

## NICARAGUA

### **IDB: COUNTRY STRATEGY WITH NICARAGUA 2008-2012**

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## ABBREVIATIONS

ALBA	Alternativa Bolivariana para los Pueblos de América [Bolivarian Alternative for the Americas]
BCS-NI	The Bank's country strategy with Nicaragua
CABEI	Central American Bank for Economic Integration
CAFTA-DR	The Dominican Republic–Central America–United States Free Trade Agreement
CDI	Centro de Desarrollo Infantil [Child development center]
CONAPAS	Comisión Nacional de Agua Potable y Alcantarillado Sanitario [National Water and Sanitary Sewerage Commission]
CPAR	Country Procurement Assessment Report
CPC	Consejos del Poder Ciudadano [committees for citizen power]
CPE	Country Program Evaluation
DCSC	Dirección de Convivencia y Seguridad Ciudadana [Citizen Coexistence and Security Division]
DGA	Dirección General de Servicios Aduaneros [Customs Services Directorate]
DGCE	Dirección General de Contrataciones del Estado [Government Contracting Directorate]
DGI	Dirección General de Ingresos [Revenue Directorate]
EMNV	Encuesta de Medición de Nivel de Vida [standard of living survey]
ENACAL	Empresa Nicaragüense de Acueductos y Alcantarillados [Nicaraguan Water and Sewerage Company]
FISE	Fondo de Inversión Social de Emergencia [Emergency Social Investment Fund]
FOMAV	Fondo de Mantenimiento Vial [Road Maintenance Fund]
FOSOVI	Fondo Social de Vivienda [Social Housing Fund]
FSO	Fund for Special Operations
GDP	gross domestic product
HIPC	Heavily Indebted Poor Countries
IDB	Inter-American Development Bank
IFA	Integrated Fiduciary Assessment
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
INAA	Instituto Nicaragüense de Acueductos y Alcantarillados [Nicaraguan Water and Sewerage Administration]
INETER	Instituto Nicaragüense de Estudios Territoriales [Territorial Studies Institute]
INIDE	Instituto Nacional de Información de Desarrollo [National Development Information Institute]
INVUR	Instituto de la Vivienda Urbana y Rural [Urban and Rural Housing Administration]
MARENA	Ministry of the Environment and Natural Resources
MDG	Millennium Development Goal
MECD	Ministry of Education, Culture and Sports
MER	Mercado Eléctrico Regional [Regional Electricity Market]
MERCOSUR	Mercado Común del Sur [Southern Common Market]
MHCP	Ministry of Finance
MIF	Multilateral Investment Fund
MINSA	Ministry of Health
MSBs	micro enterprises and small businesses
MSMBs	microenterprises and small and medium-sized businesses

MTI	Ministry of Transport and Infrastructure
NFP	nonfinancial product
NGO	nongovernmental organization
OECD/DAC	Organization for Economic Cooperation and Development/Development Assistance Committee
OM	Opportunities for the Majority
OPEC	Organization of Petroleum Exporting Countries
OVE	Office of Evaluation and Oversight
PAININ	Programa de Atención Integral a la Niñez [comprehensive child care program]
PAM	Performance Assessment Matrix
PBL	policy-based loan
PDL	performance-driven loan
PDR1	Programa de Desarrollo Rural Integrado [comprehensive rural development program]
PEF	Programa Económico Financiero [Economic Financial Program]
PEFA	Public Expenditure and Financial Accountability Program
PGR	Procuraduría General de la República [Office of the Attorney General of the Republic]
PGRE	Presupuesto General de la República [General Budget of the Republic]
PNDH	Plan Nacional de Desarrollo Humano [National Human Development Plan]
POSAF	Programa Socio-Ambiental y de Desarrollo Forestal [socioenvironmental and forest development program]
PPP	Puebla-Panama Plan
PRODEV	Medium-term action plan for development effectiveness
PROMIPYME	Programa de Apoyo a la Micro, Pequeña y Mediana Empresa [support program for MSMBs]
PRORURAL	Programa del Gobierno de Nicaragua para el Desarrollo Rural Productivo Sostenible [Nicaraguan government program for sustainable rural productive development]
SCF	Structured and Corporate Finance Department
SEP	Social Entrepreneurship Program
SIEPAC	Sistema de Interconexión Eléctrica para los Países de América Central [Central American Electric Interconnection System]
SIGFA	Sistema de Información Gerencial, Financiera y Administrativa [managerial, financial, and administrative information system]
SIGFAPRO	Sistema Integrado de Gestión Financiera Administrativa y Auditoría de Proyectos [integrated system for project financial and administrative management and auditing]
SILAIS	Sistema Local de Atención Integral de Salud [local comprehensive health care system]
SINAPRED	Sistema Nacional de Prevención, Mitigación y Atención de Desastres [national disaster prevention, mitigation and response system]
SMEs	small and medium-sized enterprises
SNCCE	Sistema Nacional de Compras y Contrataciones del Estado [national government procurement and contracting system]
SWAp	sector-wide approach
TC	technical-cooperation program
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization

## EXECUTIVE SUMMARY

Nicaragua's **economic context** is marked by economic growth that has outpaced population growth, but has not been high enough to bring about a substantial reduction in poverty levels. The social context is characterized by sharp inequality and a concentration of poverty in rural areas, which is particularly severe on the Caribbean coast. Given this situation, some of the development challenges facing Nicaragua are to: (i) secure a solid and stable macroeconomic framework, giving priority to deepening fiscal consolidation and reducing external vulnerability; (ii) quicken the pace of sustainable and inclusive growth, which will require comprehensive development of the rural sector and an improved framework for private investment; (iii) reduce poverty, particularly extreme poverty, which will require increased social investment (health care, housing, and water and sanitation) that is more effective and the development of a social welfare system; and (iv) build the country's capacity for environmental sustainability and natural disaster prevention.

**The Bank's 2008-2012 country strategy with Nicaragua** (BCS-NI) parallels the country's political cycle (2007-2012) which began with the election of President Daniel Ortega Saavedra in November 2006. The BCS-NI 2008-2012 is based on: (i) support for the government's development priorities in a more targeted manner, with clearer objectives and actions in sectors where the Bank has comparative advantages; (ii) loans in execution and new operations, to align them with the government program (Plan Nacional de Desarrollo Humano [National Human Development Plan] (PNDH); (iii) priority attached to strengthening the institutional framework; (iv) tapping the synergies between the different Bank windows for private sector development (SCF, MIF, IIC, SEP, and OM) with a view to complementing the actions of those windows and promoting the use of the MIF, SEP, and OM; (v) coordination with international cooperation agencies; and (vi) the lessons learned by the Bank in the country and the recommendations of the Country Program Evaluation of the Bank's activities in Nicaragua under the 2002-2007 strategy.

The **general objective of the 2008-2012 BCS-NI** is to provide selective support for the Nicaraguan government in reducing and managing these vulnerabilities, which inhibit attainment of the country's goals of growth and equity. The Bank's contribution is expected to focus on five objectives in the government's plan: (i) fiscal sustainability and the strengthening of public management; (ii) reliability of the electric power supply and improvement of the existing road system; (iii) management and coverage of social services, including the development of a social welfare system; (iv) productive development; and (v) institutional management for natural disaster prevention.

In light of the multilateral debt alleviation program, the size of the operations program has been determined in a framework of debt sustainability and an enhanced system for performance-based allocation and FSO funds available for allocation. However, when the present strategy was being prepared, the amount of FSO funding that would be assigned to Nicaragua in the 2009-2012 period had not been determined. Therefore, the base-case scenario for loans assumes annual approvals in 2009-2012 similar to those in 2007-2008 and disbursements of US\$564.34 million for the 2008-2012 period.

A scenario based on the country's absorption capacity has also been considered, which reflects financing needs of about US\$120 million per year. This scenario is consistent with debt sustainability and would make it possible to increase the amount of some of the projects in the operations program, in particular those involving basic infrastructure and PBLs (see Annexes VI and VII). The flow of disbursements for the 2008-2012 period is US\$621.6 million, with an average of US\$124.3 million per year, i.e., slightly lower than the disbursement level under the previous strategy period.

The operations program calls for sustained support for the energy sector, which has been identified by the government as a priority for Bank action, and for fiscal sustainability. Apart from boosting the efficiency and effectiveness of spending, the latter will allow for the use of more flexible lending instruments. Priority is also given to the continuation of efforts in the health care, social protection, housing, and productive development sectors, and to the creation of conditions for sustainable economic growth. In the second stage, the efforts already begun in the rural sector will be consolidated through development of the Caribbean coast, and support for the transport and water and sanitation sectors will continue. The process of reviewing the loans in execution began, with a view to bringing it into line with the priorities of the government's program and with the areas identified for Bank action in the present strategy.

**The risks of the strategy** fall into two categories: country risks and risks associated with the Bank's strategy. The country risks include: (i) increases in food and oil prices, which could affect the economy, worsening the prevailing poverty; and (ii) the slowdown in the developed economies, particularly in the United States, and the financial crisis, which could affect implementation of the BCS-NI and attainment of the expected results by impacting tax revenues and fiscal sustainability and increasing the current account deficit. The risks associated with the Bank's strategy are as follows: (i) potential cost overruns due to higher inflation could cause problems in the financing of certain projects supporting the BCS-NI; (ii) the weaknesses that still persist in the mechanisms to prioritize public spending on poverty could lessen the impact of the projects in the Bank's portfolio and, therefore, the impact of the BCS-NI; (iii) a deterioration in the investment climate could inhibit participation by the private sector in the financing of projects in key sectors such as energy and road infrastructure and development of the productive sector and tourism; (iv) natural disasters could cancel out the positive impact of the Bank's portfolio; (v) delays in approving the budget and insufficient budget allocations could delay execution of the projects in the portfolio; and (vi) existing weaknesses in project monitoring and follow-up systems could make it difficult to measure the impact of the Bank's portfolio and the BCS-NI.

**The dialogue agenda** will focus on: (i) maintaining and strengthening coordination with donors, assuming the commitments acquired under the Accra Action Plan related to ownership, alignment, and harmonization of international cooperation; (ii) continuing to support efforts aimed at improving the climate for private investment; (iii) supporting the country with different actions to strengthen governance and thereby contribute to a suitable environment to facilitate access to external aid flows and private investment; and (iv) continuing with efforts to work with a broader concept of civil society, as called for in the Citizen Participation Act.

