC Initiative, under both the export and the fiscal/openness criteria. Nicaragua meets the thresholds required for assistance under the fiscal/openness criterion since the export-to-GDP ratio and central government revenue-to-GDP ratio in 1998 were 43 percent and 25 percent, respectively, using a three-year average of GDP, central government revenue and exports of goods and nonfactor services.

69. As previously described, Nicaragua's improvement in economic performance has been strong since the early 1990s aided by a Stand-By Arrangement in 1991–92, the first three-year ESAF arrangement in 1994 and a staff-monitoring program in 1995–96, and

structural adjustment credits of IDA and the IDB. In addition, policy implementation and current performance have been satisfactory so far under the new three-year ESAF arrangement approved in March 1998. Thus, Nicaragua's policy implementation under the Fund and IDA programs provides for three or more years of satisfactory track record of performance. Furthermore, to strengthen the conditions to sustainable economic growth, the authorities decided to accelerate the structural reform process in relation to what was initially envisaged in the program, including the financial system reform, the social security system reform, and the streamlining of the executive branch. The authorities also have developed social indicators and quantitative targets for social programs. It is also expected that an enhanced poverty reduction strategy, in line with that envisaged under the proposed enhancement of the HIPC Initiative framework, would be in place around the time of the decision point. In light of these factors, and on balance, the staffs are of the view that Nicaragua would fulfill the conditions for reaching the decision point following: (a) the approval by the national assembly of the three bills included in the financial sector reform¹¹, in consultation with the staffs of the Fund, the Bank, and the IDB, and of the public sector procurement law with the assistance from the Bank and the Fund;¹² (b) submission to the assembly of the bill for the social security reform, in consultation with the staffs of the Bank, the IDB, and the Fund;¹³ and (c) further satisfactory progress on improving governance in the areas of transparency and accountability in the management of public finances, resolution of outstanding property claims, and modernization and strengthening of the judiciary. Therefore, given the expectation that the conditions are to be fulfilled before year-end, Nicaragua could reach the decision point under the Initiative by the end of 1999, provided adequate financial assurances have been secured from creditors. The staffs envisage a difficult consultation process with some of the creditors before these assurances can be secured.

70. In light of the proposed enhancement of the HIPC Initiative framework, the staffs intend to present in the final HIPC document specific recommendations with respect to the conditions needed to be fulfilled before Nicaragua would reach the completion point under the Initiative. Main future reforms which the staffs consider to be essential are summarized in Box 3.

¹¹ As described in paragraph 38 above.

¹² As described in paragraph 42 above.

¹³ As described in paragraph 41 above.

**Box 3. Nicaragua: Main Areas of Reforms to be Implemented
Before the Completion Point**

1. Bring remaining public enterprises (mainly public utilities) to the point of sale.
2. Satisfactory implementation of laws strengthening the financial system including improved prudential norms.
3. Start satisfactory implementation of the social security reform.
4. Further satisfactory progress in improving governance.
5. Implementation of the enhanced framework for poverty reduction.

D. Potential Assistance Under the Initiative

71. **Assistance and burden sharing:** The cost of assistance under the current HIPC Initiative framework and under the proposed enhanced framework is presented in Tables 16 and 17. The breakdown of the total cost by creditor group is also shown, assuming proportional burden sharing. Preliminary calculations by the staffs suggest that, in order for bilateral creditors to deliver their share of assistance required, the NPV reduction on eligible debt would likely exceed 90 percent under both the current and the proposed enhancement of the HIPC Initiative framework. Under the current HIPC Initiative framework the amount of assistance could be in the range of US\$1.9–2.4 billion in NPV terms at the completion point which is assumed to be in 2002.

72. Taking into account the proposed enhancement of the HIPC Initiative framework,¹⁴ the staffs will present a recommendation on the debt sustainability target in the final HIPC document. Assuming a decision point in 1999, this could imply an assistance of about US\$2.3 billion under either the export or the fiscal/openness criteria (Table 17). Because of the large external borrowing required to help finance the reconstruction program as well as the nonconcessional deferral on debt service payments, the NPV of debt-to-exports would raise further until the year 2000, even after a hypothetical stock-of-debt operation (Table 18). Thus, it might be difficult to bring Nicaragua's ratio of NPV of debt-to-exports to 150 percent at the completion point, after decision-point based assistance under the proposed enhancement of the HIPC Initiative framework.

¹⁴ IDA/SecM99-475, EBS/99/138 and Bank and Fund Board discussions on August 3 and 5, 1999, respectively.

E. The Authorities' Views

73. The authorities noted that during the 1990s, Nicaragua has established a remarkable track record of adjustments and reforms, which is considered to be a major achievement for any transition country recovering from civil strife. These reforms have been made as part of the re-establishment of democracy and a move toward a market-based economy.

Notwithstanding these achievements, there is a strong need to invest resources in social and infrastructure programs, accelerate GDP growth and reduce poverty. Debt relief that might become available under the HIPC Initiative would help provide financing for critical social and infrastructure programs.

74. The authorities expressed their eagerness to benefit from the HIPC Initiative and their preference for the choice of a debt sustainability target that would provide Nicaragua with the maximum possible assistance under the Initiative. They also emphasized the importance of an early completion point and an up-front assistance, given the very high debt service burden. A short interim period before reaching the completion point under the HIPC Initiative would provide timely support to deepen the current poverty alleviation programs and infrastructure development efforts. In addition, it would strengthen private sector confidence in the country's economic prospects.

75. The authorities stressed that the long-term projections of the DSA suggest that in the case of Nicaragua, the HIPC assistance also needs to be tailored to ease the burden of the external debt service over the coming years, particularly in light of the increase in debt service after February 2001, when the current deferral of payments comes to an end. Given Nicaragua's external and fiscal vulnerability, and the efforts that need to be made for national reconstruction and improvements in social indicators, it is crucial that the assistance delivered under the HIPC Initiative brings the debt service-to-exports ratio below 15 percent.

76. The authorities are committed to maintain prudent financial policies and deepen structural reforms. Further fiscal consolidation will be undertaken, including the substantial strengthening of public sector savings, while social and investment expenditures are increased. In addition, the authorities emphasized their commitment to the reforms discussed above as a basis for sustainable economic growth and poverty alleviation.

77. The authorities stressed the importance of maintaining access to external financing on highly concessional terms over the medium and long term. They noted that the assistance potentially available under the HIPC Initiative would only help Nicaragua if the volume of other external financing flows were maintained at their historical levels.

78. The government has expressed its appreciation to all creditors for their continued support of Nicaragua's stabilization and structural adjustment efforts since 1990, and for the important financial assistance received following Hurricane Mitch. The authorities have also noted with gratitude the constructive engagement of creditors in the context of the HIPC Initiative.

V. ISSUES FOR DISCUSSION

79. The preliminary debt sustainability analysis presented in this paper indicates that Nicaragua would be eligible for assistance under the HIPC Initiative, considering that its debt burden indicators are among the highest of all the HIPC cases. The additional debt relief that may be available under the Initiative would allow a reduction in Nicaragua's debt burden to sustainable levels and a normalization of relations with all creditors. The relief would also provide crucial resources for Nicaragua to strengthen essential services in the social sectors and build necessary infrastructure, while fostering prudent financial policies that would contribute to macroeconomic stability. The staffs seek guidance from Executive Directors on the following issues:

80. **Eligibility.** Do Directors consider Nicaragua eligible for assistance under the Initiative?

81. **Timing of the decision point.** Do Directors agree with the conditions proposed by the staffs for reaching the decision point and view as appropriate to consider a final HIPC document as soon as these conditions have been fulfilled and adequate financial assurances from creditors have been secured?

82. Assistance under the Initiative and the timing of the completion point obviously depend on whether the proposed enhancement of the HIPC Initiative framework is approved by the Board. Do Directors have any comments on proposed reforms to which a floating completion point would be tied?

83. Do Directors agree that staffs could start consultations with creditors on the basis of the enhanced framework once this has been endorsed?

Table 5. Nicaragua: Selected Economic and Financial Indicators

	Average 1994-96	Actual 1997	Prog. 1998	Actual	Proj. 1/ 1999	Prog.	Prog. 2000	2001
(Annual percentage change, unless otherwise stated)								
National income, prices, and unemployment								
GDP at constant prices	4.1	5.1	4.8	4.0	6.0	6.3	6.5	6.5
Consumer prices (end of period)	11.9	7.3	8.0	18.5	12-14	10.0	8.0	6.0
Consumer prices (period average)	10.1	9.2	10.1	13.0	16.9	13.9	10.1	7.4
Unemployment rate (percent)	16.7	14.3	...	13.2	...	...	...	...
External sector								
Exports, f.o.b.	36.1	5.0	16.8	-18.5	-2.5	-3.1	10.0	11.0
Export volume	22.2	4.3	17.3	-19.6	0.7	6.2	8.2	7.7
Imports, f.o.b.	16.2	17.6	9.9	0.9	8.4	12.4	9.0	7.5
Import volume	12.4	24.7	8.4	8.6	6.7	7.4	6.7	6.5
Terms of trade (deterioration -)	8.9	6.8	-1.8	7.1	-4.7	-11.7	-0.5	2.0
Nominal effective exchange rate								
End of period (depreciation -)	-4.3	-3.7	...	-6.8	...	...	...	...
Real effective exchange rate								
End of period (depreciation -)	-5.2	1.7	...	2.5	...	...	...	...
Money and credit								
Net domestic assets of the central bank 2/	25.6	-36.8	-102.0	27.4	-94.6	-94.3	-28.3	-12.4
Nonfinancial public sector (net) 2/	45.6	132.3	-194.6	-85.8	-126.6	-123.7	-62.1	-34.9
Financial institutions (net) 2/	-22.6	-22.3	-51.2	-4.7	-16.3	-13.4	-18.0	-19.1
Currency in circulation	20.1	26.8	9.0	22.2	11.7	11.9	10.0	8.0
Financial system liabilities to private sector 3/	39.3	65.6	30.2	21.7	22.5	28.4	23.5	18.1
Financial system credit to private sector	15.0	9.7	24.7	34.7	23.0	33.0	29.4	25.4
Money income velocity (GDP/M3)	2.5	1.6	1.6	1.6	1.5	1.4	1.4	1.3
Interest rate on deposits (percent per annum)	11.7	11.5	...	11.5	...	...	...	...
(In percent of GDP)								
Public sector								
Combined public sector saving 4/	1.6	4.0	4.3	5.6	5.0	4.8	5.8	5.3
Combined public sector overall balance (before grants) 4/	-14.2	-9.7	-9.0	-7.0	-11.0	-13.6	-10.2	-8.3
Nonfinancial public sector saving	1.8	4.5	6.5	8.6	6.5	6.5	7.3	6.4
Nonfinancial public sector overall balance (before grants)	-13.9	-9.2	-6.8	-4.0	-9.5	-12.0	-8.8	-7.2
Central bank operational result (deficit -)	-0.2	-0.5	-2.2	-3.0	-1.5	-1.6	-1.4	-1.1
Savings and investment								
Gross domestic investment	24.7	32.2	28.0	33.4	33.2	37.0	36.0	35.0
Public	15.7	13.7	13.3	12.6	16.0	18.4	16.0	13.6
Private	8.9	18.5	14.7	20.8	17.2	18.6	20.0	21.4
National savings	0.4	6.4	7.2	5.8	5.4	6.7	7.8	7.6
Public	1.6	4.0	4.3	5.6	5.0	4.8	5.8	5.3
Private	-1.2	2.4	2.9	0.2	0.4	1.8	2.0	2.3
External savings 5/	24.3	25.8	20.8	27.6	27.8	30.3	28.2	27.4
External sector								
External current account balance	-39.6	-30.3	-23.2	-32.9	-31.4	-33.9	-31.7	-29.1
(excluding interest obligations)	-19.0	-19.9	-15.9	-23.4	-23.5	-26.0	-24.0	-21.7
Trade balance (deficit -)	-20.4	-26.2	-20.5	-31.7	-32.9	-36.7	-36.5	-35.4
Outstanding external public debt (end of year)	496.8	296.7	289.0	280.0	...	...	...	...
(In percent of exports of goods and nonfactor services)								
Contractual debt service, before future debt relief	182.4	45.8	30.1	40.0	43.5	39.6	35.4	33.6
Contractual interest obligations, before future debt relief	65.6	22.8	14.2	24.5	22.1	21.5	20.8	19.5
Adjusted official reserves (in months of imports) 6/	1.4	0.2	1.8	1.0	2.7	2.5	3.1	3.5

Sources: Central Bank of Nicaragua; Ministry of Finance; and staff estimates.

