

INTERNATIONAL MONETARY FUND AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

NICARAGUA

Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper

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

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The document prepared by the Nicaraguan authorities goes well beyond the basic requirements for an Interim-PRSP and provides a sound basis for the completion of a fully participatory PRSP, as well as an adequate framework for Fund and IDA concessional assistance programs. Its major strengths are: (i) a clear commitment toward poverty reduction; (ii) a good diagnosis of poverty; (iii) identification of goals, targets, and intermediate indicators; (iv) incorporation of cross-cutting themes; (v) commitment to macroeconomic stability and identification of broad program areas critical for poverty reduction; (vi) monitoring of debt relief funds; and (vii) involvement of civil society through a consultation process. To complete the PRSP, the staffs recommend focusing on the following key areas: (i) strengthening the macroeconomic framework to support the poverty reduction strategy, taking into account fully the implications of bank restructuring and likely availability of noninflationary financing; (ii) prioritizing public expenditures; (iii) costing of activities linked with indicators and goals; (iv) focusing greater attention to needed institutional reforms in the social sectors; and (v) ensuring a broad participatory process and realigning donor assistance to better support the PRSP.

A. Nicaragua's "A Strengthened Poverty Reduction Strategy"

1. The document "A Strengthened Poverty Reduction Strategy" (SPRS) prepared by the Nicaraguan authorities,¹ which is a preliminary draft of their full PRSP and has been

¹ The Social and Economic Cabinets are responsible for the development and implementation of the poverty reduction strategy. The Technical Secretariat of the Presidency (SETEC)—with support from the central bank, the ministry of finance, and the ministry of foreign affairs—is responsible for the technical work and coordination with the rest of the government, civil society, and the donor community. The National Council for Social and Economic Planning (CONPES) and its recently formed Institutional Development Commission, with technical support from UNDP, is responsible for coordinating civil society participation.

submitted as an Interim Poverty Reduction Strategy Paper (I-PRSP), indicates a clear commitment to poverty reduction. The diagnosis shows that, although there was a modest reduction in poverty between 1993 and 1998, poverty is pervasive and Nicaragua remains one of the poorest countries in the Western Hemisphere. The authorities clearly state that addressing Nicaragua's high poverty levels and low social indicators will require commitment to a long-term poverty reduction strategy. Important indications of this commitment include: the continued emphasis on improving social infrastructure in the poorest rural areas, which has contributed to a significant improvement in health and, particularly, education indicators among the rural poor during 1993 to 1998; the Emergency Social Investment Fund's (FISE) adherence to a poverty map to prioritize projects; the creation in 1998 of a high-level Technical Secretariat within the Presidency to coordinate social and economic policies more effectively; and the creation in 1999 of a permanent council (CONPES) to carry out policy consultations with civil society.

2. **The SPRS is firmly grounded on a comprehensive poverty analysis and diagnosis.** The collection of systematic information on poverty indicators in Nicaragua began in earnest during the 1990s, and includes two Living Standards Measurement Surveys (LSMS), carried out in 1993 and 1998, and the population census of 1995. Based on this information, the SPRS provides a fairly detailed description of the extent and patterns of poverty in Nicaragua, including a comprehensive and updated poverty map (Annex IV of the SPRS). Also, the strategy's emphasis on social protection mechanisms (see below) is backed by the findings of a recent IDA-supported qualitative poverty assessment, which places risk and vulnerability at the center of the poor's perception of what makes them poor. The availability of two comparable surveys separated in time also has permitted an initial evaluation of the impact of policies introduced in the early 1990s in reducing poverty.

3. **The SPRS makes a good effort to identify appropriate goals, targets, and intermediate indicators.** The goals, targets, and intermediate indicators to measure progress in the implementation of the poverty reduction strategy were selected on the basis of the poverty analysis, a participatory consultation process and a review of the country's commitments made in various U.N. conferences. Nicaragua seeks to meet all the International Development Goals proposed by the OECD-DAC by the year 2015, including especially to cut extreme poverty in half, as well as three additional goals that reflect country-specific characteristics and needs. These additional goals refer to reducing child malnutrition, expanding the coverage of potable water and sanitation services, and reducing the illiteracy rate. Child malnutrition indicators are high by regional standards and have shown little improvement over the last 30 years, while inadequate access to water and sanitation services contributes to the low level of a number of social indicators, so that the attention placed on these two indicators is clearly warranted. Nicaragua's overall illiteracy rate, on the other hand, is below the regional average, and its inclusion as a goal complements the schooling target included in the International Development Goals. While most of the targets appear feasible, a few appear very ambitious and may need to be reviewed after initial program implementation findings become available (see paragraph 13).