### Matrix of the Country Strategy with Nicaragua

Country objective	Country indicators	IDB objective and strategic line	Contribution of 2008-2012 BCS-NI and IDB indicators
<b>Strategic area I: Fiscal sustainability and strengthening of public management</b>			
<p>Macroeconomic stability, development, and modernization of the financial system.</p> <p>To improve coordination, consistency, effectiveness, and efficiency on all levels of public planning and intervention.</p>	<p>Internal public debt balance (% of GDP) (PEF) Baseline 2007: 19.9% Target 2009: 11.9%; Target 2011: 8.1%</p> <p>External public debt balance (% GDP) (PEF) Baseline 2007: 59.1% Targets (after receiving pending HIPC relief): 2008: 39.7%; 2009: 42.9%; 2010: 45.4%</p> <p>Overall public sector balance before donations (PEF) Baseline 2007: 3.1% Targets: 2008: 6.2%; 2009: 5.4%; 2010: 5.5%; 2011: 6.9%.</p>	<p><b>Objective:</b> To contribute to the design and implementation of reforms to improve tax and customs management, spending efficiency and effectiveness, and public management.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>(i) To support policy reforms in the fiscal and social areas.</li> <li>(ii) To modernize and strengthen public sector institutions, including implementation of the civil service and administrative career law and consolidation of reforms in the areas of justice, auditing, and internal control. In addition, planning, municipal development, and citizen security capacity will be strengthened.</li> <li>(iii) To strengthen the national financial administration, public investment, civil service and administrative career, contracting, and monitoring and evaluation systems.</li> </ul>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) Strengthen the national financial administration, contracting, public investment, and monitoring and tracking systems</li> <li>(ii) Improve public management.</li> </ul> <p><b>Indicators:</b> Taxpayer Master File operating in accordance with good international practices.</p> <p>Higher efficiency and effectiveness of spending through evaluation (ex ante) of at least 50% of central government projects registered in the national public investment system for the budget year.</p>



Country objective	Country indicators	IDB objective and strategic line	Contribution of 2008-2012 BCS-NI and IDB indicators
<b>Strategic area II: Reliability of the electric power supply and improvement of the existing road system</b>			
<b>A. Reliability of the power supply</b>			
<p>To increase the installed capacity and efficiency of the energy sector, spurring public and private investment in power generation, particularly from renewable sources that reduce oil dependency.</p>	<p>Number of additional rural dwellings with electricity each year (PAM) Baseline 2006: 6,129 Targets: 2008: 9,960; 2009: 6,702; 2010: 4,310</p> <p>Percentage of backup power in the interconnected national system (PAM) Baseline 2007: 3.3% Targets: 2008: 21.8%; 2009: 27.0%; 2010: 32.0%</p> <p>Power transmission lines (Central American interconnection) (km) Baseline 2007: 540 km Target 2010: 1,620 km</p>	<p><b>Objective:</b> To improve the quantity, quality, and reliability of the power supply, making it efficient, sustainable, and compatible with the promotion of private investments.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>(i) To increase coverage through investments in transmission, transformation, and rehabilitation of generating plants.</li> <li>(ii) To promote physical and power integration in Central America.</li> <li>(iii) To support the quest for alternative energy sources, including biofuels and renewable energy.</li> <li>(iv) To support institutional strengthening in the sector in the short term to improve electricity service conditions.</li> </ul>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) Reduce the number of interruptions in the flow of electricity;</li> <li>(ii) Reduce technical and nontechnical losses in power distribution;</li> <li>(iii) Increase the capacity of transmission lines in the context of SIEPAC</li> </ul> <p><b>Indicators:</b></p> <p>Average number of power cuts per year on 230 kV lines. Baseline 2007: 30; Target 2010: 20</p> <p>Technical and nontechnical losses in power distribution (%) Baseline 2007: 27%; Target 2011: 13%</p>
<b>B. Improvement of the existing road system</b>			
<p>To develop a program of public investments in road infrastructure, giving priority to the construction of highways that link productive centers outside the metropolitan area to export markets.</p>	<p>Number of kilometers of the paved (asphalted) road system rehabilitated (PAM) Baseline 2007: 74 km Targets: 2008: 110.8 km; 2009: 98 km; 2010: 71 km</p> <p>Number of kilometers of the maintainable system maintained annually (FOMAV) (PAM) Baseline 2006: 793 km Targets: 2008: 3,500 km; 2009: 5,400 km; 2010: 5,600 km</p>	<p><b>Objective:</b> To undertake interventions to improve the connection of the productive sectors to export markets and integrate the nine regions into the national economy and the country into the Mesoamerican region.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>(i) To improve the highway system.</li> <li>(ii) To ensure road maintenance and institutional strengthening in the sector.</li> </ul>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) Expand the paved road system and the road system maintained by FOMAV.</li> </ul> <p><b>Indicators:</b></p> <p>Number of kilometers of rehabilitated roads in the paved road system.</p> <p>Number of kilometers maintained each year (FOMAV).</p>

Country objective	Country indicators	IDB objective and strategic line	Contribution of 2008-2012 BCS-NI and IDB indicators
<b>Strategic area III: Development of a social welfare system and improvement, management, and coverage of basic social services</b>			
<b>A. Development of a social welfare system</b>			
Support the gradual development of a system to promote social welfare for all households in extreme poverty, by promoting interagency and inter-sector cooperation and synergy among interventions on the demand for and supply of basic services and promotion of the productive capacity of vulnerable households.	<p>Spending on poverty reduction (% GDP) (PEF, PAM, and PNDH) Baseline 2007: 12.5% Targets: 2008: 13.2%; 2009: 15%; 2010: 15.8%; 2011: 16.6%; 2012: 17.3%</p> <p>According to draft 2009 General Budget of the Republic (PGRE): Baseline 2007: 12.5% Targets: 2009: 15%; 2010: 15.8%; 2011: 16.5%; 2021: 17.3%</p>	<p><b>Objective:</b> To enhance the effectiveness of public spending on poverty reduction.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>(i) To continue with actions for gradual development of a social welfare system, with emphasis on peri-urban areas</li> <li>(ii) To support low-income families through actions for the comprehensive development of children under age six</li> <li>(iii) To undertake actions to reduce the social vulnerability of families in extreme poverty in rural and peri-urban areas</li> <li>(iv) To design specific interventions to mitigate poverty in vulnerable groups (women, Afro-descendants, people with disabilities).</li> </ul>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) Increase in maternal and child health coverage</li> </ul> <p><b>Indicators:</b> Number of children under age six from neighborhoods benefitted by the program attending child development centers. Baseline 2007: 0 Targets: to be determined Deliveries in health-care institutions broken down by SILAIS (PAM) Baseline 2006: 62.4% Targets: 2008: 78%; 2009: 79%; 2010: 79%</p>
<b>B. Management and coverage of water and sanitation services</b>			
To invest in water and sanitation and develop a national policy for water resources management.	<p>Effective coverage of drinking water in urban areas (PAM) Baseline 2006: 63% Targets: 2008: 70%; 2009: 78%; 2010: 82% Target MDG 2015: 90%</p> <p>Coverage of drinking water in rural areas (PAM) (FISE and INIDE) Baseline 2006: 53.1% Targets: 2008: 53.7%; 2009: 54.1%; 2010: 54.4%</p> <p>Water supply and sanitation coverage (MDG) Baseline 2006: 36.1% Targets: 2008: 37%; 2009: 38%; 2010: 3%; 2015: 5%</p>	<p><b>Objective:</b> To improve water and sanitation supply and coverage to support attaining the MDGs.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>(i) To strengthen institutional management of the sector and investments in drinking water, sanitation, and solid waste management, seeking efficiency, quality, and sustainability in delivery of the services.</li> <li>(ii) To support the formulation of a long-term strategy for development of the sectors, including a sector plan to link donor contributions to a sector development strategy</li> </ul>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) An increase in water supply coverage in rural and urban areas and sanitation coverage</li> </ul> <p><b>Indicators:</b> Percentage of effective water supply coverage Percentage of sanitation coverage. Long-term strategy for sector development.</p>

Country objective	Country indicators	IDB objective and strategic line	Contribution of 2008-2012 BCS-NI and IDB indicators
<b>C. Management and coverage of housing</b>			
To promote a housing construction strategy in urban and rural areas that gives priority to the most vulnerable sectors.		<p><b>Objective:</b> To boost access to housing for low- and moderate-income families.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>(i) To continue with the approach of offering low-income housing subsidies.</li> <li>(ii) To support growth in the market and strengthening of the sector.</li> </ul>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) Increase in the coverage of demand for low-income housing.</li> </ul> <p><b>Indicators:</b></p> <p>Percentage of coverage of aggregate annual demand for low-income housing</p>
<b>D. Management and coverage of health care services</b>			
To make progress toward the MDGs in the health care sector.	<p>Maternal mortality (for every 100,000 live births) (MDG) Baseline 2005: 86.5 Targets: 2008: 94; 2009: 90; 2010: 85</p> <p>Infant mortality (children under 1 year per 1,000 live births) (MDG) Baseline 2007: 29 Target 2010: 25; 2015: 20</p> <p>Percentage of babies delivered in health-care institutions, broken down by SILAIS (PAM) Baseline 2006: 62.4% Targets: 2008: 78%; 2009: 79%; 2010: 79%</p>	<p><b>Objective:</b> To make a sustainable improvement in the quality and coverage of health care services for the most vulnerable population.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>(i) To create integrated health care networks particularly for maternal and child care.</li> <li>(ii) To bolster the institutional capacity of MINSAs.</li> <li>(iii) To modernize hospital infrastructure and equipment of the service network, promoting the design of a master plan for investments in health care.</li> </ul>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) Increase in coverage of health care services, particularly for mothers and children</li> </ul> <p><b>Indicators:</b></p> <p>Coverage of deliveries in health-care institutions, broken down by SILAIS.</p> <p>Percentage of health care coverage.</p>
<b>Strategic area IV: Productive development</b>			
To support the agriculture sector by providing adequate financing and technical assistance, and developing better marketing channels for small producers, with stress on food security and sovereignty.	<p>Annual growth rate in crop farming (value added) Baseline 2007 (2.6%) Targets: 2008: 9.8%; 2009: 1.5%; 2010: 6.3%</p>	<p><b>Objective:</b> To continue financing rural development initiatives linked to micro, small, and medium-sized producers; continue to provide support through a sector-wide approach, with the objective of boosting competitiveness and increasing the exportable supply.</p>	<p><b>Contribution:</b></p> <ul style="list-style-type: none"> <li>(i) Increase the rate of growth of the agriculture sector</li> <li>(ii) Increase diversification of exports</li> </ul>