1/ Presented in EBS/99/8, January 28, 1999, as post-hurricane projection.

2/ In relation to currency in circulation at the beginning of the year.

3/ Includes CENIS held by the private sector.

4/ Includes quasi-fiscal losses.

5/ External current account deficit, excluding interest to non-Paris Club bilateral creditors that are eligible for debt rescheduling.

6/ Gross reserves net of outstanding stock of CENIS.

Table 6. Nicaragua: Social Expenditures

	Actual			Prel.	Projected		
	1995	1996	1997	1998	1999	2000	2001
(In percent of GDP)							
Total social expenditure	12.7	12.4	11.8	11.3	14.8	15.3	15.4
Education 1/	4.6	4.7	5.1	4.9	5.9	5.8	6.1
Health 1/	4.8	4.6	4.0	3.7	5.5	5.6	5.3
Housing	0.0	0.0	0.0	0.0	0.2	0.7	1.3
Other 2/	3.3	3.1	2.7	2.7	3.1	3.1	2.8
(In dollars per capita)							
Total social expenditure	55.5	54.3	51.4	50.0	69.2	75.9	80.8
Education 1/	19.9	20.7	22.2	21.6	27.8	29.0	31.8
Health 1/	21.1	20.1	17.4	16.5	25.7	27.9	27.5
Housing	0.1	0.0	0.0	0.0	1.0	3.6	6.7
Other 2/	14.4	13.5	11.8	11.9	14.7	15.4	14.8
(In percent of total government expenditure)							
Total social expenditure	40.2	40.3	35.8	35.9	44.2	48.7	48.3
Education 1/	14.4	15.4	15.5	15.5	17.8	18.6	19.0
Health 1/	15.3	14.9	12.1	11.9	16.4	17.9	16.5
Housing	0.1	0.0	0.0	0.0	0.7	2.3	4.0
Other 2/	10.4	10.0	8.2	8.5	9.4	9.9	8.8
(In millions of cordobas, unless otherwise indicated)							
Total social expenditure	1,815	2,072	2,262	2,529	4,010	4,873	5,634
Education	651	790	976	1,092	1,610	1,865	2,215
Health	690	766	766	836	1,488	1,792	1,919
Housing	3	1	0	0	61	230	470
Other 1/	471	515	519	601	851	988	1,030
Rural development	115	148	193	254	208	196	207
Family support	0	12	21	32	106	134	136
Social assistance	156	147	111	76	52	118	98
Other	200	208	194	239	485	540	590
Nominal GDP	14,247	16,649	19,116	22,463	27,188	31,879	36,481
Central government total expenditure	4,512	5,146	6,316	7,037	9,071	10,006	11,660
Population (in millions of habitants)	4.4	4.5	4.6	4.8	4.9	5.1	5.2
Exchange rate (Cordobas/U.S. dollar)	7.5	8.5	9.5	10.6	11.8	12.7	13.4
(In percentage of external debt service 3/)							
Total social expenditure	85	95	97	138	209	256	174
Gross official foreign aid 4/	146	165	150	275	443	338	193

Sources: Ministry of Finance; FISE; the Central Bank of Nicaragua; and staff estimates and projections.

1/ Includes FISE.

2/ Includes MAS, FISE, Institute of Municipal Promotion, IND, INCUL.

3/ Actual payments until 1998; due after rescheduling under full use of traditional rescheduling mechanisms for 1999-01.

4/ Official grants and loans, including the IMF.

Table 7. Nicaragua: Social Development Indicators, 1998–01

Objectives	Verifiable Indicators	Means of Verification	Targets (end of period)			
1. Education			1998	1999	2000	2001
Increase completion rate in primary education, particularly in rural areas	1. Dropout rate at the end of third grade (in percent)	Statistics; Ministry of Education, supported by IDA and IDB	8.5	7.5	6.5	5.5
	2. Completion rate in the third grade, in rural areas (in percent)	Statistics; Ministry of Education, supported by IDA and IDB	boys 70 girls 74	71 75	72 76	73 77
Improve quality of public education through decentralization, improved curricula, and better teaching	3. Percentage of primary school students in schools managed by local councils	Statistics; Ministry of Education, supported by IDA and IDB	75	90	99	99
	4. Percentage of students in schools with reformed curricula	Statistics; Ministry of Education, supported by IDA and IDB	Primary 89 Secondary -	95 -	100 6	100 45
	5. Percentage of school teachers without formal training	Statistics; Ministry of Education, supported by IDA and IDB	13.5	12.5	11.5	10.5
	6. Percentage of teachers in autonomous schools receiving performance incentives	Statistics; Ministry of Education, supported by IDA and IDB	77	80	90	95
2. Health			1998	1999	2000	2001
Expand and improve preventive and primary care, especially in the poorest areas	1. Current expenditure per capita in 8 high-risk rural areas (in U.S. dollar equivalents)	Statistics; Ministry of Health, supported by IDA and IDB	18	20	21	23.5
	2. Percentage of population provided with the basic primary protection package	Statistics; Ministry of Health, supported by IDA and IDB	-	15	45	75

Table 7 (continued). Nicaragua: Social Development Indicators, 1998–01

Objectives	Verifiable Indicators	Means of Verification	Targets (end of period)			
Improve efficiency in delivery of health care	3. Average number of check-ups for children under one year old	Statistics; Ministry of Health, supported by IDA and IDB	2.7	3.0	3.5	4.0
	4. Percentage of the national system with reformed system of allocation and distribution of medical supplies	Statistics; Ministry of Health, supported by IDA and IDB	-	14	35	65
	5. Number of health centers and hospitals operating under management contracts	Statistics; Ministry of Health, supported by IDA and IDB	-	15	40	60
	6. Proceeds from cost recovery as percent of expenditure on maintenance and equipment	Statistics; Ministry of Health, supported by IDA and IDB	2	5	8	10
3. Rural development						
Improve productivity of poor small farmers	1. Number of farmers assisted by extension services, cumulative	Statistics; Ministry of Agriculture supported by IDA	1998 63,000	1999 80,000	2000 95,000	2001 95,000
	2. Number of households benefiting from the family garden project, cumulative	Statistics; Ministry of Agriculture, supported by IDA	80	4,000	5,000	6,000

Table 7 (concluded). Nicaragua: Social Development Indicators, 1998–01

Objectives	Verifiable Indicators	Means of Verification	Targets (end of period)				
4. Expand and improve social infrastructure in poor communities	1. Total number and value (in US dollar millions) of small community social projects being implemented	Technical secretariat of the Presidency and FISE	projects value	1,014 38	830 39.5	925 41.5	1,000 42.5
	2. Water, sanitation and other community services projects being implemented	Technical secretariat of the Presidency and FISE	projects value	148 9.7	170 14.0	185 15.0	200 16.0

Source: Nicaraguan authorities.

Table 8. Nicaragua: Discount Rate and Exchange Rate Assumptions 1/

	Discount Rates 2/ (in percent)	Exchange Rates 3/ (per U.S. dollar)
Currency		
Austrian Schilling	5.28	11.75
Belgian Franc	5.59	34.58
Can. Dollar	6.25	1.53
Danish Krone	5.64	6.39
Finnish Markka	5.35	5.10
French Franc	5.36	5.62
German Mark	5.16	1.67
Italian Lira	5.58	1,653.10
Japanese Yen	2.22	115.60
Neth. Guilder	5.78	1.89
Norwegian Krone	6.54	7.60
Spanish Peseta	5.31	142.61
Swedish Krona	5.66	8.06
Swiss Franc	4.05	1.38
UK Pound	6.81	0.60
US Dollar	6.23	1.00
ECU	5.00	0.86
SDR	5.25	0.71
Proxy rates 4/		
Chinese yuan 1 5/	6.23	3.20
Chinese yuan 2 5/	6.23	3.72
Indian ruppe	5.25	42.48
Nicaraguan cordoba 6/	6.23	11.19
Venezuelan bolivar	5.25	563.50
IDB unit of account	5.25	0.65
Pool of currencies 7/	5.25	...

Sources: OECD; and IMF, International Financial Statistics.

1/ The base date for a decision point in 1999 is end-1998.

2/ The discount rates used are the average Commercial Interest Reference Rates for the respective currencies over the six-month period to the base date (July-December 1998).

3/ The exchange rates are those at the base date (end-1998).

4/ CIRRs are not available for these currencies; SDR or U.S. dollar discount rates are used as proxies.

5/ Exchange rates in terms of U.S. dollars defined in the loan contract.

6/ Payments are indexed to the U.S. dollar.

7/ Three loans from the IBRD.

Table 9. Nicaragua: Nominal Stocks and Net Present Value of External Debt Outstanding at End-1998 1/

	Nominal Debt		NPV of Debt	
	US\$ million	Percent	US\$ million	Percent
Total	5,948	100.0	5,238	100.0
Multilateral Institutions	1,895	31.9	1,362	26.0
IMF	52	0.9	41	0.8
IDA/IBRD	504	8.5	233	4.4
Other	1,339	22.5	1,088	20.8
<i>Of which:</i>				
IDB	830	14.0	567	10.8
CABEI	447	7.5	474	9.0
IFAD	21	0.4	13	0.2
Opec Fund	28	0.5	26	0.5
FOCEM 2/	0	0.0	3	0.0
Nordic Fund	13	0.2	6	0.1
Official Bilateral	3805	64.0	3628	69.3
Paris Club	1516	25.5	1360	26.0
<i>Of which:</i>				
Russia	356	6.0	348	6.6
Germany	427	7.2	383	7.3
Other Official	2289	38.5	2267	43.3
<i>Of which:</i>				
Costa Rica	491	8.3	491	9.4
Guatemala	455	7.7	456	8.7
Commercial	248	4.2	249	4.8

Sources: Nicaraguan authorities; and staff estimates.

1/ The decision point is assumed to be in 1999. Thus, 1998 marks the latest year for which actual data are available at the decision point.

2/ The principal has been repaid through the delivery of a zero-coupon bond.