4. **The strategy rests on four fundamental pillars and incorporates three important cross-cutting themes.** The four pillars are: (i) broad-based economic growth, with an emphasis on productive employment generation and rural development; (ii) greater and better investment in the human capital of the poor; (iii) better protection of vulnerable populations; and (iv) the strengthening of institutions and good governance. These pillars are intertwined with three cross-cutting themes that are also considered essential for reducing Nicaragua's poverty, namely reducing the country's environmental degradation and ecological vulnerability, bringing about greater social equity, and a further decentralization of government. These strategic pillars appear generally adequate for addressing Nicaragua's poverty situation. Nevertheless, further clarification will be necessary to operationalize the cross-cutting theme of social equity in the context of overall poverty reduction.

5. **The SPRS states the authorities' commitment to consolidate macroeconomic stability, continue with structural reforms, and improve governance.** These commitments are broadly consistent with the ongoing PRGF program. However, the SPRS envisages relatively high levels of public investment over the next few years, which may not be consistent with available concessional external financing, the objective of lowering inflation and the government's implementation capacity. Moreover, although the mobilization of domestic resources relies largely on a "growth dividend," tax and expenditure reforms also may need to be implemented to reach the targeted increase in poverty-reducing expenditures.

6. **The SPRS also emphasizes the authorities' commitment to implementation of ongoing social and structural reforms.** Many of these reforms, and associated policy dialogue, already are supported by IDA. These reforms include, in particular, pension system reforms and the strengthening of the financial sector (which is being supported by an IDA Pension Reform and Financial System Technical Assistance Credit), the privatization of the telecommunications utility and strengthening of the regulatory agency (supported by a Telecommunications Sector Reform Credit), completing the implementation of an Integrated Financial Accounting System (supported by an Economic Management TA Credit), advances in the implementation of a decentralization strategy (supported by a Rural Municipalities Credit), and legal reforms in the health and education sectors (supported by credits in both sectors).

7. **The government's document identifies seven broad program areas that will be critical to the success of the strategy.** These areas, which are to become the main recipients of HIPC debt service relief (Table 8 of the SPRS document), comprise programs in education and health supported by the Supplementary Social Fund, the social safety net program, increased coverage of social services in key municipalities, developing the country's Atlantic region, the Social Investment Fund (FISE), and urban poverty reduction. One aspect that requires clarification in this choice of core programs is the absence of rural development initiatives and inclusion of urban poverty reduction, even though the country's poverty profile shows that most of the poor by far are concentrated in rural areas.

8. **The SPRS presents a credible approach to monitor the use of debt relief funds in line with the poverty reduction strategy.** The document proposes to use the Supplementary Social Fund (SSF) as the institutional vehicle for channeling HIPC-related funds to identified priority programs. This Fund was created three years ago to channel external finance to specific projects proposed and executed by certain line ministries, and to monitor the execution and impact of those projects. The initial experiences with the functioning of the SSF have been generally positive and the SSF will be able to track the debt relief savings through the budget, but substantial improvements in monitoring and evaluation of impacts need to take place. These improvements will be supported through an IDB PRSP implementation project. The responsibility for monitoring progress in the attainment of the goals and intermediate indicators described earlier will lie with the Technical Secretariat of the Presidency (SETEC). In addition, the strategy gives special attention to ongoing institutional reforms to generate more timely and transparent information on public expenditures, improved public investment management, as well as greater efficiency and transparency in public procurement.

9. **The SPRS builds on past efforts at poverty reduction, involving civil society through an intensive consultative process.** By the time the international donor community sought to link more explicitly the benefits of the enhanced HIPC initiative to the preparation of participatory poverty reduction strategies, Nicaragua had already advanced in this task. Upon taking office in 1997, the present government initiated consultations to mobilize domestic support for its policies, followed by a request for external support at the April 1998 Consultative Group meeting in Geneva. The consultation process was intensified, partly at the urging of civil society organizations, in the aftermath of Hurricane Mitch, with the creation of six councils in late 1998 to assess the damage and priority needs of the affected population, and develop a reconstruction plan. Finally, in early 1999, the government created the National Council for Social and Economic Planning (CONPES), with a permanent mandate to advise the President on the formulation and evaluation of social and economic programs. CONPES, whose membership consists of a broad group of leaders of political parties, business community, labor unions, churches, universities, and a network of NGOs, has become the primary channel of consultations between the government and civil society on social and economic strategy, and for the PRSP in particular. Annex I contains a detailed description of the consultation process and a frank discussion of the comments and recommendations received. With support from UNDP, the authorities are implementing a more formal program to improve the contributions, participation, and consensus-building process for the PRSP. The National Program for the Analysis and Formulation of Public Policy will systematize participatory mechanisms and decision-making processes.