Country objective	Country indicators	IDB objective and strategic line	Contribution of 2008-2012 BCS-NI and IDB indicators
<p>To seek better access to the external market through the negotiation of new trade agreements (ALBA, MERCOSUR, European Union, and Asian markets), and optimum use of CAFTA-DR.</p>	<p>Annual growth in livestock farming (value added) Baseline 2007: 8% Targets: 2008: 4.3%; 2009: 6%; 2010: 5.8%</p> <p>Physical and financial progress in executing PRORURAL (based on data published in the annual report) (PAM) Baseline 2007: 75% Targets: 2009: 80%; 2010: 85%</p> <p>Number of families receiving food production support, producing for on-farm consumption (PAM) Baseline 2007: 4,000 Targets: 2008: 14,000; 2009: 26,000; 2010: 38,500</p>	<p><b>Strategic lines:</b></p> <p>(i) To promote comprehensive support programs for the rural sector that promote employment (and include technical assistance and training, institutional strengthening, modernization of agricultural health services, incorporation of international standards, expanded facilities for access to credit, and others) and address gender gaps in the rural economy.</p> <p>(ii) Financing for the productive sector will be provided through the private sector windows (SCF, IIC, OM, and SEP) and MIF resources will be used to finance technical assistance.</p> <p>(iii) Given the country's tourism potential and to complement efforts aimed at diversifying the rural economy, sustainable rural tourism development will be promoted.</p>	<p><b>Indicators:</b></p> <p>Effective mechanism to support food security and boost the productivity of rural families receiving the production support.</p> <p>Increase in the economic activity of the sectors where the IDB will intervene (tourism, coffee, meat, dairy, basic grains, certified seeds, shrimp farming, forestry, and wood products).</p>
<b>Strategic area V: Institutional management for natural disaster prevention</b>			
<p>To develop suitable environmental management that guarantees access to external markets and facilitates the sustainability of economic growth.</p>	<p>Risk management index Baseline 2005: 29.6% Target 2011: 43.6%</p>	<p><b>Objective:</b> To mitigate vulnerability to natural disasters and strengthen institutional management for disaster prevention.</p> <p><b>Strategic lines:</b></p> <p>(i) To finance interventions that help strengthen institutional management for natural disaster prevention and management.</p>	<p><b>Contribution:</b></p> <p>(i) Improve institutional management of risks in natural disasters</p> <p>(ii) Reduce the most significant sources of risk in urban areas</p> <p><b>Indicators:</b></p> <p>To build a system of indicators and baselines for natural disaster prevention and management.</p> <p>To reduce the main sources of risk in urban areas (Managua).</p>

## I. INTRODUCTION

- 1.1 The present Bank country strategy with Nicaragua (BCS-NI) for the 2008-2012 period is the result of a process of dialogue between the Bank and the government on the main challenges facing the country, the way to address them, policy priorities, the government's philosophy, and the Bank's comparative advantages. The results of this process were presented to and discussed with civil society organizations, the business sector, and the international community.
- 1.2 The 2008-2012 BCS-NI is based on: (i) supporting the government's development priorities in a more targeted manner, with a clearer definition of the contribution expected from the Bank and actions in sectors where the Bank has comparative advantages; (ii) supporting the loans in execution and new operations, to align them with the government's program (National Human Development Plan—PNDH); (iii) giving priority to strengthening the institutional framework; (iv) tapping the synergies between the different Bank windows for private sector development (SCF, MIF, IIC, SEP, and OM); and (v) coordinating with international cooperation agencies to improve monitoring of sector goals and ensure that each institution fulfills its individual commitments. This approach has taken into account the lessons learned in Nicaragua by the Bank and the recommendations of the 2002-2007 Country Program Evaluation (CPE), which was discussed by the Programming Committee of the Bank's Board of Executive Directors on 6 October 2008.
- 1.3 The current situation and challenges and the government's program are described in Chapters II and III. Chapter IV presents the proposed country strategy, including the objectives, main areas of the Bank's targeting, and instruments, and analyzes the potential outcomes and risks as well as dialogue agenda with the authorities.

## II. CURRENT SITUATION AND CHALLENGES

- 2.1 Nicaragua is the second-poorest country in Latin America and the Caribbean, with per capita GDP of US\$1,023 in 2007. Its economy, traditionally based on agricultural exports, is small and open and continues to be vulnerable to external shocks and natural disasters. Since 1997, its terms of trade have fallen by two thirds. The country is highly dependent on remittances (about 12% of GDP) and donations from industrialized countries (about 4% of GDP and 16% of the central government's total budget).
- 2.2 Although Nicaragua made progress in the coverage and supply of basic social services in the last decade, the results have been mixed. While some individual indicators have improved,<sup>1</sup> poverty continues to affect close to one half of the

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<sup>1</sup> According to figures from the Ministry of Finance and the Central Bank of Nicaragua, government spending on social services rose from 7.7% of GDP in 2001 to around 11% in 2005, with 4% going to education and 3.8% to health care.

population (see Annex II) and there are significant regional and gender differences in terms of access to social services.<sup>2</sup> From 2001 to 2006, programs were carried out that had documented impacts in the areas of nutrition, preventive health, and education; it must be recognized, however, that not enough funding has been available to keep pace with the country's enormous needs. The impact of social spending has not been commensurate with the increase in its size, which suggests deepening the efforts initiated in 2007 to improve its efficiency and quality.

- 2.3 The main factors that stand in the way of better progress in these areas and the risks facing the country in the short and medium terms are presented below.

**A. Macroeconomic stability and fiscal sustainability**

- 2.4 In the economic policy area, Nicaragua has made progress in macroeconomic stability and fiscal sustainability. Since 2001, the country has made efforts to maintain disciplined macroeconomic policies and to carry out structural reforms. It was able to consolidate its fiscal position through several tax reforms that raised the tax burden from 12.7% to 18% of GDP between 2001 and 2007. As a result, the balance in the nonfinancial public sector (after donations) has improved, moving from a deficit of 6.6% of GDP in 2001 to a surplus of 1.6% in 2007 and spending has been reoriented to place greater emphasis on poverty interventions. Monetary and exchange policy has been based on a system of small and continuous devaluations, complemented by a process of opening up the economy through lower tariffs on imports and the elimination of export taxes and quotas. However, inflation over the last year created a dilemma over whether to use the exchange rate as an anti-inflationary tool or as a tool to protect competitiveness.
- 2.5 The country consolidated the financial system by surmounting a banking crisis in 1999-2001<sup>3</sup> and since then it has been expanding its financial operations. The interest rates and intermediation spreads remain high but they are lower than in other low-middle-income countries.<sup>4</sup> Despite this recovery, the financial system continues to be vulnerable to devaluation of the exchange rate, particularly because it has a high rate of dollarization of savings and loans is high.
- 2.6 External sustainability has moderated gradually, posting a current account deficit in 2006 of 13.5% of GDP thanks to real growth in exports (11.5%) and remittances (17%) in the 2002-2006 period. In addition to a recovery in some traditional exports such as coffee and meat, significant diversification has taken place as a result of the policies mentioned, particularly maintenance of a competitive real exchange rate and a boom in in-bond clothing assembly. However, with the rise in international

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<sup>2</sup> Two thirds of poor households are headed by women. The percentage of poor households is twice as high in rural areas than in urban ones and in the case of extreme poverty, it is five times higher. The Atlantic region has the highest incidence of poverty.

<sup>3</sup> Six banks closed during the crisis.

<sup>4</sup> Agosin Manuel, Bolaños Rodrigo, and Delgado Félix, Nicaragua: A la Búsqueda del Crecimiento Perdido, IDB, November 2007.

oil prices, the current account deficit climbed to 18.3% of GDP in 2007 and estimates suggest it will reach 25.7% of GDP in 2008.

- 2.7 One of the main advances in fiscal sustainability has been the forgiveness of the public debt under the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative.<sup>5</sup> As a result, the external public debt balance fell from 169% of GDP in 2000 to 59% in 2007.<sup>6</sup> A debt sustainability analysis indicates that the fiscal balance has improved as a result of debt alleviation and ongoing fiscal consolidation but that the country continues to present a moderate risk of excessive indebtedness on account of its vulnerability to: (i) a drop in official transfers and foreign direct investment; (ii) a reduction in the degree of concessionality of loans; and (iii) a slowdown in GDP growth (see Annex IV).
- 2.8 In this area, one medium-term risk stems from possible increases in civil service wages and in transfer payments to the municipalities. With respect to the former, the Civil Service Act established a new merit-based scale of wages and benefits. The cost of applying the new scale to all employees covered by the national budget is an estimated 2% to 3% of annual GDP, which is why the wage scale and other provisions of the new Act are being applied gradually.
- 2.9 The 2003 Municipal Transfer Payments Act requires the transfer of 4 percentage points of tax revenues to the municipalities starting in 2004, to be increased by one percentage point a year until they reach a minimum of 10% of tax revenues in 2010. However, the act does not contain provisions related to fiscal sustainability.
- 2.10 The macroeconomic and fiscal risks described above underline the importance of continuing the efforts undertaken to preserve macroeconomic stability and fiscal sustainability, such as: (i) assuring and increasing tax revenues through improvements in tax and customs administration, a broadening of the taxpayer base, and better control; and (ii) improving the efficiency of public spending through better prioritization, targeting, and transparency.

## **B. Constraints on growth**

- 2.11 Between 1994 and 2006, GDP grew at a rate of 4.1% per year, for annual per capita growth of 2%. However, Nicaragua needs to grow faster if it is to substantially reduce poverty. Available analyses indicate that the problem is not just with the level of investment but also with its effectiveness. Fixed investment is about 25% of GDP—one of the highest in the region—but it is not reflected in economic growth. An assessment of the constraints on growth suggests that the main ones stem from: (i) inadequate physical infrastructure; (ii) institutional weaknesses in the area of governance that affect the climate for attracting private investment and reduce its impact on growth; and (iii) inefficient development of the export-oriented

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<sup>5</sup> Annex III presents the chronology of the debt forgiveness process.

<sup>6</sup> From US\$6,659,900,000 in 2000 to US\$3,384,000,000 in 2007.

rural sector.<sup>7</sup> In the short and medium terms, these constraints will be compounded by an unfavorable international context and the slowdown in the U.S. economy, which may have significant negative impacts on growth in Nicaragua, since two thirds of its exports go to the United States.<sup>8</sup> Annex V contains a summary of the food and financial crises.

## **1. Basic infrastructure**

- 2.12 The poor coverage and quality of the basic power and transportation infrastructure has held back growth in Nicaragua. Electricity coverage is 68%,<sup>9</sup> which is below the Central American average of 73%. Recently, the rise in oil prices has had a very severe impact owing to the heavy dependency of electricity generation on oil-based products (73%). The country has committed funds to participate in the Regional Electricity Market (MER); the effort has been limited owing to the current characteristics of the national transmission grid, which has had a very high level of interruptions.
- 2.13 One of the biggest problems in the energy sector has been the lack of investment in power generation, which is currently dominated by diesel plants that are relatively obsolete, despite the fact that the country has renewable resources. Weaknesses in the regulatory framework also affect the sector. Power outages are partly the result of the lack of generating capacity, interruptions in the transmission system, and the financial weakness of the system, which runs the risk of not being able to cover the future demand that would result from the expected economic growth. Power outages have been virtually suspended in the last year thanks to the installation of thermal plants.
- 2.14 In terms of power distribution, one of the most important challenges is to reduce losses. Although these are smaller, they still amount to 27%, which translates into a liquidity problem that spreads along the entire electric power chain. This, coupled with the increase in the cost of electricity generation on account of the high dependency on oil and the lag in rate adjustments, resulted in the distribution company's insolvency. This, together with the company's lag in terms of meeting its investment commitments, led the government to step in as a minority partner in power distribution in the country.
- 2.15 The seriousness of the energy situation and the importance of the sector call for rapid progress in cleaning the sector up financially. It is vital that the rate system be revised and that conditions continue to be promoted to stimulate public and private investment in generation using renewable sources and in transmission. In the medium and long terms, efforts should be directed to interconnecting with Central

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<sup>7</sup> Agosin, M., *op. cit.*

<sup>8</sup> Estimates suggest that growth in the Nicaraguan economy has an elasticity of 0.41 with respect to GDP growth in the United States. Shaun K. Roache, "Central America's Regional Trends and U.S. Cycles," February 2008, IMF Working Paper 08/50.