Table 10. Nicaragua: Main Assumptions on Macroeconomic Framework, 1998-18

(Percentage change, unless otherwise indicated)

	Est. 1998	New Prog.			Proj.						
		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Economic growth											
Real GDP	4.0	6.3	6.5	6.5	6.0	6.0	6.0	5.8	5.5	5.5	5.5
National accounts											
Investment (percent of GDP)	33.4	37.0	36.0	35.0	35.0	34.5	32.5	31.2	30.1	29.1	28.3
National savings (percent of GDP)	5.8	6.7	7.8	7.6	9.4	11.3	11.9	12.4	12.4	12.4	12.5
Balance of Payments											
Export volume growth 1/	-19.6	6.2	8.2	7.7	6.8	6.8	6.7	6.5	6.2	6.1	6.1
Import volume growth 1/	8.6	7.4	6.7	6.5	2.7	3.5	4.2	4.8	5.5	5.5	5.5
Terms of trade	7.1	-11.7	-0.5	2.0	1.9	1.4	1.3	1.0	0.7	0.7	0.7
Exports of goods and services (percent of GDP) 2/	39.1	36.5	37.0	37.8	39.0	39.9	40.5	41.1	41.6	42.1	42.6
Imports of goods and services (percent of GDP) 2/	71.5	72.8	72.7	71.6	69.7	68.0	66.4	65.2	64.6	64.0	63.5
Current account (percent of GDP)	-32.9	-33.9	-31.7	-29.1	-26.5	-23.9	-21.2	-19.3	-18.2	-17.1	-16.2
Gross reserves (months of imports)	1.0	2.5	3.1	3.5	3.6	3.7	3.6	3.6	3.7	3.7	3.7

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Exports (imports) of goods.

2/ Exports (imports) of goods and services as defined in *IMF Balance of Payments Manual, 5th edition, 1993*.

Table 10 (Concluded). Nicaragua: Main Assumptions on Macroeconomic Framework, 1998-18

(Percentage change, unless otherwise indicated)

	Proj.										Average	
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	1999-08	2009-18
Economic growth	5.5	5.5	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	6.0	5.1
Real GDP												
National accounts	27.4	27.0	26.6	26.2	25.8	25.4	25.0	24.6	24.2	23.8	32.8	25.6
Investment (percent of GDP)	12.5	13.0	13.5	14.1	14.6	15.0	15.5	16.0	16.4	16.9	10.4	14.7
National savings (percent of GDP)												
Balance of payments	6.0	6.0	5.9	5.7	5.6	5.6	5.6	5.6	5.5	5.5	6.7	5.7
Export volume growth 1/	5.5	5.5	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.2	5.1
Import volume growth 1/	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	-0.2	0.8
Terms of trade	43.0	43.5	44.2	44.8	45.4	46.0	46.7	47.3	48.0	48.6	39.8	45.8
Exports of goods and services (percent of GDP) 2/	63.0	62.5	62.0	61.5	61.1	60.6	60.2	59.8	59.4	59.0	67.8	60.9
Imports of goods and services (percent of GDP) 2/	-15.2	-14.3	-13.3	-12.3	-11.4	-10.5	-9.6	-8.7	-7.8	-6.9	-23.7	-11.0
Current account (percent of GDP)	3.7	3.8	3.9	4.0	4.0	4.0	4.0	4.1	4.1	4.1	3.5	4.0
Gross reserves (months of imports)												

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Exports (imports) of goods.

2/ Exports (imports) of goods and services as defined in *IMF Balance of Payments Manual, 5th edition, 1993*.

Table 11. Nicaragua: Medium-Term Balance of Payments, 1998-18

(In millions of U.S. dollars)

	Est. 1998	Projected									
		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Current account	-699	-781	-796	-793	-772	-747	-718	-707	-717	-728	-741
Trade balance	-672	-845	-916	-963	-961	-974	-998	-1036	-1095	-1157	-1223
Exports	573	555	611	678	749	823	904	988	1074	1165	1265
Of which:											
Free trade zones	0	0	0	0	0	0	0	0	0	0	0
Imports	-1,245	-1,400	-1,526	-1,641	-1,710	-1,798	-1,902	-2,024	-2,168	-2,323	-2,488
Nonfactor services (net)	-15	9	20	44	68	94	123	155	187	223	263
Of which:											
Receipts	257	287	318	352	387	426	469	517	568	624	687
Interest	-203	-181	-194	-201	-210	-200	-196	-193	-190	-189	-195
Other current transactions (net)	191	237	293	327	332	333	353	367	381	395	414
Of which:											
Private transfers	232	280	338	370	376	380	403	419	436	453	476
Capital account	534	728	664	619	495	595	636	638	621	625	603
Official (net)	313	458	341	275	111	187	229	217	200	204	182
Transfers	189	310	227	221	210	210	210	210	200	190	175
Disbursements	264	305	245	209	210	210	210	210	210	210	200
Amortization	-129	-149	-130	-139	-309	-233	-191	-203	-210	-196	-193
Other (net) 1/	-12	-8	-1	-16	0	0	0	0	0	0	0
Other capital	221	271	323	343	384	408	407	421	421	421	421
Overall balance	-165	-52	-132	-175	-277	-152	-82	-69	-95	-103	-138
Change in international reserves (increase -)	6	-118	-46	-25	-40	-50	-60	-80	-100	-100	-100
Of which:											
IMF (net)	22	103	31	31	-6	-8	-29	-33	-40	-40	-38
Change in arrears	24	-2,063	0	0	0	0	0	0	0	0	0
Debt rescheduling	135	98	105	23	0	0	0	0	0	0	0
Financing gap	0	2135	74	177	317	202	142	149	195	203	238
Assumed debt rescheduling 2/	0	2135	74	87	143	54	38	38	38	40	44
New borrowing 3/	0	0	0	90	174	148	104	111	158	163	194
Memorandum items:											
Gross reserves (in months of imports) 4/	1.0	2.5	3.1	3.5	3.6	3.7	3.6	3.6	3.7	3.7	3.7
Debt service ratio	40.0	39.6	35.4	33.6	46.2	35.3	30.2	28.5	26.8	23.8	21.9
Debt service ratio (after rescheduling)	32.4	19.3	16.1	23.4	33.6	30.9	27.4	26.0	24.5	21.6	19.6
Debt service-to-fiscal revenue ratio 5/	48.2	28.4	24.5	36.8	54.2	51.0	46.0	44.1	42.1	37.5	34.5
Current account (in percent of GDP)	-32.9	-33.9	-31.7	-29.1	-26.5	-23.9	-21.2	-19.3	-18.2	-17.1	-16.2
Total external debt (after rescheduling)	5,948	4,920	5,219	5,238	5,391	5,546	5,654	5,754	5,907	6,062	6,251
NPV of debt (after rescheduling)	5,238	3,921	4,147	4,137	4,213	4,258	4,290	4,311	4,347	4,404	4,481
NPV of debt -to-export ratio (after rescheduling) 6/	631	466	446	402	371	341	312	286	265	246	230
NPV of debt -to-revenue ratio (after rescheduling) 7/	993	648	597	526	478	440	408	379	355	334	315

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Short-term debt, and private debt due to official creditors. Not included in the debt sustainability analysis.

2/ Assumes: a) flow rescheduling of pre-cutoff NPRD by non-Paris Club bilateral creditors on comparable terms to the 1998 Paris Club rescheduling; b) a buyback of eligible commercial debt in 1999, on the same terms as the 1995 buyback operation; c) a stock-of-debt operation in March 2001 on Naples terms by Paris Club creditors on all eligible debt and comparable treatment from other official and commercial bilateral creditors.

3/ With an interest rate of 2 percent, 10-year grace period and 40-year maturity.

4/ Net of the stock of CENIs, and in terms of imports of goods and non-factor services in the following year.

5/ After rescheduling.

6/ Based on current year exports.

7/ At end-1998 exchange rate.

Table 11 (Concluded). Nicaragua: Medium-Term Balance of Payments, 1998-18

(In millions of U.S. dollars)

	Projected										Average	
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	1999-08	2009-18
Current account	-751	-760	-759	-752	-746	-739	-725	-705	-678	-646	-750	-726
Trade balance	-1294	-1368	-1432	-1501	-1574	-1651	-1731	-1814	-1904	-1996	-1017	-1626
Exports	1371	1487	1611	1743	1884	2036	2200	2379	2568	2772	881	2005
Imports	-2,665	-2,854	-3,043	-3,244	-3,458	-3,686	-3,931	-4,193	-4,472	-4,769	-1,898	-3,632
Nonfactor services (net)	308	358	415	478	546	623	708	804	907	1022	119	617
<i>Of which:</i>												
Receipts	755	830	913	1002	1101	1209	1328	1459	1603	1760	463	1196
Interest	-195	-195	-198	-198	-199	-200	-200	-201	-194	-188	-195	-197
Other current transactions (net)	429	444	456	470	481	488	498	506	512	516	343	480
Capital account	572	534	526	541	526	507	486	478	477	465	622	511
Official (net)	151	113	105	120	104	86	65	57	56	44	240	90
Transfers	160	140	140	140	140	140	140	140	140	140	216	142
Disbursements	200	200	200	200	200	200	200	200	200	200	222	200
Amortization	-209	-227	-235	-220	-236	-254	-275	-283	-284	-296	-195	-252
Other (net) 1/	0	0	0	0	0	0	0	0	0	0	-2	0
Other capital	421	421	421	421	421	421	421	421	421	421	382	421
Overall balance	-179	-226	-233	-211	-221	-232	-239	-226	-201	-181	-128	-215
Change in international reserves (increase -)	-100	-100	-100	-100	-100	-100	-100	-120	-120	-120	-72	-106
<i>Of which:</i>												
IMF (net)	-15	-7	0	0	0	0	0	0	0	0	-3	-2
Change in arrears	0	0	0	0	0	0	0	0	0	0	-206	0
Debt rescheduling	0	0	0	0	0	0	0	0	0	0	23	0
Financing gap	279	326	333	311	321	332	339	346	321	301	383	321
Assumed debt rescheduling 2/	44	43	42	42	42	42	42	33	18	9	269	36
New borrowing 3/	235	283	291	269	279	290	297	313	303	292	114	285
Memorandum items:												
Gross reserves (in months of imports) 4/	3.7	3.8	3.9	4.0	4.0	4.0	4.0	4.1	4.1	4.1	3.5	4.0
Debt service ratio	19.7	18.5	17.2	15.2	14.6	14.0	13.5	12.6	11.5	10.7	32.1	14.7
Debt service ratio (after rescheduling)	17.6	16.7	15.5	13.7	13.2	12.7	12.3	11.7	11.0	10.5	24.3	13.5
Debt service-to-fiscal revenue ratio 5/	31.3	30.0	28.3	25.4	24.7	24.2	23.7	23.0	21.8	21.0	39.9	25.3
Current account (in percent of GDP)	-15.2	-14.3	-13.3	-12.3	-11.4	-10.5	-9.6	-8.7	-7.8	-6.9	-23.7	-11.0
Total external debt (after rescheduling)	6,492	6,769	7,053	7,330	7,606	7,876	8,137	8,401	8,333	8,244	5,594	7,624
NPV of debt (after rescheduling)	4,592	4,723	4,861	5,010	5,159	5,304	5,442	5,581	5,556	5,514	4,251	5,174
NPV of debt -to-export ratio (after rescheduling) 6/	216	204	193	182	173	163	154	145	133	122	337	169
NPV of debt -to-revenue ratio (after rescheduling) 7/	300	286	274	264	253	243	232	222	206	190	448	247

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Short-term debt, and private debt due to official creditors. Not included in the debt sustainability analysis.