B. Recommendations for Completing the PRSP

10. **The SPRS is particularly strong in the poverty diagnosis, the incorporation of cross-cutting themes, the monitoring and choice of targets, and the record of consultations and their results.** The present document goes well beyond meeting the minimum requirements for an SPRS. The chain of argumentation, from poverty analysis to goals/indicators to policies and programs reflects a sound logical sequence. There is also a good record of the consultations to date and their outcomes. Further work is necessary, however, to strengthen the links between each element of this chain, as contemplated in the work plan at the end of the SPRS, and including more attention to the qualitative and participatory aspects of the poverty analysis.

11. **Further work needs to focus especially on the following areas: (i) strengthening the macroeconomic framework and improving its integration into the overall strategy; (ii) prioritizing public sector projects and programs; (iii) costing of poverty reduction activities; (iv) placing greater attention on needed institutional reforms in the social sectors; and (v) ensuring a broad participatory process, beyond Managua, and realigning donor assistance to better support the PRSP.** For a full PRSP, a well-articulated macroframework supportive of the poverty reduction strategy and consistent with sustainable debt dynamics needs to be formulated based on the projected availability of public revenues, noninflationary domestic financing, and concessional external resources. This macroframework should also incorporate the implications of bank restructuring—which could be large—and contain a discussion of the medium-term financing gaps and an outline of scenarios based on lower-than-expected external financing. Moreover, the investment and external financing projections warrant a review in the context of Nicaragua’s institutional capacity to implement projects. The framework should also aim to protect the economy against adverse exogenous shocks and to buttress confidence in the context of a weak financial system.

12. **The public sector’s poverty-reducing projects and programs need to be prioritized further.** The matrix in Annex V of the SPRS appears to include all public activities and expenditures in poverty-related areas, according equal weight to major and secondary measures. These activities need to be reordered into fewer, more manageable priority activities, followed by a ranking of supplementary activities to be undertaken as financial resources and institutional capacities permit. A key task will be to consolidate or eliminate inherited projects that no longer constitute priorities or that have proven themselves to be ineffective. It is also important in this context to keep under review which sub-set of activities in the total public expenditure program will benefit from additional resources released by HIPC debt relief. Table 8 of the SPRS document assigns 50 percent of these additional resources to social spending and none to rural development. This proposed allocation implies an unusually low marginal impact of ongoing rural development programs, and would suggest an urgent need for reforming those programs in light of the great importance of rural incomes to poverty alleviation in Nicaragua. It may also overestimate the absorptive capacity of the social sectors. Finally, it is important that the PRSP articulate more clearly the development of a medium-term expenditure framework, in part to resolve the lack

of clarity between capital and recurrent expenditures that affects the budget figures in the report.

13. **Further work is needed on the costing of particular activities and links with indicators and goals.** The social goals and targets identified in the report aim in the right direction, but it is sometimes difficult to judge on the basis of the information provided whether they are feasible or too ambitious. For example, the SPRS projects a very ambitious 20 percent decline in infant mortality over seven years and emphasizes the expansion of immunization coverage as a key indicator to attain this goal. Immunization coverage is already comparatively high in Nicaragua, so that the marginal impact of expanding that coverage further on infant mortality rates would appear to be fairly low. More information on the costing of individual activities (e.g., the price of immunizing one additional child times the number of uncovered children), together with an explanation of the links between specific activities and these goals will be needed in the PRSP to assess the effectiveness of those activities, estimate their overall fiscal cost, and permit an evaluation of tradeoffs between competing activities. While the authorities are urged to improve the cost estimates for the program, it is also important, however, to keep technical limitations in mind. The costs of outcome indicators should be estimated whenever possible, but in many cases it will be technically difficult to go beyond a costing of intended inputs. Programs to strengthen the country's institutional capacity will be required to reduce these technical limitations and, more generally, achieve a more effective linking of policies, expenditures and results.

14. **The sectoral strategies discussed in the report need to be refocused in the social sectors.** The report gives insufficient attention to the need for institutional reform, and too much on additional resources, which, if merely used to pursue business as usual, are unlikely to yield the desired sector outcomes. Greater emphasis on more efficient program implementation in the social sectors and the rationalization of donor-funded activities in support of sector reforms is needed. This is especially true in the health sector, where the current mismatch of human resources and misallocation of medical supplies are so pronounced that an expansion of resources without fundamental structural corrections would have little impact on health service delivery. Similarly, the nutrition strategy needs to be strengthened with more emphasis on measures to change household behavior and nutrition practices, while the population strategy needs to be better targeted, with a focus on adolescents and the rural poor. With regard to social protection, what has been presented so far is only a work plan to arrive at a strategy, rather than the strategy itself. While part of that work plan involves pilot projects that will take time to complete and evaluate, there is enough material available now to develop the main elements of a strategy. Detailed comments on the overall strategy and programs in the social sectors are being submitted to the authorities for consideration.