<sup>9</sup> Source: INIDE. Eighth Population Census and Fourth Housing Census 2005.



America through the Central American Electric Interconnection System (SIEPAC) and to transforming the country's energy matrix.

- 2.16 Nicaragua also faces challenges in transportation infrastructure and services. Just 20% of highways and roads are in good condition. The 2005 standard of living survey (EMNV) found that just 22.3% of households have access to a paved road and access is even more limited for the poorest households and for rural regions, particularly on the Caribbean coast. This situation stems from the historic shortfall in investments to expand and maintain road systems and from institutional problems. Rehabilitation of the transportation infrastructure requires large and quick investments. Although the country has built up its road maintenance fund (FOMAV) as a mechanism to maintain investments in the sector, available resources are insufficient. The lack of maintenance leads to deterioration of the roads and increases in operating costs and travel times and makes large investments in rehabilitation necessary.
- 2.17 Apart from infrastructure, urban and interurban freight and passenger transport services are also deficient. The market is small, the industry is fragmented and is not modern. Nicaraguan transporters are therefore not competitive with transporters in the neighboring countries in hauling export and import cargo. The sustainability of investments for expansion, construction, and maintenance is also threatened by poor control of weights and measures.<sup>10</sup>
- 2.18 The country has made significant progress by giving priority to investments in a series of main highways<sup>11</sup> and in secondary roads to connect regional production centers to the central region and to ports for export, to tap the potential of gaining a stronger foothold in the global economy. However, this effort needs to be coupled with actions to strengthen institutional capacities in the sector so as not to jeopardize the effectiveness of the investments. Building up the sector's institutions implies: (i) boosting the capacity of the Ministry of Transport and Infrastructure (MTI) to execute road investments; (ii) ensuring the provision of funds for maintenance and strengthening the way in which the Road Maintenance Fund (FOMAV) is organized; and (iii) building up the institutional capacity of the MTI to regulate and operate the transportation infrastructure system.

## **2. Institutional context and the climate for private investment**

- 2.19 Attracting private flows to cover the country's investment requirements will require continued strengthening of the institutional and regulatory framework in which investors perform. Pro-growth policies would have greater impact if the institutional context were strengthened to promote greater efficiency in public management. Given the prevailing situation in the international financial markets,

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<sup>10</sup> Current overload levels are estimated to reduce the useful life of roads by 50%. See "Nota Sectorial de Transporte" in *Documento de Diálogo de Políticas*, IDB, 2006.

<sup>11</sup> Includes the south coast, Acoyapa-San Carlos, Nueva Guinea-Bluefields, and Río Blanco-Puerto Cabezas highways.

these elements will become more relevant for Nicaragua to gain access to flows of official aid and foreign investment.

- 2.20 Despite the efforts to strengthen the areas of justice, auditing, and internal control over the last decade, the challenges to achieve greater independence in these areas are still significant. The Judicial Branch requires effective application of the Judicial Career Act and its enabling regulations and a revision of the system for selecting the Supreme Court justices to give them greater autonomy and ensure the impartiality of judges in order to provide greater legal certainty and better access to justice. The Office of the Comptroller General requires actions that will ensure transparency in the management of public sector resources, enable it to carry out the basic function of auditing the national budget, and guarantee its independence.
- 2.21 Last, efficient performance of government functions requires a competent public sector based on a civil service selected by merit, and human resource management that promotes training and provides performance incentives. To achieve this, efforts aimed at the application of the Civil Service Act need to be consolidated.

### **3. Rural development**

- 2.22 The agriculture/forestry sector accounts for 19% of national GDP and more than 75% of exports and is the main source of employment in rural areas. The sector is very heterogeneous since it is composed of a modern business productive subsector that fundamentally produces for export and a subsector of small producers who work most of the country's farms (80%), with areas ranging from 0.5 *manzanas* to 50 *manzanas*. This last group of producers has little access to working capital and its productivity is low. This means that more than 40% of the population in rural areas continues to experience high poverty rates (66%).<sup>12</sup>
- 2.23 Given the low levels of productivity in the sector, improvements in it would increase production without necessarily having to expand the agricultural frontier. To that end, it will be necessary to improve the sector's general framework through: (i) improvements in the supply of public goods, such as productive infrastructure, food traceability and safety certification, observance of the agricultural health regulations of the destination countries, land ownership rights; (ii) provision of services to support value added and participation in chains (storage, cold chains, contacts with importers in destination countries, uniformity of quality, etc.); (iii) rural financial services; and (iv) development of related infrastructure (rural roads, ports). All of the above would make it possible for microenterprises and small businesses (MSBs) and small producers to join marketing circuits for the local and export markets.
- 2.24 To diversify the rural economy and deepen support for the sector, progress needs to be made in the CAFTA-DR complementary agenda, including: (i) adjustments in administrative rules and procedures that make it difficult to formalize small

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<sup>12</sup> Program for the Improvement of Surveys and the Measurement of Living Conditions (MECOVI) 2005.

production units; (ii) the development of horizontal chains between small producers and vertical chains between small, medium-sized, and large businesses; (iii) identification of policies and programs to strengthen sectors in which participation by small producers is high; (iv) the development of sustainable rural tourism;<sup>13</sup> (v) closer integration of the Caribbean coast nationally and regionally; (vi) increased value added of exports in general and exports originating in the free zones; and (vii) promotion of foreign direct investment outside the free zones, particularly in the agriculture sector.

### **C. Constraints on social well-being**

- 2.25 Nicaragua has high poverty rates, particularly in geographic areas with difficult access where groups that have traditionally been excluded, such as indigenous peoples and Afro-descendants, are generally found. This poverty is more acute in rural areas and among the most vulnerable groups, such as women and children. To surmount this problem, social policies should be directed to providing effective support for the accumulation of human capital, which is indispensable for increasing the productivity and competitiveness of the economy<sup>14</sup> and ensuring that the populace obtains a larger share of the fruits of growth, with priority focus on vulnerable groups.
- 2.26 Making social policies more effective means tackling the problems of managing social spending, its quality, efficiency, and targeting. This requires setting priorities and a strategic orientation that facilitates the articulation of a social protection policy to guide: (i) the coordination of the different agencies that participate in the sector; (ii) investments in social infrastructure; and (iii) the strengthening of sector institutions<sup>15</sup> and harmonization among the many stakeholders. This effort could facilitate the establishment of a long-term commitment by international cooperation agencies to secure the funds required to speed up poverty reduction.
- 2.27 Health care coverage for the poor continues to face significant problems, particularly in heavily indigenous rural and peri-urban areas. Such problems are compounded by the lack of continuity among the levels of the network of services.<sup>16</sup>

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<sup>13</sup> Tourism is one of the country's main sources of foreign currency. Exports of tourist services have doubled since 1998, reaching US\$221 million in 2006 (compared with US\$254 million in net exports—value added—from the free zones in the same year).

<sup>14</sup> Perry *et al.* (2006) presents evidence that high poverty levels limit investment and growth, particularly when the financial system is not developed. The authors estimate that a 10 percentage points increase in poverty reduces investment by between 6 percentage points and 8 percentage points of GDP.

<sup>15</sup> The institutions responsible for implementing social policies suffer from serious structural problems, including a shortage of infrastructure, institutional fragility, weakness in policy formulation and investment planning, shortcomings in human resources, and scant financial resources. See “Nota Sectorial de Transporte” in *Documento de Diálogo de Políticas*, BID, 2006.

<sup>16</sup> Análisis de Situación del Sector Salud. Plan Nacional de Salud 2004-2015. [Analysis of the health sector situation. National health plan for 2004-2015] Ministry of Health (MINSA).

This weakness is apparent in the lack of integration of the health services network and the limited investment in infrastructure.

- 2.28 In education, the 1990s were characterized by the application of a school autonomy model as a mechanism to improve administrative efficiency. Achievements in increasing school coverage were very modest, with levels of just 87% in primary school and 42% in secondary school, which is below the Latin American average of 94% and 68%, respectively.<sup>17</sup> Problems of efficiency and quality of education and insufficient teacher training are also apparent.<sup>18</sup> Apart from these lags, there are major socioeconomic and gender inequities.<sup>19</sup>
- 2.29 In the water and sanitation sector, institutional changes were made in the 1990s that separated the functions of stewardship, regulation, and service delivery under a model that allowed private sector participation in the delivery of services. However, the resistance of civil society to such participation made it impossible to implement the model, which was prohibited by the National Assembly in 2003. In this context, coverage was just 75.8% nationwide, with major differences between urban and rural areas (95% and 48%).<sup>20</sup> Sanitary sewer coverage is only 35% and, according to estimates by the National Water and Sanitary Sewerage Commission (CONAPAS), just 42% of all wastewater generated is treated in some way, which points to the country's lag in the area of sanitation.
- 2.30 The need to improve water and sanitation coverage becomes more pressing with the demands of urban growth and population growth.<sup>21</sup> The sector also faces large challenges in the institutional sphere, such as: (i) adjusting the institutional structure in order to generate internal resources and absorb external resources for a sustainable development strategy; (ii) improving the efficiency of the Nicaraguan Water and Sewerage Company (ENACAL); and (iii) strengthening the regulatory agency (Nicaraguan Water and Sewerage Administration-INAA) and CONAPAS.
- 2.31 In the housing sector, despite the use of subsidies since the mid-1990s, close to 85% of households do not earn enough to buy a house and formal housing production only covers half of the new families needing a place to live, which forces a large part of the population to turn to informal solutions. With regard to property rights, close to one half of all families that own their housing units have no

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<sup>17</sup> UNESCO.

<sup>18</sup> Nine years in preschool, 12 years in primary school, and 13 years in high school (World Bank).

<sup>19</sup> Plan Común de Trabajo 2005-2008, MECD. The percentage of children who do not attend school is six times higher in poor families and just 70% of boys complete primary school (compared to 77% for girls).

<sup>20</sup> Official estimates by INIDE and ENACAL.