2/ Assumes: a) flow-rescheduling of pre-cut off NPRD by non-Paris Club bilateral creditors on comparable terms to the 1998 Paris Club rescheduling; b) a buyback of eligible commercial debt in 1999, on the same terms as the 1995 buybank operation; c) a stock-of-debt operation in March 2001 on Naples terms by Paris Club creditors on all eligible debt and comparable treatment from other official and commercial bilateral creditors.

3/ With an interest rate of 2 percent, 10-year grace period and 40-year maturity.

4/ Net of the stock of CENIs, and in terms of imports of goods and non-factor services in the following year.

5/ After rescheduling.

6/ Based on current year exports.

7/ At end-1998 exchange rate.

Table 12. Nicaragua: Net Present Value of Debt After Reschedulings, 1998-18 1/

(In millions of U.S. dollars)

	Est.	Projected										Average	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1999-08	2009-18
1. NPV of total debt (2+5) 2/	5,238	3,921	4,147	4,137	4,213	4,258	4,290	4,311	4,347	4,404	4,481	4,251	5,174
2. NPV of old debt (3+4)	5,238	3,691	3,763	3,610	3,468	3,306	3,171	3,028	2,881	2,762	2,660	3,234	2,094
3. Official bilateral and commercial	3,877	2,339	2,425	2,291	2,169	2,036	1,929	1,823	1,721	1,654	1,583	1,997	1,159
Paris Club	1,360	1,383	1,469	1,371	1,301	1,201	1,126	1,051	974	921	865	1,166	587
Post-cutoff date	230	229	239	244	232	219	205	192	178	169	160	207	107
ODA	222	223	231	236	227	216	203	191	178	169	160	203	107
Non-ODA	8	7	7	8	5	3	2	1	0	0	0	3	0
Pre-cutoff date	1,131	1,154	1,230	1,127	1,069	981	921	859	796	751	705	959	480
ODA	93	92	95	73	72	71	72	73	74	75	76	77	83
Non-ODA	1,037	1,063	1,135	1,054	997	910	849	787	722	677	629	882	398
Of which :													
"Nonreschedulable" 3/	116	115	128	130	120	111	101	91	81	76	71	102	14
Other official bilateral	2,267	932	941	911	862	830	800	770	744	732	717	824	571
"Nonreschedulable" 4/	71	64	57	49	41	37	33	29	25	20	14	37	1
"Reschedulable"	2,196	867	885	862	821	793	767	741	720	712	702	787	570
Post-cutoff date	171	156	140	127	116	103	91	78	69	61	52	99	14
ODA	0	0	0	0	0	0	0	0	0	0	0	0	0
Non-ODA	171	156	140	127	116	103	91	78	69	61	52	99	14
Pre-cutoff date	2,025	712	745	735	705	690	676	662	650	651	650	688	556
ODA	21	12	11	5	3	4	4	4	4	4	5	6	7
Non-ODA	2,004	700	734	730	701	687	672	658	646	647	645	682	549
Commercial	249	24	15	9	6	4	3	2	2	2	2	7	1
Post-cutoff date	33	22	13	7	4	2	1	0	0	0	0	5	0
Pre-cutoff date	216	2	2	2	2	2	2	2	2	2	2	2	1
4. Multilateral	1,362	1,352	1,338	1,319	1,299	1,271	1,242	1,205	1,161	1,109	1,077	1,237	935
IDB	567	561	552	544	530	516	503	485	464	441	418	501	293
IBRD/IDA	233	233	235	237	241	245	248	250	250	251	251	244	235
IMF	41	40	36	32	28	21	15	11	7	2	0	19	0
Others	521	518	515	506	500	488	476	459	440	414	408	472	407
Of which :													
CABEI	474	477	479	477	474	466	456	440	421	396	391	448	393
5. NPV of new debt	0	231	384	527	745	952	1,119	1,283	1,466	1,641	1,821	1,017	3,080
Multilateral	0	188	326	452	637	817	963	1,119	1,290	1,455	1,626	887	2,860
Bilateral	0	42	58	74	108	134	156	165	176	186	195	129	220

Table 12 (Concluded). Nicaragua: Net Present Value of Debt After Reschedulings, 1998-18 1/

(In millions of U.S. dollars)

	Est.	Projected										Average	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1999-08	2009-18
Memorandum items:													
NPV of interim assistance from CABI	110	117	124	132	140	149	158	168	179	190	202	156	285
Exports of goods and services 5/	830	842	929	1,030	1,136	1,249	1,373	1,505	1,642	1,789	1,951	1,345	3,201
Three-year export average 6/	871	867	867	934	1,031	1,138	1,253	1,376	1,507	1,645	1,794	1,241	2,950
Central government revenue 7/	528	605	695	786	882	967	1,051	1,136	1,225	1,320	1,423	1,009	2,154
NPV of debt-to-exports ratio 8/	602	452	478	443	408	374	342	313	289	268	250	362	183
NPV of debt-to-revenue ratio	993	648	597	526	478	440	408	379	355	334	315	448	247

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Refers to public and publicly guaranteed external debt only and assumes full use of traditional debt relief mechanisms, i.e., a Paris Club flow rescheduling on Naples terms (67 percent NPV reduction) and a stock-of-debt operation, and at least comparable action by other official bilateral and commercial creditors. The stock-of-debt operation is assumed to take place in March 2001, at the end of the Paris Club rescheduling consolidation period.

2/ Discounted on the basis of the average Commercial Interest Reference Rate for the respective currency, derived over the six-month period prior to the latest date for which actual data are available (base date). The conversion of currency-specific NPVs into U.S. dollars occurs for all years at the base date exchange rate.

3/ Short-term debt rescheduled in 1991 on London terms, and moratorium interest deferred. The Agreed Minutes specify that these amounts would not be subjected to further reorganization.

4/ Refers to debt that has already been subject to a substantial reduction (at least 92 percent NPV reduction) and that would only be rescheduled further if needed to achieve comparability of treatment.

5/ As defined in *IMF Balance of Payments Manual, 5th edition, 1993*.

6/ Backward-looking average (e.g., average of exports over the period 1997-99 is reported for 1999).

7/ Converted into U.S. dollars at the end-1998 exchange rate.

8/ NPV of debt in percent of three-year average of exports of goods and services.

Table 13. Nicaragua: Debt Service Payments on Public and Publicly Guaranteed External Debt, 1998-18

	Est. 1998	Projected										Average	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1999-08	2009-18
(In millions of U.S. dollars)													
Debt service on outstanding debt	331	266	271	266	347	261	258	260	258	265	243	270	186
Principal	129	131	135	138	224	150	152	159	164	176	154	158	126
Multilateral	37	36	42	48	49	58	59	66	73	81	53	56	46
IDB	18	18	22	22	26	27	25	30	32	33	33	27	30
IBRD/IDA	9	7	6	6	5	5	7	8	9	9	10	7	15
IMF	0	3	6	6	6	8	8	5	5	5	2	5	0
Others	9	9	8	14	12	17	19	23	27	34	7	17	1
Official bilateral	82	84	84	84	173	90	92	92	90	94	101	99	80
Paris Club	35	33	33	36	63	66	69	70	73	79	86	61	73
Post-cutoff date	5	5	5	8	11	12	13	12	12	12	12	10	12
<i>Of which:</i>													
ODA	3	3	3	6	9	11	13	12	12	12	12	9	12
Pre-cutoff date	30	29	28	29	53	54	56	58	61	67	74	51	61
NPRD	11	9	7	7	7	6	6	6	6	6	6	7	2
<i>Of which:</i>													
ODA	6	6	6	6	6	6	6	6	6	6	6	6	2
PRD-London	13	14	15	10	11	12	14	15	17	23	28	16	33
<i>Of which:</i>													
ODA	0	0	0	0	0	0	0	0	0	0	1	0	2
PRD-Naples 1/	6	6	6	12	35	35	36	37	38	39	40	28	26
<i>Of which:</i>													
ODA	0	0	0	0	0	0	0	0	0	0	0	0	0
Other official bilateral	47	51	51	48	109	24	23	22	18	15	15	38	7
Post-cutoff date	13	18	19	15	13	15	14	14	11	10	10	14	6
Pre-cutoff date	34	33	33	33	96	9	8	8	7	5	5	24	1
Commercial	10	11	8	6	3	2	1	1	0	0	0	3	0
Post-cutoff date	10	11	8	6	3	2	1	1	0	0	0	3	0
Pre-cutoff date	0	0	0	0	0	0	0	0	0	0	0	0	0
Interest	202	135	136	128	123	112	106	101	95	89	89	111	61
Multilateral	49	52	50	48	47	45	43	42	40	38	43	45	36
IDB	20	19	19	18	18	17	16	17	17	16	15	17	9
IBRD/IDA	5	5	4	4	4	4	4	3	3	3	3	4	3
IMF	0	0	0	0	0	0	0	0	0	0	0	0	0
Others	23	27	27	26	25	24	23	22	20	18	24	24	24
Official bilateral	150	81	84	80	76	66	62	58	54	51	46	66	24
Paris Club	60	60	66	64	63	60	57	53	50	47	43	56	21
Post-cutoff date	5	6	5	5	5	5	4	4	4	4	4	5	2
<i>Of which:</i>													
ODA	5	5	5	5	5	5	4	4	4	4	4	4	2

Table 13 (Concluded). Nicaragua: Debt Service Payments on Public and Publicly Guaranteed External Debt, 1998-18

	Est. 1998	Projected										Average	
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1999-08	2009-18	
(In millions of U.S. dollars)													
NPRD	2	2	2	2	1	1	1	1	1	1	1	1	0
<i>Of which:</i>													
ODA	2	2	2	2	1	1	1	1	1	1	1	1	0
PRD-London	22	22	23	22	22	21	21	20	19	19	18	21	8
<i>Of which:</i>													
ODA	1	1	1	1	1	1	1	1	1	1	1	1	1
PRD-Naples 1/	30	30	36	36	35	33	30	28	26	23	21	30	10
<i>Of which:</i>													
ODA	0	0	0	0	0	0	0	0	0	0	0	0	0
Other official bilateral	90	21	18	15	13	7	6	5	4	4	4	10	3
Post-cutoff date	8	8	7	6	6	5	4	4	3	3	2	5	1
Pre-cutoff date	82	12	11	9	7	2	1	1	1	2	1	5	3
Commercial	3	2	2	1	0	0	0	0	0	0	0	1	0
Post-cutoff date	3	2	2	1	0	0	0	0	0	0	0	1	0
Pre-cutoff date	0	0	0	0	0	0	0	0	0	0	0	0	0
Debt service on new borrowing 2/	0	6	10	13	20	26	52	66	83	102	122	50	183
Principal	0	1	1	1	1	1	23	31	42	57	70	23	94
Interest	0	5	9	12	19	25	30	35	40	46	52	27	88
Debt service on reschedulings 3/	1	61	49	66	157	153	105	103	99	59	62	91	82
Principal	0	20	0	6	90	90	45	46	44	4	7	35	34
Interest	1	41	48	61	68	63	60	58	55	55	54	56	48
Memorandum items:													
Total debt service after debt relief	269	163	150	241	382	387	377	391	403	386	382	326	415
Principal	102	92	79	99	198	206	200	216	230	214	203	174	227
Interest	167	71	71	143	184	180	177	174	172	172	179	152	189

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Including Russia.