15. **The staffs recommend that the completion of the PRSP not be rushed, ensuring sufficient time to complete pending work in key areas, and broadening and institutionalizing the participatory process.** The authorities expect to have formally completed and consulted the PRSP by the end of the year 2000, even though many activities in the work plan contained in the SPRS extend well into the year 2001. This reflects the

authorities' view—which the staffs' share—that the SPRS is a “living document” that will continue to evolve over time and require ongoing consultations through CONPES and with donors. In terms of process, the authorities are aware of the need to go beyond the capital city with further consultations in the lead-up to the full PRSP. They are also aware that the consultations need to address macroeconomic and structural issues, and not just be confined to social sector issues. Finally, there is the broader discussion of how the implementation of the strategy is to be budgeted, managed, or monitored with participation of CONPES and other forums to enhance civic participation. The authorities have prepared an excellent I-PRSP and their desire to quickly complete the PRSP and begin its formal implementation is understandable, but the staffs would like to express caution against rushing the process of finalizing the full PRSP.

C. Assistance Needs and Implementation Risk

16. **Completion of the PRSP and its implementation will require significant donor support.** IDA has been providing inputs to the PRSP through the preparation of a Poverty Assessment (now in green cover), an Impact Evaluation of the Social Investment Fund, the Poverty Map, and plans to hold a Public Expenditure Workshop in December 2000 and complete a green cover Public Expenditure Review in early 2001. IDA also will continue to assist in the implementation of social and structural reforms through ongoing and future dialogue and lending operations, including a possible PRSP-supporting program credit. The IMF will continue to assist in the surveillance of economic developments, the implementation of prudent financial and wage policies, and structural reforms. The satisfactory resolution of bank problems and its macroeconomic implications and improvements in governance will be given particular importance in the context of the PRGF program. IDB is currently preparing a credit operation to support the implementation of the PRSP and another to modernize the public procurement system. Also, IDB and UNDP are assisting the PRSP consultation process through technical and financial support to CONPES. The proposed donor support should cover most technical needs for completing the PRSP. Nevertheless, some areas, particularly the costing of social programs (paragraph 10), are at the forefront of analytic research and may require additional support from both bilateral and multilateral sources.

17. **Risks which may affect implementation of the strategy** can arise from a deterioration of the external environment, such as adverse terms of trade shocks, a slowdown in the world economy, reduced access to foreign markets, and reduced availability of foreign aid. On the domestic front, the fragility of the financial system presents a considerable risk, especially in the context of Nicaragua's dependence on potentially volatile private capital flows and a banking supervision system that is still weak. A further risk is that the public sector's weak institutional capacity could constrain implementation of key poverty-related programs. Moreover, Nicaragua's electoral cycle (national elections are scheduled for November 2001) could weaken the resolve to maintain wage and overall public expenditure restraint and divert attention from the implementation of necessary structural reforms and improvements in governance.

D. Conclusion

18. The staffs of IDA and the IMF consider that this SPRS provides a sound basis for the development of a fully participatory PRSP, for reaching the decision point under the HIPC Initiative, and for Bank and Fund concessional assistance. The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.

Nicaragua: Summary of IDA/IMF Key Activities in 2000/01

IDA¹	Date
I-PRSP/Joint Staff Assessment	October 2000
HIPC Decision Point	October 2000
Public Expenditure Workshop	December 2000
Land Management II	January 2001
Road Rehabilitation Project	February 2001
Rural Municipalities II	March 2001
PRSP/JSA	March 2001
Community Development Project	April 2001
PRSP-supporting program credit	May 2001
Public Expenditure Review (gray cover)	June 2001
 IMF	
First and Second Review of PRGF	October 2000
I-PRSP/Joint Staff Assessment	October 2000
HIPC Decision Point	October 2000
Article IV/Third Annual PRGF Arrangement	January 2001
PRSP/JSA	March 2001

¹ The projects and programs reflected in this summary represent a subset of the Bank's current portfolio. Over time, the Bank's CAS and its menu of operations will become closely tied to the country's PRSP, take account of its comparative advantage among other external partners, and its own diagnosis and assessment of how best it can contribute effectively to the country's development effort.