<sup>21</sup> The total population is projected to almost double by 2015 with respect to 1990, to 7 million, 63% of whom (4.4 million) will live in urban areas.

legal title, and the financial market which offers traditional mortgages is only accessible to the higher-income population.<sup>22</sup>

- 2.32 To improve access and the quality of housing, particularly for the very poor, the sector's main challenges are: (i) consolidating the incipient institutional structure, including the Urban and Rural Housing Administration – Social Housing Fund (INVUR-FOSOFI) and auxiliary agencies; (ii) boosting the government's role of promotion and facilitation and the role of the private sector in housing financing and construction; and (iii) providing continuity for the system of housing subsidies granted by FOSOFI that are an incentive for low-income sectors to obtain decent housing solutions.

#### **D. Environmental sustainability and natural disaster prevention**

- 2.33 Nicaragua's geographic position and geomorphology make it extremely vulnerable to natural disasters of all kinds.<sup>23</sup> It has the second highest incidence of tropical storms in the world and is one of the 30 countries most affected by earthquakes.<sup>24</sup> Although 100% of the territory is exposed, Managua and the Pacific coast, where most people live and key investments have been made in infrastructure (energy, roads, and ports), are at highest risk for multiple events. Vulnerability to natural disasters is linked to environmental degradation, a factor that also affects the country's competitiveness.<sup>25</sup> Apart from human losses, natural disasters do serious harm to the economy.
- 2.34 Nicaragua has made progress in disaster risk management. The national disaster prevention, mitigation, and response system (SINAPRED)<sup>26</sup> has improved the distribution of institutional roles and responsibilities. The Territorial Studies Institute (INETER) is better able to identify threats hanging over the country.

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<sup>22</sup> Nicaraguan government 2005. Informe de Diagnóstico para la preparación del Plan Nacional de Vivienda [diagnostic report for preparing the national housing plan].

<sup>23</sup> Nicaragua is vulnerable to tsunamis, flooding, landslides, drought, hurricanes, volcanic threats, and earthquakes (SINAPRED, October 2008). Between 1970 and 2007 the country suffered two earthquakes, four hurricanes, two major volcanic eruptions, and several droughts. According to country estimates, losses from these events amounted to US\$4 billion over the last four decades. More than three million people were affected. Análisis Ambiental de Nicaragua [environmental analysis of Nicaragua], IDB 2007 and ECLAC.

<sup>24</sup> UNDP (2004). A Global Report: Reducing Disaster Risk. A Challenge for Development.

<sup>25</sup> For example, coffee and livestock production are vulnerable to drought, while tourism and shrimp farming are vulnerable to hurricanes and earthquakes. Commerce in rural zones relies heavily on road infrastructure, which is vulnerable to different natural threats.

<sup>26</sup> Under the terms of Law 337, which creates the national disaster prevention, mitigation, and response system. The law is accompanied by regulations and a manual for system operation, complemented by a legal framework of decrees (Decrees 53-2000, 98-2000, 118-2001, 15-2002, 96-2002, and 103-2002) intended to permit the operation of a system geared to risk reduction through disaster prevention, response, and mitigation and to improved risk management.

Nonetheless, Nicaragua is the Latin American country that is least effective in responding to and recovering from crises.<sup>27</sup>

- 2.35 The pending agenda in this area includes: (i) better management of key natural resources (water, soil, forests, biodiversity, protected areas); (ii) heightened capacity of public, private, and community institutions for disaster prevention and environmental governance, under the leadership of the Ministry of the Environment and Natural Resources (MARENA); (iii) development of horizontal and vertical coordination protocols in all municipios to help protect human lives and make investments in infrastructure; and (iv) development of natural disaster insurance mechanisms.

### III. THE GOVERNMENT'S PROGRAM

- 3.1 The government's program (PNDH) centers on reactivating the economy and alleviating poverty. In the economic sphere, it seeks to achieve sustained growth rates by boosting national production capacity in a context of macroeconomic stability. In the social sphere, consistent with the Millennium Development Goals (MDGs), the main objectives are: to expand school coverage, reduce illiteracy, reduce maternal and child mortality, increase water and sanitation coverage, and provide housing.
- 3.2 The vision and approach of the current government with respect to addressing the main challenges facing the country involve: (i) better leadership and participation by the State in the delivery of services; (ii) a refocus of public policy to favor the poor; (iii) stronger economic growth and a reduction in external dependence;<sup>28</sup> (iv) the introduction of new strategic elements for citizen participation (direct democracy); and (v) a new production strategy based on the potential of micro, small, and medium-sized entrepreneurs, seeking food sovereignty and capital development of the poor to enable them to generate wealth.
- 3.3 To attain sustained growth rates, the government has given priority to the following lines of action: (i) promote the country's productive capacity by upgrading infrastructure and developing human capital; (ii) increase the installed capacity and efficiency of the energy sector, spurring public and private investment in power generation, particularly from renewable sources that reduce oil dependency; (iii) support the agriculture sector by providing adequate financing and technical assistance, and developing marketing channels that are more favorable to small producers, with emphasis on food security and sovereignty; (iv) invest in water and sanitation and develop a national policy for water resource management; (v) seek better access to the external market by negotiating new trade agreements (ALBA,

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<sup>27</sup> Índice de Gestión de Riesgos, [Risk Management index] Cardona (2006).

<sup>28</sup> "New priorities, objectives, and goals have arisen that go beyond the welfare approach of the PND and the development assumptions of the neoliberal model." Plan Nacional de Desarrollo Humano [National human development plan] 2008-2012. Government of Reconciliation and National Unity.

- MERCOSUR, European Union, and Asian markets) and taking full advantage of CAFTA-DR; and (vi) develop suitable environmental management that guarantees access to external markets and facilitates the sustainability of economic growth.
- 3.4 To combat poverty and build human capital, the government is pursuing the capital development of the poor and is seeking to boost their productive capacity. This approach is based on the following principal points: (i) capital development of the poor as potential producers, going beyond the welfare approach; (ii) implementation of policies for free health care and education and direct subsidies for the main services provided by the government to the most vulnerable sectors; (iii) promotion of financial mechanisms and instruments that favor small producers in rural areas; (iv) formulation of a new generation of programs and projects to ensure attainment of the MDGs; (v) active participation by the poor in solving their problems; and (vi) strengthening of local, municipal, and regional governments, particularly on the Caribbean coast.
- 3.5 In terms of financing for the government's plan, the proposed course of action depends heavily on: (i) flows of external aid; and (ii) flows of private investment.

#### **IV. THE BANK'S 2008-2012 STRATEGY**

##### **A. Contribution of the IDB Group for the 2008-2012 period**

- 4.1 The general objective of 2008-2012 BCS-NI is to provide selective support for the Nicaraguan government in reducing and managing vulnerabilities, which inhibit attainment of the growth and equity goals the country has set. The Bank's contribution is expected to focus on five objectives in the government's plan: (i) fiscal sustainability; (ii) reliability of the electric power supply and improvement of the existing road system; (iii) management and coverage of social services, including the development of a social welfare system; (iv) productive development; and (v) institutional management for natural disaster prevention.

##### **1. Fiscal sustainability and the strengthening of public management**

- 4.2 The Bank's action in this area is intended to help: (i) strengthen the national financial administration, public investment, administrative career and civil service, contracting, and monitoring and evaluation systems; and (ii) improve public management.
- 4.3 The Bank will contribute to the design and implementation of reforms to improve tax and customs management and spending efficiency and effectiveness. It will back a new generation of fiscal reforms, through operations to support fiscal and social policy reforms, specifically through a programmatic loan.
- 4.4 Efforts will continue to focus on the modernization and strengthening of public sector institutions, including the implementation of the Civil Service and Administrative Career Act and the consolidation of reforms in the areas of justice,

auditing, and internal control. In addition, capacity in the areas of planning, municipal development, and citizen security will be strengthened. With the objective of strengthening monitoring and tracking systems, the Bank, in coordination with other donors, will support a process of comprehensive modernization of the national statistics system and public registries, ranging from a review of their institutional framework to end services for users.

## **2. Reliability of the power supply and improvement of the existing road system**

### **a. Reliability of the power supply**

- 4.5 The Bank's action in this area will contribute to: (i) a reduction in the number of interruptions in the flow of electricity; (ii) a reduction in technical and nontechnical losses in power distribution; and (iii) an increase in the capacity of transmission lines in the context of SIEPAC.
- 4.6 The Bank will support: (i) an increase in coverage through investments in transmission, transformation, and rehabilitation of generating plants to assure and increase the reliability of current supply and prepare for medium-term demand; (ii) promotion of energy integration with Central America, through the SIEPAC project; (iii) the search for alternative generation sources; and (iv) institutional strengthening of the public sector in the short term to sustain and improve electricity service conditions in the country.
- 4.7 Given the sector's investment needs, the Bank will actively seek participation by its different windows, including the private-sector window, in power generation projects and will manage the search for cofinancing. Small projects based on renewable sources will be given priority and particular support will be provided for generation alternatives using biofuels and renewable energy sources.

### **b. Improvement of the existing road system**

- 4.8 Under the strategy, Bank action in this area will contribute to the expansion of the paved road system and the system maintained by FOMAV, giving priority to interventions that integrate the regions into the national economy and link the country to the other countries in the Mesoamerican region. Given the investment requirements in transportation, closer relations will be sought with all donors in the sector—the Millennium Challenge Account, OPEC, the World Bank, CABEI, and Japan.

## **3. Development of a social welfare system and improvement, management, and coverage of basic social services**

- 4.9 The BCS-NI will seek to contribute to an increase in the effectiveness of public spending aimed at poverty reduction through: (i) the design and implementation of actions for the gradual development of a social welfare system, with emphasis on peri-urban areas, either by financing investments in services or by promoting



interagency and inter-sector cooperation to coordinate the demand for and supply of basic services and the promotion of the productive capacity of vulnerable households; (ii) the design and implementation of actions for the comprehensive development of children under age six from low-income families and promotion of an improvement in conditions for educational achievement, thereby helping to break the intergenerational transmission of poverty; and (iii) a reduction in the social vulnerability of families living in extreme poverty in rural and peri-urban areas by offering them better opportunities, through the direct provision of social services or referrals to them, job placement or productive integration, and investments in basic infrastructure.

- 4.10 Given the incidence of poverty among vulnerable groups (women, Afro-descendants, people with disabilities, etc.), the design of specific interventions and their integration as components of larger programs will be sought.
- 4.11 The Bank's action in this area will contribute to: (i) an increase in water supply coverage in rural and urban areas and sanitation coverage; (ii) an increase in the coverage of demand for low-income housing; (iii) an increase in comprehensive child care coverage; and (iv) an increase in the number of babies delivered at the different SILAIS. The Bank will provide support in the form of investments and technical assistance for improving the supply and effectiveness of spending on basic services.

**a. Management and coverage of water and sanitation services**

- 4.12 The Bank's intervention in the water and sanitation sector will seek to improve the supply and coverage of water and sanitation services to support attainment of the MDGs by strengthening institutional management in the sector and investing in water, sanitation, and solid waste management, in search of efficiency, quality, and sustainability in the delivery of those services.
- 4.13 The Bank will also support the government in formulating and implementing a long-term strategy for development of the water and sanitation sector, including a sector plan to link donor contributions to a sector development strategy. To this end, efforts will be undertaken with other donors to coordinate policies, synchronize financing, and seek cofinancing.