2/ Debt disbursed after 1998.

3/ Including the 1998 Paris Club rescheduling, and assuming a flow rescheduling by non-Paris Club bilateral creditors on comparable terms. Assumes also a buyback of eligible commercial debt in 1999, on the same terms as the 1995 buyback operation, and a stock-of-debt operation on Naples terms in March 2001.

Table 14. Nicaragua: External Debt Indicators 1/

	Est. 1998	Projected										Average	
		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1999-08	2009-18
(In millions of U.S. dollars)													
Baseline Scenario													
Nominal debt stock	5,948	4,920	5,219	5,238	5,391	5,546	5,654	5,754	5,907	6,062	6,251	5,594	7,624
Multilateral	1,895	2,208	2,422	2,595	2,874	3,128	3,323	3,529	3,759	3,973	4,230	3,204	6,025
Official Bilateral	3,805	2,690	2,782	2,634	2,511	2,414	2,329	2,224	2,147	2,087	2,020	2,384	1,597
<i>Of which:</i>													
Paris Club	1,516	1,573	1,641	1,551	1,438	1,338	1,257	1,176	1,106	1,048	988	1,311	685
Commercial	248	23	15	9	6	4	3	1	1	1	1	6	1
NPV of debt	5,238	3,921	4,147	4,137	4,213	4,258	4,290	4,311	4,347	4,404	4,481	4,251	5,174
Multilateral	1,362	1,540	1,664	1,771	1,936	2,088	2,205	2,324	2,451	2,564	2,703	2,124	3,795
Official Bilateral	3,628	2,357	2,468	2,356	2,271	2,165	2,082	1,986	1,894	1,838	1,776	2,119	1,377
<i>Of which:</i>													
Paris Club	1,360	1,383	1,469	1,371	1,301	1,201	1,126	1,051	974	921	865	1,166	587
Commercial	249	24	15	9	6	4	3	2	2	2	2	7	1
(In percent of exports of goods and services) 2/													
NPV of debt /3	602	452	478	443	408	374	342	313	289	268	250	362	183
<i>Of which:</i>													
Multilateral	156	178	192	190	188	183	176	169	163	156	151	174	132
Debt service	32	19	16	23	34	31	27	26	25	22	20	24	15
<i>Of which:</i>													
Multilateral	10	11	11	10	10	10	11	11	11	12	10	11	8
(In percent)													
NPV of debt-to-revenue ratio 4/	993	648	597	526	478	440	408	379	355	334	315	448	247
NPV of debt-to-GDP ratio	247	170	165	152	145	136	127	118	110	104	98	132	77
Sensitivity analysis: Impact of													
Lower export growth 5/													
NPV of debt-to-export ratio	602	453	480	446	414	384	357	332	312	296	284	376	248
Debt-service ratio	32	19	16	24	34	32	28	27	26	23	22	25	17
Less favorable financing 6/													
NPV of debt-to-export ratio	602	452	478	443	416	386	358	331	310	293	279	375	228
Debt-service ratio	32	19	16	23	34	32	28	27	26	24	23	25	19

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ All debt indicators refer to public and publicly guaranteed (PPG) debt and are defined after rescheduling, unless otherwise indicated. Assumes a flow rescheduling by non-Paris Club bilateral creditors on comparable terms with the Paris Club rescheduling. Assumes also a buyback of eligible commercial debt in 1999, on the same terms as the 1995 buyback operation, and a stock-of-debt operation in March 2001.

2/ As defined in *IMF Balance of Payments Manual, 5th edition, 1993*.

3/ Based on a three-year average of exports centered on the previous year (e.g. export average over 1997-99 for NPV of debt-to-exports ratio in 1999).

4/ Revenues are defined as central government revenues, excluding grants.

5/ Assumes that the volume growth of non-traditional exports is 3 percent lower each year than in the baseline.

6/ Assumes that the financing gap is filled with new borrowing with an interest rate of 5 percent, 5-year grace and 20-year maturity, compared with 2 percent 10-year grace and 40-year maturity in the baseline.

Table 15. Nicaragua: Summary Vulnerability Indicators Under the HIPC Initiative 1/

Country 3/	Percent share in exports** of :			Public sector external debt service as a percent of: 2/		NPV of public and publicly guaranteed debt as percent of GDP 1/ 2/	Noninterest current account in percent of GDP 6/ 1/	Reserve coverage (months of imports) 7/	Fiscal indicators* as a percent of GDP 1/		
	Main product	Three main products	of exports** 4/	Government revenue 5/	Government expenditure				Tax revenue	Official grants	Primary balance
Nicaragua	13.5 Coffee	27.1	28.4	35.7	25.2	207.8	-16.5	1.8	20.7	6.1	-4.8
Group A											
Bolivia	12.3 Soybeans	33.0	20.9	20.3	16.6	44.6	-5.8	7.3	17.1	2.4	-1.6
Burkina Faso	33.5 Cotton	64.4	18.9	16.6	9.6	27.0	-13.9	CFA Zone	11.5	8.4	1.7
Guyana	21.1 Sugar	48.9	34.0	42.4	37.1	160.5	-4.4	5.2	31.8	2.3	2.6
Mali	47.1 Cotton	75.1	20.6	17.4	11.6	47.6	-13.7	CFA Zone	12.7	7.1	-6.9
Mozambique	14.7 Prawns	23.8	31.1	31.4	16.1	242.3	-21.7	4.4	12.3	8.8	-10.8
Uganda	55.7 Coffee	62.6	35.2	18.2	11.3	31.0	-6.3	3.6	10.5	4.5	-1.0
Mean	30.7	51.3	26.8	24.4	17.1	92.2	-10.9	5.1	16.0	5.6	-2.7
Median	27.3	55.8	26.0	19.3	13.9	46.1	-10.0	4.8	12.5	5.8	-1.3
Group B											
Cameroon	27.1 Oil	46.9	11.0	93.6	78.3	93.1	2.8	CFA Zone	9.9	0.5	5.2
Chad	43.7 Cotton	67.7	13.6	22.9	9.5	32.7	-16.0	CFA Zone	9.0	6.9	0.2
Congo	83.6 Crude oil	93.1	...	27.2	25.2	144.4	-39.6	CFA Zone	29.0	0.9	10.7
Cote d'Ivoire	32.3 Cocoa	47.0	10.5	50.2	44.7	143.2	11.6	CFA Zone	19.0	0.7	3.1
Ethiopia	34.9 Coffee	42.7	16.2	17.1	11.7	...	-8.5	7.7	12.5	2.9	-6.1
Guinea	37.2 Bauxite	58.2	11.9	32.6	20.9	33.5	-6.5	2.8	7.1	3.1	-4.5
Guinea Bissau	69.3 Cashew	78.7	30.8	73.5	27.2	199.9	-11.2	CFA Zone	7.0	9.1	-14.8
Honduras	22.5 Coffee	46.3	13.3	70.7	59.9	71.7	-2.7	2.7	16.5	0.2	2.9
Madagascar	7.7 Shellfish	17.6	21.5	91.4	44.1	95.0	-3.0	3.1	8.5	4.2	-4.4
Mauritania	53.6 Fish	93.9	6.9	12.6	15.4	134.1	-8.3	2.8	17.5	2.2	8.6
Niger	50.6 Uranium	69.3	19.3	25.5	13.4	42.5	-9.7	CFA Zone	7.4	4.0	0.6
Sierra Leone	52.8 Rutile	97.3	18.6	22.2	13.3	58.7	-14.7	1.4	10.4	3.7	-1.2
Tanzania	11.8 Coffee	30.5	33.0	63.6	47.9	99.8	-13.7	1.5	11.3	1.0	-1.1
Togo	19.5 Phosphate	46.0	22.4	31.0	28.7	54.9	-5.0	CFA Zone	14.0	2.8	-3.4
Zambia	48.0 Copper	67.4	20.0	33.5	25.1	96.2	-7.9	1.5	14.9	2.1	4.5
Mean	39.6	60.2	17.8	44.5	31.0	92.8	-8.8	2.9	12.9	2.9	0.0
Median	37.2	58.2	17.4	32.6	25.2	94.0	-8.3	2.7	11.3	2.8	0.2
Both Groups' Mean	37.1	57.7	20.5	38.8	27.0	92.6	-9.4	3.7	13.8	3.7	-0.7
Both Groups' Median	34.9	58.2	19.7	31.0	20.9	82.4	-8.3	3.0	12.3	2.9	-1.0

Sources: Staff estimates.

1/ All data refer to 1996 (1995/96) and are consistent with the latest debt sustainability analysis (DSA) that was presented to the Boards of the IMF and IDA. For countries where the latest DSA was prepared prior to 1997 (Chad, Congo, Honduras, Niger and

2/ After assumed debt rescheduling/relief, including Paris Club stock-of-debt operation on Naples terms, where applicable.

3/ Excluded from the original group of 41 HIPC's are those for which no debt sustainability analysis has been prepared; that are not IDA-only; that have not embarked yet on the first stage of the Initiative; that have never received concessional Paris Club

4/ Defined as the standard deviation in export values over the 10-year period 1986-95 (1985/86-1994/95), in percent of the average.

5/ Excluding grants.

6/ Current account balance excludes interest and net official transfers.

7/ Imports of goods and services.

* Note: Central Government. For Bolivia, government refers to general government.

** Exports of goods and services, as defined in *IMF Balance of Payments Manual, 5th edition*.

Table 16. Nicaragua: Projected Assistance Levels Under the Current HIPC Initiative Framework

(in millions of U.S. dollars, unless otherwise indicated)

Target for the NPV of Debt-to-		Decision point in 1999 and completion point in 2002				Required NPV reduction of Paris Club non-ODA PRD on Naples terms assuming comparable action of other non-multilateral creditors 4/	Target for the NPV of debt-to-export ratio	Decision Point in 2000 and Completion Point in 2003			
-export ratio (in percent)	-revenue ratio (in percent)	Total	Bilateral 3/	Multilateral 3/	Common reduction factor (in percent)			Total	Bilateral 3/	Multilateral 3/	Common reduction factor (in percent)
200	...	2,401	1,318	1,083	73.6	93.1	200	2,290	1,187	1,103	66.5
210	...	2,308	1,267	1,041	70.7	92.0	210	2,187	1,134	1,053	63.5
220	...	2,215	1,216	999	67.9	91.0	220	2,084	1,080	1,003	60.5
230	...	2,121	1,165	957	65.0	90.0	230	1,981	1,027	954	57.5
240	...	2,028	1,113	915	62.1	88.9	240	1,877	973	904	54.5
250	...	1,935	1,062	873	59.3	87.9	250	1,774	920	854	51.5
235.8	280	2,067	1,135	932	63.3	89.4	239.4	1,884	977	907	54.7
Memorandum items:											
NPV of debt 1/		4,269	2,366	1,903				4,353	2,277	2,076	
Adjusted NPV of debt 1/ 2/		4,220	2,317	1,903				4,312	2,236	2,076	
Shares (in percent)		100.0	54.9	45.1				100.0	51.9	48.1	
NPV of debt-to-export ratio (in percent) 1/		457						422			
NPV of debt-to-revenue ratio (in percent) 1/		543						494			
Three-year export average		934						1,031			
Central government revenue		786						882			

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Including interim assistance from CABEL. The data are one year before the completion point, that is, for a completion point in 2002, the data is for end-2001.

2/ Excludes debt to other official bilateral creditors that has already been subjected to a substantial reduction (92 percent or more) and that would not be expected to be reduced further.

3/ The contribution of Paris Club and other bilateral creditors is measured in relation to the NPV of claims at the completion point after the full application on eligible debt of traditional rescheduling mechanisms (i.e., a stock-of-debt operation on Nap).

4/ Assuming no treatment of short-term PRD on London terms, and moratorium interest deferred. Fully topping up these debts would decrease the NPV reduction needed by more than 2 percentage points.

Table 17. Nicaragua: Projected Assistance Levels Under the Proposed Enhancement of the HIPC Initiative Framework

(in millions of U.S. dollars, unless otherwise indicated)

Target for the NPV of Debt-to-		Decision Point in 1999				Required NPV	Target for the NPV of debt-to- -export ratio	Decision Point in 2000				Required NPV
-export ratio (in percent)	-revenue ratio (in percent)	Total	Bilateral 2/	Multilateral 2/	Common reduction factor (in percent)	reduction of Paris Club non-ODA PRD on Naples terms assuming comparable action of other nonmultilateral creditors 3/		Total	Bilateral 2/	Multilateral 2/	Common reduction factor (in percent)	reduction of Paris Club non-ODA PRD on Naples terms assuming comparable action of other nonmultilateral creditors 3/
150	...	2,312	1,372	940	63.9	97.3	150	2,507	1,416	1,091	65.9	98.4
151.5	250	2,299	1,364	935	63.5	97.1	174.5	2,295	1,296	999	60.3	95.7
Memorandum items:												
NPV of debt 1/		3,618	2,147	1,472				3,807	2,150	1,657		
Shares (in percent)		100.0	59.3	40.7				100.0	56.5	43.5		
NPV of bilaterals ODA debt		294						291				
In percent of exports		34						34				
In percent of revenue		56						48				
NPV of debt-to-export ratio (in percent) 1/		416						439				
NPV of debt-to-revenue ratio (in percent) 1/		686						629				
Three-year export average		871						867				
Central government revenue		528						605				

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Including interim assistance from CABEL. The data are one year before the decision point, that is, for a decision point in 1999, the data are end-1998.

2/ The contribution of Paris Club and other bilateral creditors is measured in relation to the NPV of claims at the decision point after the full application on eligible debt of traditional rescheduling mechanisms (i.e., a stock-of debt operation on Naples terms effecting a 67 percent NPV reduction), with the contribution of individual creditors (both bilateral and multilateral) based on their share of the debt at the decision point.

3/ Assuming no treatment of short-term PRD on London terms, and moratorium interest deferred. Fully topping up these debts would decrease the NPV reduction needed by more than 2 percentage points.

Table 18. Nicaragua: Net Present Value of Debt After Reschedulings for Alternative Dates of the Stock-of-Debt Operation 1/

(In millions of U.S. dollars)

	Stock-of-Debt Operation in:			
	1998	1999	2000	2001
1. NPV of total debt (2+5) 2/	3,508	3,690	3,936	4,137
2. NPV of old debt (3+4)	3,508	3,460	3,552	3,610
3. Official bilateral and commercial	2,147	2,108	2,214	2,291
Paris Club	1,230	1,246	1,316	1,371
Post-cutoff date	230	229	239	244
ODA	222	223	231	236
Non-ODA	8	7	7	8
Pre-cutoff date	1,000	1,017	1,078	1,127
ODA	68	66	68	73
Non-ODA	932	951	1,010	1,054
Of which :				
"Nonreschedulable" 3/	116	115	128	130
Other official bilateral	882	838	883	911
"Nonreschedulable" 4/	71	64	57	49
"Reschedulable"	810	774	827	862
Post-cutoff date	171	156	140	127
ODA	0	0	0	0
Non-ODA	171	156	140	127
Pre-cutoff date	639	618	687	735
ODA	4	3	3	5
Non-ODA	635	616	684	730
Commercial	35	24	15	9
Post-cutoff date	33	22	13	7
Pre-cutoff date	2	2	2	2
4. Multilateral	1,362	1,352	1,338	1,319
IDB	567	561	552	544
IBRD/IDA	233	233	235	237
IMF	41	40	36	32
Others	521	518	515	506
Of which:				
CABEI	474	477	479	477
5. NPV of new debt	0	231	384	527
Multilateral	0	188	326	452
Bilateral	0	42	58	74
Memorandum items:				
NPV of interim assistance from CABEI	110	117	124	132
Exports of goods and services 5/	830	842	929	1,030
Three-year export average 6/	871	867	867	934
Central government revenue 7/	528	605	695	786
NPV of debt-to-exports ratio 8/	403	426	454	443
NPV of debt-to-revenue ratio	665	610	566	526

Sources: Nicaraguan authorities; and staff estimates and projections.

1/ Refers to public and publicly guaranteed external debt only and assumes full use of traditional debt relief mechanisms, i.e., a Paris Club flow rescheduling on Naples terms (67 percent NPV reduction) and a stock-of-debt operation, and at least comparable action by other official bilateral and commercial creditors. The stock-of-debt operation is assumed to take place at the end of the year, except for 2001, for which it is assumed to take place in March, at the end of the Paris Club rescheduling consolidation period.

2/ Discounted on the basis of the average commercial interest reference rate for the respective currency, derived over the six-months period prior to the latest date for which actual data are available (base date). The conversion of currency-specific NPVs.

3/ Short-term debt rescheduled in 1991 on London terms, and moratorium interest deferred. The Agreed Minutes specify that these amounts would not be subjected to further reorganization.

4/ Refers to debt that has already been subject to a substantial reduction (at least 92 percent NPV reduction) and that it would only be rescheduled further if needed to achieve comparability of treatment.

5/ As defined in *IMF Balance of Payments Manual, 5th edition, 1993*.

6/ Backward-looking average (e.g. average of exports over the period 1997-99 is reported for 1999).

7/ Converted into U.S. dollars at the end-1998 exchange rate.

8/ NPV of debt in percent of three-year average of exports of goods and services.

Table 19. Nicaragua: Status of Countries Considered Under the HIPC Initiative

Country (In order of expected decision point within groups)	Decision Point	Completion Point	NPV of Debt-to- Export Target (In percent)	Assistance at Completion Point (In millions of U.S. dollars, present value, at completion point)					Percentage Reduction in NPV of Debt 1/	Estimated Total Nominal Debt Service Relief (In millions of U.S. dollars)	Satisfactory Assurances from Other Creditors
				Total	Bilateral	Multilateral	IMF	World Bank			
Completion point reached											
Uganda	Apr. 97	Apr. 98	202	347	73	274	69	160	20	650	Received
Bolivia	Sep. 97	Sep. 98	225	448	157	291	29	54	13	760	Received
Guyana	Dec. 97	May 99	107 2/	256	91	165	35	27	24	410	Received
Mozambique	Apr. 98	Mid-99	200 3/	1,716	1076	641	125	381	63	3,700	Received
Decision point reached and assistance committed by IMF and World Bank											
Burkina Faso	Sep. 97	Apr. 00	205	115	21	94	10	44	14	200	Being sought
Côte d'Ivoire	Mar. 98	Mar. 01	141 2/	345	163	182	23	91	6 4/	800	Being sought
Mali	Sep. 98	Dec. 99	200	128	37	90	14	44	10	250	Being sought
Total assistance provided/committed (of seven countries)				3,355	1,618	1,737	305 5/	801	20	6,770	
Preliminary HIPC document issued; targets based on majority view in preliminary discussions at IMF and World Bank Boards; assistance based on preliminary HIPC documents and subject to change											
Guinea-Bissau	2000 6/	2003	200	300	148	153	8	73	73	600	...
Ethiopia	1999 7/	2002	200	636	225	411	22	214	23	1,300	...
Mauritania	Jul-99 8/	2002	200	271	114	157	21	43	25	550	...
Debt judged sustainable											
Benin	Jul. 97	...	...	...	...	...	...	...	...	...	...
Senegal	Apr. 98	...	...	...	...	...	...	...	...	...	...

Sources: IMF and World Bank Board decisions, completion point documents, decision point documents, preliminary HIPC documents, and staff calculations.

1/ In percent of net present value of debt at completion point, after full use of traditional debt-relief mechanisms.

2/ Eligible under fiscal/openness criteria; NPV of debt-to-exports target chosen to meet NPV of debt-to-revenue target of 280 percent, as projected at the decision point.

3/ Includes additional assistance required to meet 200 percent debt-to-exports target at completion point for Mozambique.

4/ Nonreschedulable debt to non-Paris Club official bilateral creditors and the London Club, which was already subject to a highly concessional restructuring, is excluded from the NPV of debt at the completion point in the calculation of this ratio.

5/ Equivalent to SDR 212 million.

6/ Debt situation needs to be revisited once the current conflict has ended and a new recovery program agreed.

7/ Country case is delayed due to conflict.

8/ Boards will be recommended to agree that Mauritania could be considered to be ready to reach the decision point in July 1999 once the new ESAF arrangement is approved by the Fund Board. The formal decision point would be expected in the fall of 1999, when assistance is expected to be committed by the Boards on the basis of the enhanced HIPC Initiative framework expected to have been agreed by that time.

I. FUND ARRANGEMENTS
(In millions of US dollars, as of July 28, 1999)

	Approval Date	Expiration Date	Amount Approved	Amount Disbursed
Stand-By	9/18/91	3/17/93	40.86	17.03
ESAF	6/24/94	6/23/97	120.12	20.02
ESAF 1/	3/18/98	3/17/01	148.96	81.69

1/ Including augmentation in February 1999.

II. IBRD LOANS AND IDA CREDITS TO THE OPERATION PORTFOLIO
(In millions of U.S. dollars, as of July 13, 1999)

Credit Number	Approval Date	Borrower/Purpose	IDA	Cancellations	Undisbursed
25360	FY94	Technical Land Mgmt.	44.0	0.00	4.74
26890	FY95	Education I	47.2	0.00	14.45
26900	FY95	Institutional Development	23.0	0.00	4.85
28710	FY96	Road Rehab. & Maintenance	25.0	0.00	5.95
29180	FY97	Rural Municipalities	30.0	0.00	10.54
30840	FY98	Health II	21.0	0.00	22.56
30850	FY98	Transport II	47.4	0.00	39.85
30560	FY99	Financial Sect. Adjust.(FSAC)	71.4	0.00	16.19
31420	FY99	FISE III	45.0	0.00	36.20
31600	FY99	Forestry	9.0	0.00	8.56
Total for 10 active credits			366.0	0.00	163.89

	Active Credits	Closed Credits	Total
Total disbursed (IBRD and IDA)	192.29	623.34	815.63
Of which: repaid	0.00	233.31	233.31
Amount sold	0.00	5.62	5.62
Of which: repaid	0.00	5.62	5.62
Total undisbursed	163.89	0.52	164.41

All IBRD loans are closed.