**b. Management and coverage of the housing sector**

- 4.14 Given that the subsidies program carried out previously generated good results, this approach to improving the living conditions of low- and moderate-income families will continue. Support will also be provided to expand the markets and strengthen the sector. A new phase of the low-income housing program will be financed, which will continue to help reduce the housing deficit through partial subsidies for low-income families to purchase or upgrade their homes and technical assistance for microfinance providers to optimize market opportunities and strengthen the sector's institutions. The scope of the Bank's operation represents a very small

percentage of the country's needs, but its importance lies in establishing the platform to channel aid to the sector, with other sources of financing.

### **c. Management and coverage of health care services**

- 4.15 The objective of the Bank's intervention in this sector is to support the government's efforts to improve the quality of health care services and extend coverage on a sustainable basis to the most vulnerable population through the creation of integrated health systems, with special emphasis on the provision of maternal and child health services. In the first phase, the institutional capacity of MINSA will be strengthened and hospital infrastructure and equipment will be modernized. Support for the sector will be deepened in a second phase. A master plan for sector investments will be drawn up to identify and organize contributions from different donors. Since this intervention takes a sector-wide approach, it will seek complementarity and harmonization with the other donors and the strengthening of national policies.

## **4. Productive development**

- 4.16 The Bank's action in this area will contribute to: (i) a higher growth rate in the agriculture sector; and (ii) greater diversification of exports.
- 4.17 In close cooperation with other donors, the Bank plans to continue financing rural development initiatives linked to micro, small, and medium-sized producers through a sector-wide approach, with the objective of boosting competitiveness, contributing to food security, and increasing the exportable supply.
- 4.18 Given the country's potential to become a supplier of agricultural products to the other Central American countries, the Bank's programs will support the productivity of small rural producers, while trying to redress the gender gaps in the rural economy. To this end, it will foster comprehensive support programs for the rural sector that promote jobs and include technical assistance and training, institutional strengthening, modernization of agricultural health services, incorporation of international standards, and other measures to boost exports, as well as better access to credit. It will also encourage more active participation by women in the efforts to incorporate MSMBs and small producers into marketing circuits for the local and export markets. These actions will be coordinated with the donors in the PRORURAL group.
- 4.19 Given the country's tourism potential, and to complement efforts aimed at diversifying the rural economy, sustainable rural tourism development will be promoted.
- 4.20 The productive sector will be financed through the private sector windows (SCF, IIC, OM, and SEP), while MIF funds will finance technical assistance intended to: improve competitiveness and the business climate, including implementation of a regulatory framework to facilitate the development of MSMBs; increase the supply of new financial products; consolidate the capacity of MSMBs to benefit from

changes in the markets, supporting their effective entry into the global marketplace; promote the development of public-private partnerships and technological innovation, with a value-chain approach; and promote sustainable tourism. The MIF will also finance financial and microfinance institutions. Whenever possible, the Bank will work in association with other donors and with the commitment of the private sector, organizing and disseminating knowledge stemming from experiences in the country.

## **5. Institutional management for disaster prevention**

- 4.21 To mitigate vulnerability to natural disasters and cushion the social and economic impacts these events can cause, the Bank will finance interventions to help strengthen institutional management for natural disaster prevention and management. These actions will be complemented by investments in the productive sectors and infrastructure and by sector work, in particular the Country Environmental Analysis and other additional studies. The Bank's action in this area will help improve the institutional management of risks in natural disasters and reduce the most significant sources of risk in urban areas.

### **B. Financial instruments and flows**

- 4.22 The instruments for implementing the strategy are loans in execution and the operations program (see Annex VI).

#### **1. Alignment of the portfolio with the government's program**

- 4.23 The portfolio in Nicaragua is one of the Bank's largest in terms of the number of projects. As of 30 September 2008, it contained 100 operations involving approvals of US\$818.8 million (US\$335.6 million undisbursed).
- 4.24 In 2007, a process was begun to review loans in execution, with a view to aligning them with the priorities in the government's program and the areas identified for Bank action. The portfolio review has also sought to reassign funds available from operations whose execution period is about to end, to finance activities that have no funding from other donors or that were not included in the Bank's operations program, given the areas of concentration established for fresh funds.
- 4.25 The following adjustments have been made to the loans in execution: (i) in the citizen security program (1590/SF-NI), changes in the Ministry of the Interior led to the transfer of the Department of Citizen Security and Peaceful Coexistence (DCSC) to the National Police; (ii) modifications in the implementation of the ENACAL modernization program (1049/SF-NI), where the institution's operating goals will be achieved without the support of an international consultant in the subprogram for business strengthening; (iii) reorientation of the comprehensive child care program (1729/SF-NI), where services will be delivered directly by the government and not through NGOs; (iv) strengthening of the Ministry of Family Affairs (1576/SF-NI), directing the activity to the municipios where the comprehensive child care program (PAININ) will operate; (v) change in the

coordination mechanism for execution of the program of support for the National Development Plan (1702/SF-NI), because the Competitiveness Committee has ceased to exist under the current administration; (vi) program to support public investment coordination and effectiveness (1545/SF-NI), to streamline execution of the preinvestment component, boost the capacity of the MHCP in the areas of planning and budget monitoring, and strengthen the functions of project formulation and evaluation in the sector ministries and public agencies; and (vii) the program for institutional strengthening of the tax revenue and customs administrations (DGI and DGA) (1045/SF-NI), to redirect available program funds into the consolidation of the customs information system and improve the tax revenue audit function.

## **2. Operations program**

### **a. Size and instruments**

- 4.26 In light of the multilateral debt relief implementation program, the size of the operations program has been defined in a framework of debt sustainability, an enhanced system for performance-based allocation, and the FSO funds available for allocation.<sup>29</sup> However, when the present strategy was being prepared, the amount of FSO funding that would be assigned to Nicaragua for the 2009-2012 period had not been determined. Accordingly, the base-case scenario for loans assumes annual approvals in 2009-2012 similar to those in 2007-2008 (see Annexes VI and VII).
- 4.27 A scenario based on the country's absorption capacity has also been considered,<sup>30</sup> which reflects financing needs of about US\$120 million per year. This scenario is consistent with debt sustainability and would make it possible to increase the amount of some of the projects in the operations program, in particular those involving basic infrastructure and PBLs (see Annexes VI and VII).
- 4.28 Consistent with OVE's recommendations in the Country Program Evaluation,<sup>31</sup> the proposed operations program reflects a reduction in the number of interventions, focusing the Bank's action on fewer sectors, with operations involving larger amounts. Indeed, the BCS-NI anticipates that three operations will be approved in 2008 and about five per year from 2009 to 2012. Thus, and considering the maturity of the current portfolio, the number of loan operations in execution would be reduced from 35 in 2007 to 30 in 2008, and 21 at the start of 2012.

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<sup>29</sup> IDB, Implementation of multilateral debt relief and concessional finance reform at the IDB. Proposal for the implementation of a Debt Sustainability and Enhanced Performance-based Allocation Framework (document GN-2442).

<sup>30</sup> To estimate the absorption capacity, the historical profile of investment disbursements was established and the maximum level of approvals over the last decade and their respective disbursement levels were identified.

<sup>31</sup> See Annex VIII, Previous strategy. Results and lessons learned.

- 4.29 To introduce greater flexibility, the BCS-NI proposes to promote the use of the following financial instruments: traditional investment, multiphase, and sector facility loans, policy-based loans (PBLs), and nonreimbursable technical-cooperation operations.
- 4.30 The sector programmatic approach will be promoted, initially through the use of traditional investment instruments and PBLs, and as progress is made in strengthening institutional capacity, more flexible instruments will continue to be incorporated, such as performance-driven loans (PDLs), already in use in the health sector.
- 4.31 Consideration was given to incorporating PBLs into the operations program, attempting to make the conditionalities conform to the matrix agreed on with the donors in the Budget Support Group. Given the importance of the fiscal and social areas for the objective of poverty reduction, a programmatic approach (three years) will be adopted in those areas.
- 4.32 Considering the government's willingness to develop comprehensive sector approaches, consideration would be given to the use of SWAps or common funds in sectors that the government defines as priorities. While progress is made in building up the country's fiduciary capacity, work would initially be based on rules agreed upon with the donors. Both in the case of budget support and common funds, the Bank will work in cooperation with the Legal Department, the government, and the donors to facilitate its participation in those mechanisms. The Bank will also continue the work of coordination and harmonization with donors for joint financing to strengthen national systems (financial administration, contracting, public investments, and monitoring and evaluation).
- 4.33 As for technical-cooperation projects, the program will be designed in accordance with the following principles: (i) channeling FSO funds into activities related to strengthening both the national systems and the government's capacity in preparing operations; (ii) maximizing the use of trust funds to benefit country programming and improve the framework for private investment; and (iii) breathing new life into the Special Program for Employment, Poverty Reduction, and Social Development in Support of the Millennium Development Goals (GN-2426-3).
- 4.34 Since the amount of annual approvals in the public sector is limited by the ceilings established by the program "Implementation of multilateral debt relief and concessional finance reform at the IDB" (document GN-2442), one of the objectives of the present strategy is to enhance Bank participation in financing for the private sector, by gradually stepping up the activities of the private sector group (SCF, MIF, IIC, SEP, and OM) and placing special emphasis on developing the portfolio of SCF, OM, and SEP projects. To that end: (i) the strategic lines of support for the private sector will be updated; (ii) private sector support staff at the Country Office will be strengthened (IIC, OM, MIF, SCF); (iii) a permanent effort will be made to publicize the private sector windows; and (iv) operations under each of the windows will be actively promoted.

- 4.35 At the same time, the Bank will seek to act as a catalyst in the quest for cofinancing, taking advantage of its status as the country's largest source of financing and the concessional nature of its funds.

**b. Targeting**

- 4.36 It was agreed with the authorities to restrict the number of loans to be approved to an average of five per year, based on the government's priorities and the Bank's comparative advantages. This means that the portfolio will gradually be composed of a smaller number of operations involving larger amounts, with a more direct potential impact on the country's development. In light of anticipated allocations of FSO resources, the concentration of operations in a smaller number of sectors will force a higher level of maturity in the operations being prepared, to ensure a positive flow of funds for the country. This involves an exit by the Bank from areas that it has been supporting recently.
- 4.37 In this regard, the operations program provides for sustained support for the energy sector, which has been identified by the government as a priority for Bank action, and for fiscal sustainability, which, in addition to improving the effectiveness and efficiency of spending, will make it possible to use more flexible lending instruments. It will also give priority to continuing with the efforts in the health care, social protection, housing, and productive development sectors, and to creating the conditions for sustainable economic growth. In a second stage, the efforts already begun in the rural sector will be consolidated through development of the Caribbean coast and support for the transport and water and sanitation sectors will continue.