III. IDB LOANS
(In millions of U.S. dollars, as of June 15, 1999)

Year	Purpose	Approved	Undisbursed
	Sixty-five loans fully disbursed	1,022.3	
1991	Electricity sector	19.0	0.4
1992	Water and sewerage	15.0	0.1
	Nonconventional credit	23.6	2.0
	Agricultural services	7.3	1.4
1994	Agricultural service	8.8	2.0
	Rural development	30.0	2.3
	Pre-investment studies	14.0	8.8
1995	Roads	75.0	22.6
	Strengthening central bank	3.5	0.4
1996	Forestry resources conservation	15.3	6.4
	Lake Managua Basin Management	15.0	14.5
1997	FISE III	50.0	27.2
	Rural development	40.0	34.9
1998	Electricity sector	76.1	65.2
	Financial sector reform	65.8	50.3
1999	Education Reform	9.4	9.4
	Health modernization	48.6	48.4
	Roads	50.0	49.5
	Others	10.0	4.0
	Subtotal	576.4	349.8
	Total	1,598.7	349.8
	Repaid	446.0	
	Total now held by IDB	1,152.7	

NICARAGUA—SELECTED DATA ISSUES

1. Nicaragua's trade data are compiled from customs returns. Except for transactions of the free trade zones, the coverage and valuation of exports of goods are in general reliable, although the valuation of imports of goods since 1997 is based on reference prices used for fiscal purposes instead of actual transaction prices. As a result, and on the basis of comparisons with partner's country data, the staff believes that the import figures provided by the customs administration are overestimated by about 10 percent. The authorities have indicated their intention to start compiling import data based on actual transaction prices in the year 2000.
2. There is no official compilation of transactions by the free trade zones enterprises. However, data on exports of goods by the enterprises located in the free trade zones are compiled by the agency in charge of the management of these zones, Corporación de Zonas Francas (CZF). Data on imports are not systematically recorded. Most of the goods are imported from countries in Asia, and after being processed in the free trade zone, are re-exported to the United States. In accordance with the fifth edition of the Balance of Payments Manual, these transactions by the free trade zone enterprises should be treated as exports of services, recorded on a net basis. A study prepared by the CZF, based on data for 1997, estimated the value added in the free trade zones (based on the value of net exports) to be about 38 percent of the value of exports declared. The staff used this figure to estimate the service receipts from the free trade zones. The authorities intend to start compiling these data in a more systematic way in the near future, so that actual figures may be available at the time of the completion point under the HIPC Initiative.
3. There are weaknesses in other external data, including the coverage of the services account (in particular receipts from tourism), private transfers and foreign direct investment. A more frequent use of surveys of the enterprises and banks could improve the authorities' estimates of these data. Other macroeconomic data reported by Nicaragua are in general adequate, although there are statistical shortcomings in the area of national accounts that result in an underestimation of GDP, and in the coverage and timing availability of basic data. Efforts are being made to improve the statistical base with the help of technical assistance from the Fund, the World Bank, and the IDB.

NICARAGUA: DEBT MANAGEMENT ISSUES

1. Several agencies of the government are involved in the management of public sector debt, with the Central Bank of Nicaragua (BCN) taking the lead because of the technical and analytical expertise of its staff. The database on external debt is maintained at the BCN, which, as the financial agent of the government, also manages the servicing of external debt. The ministry of finance has a small division charged with responsibilities of public sector debt management, concentrating primarily on domestic debt; the Secretariat for External Cooperation manages concessional resources including bilateral grants; and the technical secretariat in the office of the presidency provides input on public sector debt management to the above three agencies. As could be expected, this structure requires a high degree of coordination among the agencies, and often results in duplication of responsibilities.
2. A recently approved law (Ley 290) aims to consolidate debt management responsibilities and to strengthen inter-agency coordination through the establishment of a technical committee for debt. This committee is composed of high level officials from the ministry of finance, the technical secretariat in the office of the presidency, the Secretariat for External Cooperation and the BCN. The new law also shifts the core responsibility of debt management to the ministry of finance in order to integrate public sector debt within the overall management of public resources. However, as there is some concern that the unit within the ministry of finance is understaffed and not experienced enough in external debt management, it is important that the BCN, with its qualified staff, continues to provide support in debt management and debt negotiations until a comparable capacity is built up in the ministry of finance.
3. The new law also consolidates the procedures for approval of new borrowing under the ministry of finance. Detailed guidelines and rules on loan approval are expected to be approved in the third quarter of 1999 through a presidential decree. The implementation of these procedures should ensure that external borrowing by individual government agencies and public enterprises is consistent with macroeconomic policies and conforms with the government's required degree of concessionality.
4. The coverage on external debt statistics is quite extensive, with the BCN maintaining information on external debt in the UNCTAD/DMFAS system. The BCN also began collecting information on private sector debt on a loan-by-loan basis a few years ago, and continues to monitor short-term debt flows through banking surveys.
5. Nicaragua has gone through three Paris Club operations since 1991, and has successfully negotiated debt restructuring and buyback agreements with a number of bilateral and commercial creditors. The technical team working on debt negotiations can evaluate the financial impact of debt restructuring proposals, and is familiar with the details of the traditional debt relief mechanisms.
6. The authorities have recently acquired the software Debt-Pro, and the technical team can carry out debt sustainability analysis and run HIPC-related scenarios. The authorities should be encouraged to strengthen further this capacity, with special emphasis on linking debt analysis to macroeconomic programming. As the private sector capital inflows continue to grow and other forms of external financing become available, the integrated analysis of the country's external position (including short-term cash-flow analysis) will be crucial for a successful debt management strategy.

I. PUBLIC SECTOR REFORM

A. Past measures

- Public employment was reduced from 290,000 to 107,000 through downsizing of armed forces (from 83,000 to 15,000), privatization or closure of public enterprises (involving 74,000 employees) and an early retirement program. 1990–93
- Public sector employment was reduced by 10,700 positions through a voluntary retirement program (*Programa de Movilidad Laboral*). 1994–96
- Public employment was further reduced by 3,800 positions through extension of voluntary retirement program. October 97–June 99
- National assembly approved Law No. 290, prepared with IDB and Work Bank assistance, to restructure and reorganize the executive branch of the government. June 1998
- Implemented regulation on restructuring government; reduced the number of ministries and decentralized entities (by 3 each), and reduced the number of high ranking officials by 25 percent. November 98–May 99

B. Future milestones

- Issue a decree formalizing the National System of Public Investment (SNIP) for evaluating, clearing and monitoring implementation of investment projects. January 2000
- Complete implementation of voluntary retirement and contracting-out programs with further reduction of government by 400 positions. July–December 1999

II. PUBLIC ENTERPRISE REFORM AND PRIVATE SECTOR DEVELOPMENT

A. Past measures

- All but five of the 351 companies incorporated in the public sector holding company, CORNAP, and accounting for almost 30 percent of Nicaragua's GDP were privatized, returned to former owners or liquidated. 1990–95
- National assembly approved laws to separate the regulatory and operational activities of the following public utilities:
 - Telecommunications (TELCOR and ENITEL) 1995
 - Power (INE and ENEL) 1995
 - Water and sewerage (INAA and ENACAL). November 1997
- National assembly approved laws for hydrocarbon sector to:
 - Liberalized the exploration and commerce of hydrocarbons March 1998
 - Lease PETRONIC to private sector firm. June 1998
- Introduced policy of periodic tariff adjustments to bring rate structure closer to long-term marginal costs in:
 - Power sector (including rate adjustments of 1.5 percent/month) October 1997
 - Water and Sewerage (including rate adjustments of 1.5 percent/month) March 1998
 - Telecommunications sector. December 1998

- Implemented separation of ENEL into generation, transmission and distribution operations as a step towards privatization. April 1999
- Leased PETRONIC to private sector June 1999
- B. Future milestones**
- Offer distribution and generation units of ENEL for sale or long-term lease to private investors. December 1999
- Approve creation of “*Fondo Vial*” to finance road maintenance. December 1999
- Divest administration of at least two regional water and sewerage systems managed by ENACAL to private sector through concession. December 1999
- Offer at least 40 percent of ENITEL’s assets plus management control for sale to private investors. January 2000
- Transform the state port authority (ENAP) into a regulatory agency and set a regulatory framework for divesting port operations. June 2000
- Issue terms of reference and offer to sell or conclude a long-term lease for port operations. March 2000

III. TAX SYSTEM AND TAX ADMINISTRATION

A. Past measures

- Corporate income taxes were unified, number of tax brackets for personal income taxes were reduced, the maximum marginal income tax was reduced in line with regional standards, and the Value Added Tax was raised from 10 to 15 percent. 1990–91
- Updated and modernized the registry of the 10,000 largest tax contributors to improve tax collections. 1990–92
- Tax exemptions were reduced, public enterprises were subjected to taxation, income taxes applicable to agricultural and non-agricultural activities were unified and coffee exporters were subject to income tax withholding. 1993–95
- National assembly approved a major tax and customs duties reform package (*Ley de Justicia Tributaria*, No. 257), which broadened the tax base, improved the transparency of the tax system, reduced the number of exemptions to the VAT and import duties and lowered the ceiling rate on personal and corporate income taxes to 30 percent and introduced a presumptive income tax based on the value of corporate assets or agricultural land-holdings. 1997

B. Future milestones

- Implement the adjustments contemplated in Ley No. 257 as scheduled. 1999–2000
- Approval of a law on transformation of the Revenue and Customs Departments. November 1999
- Start implementing performance indicators for tax and customs collection. January 2000

IV. SOCIAL SECURITY REFORM

A. Past measures

- Separated social welfare system in INSS from pension and health insurance. 1995

B. Future milestones

- Submit to the national assembly a draft law to reform the social security system on the basis of a fully funded system with individual accounts managed by the private sector, and adjust parameters to reduce losses of the current system. August 1999
- Approval by the national assembly of the social security reform law. December 1999
- Start to implement revised parameters of the existing pension system. January 2000
- Start to introduce a new pension system. September 2000

V. FINANCIAL SECTOR REFORM

A. Past measures

- State-banks were recapitalized and downsized, and one state-bank, Banco Inmobiliario was closed, yielding a total reduction from 9,100 employees in 1990 to 3,500 in 1993. 1990–93
- A new law permitting the establishment of private banks and creating a Superintendency of Banks was approved. 1991
- A new general banking law and a new central bank law were approved. 1995–96
- Interest rate controls were progressively removed and directed credit was eliminated. 1991–95
- Insurance market was opened up to private sector (4 private firms were operating in 1998). 1996
- The largest state bank, BANADES, was closed and its branches were sold to the private banks, facilitating a rapid expansion of private banking services into rural areas. November 97–June 98
- Prudential norms were revised to set higher standards for asset classification and provisioning, minimum capital and capital adequacy, credit risk concentration and lending to related parties. June–November 1998
- A majority share (51%) of second largest state bank, BANIC, was awarded to private bidder. January 1999

B. Future milestones

- Approval by the national assembly of law permitting privatization of Banco de Credito Popular. September 1999
- Complete study on bank exit, crisis resolution, structure of resolution agencies and deposit insurance. October 1999

- Approval by the national assembly of additional financial sector legislation to guarantee the autonomy of the Central Bank, strengthen the Superintendency of Banks and modernize the legal environment for banks and other financial institutions. October 1999
- Superintendency of Banks to implement and enforce compliance with the prudential norms issued in 1998. 1999–2000
- Approve plan to strengthen banking safety network based on study supported by IDA. December 1999

VI. TRADE AND PRICING POLICIES

A. Past measures

- Eliminated state exporting and importing monopolies. 1991–92
- Eliminated price controls on all products except public utility tariffs, selected petroleum products, basic medicines and milk.. 1991–93
- Eliminated use of negotiable tax certificates (“CBTs”) to promote non-traditional exports. November 1997
- Reduced the import tariff ceiling from over 60 percent in 1990 to 10 percent. 1991–July 1999

B. Future milestones

- Continue to reduce and unify import tariffs according to schedule approved in the 1997 tax reform (Ley de Justicia Tributaria, No. 257). 1999–mid-2001
- Submit to the national assembly a revised foreign investment law. September 1999
- Approval of the foreign investment law by the national assembly. December 1999
- Approval by the national assembly of the new commercial code. June 2001

VII. IMPROVING GOVERNANCE

A. Past measures

- Established a National Review Commission (to review claims and recommend compensation or return of properties), an Office of Territorial Ordering (to review the legitimacy of land reform beneficiaries) and the Office of Quantification of compensation (to determine the amount of the fair compensation in cases where properties could not be returned). 1992–93
- Implemented multi-year modernization program of the judicial system, which included the construction of court houses in most municipal capitals (128 out of 147) and a training program that has included all judges. 1992–98
- Improved transparency and accountability in management of public finances through:
 - adoption of Integrated Financial Management System (SIGFA) in core central government ministries. 1996–98
 - improved expenditure control by expanding the coverage of the fiscal budget to include all extra-budgetary revenues and expenditures made through own sources (“sinceramiento”). 1997–98

- National assembly approved law to strengthen property rights (Ley de la Propiedad Reformada Urbana y Agraria) by clarifying rights of former owners (who can seek recourse to the courts if unsatisfied with the offer of indemnification), protecting small-scale landholders that received land and streamlining the property conflict resolution process by setting time limits for the completion of proceedings. November 1997

B. Future milestones

- Establish National Center for Mediation of Property Claims. September 1999
- Approval by the national assembly of the new Public Procurement Law (prepared with TA from IDB and World Bank). September 1999
- Complete implementation of centralized cash management “cuenta unica” in Treasury to all domestic revenue and transfers. September 1999
- Approval by the national assembly of administrative dispute settlement law. December 1999
- Issue 13,000 urban property titles and 4,600 rural property titles. 1999
- Extend restructuring of ministries, include all government entities in SIGFA and make accounts publicly available. 1999–2001

VIII. SOCIAL POLICY REFORMS

Education sector reforms

A. Past measures

- Major school infrastructure rehabilitation, including through FISE. 1992–98
- Introduced and expanded school autonomy program for primary and secondary schools. 1994–98
- Distributed textbooks and workbooks based on new primary school curriculum to all students in grades 1-4; curriculum for secondary level is under revision. 1995–99
- Prepared a long-term Education Plan (*Plan maestro*), including a baseline study to evaluate the selection process for school directors, with the participation of all education sector stakeholders. June 1999

B. Future milestones

- Present to the national assembly draft law to reform the sector legal framework (Ley General de Educación) to reflect the decentralization process. December 1999
- Expand school autonomy program so that at least 95 percent of secondary and 65 percent of primary schools are managed by local school boards. December 1999

Health sector reforms

A. Past measures

- Major infrastructure program was implemented, including through FISE, to rehabilitate health posts, health centers and hospitals. 1992–98

- Initiated process to decentralize public health system to improve primary and preventive health care services, and introduced program to reform pharmaceuticals procurement and distribution. 1994–98
- Shifted Primary Health Care focus from vertical to integrated, preventive PHC model. 1993–95
- Implemented reform to permit INSS to contract out the provision of health services for its beneficiaries separate of MINSA. 1995–98

B. Future Milestones

- Prepare pilot decentralization plan, according to which full control over its budget execution will be given to at least 1 SILAIS and 5 hospitals, including control over personnel, medical supplies and operating expenses. September 1999
- Implement pilot decentralization plan. January 2000
- Integrated Maternal and Child Care Model and performance-based incentive system to be operational in 17 SILAIS. December 2001
- At least 10 women's centers, providing health and reproductive advisory services, to be in operation. December 2001

Social safety nets, rural development and poverty monitoring

A. Past measures

- Eliminated marketing boards for basic grains and other products. 1990–91
- Established National System of Agricultural Technology and expanded assistance to small-scale farmers. 1993–98
- Developed poverty maps based on 1993 Living Standards Measurement Surveys. 1993–95
- Poverty map established as main criterion for targeting social policies. 1997
- Initiated a program to support small- scale basic grains producers in poor areas as identified by LSMS poverty map. 1997

B. Future milestones

- Develop an updated poverty map based on 1998 LSMS. December 1999
- Divest at least 75 percent of ENABAS' assets to private sector. December 1999
- Continue to expand coverage of agricultural extension services. 1999–2000
- Design and implement pilot safety net program that provides income support to poor families in rural areas to permit better education and health care of children. October 1999
- Implement scholarship programs for extremely poor children in rural areas. January 2000

IX. ENVIRONMENTAL SUSTAINABILITY

A. Past Measures

- Preparation and adoption of a National Forestry Action Plan and of an Environmental Action Plan. 1993–94
- Presentation to the national assembly of the draft law to regulate demarcation and titling of indigenous lands on the Atlantic coast. October 1998

B. Future Milestones

- Approval by the national assembly of the Indigenous Lands Demarcation Law or issuance of presidential decree regulating demarcation of lands in BOSAWAS and surrounding areas. December 1999
- Submit to the national assembly new laws regulating the mining sector. September 1999
- Submit to the national assembly new laws regulating the forestry and fisheries sectors. January 2000

Adjustment Record Under Fund Arrangements 1991–99

1. **The 1991–92 Stand-By Arrangement program.** In March 1991, the government began to implement an economic stabilization and structural adjustment program aimed at eliminating hyperinflation, strengthening the external position, and setting the basis for sustained economic growth. The program involved a drastic transformation of an overexpanded public sector by restoring private sector activities in banking and international trade; implementing major cuts in military and other public spending, a major tax reform (approved in 1990),¹ flexible public sector pricing policies and wage restraint; and initiating the trade and exchange liberalization process. Substantial progress was made in this period, including price stabilization and a marked improvement in the external position, while the basis was set for the transformation to a market-based economy. Quantitative performance under the program was satisfactory during 1991 and the first half of 1992; however, because of shortfalls in external assistance and some slippages in the fiscal area during the second half of 1992, some of the performance criteria of the program were not met and the second review could not be concluded.

2. **The 1994–97 ESAF program.** Beginning in late 1993 and early 1994, Nicaragua embarked on a medium-term program aimed at further consolidating macroeconomic stabilization, deepening structural reforms, and enhancing the conditions for external viability. The program, supported by the ESAF arrangement approved in June 1994, envisaged an improvement in the public finances, tight credit, and wage policies, and stable exchange rate policies; and structural reforms, including the downsizing of the public sector, strengthening the property rights, and improving financial sector activities by the phasing out inefficient state banking operations. Progress was made in all major areas, while economic performance continued to improve. In 1994, economic growth resumed, inflation declined, and international reserves strengthened. However, the public finances were weaker than envisaged, in part reflecting the adverse effect from a severe drought, and some structural reforms proceeded at a slower pace than originally contemplated; the review under the first annual arrangement was not concluded.

3. In the fourth quarter of 1995 and the first half of 1996, policy implementation improved under a staff-monitored program. Macroeconomic policies were strengthened and net international reserves recovered substantially, while progress was made on structural reforms, including on a major program of public employment reduction, the downsizing of the state banks, and the passage of legislation to initiate the privatization of the public enterprises. Subsequently, however, certain key policy actions—including the approval of tax package—were delayed and deviations from the program targets emerged in late 1996.

¹ The 1990 tax reform broadened the tax base and improved the efficiency of the tax system, including major amendments to corporate and personal income taxes, the VAT, and the general tax system.

During 1995–96, inflation was kept in the low double digits and real GDP grew by 4 percent a year.

4. **The 1998–2000 ESAF program.** In the second half of 1997, Nicaragua embarked on a medium-term program that aimed at further progress toward sustainability of the public finances and the external sector, and at strengthening structural reform and governance, while maintaining strong economic growth. The program incorporated significant economic and structural measures (including a tax reform package,² the approval of new laws on property rights and enabling the privatization of the state telephone company, and the closure of the largest state banks). The program was supported by a three-year ESAF arrangement approved in March 1998.

5. In 1998, fiscal performance was better than envisaged, despite additional expenditures and revenue losses in the wake of Hurricane Mitch; credit policy was tightened, and important progress was made in strengthening the financial system and other structural reforms; while the economy maintained a good growth performance. Under a preliminary program for 1999, prepared by the authorities and agreed with the Fund staff in the wake of Hurricane Mitch, policies continued to be generally in the right course, although there were some deviations from the fiscal and structural targets. During the first semester of 1999, economic performance strengthened, with a pickup in agricultural output and a strong increase in domestic demand. Real GDP growth is estimated to be accelerating to a rate of 6.3 percent in 1999, with unemployment declining, the rate of inflation slowing and net international reserves strengthening.

² The tax reform package (“Tax and Commercial Justice Law”), approved in May 1997, sought to further broaden the tax base by eliminating a large number of discretionary VAT and customs tax exemptions while introducing a major trade reform as the number of rates, average levels, and the spread of import duties were to be gradually reduced over several years.

Status of IDA-Supported Structural Reforms

Nicaragua: Reforms Supported by IDA Adjustment Credits and Waivers

Credit-Approved Date	Key Reforms Supported	Waivers of Conditions
<p>Economic Recovery Credit I (No. 2302-NI)</p> <p>September 26, 1991</p>	<p>To support the Government in its effort to transform the economy from a command to a market economy by: (i) downsizing and restructuring the public sector, including the privatization of state owned companies; (ii) reforming the financial system to improve resource allocation through the establishment of a competitive environment with private sector participation; and (iii) reforming the incentives systems by eliminating barriers to private sector entry to production and trade, liberalizing trade, domestic price controls and related regulations.</p>	<p>None</p>
<p>Economic Recovery Credit II (No. 2631-NI)</p> <p>June 21, 1994</p>	<p>To support the second phase of the Government's economic reform program, which aimed at: (i) carrying out a major reform of the State; (ii) increasing the efficiency of financial intermediation; and (iii) improving conditions for private sector development.</p>	<p>Yes (third tranche) Gasoline distribution by PETRONIC (State Petroleum Company) was not privatized, requiring a waiver approved by the Board. Instead of privatizing only gasoline distribution as agreed in ERC II, the Government opted for a more comprehensive reform of the sector, which has been successfully implemented. Since 1995, the exploration and sale of hydrocarbons was liberalized, sector regulatory functions were transferred to an autonomous agency (INE), and PETRONIC was leased to a private foreign operator.</p>
<p>Financial Sector Adjustment Credit (No. 3056-NI)</p> <p>April 9, 1998</p>	<p>To support the government's structural adjustment program, which aims at: (i) carrying out a major reform of the state banking sector; (ii) improving financial intermediation, especially in rural areas; and (iii) improving the regulatory framework for private banking.</p>	<p>None Under implementation; the first two tranches were approved.</p>