**3. Net flows<sup>32</sup>**

- 4.38 The BCS-NI presents a base-case scenario for loans for the 2008-2012 period that assumes an allocation of US\$80.2 million in 2008 and of US\$79.8 million for the 2009-2012 period.<sup>33</sup> As part of the strategy, the Bank is considering making substantial efforts to find cofinancing to complement the resources it allocates to the country (see paragraph 4.35). Under this scenario, three operations would be approved in 2008, including a loan for the electric power sector, a loan for the productive sector, and a programmatic sector operation to support policy reform. For the 2009-2012 period, the scenario includes operations to deepen support for poverty reduction, with emphasis on urban areas, and to improve basic and social infrastructure (water and sanitation) (see Annex I).
- 4.39 The loans in execution and the projects included in the base-case scenario will generate disbursements of US\$564.34 million over the 2008-2012 period, compared with US\$678.2 million in the previous strategy period (2002-2007). With

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<sup>32</sup> This section will be further developed after the final allocation of FSO funds.

<sup>33</sup> In 2009, the Bank will apply the respective methodology for assigning its concessional resources, which could result in an increase or reduction in FSO funds for Nicaragua.

regard to the dynamics of financial flows, the base-case scenario would produce positive net flows throughout the entire 2008-2012 period, although below the level of the previous strategy period (see Annex VII).

- 4.40 Loans in execution and projects included in the high-case scenario would generate total disbursements of US\$621.6 million for the 2008-2012 period, with an average of US\$124.3 million per year, i.e., slightly lower than the disbursement level under the previous strategy period.

### **C. Use and strengthening of national systems**

- 4.41 In line with the Paris Declaration, the Bank has established the strategic intention of adopting a model for results-based fiduciary supervision and based on the use of the country's systems, which means supporting their strengthening in the areas mentioned below.

- 4.42 In the area of financial administration<sup>34</sup> and related systems, an ambitious reform process has been carried out which resulted in a system characterized by: (i) a modern legal framework that includes a medium-term budget framework and management by results; (ii) a financial administration system that has prioritized its institutionalization through improvements in the legal framework and widespread use, and the development of the technology platform, management systems, and coverage; (iii) technical internal audit standards for the public sector, which are consistent with international practices; (iv) passage of the Public Debt Act; (v) progress in the preparation of coordinated sector assistance projects (SWAs), particularly in health care and rural development; (vi) passage of the Access to Information Act; and (vii) formulation of the Financial Administration Modernization Plan.

- 4.43 The national government procurement and contracting system (SNCCE)<sup>35</sup> has the merit of having evolved in two areas of interest: the spread of good contracting administration practices to the rest of the public administration and an improvement in the institutional framework and management through the promotion of electronic systems. The creation of a regulatory body (the Government Contracting Directorate—DGCE) in the Ministry of Finance (MHCP), the creation of technical units in the institutions, the requirement to plan, and the clear hierarchy of laws, regulations, manuals, and models are noteworthy aspects of the contracting system.

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<sup>34</sup> The most recent Country Financial Accountability Assessment (CFFA) was prepared in January 2004. A Public Expenditure and Financial Accountability Program (PEFA) was prepared in 2006 but it was not approved by the current government. An Integrated Fiduciary Assessment (IFA) will be prepared in 2008-2009.

<sup>35</sup> The most recent Country Procurement Assessment Report (CPAR) was prepared in April 2003 but was not approved by the last two governments. An IFA will be prepared in 2008-2009.

- 4.44 In order to expand and consolidate the progress in the national systems, consensus has been reached on an action plan (see Annex IX), which is consistent with the Financial Administration System Modernization Plan formulated by the authorities.
- 4.45 In both the financial administration and contracting areas, the Bank will support systems evaluation using internationally accepted methods and instruments (OECD/Development Assistance Committee, CPAR, PEFA, etc.).
- 4.46 Continuation of the reforms intended to strengthen the national systems requires that the sense of ownership and leadership demonstrated thus far by the authorities continue. Also, coordination among donors is key to implementing the reforms. It will be important to continue to improve coordination between the MHCP and the sector entities with regard to implementation of Law 550 and the reform of external auditing. Last, although widespread use of financial administration systems and their incorporation into the legal framework are proof that they have been institutionalized, their sustainability will depend on: (i) the professionalization of public servants, through the effective application of merit-based administrative career paths under the Civil Service Act; (ii) an increase in the government's capacity to formulate, implement, supervise, and evaluate modernization programs; and (iii) the availability of resources to that end.

#### **D. Risks for implementation of the BCS-NI**

##### **1. Country risk**

- 4.47 The rise in food and oil prices could affect the economy, worsening the prevailing poverty situation. The Bank will provide support through projects with a compensatory effect for the rural and urban poor and will support rural producers to enable them to take advantage of the rise in agricultural prices.
- 4.48 The slowdown in the developed economies, particularly the United States, and the financial crisis could affect growth in Nicaragua, which could have an impact on tax revenues and fiscal sustainability and produce a larger current account deficit. To mitigate this risk, the government will be supported with a programmatic PBL (2009-2012) to shore up the balance of payments and the SCF will provide funds from the Trade Facility to support the liquidity of the banks.

##### **2. Risks associated with the Bank's strategy**

- 4.49 The possible cost overruns in the projects resulting from an acceleration of inflation could cause project financing to fall short and the development objectives of some of the projects in the BCS-NI not to be reached. To address this risk, cofinancing will be sought for projects in execution (in some cases this will require amendments to the loan contracts) and a cost escalation formula will be included for new projects, particularly infrastructure projects, and an adequate amount will be set aside for contingencies. Costs will be updated for projects under way and financing alternatives will be sought.



- 4.50 The weaknesses that still persist in the mechanisms for giving priority to public spending on poverty could lessen the impact of the projects in the Bank's portfolio and hence the impact of the BCS-NI. Therefore, in the short-term, prioritization procedures will be agreed on with the government within each project and, in the medium-term, the BCS-NI provides for supporting the development of a social protection strategy, including a master system of beneficiaries.
- 4.51 A deterioration in the investment climate could inhibit participation by the private sector in financing projects in key sectors such as energy infrastructure (where the Bank's private sector window will participate) and road infrastructure and development of the rural productive sector and tourism. To address this risk, an ongoing dialogue will be maintained with the government and specific measures will be supported to improve the investment climate, particularly through the MIF.
- 4.52 The positive impact of the investments financed by the Bank could be cancelled out by natural disasters. Since this risk is so high in Nicaragua, an objective of the present strategy is for the Bank: (i) to support the government in the review and optimization of the disaster prevention and mitigation system and its institutions; (ii) to carry out projects to protect water reservoir and runoff protection works in the metropolitan area; (iii) to reinforce environmental mitigation works in rural infrastructure projects; (iv) to include environmental impact mitigation and prevention activities in all projects in the portfolio; and (v) to provide technical assistance to determine the feasibility of a fund and an insurance mechanism to cover environmental risks.
- 4.53 Delays in the approval of the budget and insufficient budget allocations could put off execution of the projects in the portfolio. The Bank will therefore maintain constant communication with the budget authorities to act preventively. If so requested, it could provide support for the dialogue with the National Assembly.
- 4.54 Existing weaknesses in project monitoring and tracking systems could make it difficult to measure the impact of the Bank's portfolio and the BCS-NI. In the short term, annual monitoring will be performed with the authorities to generate information. In the medium term, support will be provided for: (i) the development of a management by results system; and (ii) the strengthening of the national statistics system.
- 4.55 The level of fiduciary risk in Nicaragua remains high, which reflects: (i) the weakness of the executing agencies; (ii) the difficulty in simplifying review procedures through the introduction of the ex post modality; and (iii) the absence of an efficient mechanism for monitoring and tracking project execution.
- 4.56 *Weakness of the executing agencies.* The weaknesses of the executing agencies constitute a clear risk for attainment of the development objectives of Bank-financed projects and for their efficient and effective execution. This risk will be mitigated through actions and investments to strengthen and modernize the institutions, including ongoing training for borrowers and executing agencies.

- 4.57 To discourage the establishment of bodies parallel to the public administration, the projects will include an institutional strengthening component to ensure that the recommendations of the Institutional Capacity Assessment System (ICAS) are implemented, with the goal of developing local capacity as well as monitoring systems and tools.
- 4.58 In the area of procurement, recognition will be sought, in coordination with other donors, of the procurement function as a career in government.
- 4.59 *Difficulty in simplifying review procedures through the introduction of the ex post modality.* It is necessary to design and implement strategies that combine simplification with the real capacity perceived in the executing agencies, and with the need to confer flexibility to return to ex ante reviews, if advisable.
- 4.60 This risk will be mitigated by: (i) institutionalization of the assessment of the executing agencies' capacity, which will identify risks and allow for early decision making; (ii) strengthening of the project supervision process through internal audits of the executing agencies and operational audits; (iii) inclusion of financial processes that help to improve program management; and (iv) strengthening and use of national institutional systems for financial management, particularly the integrated system for project financial and administrative management and auditing (SIGFAPRO).<sup>36</sup>
- 4.61 *Absence of an efficient mechanism for monitoring and tracking of project execution.* In general, financial planning is not linked to the annual work plans. This risk will be mitigated with actions to strengthen monitoring and tracking of procurement plan execution.

#### **E. Dialogue agenda**

- 4.62 The international community has made a significant commitment to Nicaragua, as reflected in the number of donors and resources channeled (see Annex X). To maintain this support, progress must be made to improve the effectiveness of these flows.
- 4.63 The Bank's participation and its contribution in some sectors are consistent with coordination agreements with other donors. These initiatives are intended to boost efficiency and effectiveness in the use of resources more from a collective standpoint than an individual one, contributing relevant information to the public policy process about the lessons learned and results of the proposed intervention schemes. Maintaining and strengthening these forums will be a priority in the

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<sup>36</sup> The medium-term goal would be to improve this system to enable it to incorporate specific Bank procedures for contracting and payments (annual work plans) that will generate the monitoring reports required by the Bank to facilitate the financial administration of operations and help control risks. This means that the procurement module in the system should contain the procurement plan, the contracts authorized by the Bank (nonobjection), and that the payments should be linked (online) to the contractual commitments.

Bank's dialogue with the government and international agencies that cooperate in the areas of action of the BCS-NI. This is particularly relevant in Nicaragua, given the importance of flows of external assistance for supporting the country's development objectives and its fiscal and external sustainability. In this regard, it is important to assume the commitments acquired under the Accra Action Plan,<sup>37</sup> related to ownership, alignment, and harmonization of international cooperation.

- 4.64 The Bank will also continue to support efforts to improve the climate for private investment, which includes actions to promote human capital development, labor market reforms, the development of an energy policy, and the strengthening of the institutional environment. The Bank will establish a Private Sector Advisory Council for dialogue with the private sector.
- 4.65 It will also be necessary to support the country with different actions to strengthen governance and contribute to a suitable environment for gaining access to external aid flows and private investment.
- 4.66 The Bank has established a Civil Society Advisory Council that brings together NGOs and other civil society organizations. Through the Council, an ongoing dialogue will be maintained with the authorities to work with a broader concept of civil society, as called for in the Citizen Participation Act.

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<sup>37</sup> Third High Level Forum on Aid Effectiveness, September 2008, Accra, Ghana.

### Annex I. Objectives and instruments of the Country Strategy

Objective and IDB strategic lines	Portfolio (US\$ millions)	Operations program BCS-NI 2008-2012 (US\$ millions)
<b>Strategic area I: Fiscal sustainability and strengthening of public management</b>		
<p><b>Objective:</b> To contribute to the design and implementation of reforms to improve tax and customs management, spending efficiency and effectiveness, and public management.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>i. To support policy reforms in the fiscal and social areas.</li> <li>ii. To modernize and strengthen public sector institutions, including implementation of the civil service and administrative career law and consolidation of reforms in the areas of justice, auditing, and internal control. In addition, planning, municipal development, and citizen security capacity will be strengthened.</li> <li>iii. To strengthen the national financial administration, public investment, civil service and administrative career, contracting, and monitoring and evaluation systems.</li> </ul>	<p><b>Loans</b></p> <ul style="list-style-type: none"> <li>Strengthening the tax administration DGI/DGA (10.0)</li> <li>Efficiency and transparency in government procurement and contracting (18.0)</li> <li>Institutional support for the Technical Secretariat of the Office of the President (7.0)</li> <li>Modernization of the judicial branch (12.0)</li> <li>Citizen security program (7.21)</li> <li>Modernization and strengthening of the Office of the Comptroller General (5.4)</li> <li>Modernization of the Managua municipal government (5.6)</li> <li>Municipal strengthening and development (12.0)</li> <li>Support for fiscal and social improvements, I</li> </ul> <p><b>TCs</b></p> <ul style="list-style-type: none"> <li>Implementation of the new intelligent audit strategy (0.15)</li> <li>Implementation of the master taxpayer file and the Tax Code (0.15)</li> <li>Strengthening of the MHCP (0.61)</li> <li>Audit of the Office of the Attorney General 2006 (0.25)</li> <li>Institutional strengthening of the Immigration and Alien Registration Department (0.15)</li> <li>Support for implementing the management by results system, PRODEV(1.6)</li> <li>Strengthening of the Ministry of Labor (MINTRAB) (0.4)</li> <li>Sector programming and prioritization (0.92)</li> </ul>	<p><b>Loans</b></p> <ul style="list-style-type: none"> <li>PBLs Fiscal management and social spending reform I (20.0); II s(20.0); III (20.0); IV (20.0); V (20.0)</li> <li>Modernization of government financial administration (10.0)</li> </ul> <p><b>TCs</b></p> <ul style="list-style-type: none"> <li>Support for the fiscal management and social spending reform program (0.75)</li> <li>Change in the base year of the national accounts (0.25)</li> <li>Preparation of the program for modernization of the government's financial administration and strengthening of the tax administration (0.11)</li> <li>Institutional strengthening for executing public investments (0.40)</li> <li>Support for the national human development plan (0.45)</li> <li>Strengthening of the national financial administration system (5.0)</li> <li>Strengthening of the tax administration (5.0)</li> <li>Strengthening of the national contracting system (1.0)</li> <li>Strengthening of the planning, monitoring, and evaluation systems (1.0)</li> <li>Strengthening of the tax policy office (0.3)</li> <li>Design and implementation of the SISCAE, Phase II (0.55)</li> <li>Strengthening of the planning system (0.75)</li> <li>Support for the modernization of public registries (0.25)</li> <li>Preparation of lending and technical-cooperation operations (0.25)</li> <li>Development of the institutional and operating framework for development banks (0.25)</li> <li>Diagnostic study on the use of information and communication technology in small companies and its adoption in Nicaragua (0.05)</li> <li>Support for trade negotiations I, and investment promotion (0.75)</li> </ul>

Objective and IDB strategic lines	Portfolio (US\$ millions)	Operations program BCS-NI 2008-2012 (US\$ millions)
		<p><b>Nonfinancial products (NFPs)</b>            Integrated Fiduciary Assessment (IFA) (contracting system)            Independent macroeconomic evaluation 2009            Analysis of the impact of Petrocaribe            Promotion of private investment in Nicaragua            Comparative study of subnational tax collection efficiency in the Central American countries            Debt sustainability analysis            Diagnostic assessment of the planning system</p>
<b>Strategic area II: Reliability of the power supply and improvement of the existing road system</b>		
<b>A. Improvement of the reliability of the power supply</b>		
<p><b>Objective:</b> To improve the quantity, quality, and reliability of the power supply, making it efficient, sustainable, and compatible with the promotion of private investment.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>i. To increase coverage through investments in transmission, transformation, and rehabilitation of generating plants.</li> <li>ii. To promote power integration with Central America.</li> <li>iii. To support the search for alternative energy sources, including biofuels and renewable sources.</li> <li>iv. To support institutional strengthening in the sector in the short term to improve electricity service conditions.</li> </ul>	<p><b>Loans</b>            Electricity sector investment program (46.1)            National reinforcement of electric power transmission for SIEPAC (12.5)            Support for the electricity sector I (32.7)</p> <p><b>TCs</b>            Development of energy efficiency in Nicaragua (0.72)            Development of the wind generating system (0.30)            Support for preparation of the investment program (0.35)</p>	<p><b>Loans</b>            Support for the electricity sector II (40.2); III (20.0); IV (29.8); V (40.0); VI (40.0)</p> <p><b>TCs</b>            Preparation of electricity sector support programs III and IV (0.4)            Renewable energy I (0.25)</p>

Objective and IDB strategic lines	Portfolio (US\$ millions)	Operations program BCS-NI 2008-2012 (US\$ millions)
<b>B. To improve the existing road system</b>		
<p><b>Objective:</b> To undertake interventions to improve the connection of the productive sectors to export markets and integrate the nine regions into the national economic system and the country into the Mesoamerican region.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>iii. To improve the highway system</li> <li>iv. To ensure road maintenance and institutional strengthening in the sector</li> </ul>	<p><b>Loans</b></p> <ul style="list-style-type: none"> <li>Rehabilitation of the San Lorenzo-Muhán highway (25.0)</li> <li>Road program of the PPP for competitiveness (40.0)</li> <li>Road project of the PPP Zone III (25.9)</li> <li>Road program to link Acoyapa with the Costa Rican border (49.5)</li> </ul> <p><b>TC</b></p> <ul style="list-style-type: none"> <li>Support for the transformation of public transportation (0.30)</li> </ul>	<p><b>Loans</b></p> <ul style="list-style-type: none"> <li>Support for the transportation sector I (30.0); II (60.0)</li> <li>Multisector program to cover cost overruns (9.8)</li> </ul> <p><b>TC</b></p> <ul style="list-style-type: none"> <li>Preparation of the program to support the transportation sector (0.15)</li> <li>Institutional strategy for freight transportation service (0.25)</li> <li>Development of a mass transit system for Managua (0.25)</li> <li>Development of regional freight centers (0.35)</li> </ul>
<b>Strategic area III: Development of a social welfare system and improvement, management, and coverage of basic social services</b>		
<b>A. Development of a social welfare system</b>		
<p><b>Objective:</b> To enhance the effectiveness of public spending on poverty reduction.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>i. To continue with actions for gradual development of a social welfare system, with emphasis on peri-urban areas</li> <li>ii. To support low-income families through actions for the comprehensive development of children under age six</li> <li>iii. To undertake actions to reduce the social vulnerability of families in extreme poverty in rural and peri-urban areas</li> <li>iv. To design specific interventions to mitigate poverty in vulnerable groups (women, Afro-descendants, people with disabilities)</li> </ul>	<p><b>Loans</b></p> <ul style="list-style-type: none"> <li>Municipal social investment program (45.0)</li> <li>Comprehensive child care (15.0)</li> <li>Strengthening of the Ministry of Family Affairs (3.0)</li> </ul> <p><b>TC</b></p> <ul style="list-style-type: none"> <li>Preinvestment for the replacement of three schools (0.14)</li> </ul>	<p><b>Loan</b></p> <ul style="list-style-type: none"> <li>Urban social welfare program for children and adolescents (20.0)</li> </ul> <p><b>TCs</b></p> <ul style="list-style-type: none"> <li>Prioritization and monitoring of social spending (1.8)</li> <li>Initial development of a social welfare system (0.15)</li> <li>Support for revision of the curricula for technical-vocational and adult secondary education (0.2)</li> </ul> <p><b>NFP</b></p> <ul style="list-style-type: none"> <li>Social impact of microfinance institutions</li> </ul>

Objective and IDB strategic lines	Portfolio (US\$ millions)	Operations program BCS-NI 2008-2012 (US\$ millions)
<b>B. Management and coverage of water and sanitation services</b>		
<p><b>Objective:</b> To improve water and sanitation supply and coverage to support attainment of the MDGs.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>i. To strengthen institutional management of the sector and investments in drinking water, sanitation, and solid waste management, seeking efficiency, quality, and sustainability in delivery of the services.</li> <li>ii. To support for the formulation of a long-term strategy for sector development, including a sector plan to coordinate donor contributions to a sector development strategy</li> </ul>	<p><b>Loans</b></p> <p>Water and sanitation investment program (30.0) Modernization of water and sewerage (13.9) Implementation of measures to clean up Lake Managua (15.0)</p> <p><b>TC</b></p> <p>Executive water and sanitation designs (0.04)</p>	<p><b>Loans</b></p> <p>Potable water Managua (30.0) Storm drains and management of subbasin development III Managua (9.8) Water and sanitation (30.0)</p> <p><b>TCs</b></p> <p>Preparation of the potable water program for Managua (0.15) Integrated solid waste management in the Managua metropolitan area (1.0)</p> <p><b>NFP</b></p> <p>Sector strategic plan in water and sanitation</p>
<b>C. Management and coverage of housing</b>		
<p><b>Objective:</b> To boost access to housing for low- and moderate-income families.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>i. To continue with the approach of supplying low-income housing subsidies.</li> <li>ii. To support expansion of the market and strengthening of the sector.</li> </ul>	<p><b>Loans</b></p> <p>Low-income housing program I (22.4) Multiphase low-income housing program II (15.0)</p>	<p><b>Loans</b></p> <p>Multiphase low-income housing (40.0)</p> <p><b>TC</b></p> <p>Design and implementation of a national housing system (0.25)</p>
<b>D. Management and coverage of health care services</b>		
<p><b>Objective:</b> To make a sustainable improvement in the quality and coverage of health care services for the most vulnerable population.</p> <p><b>Strategic lines:</b></p> <ul style="list-style-type: none"> <li>i. To create integrated health care networks particularly for maternal and child care.</li> </ul>	<p><b>Loans</b></p> <p>Improvement in maternal and child health (30.0) Development of health systems I (20.0)</p>	<p><b>Loans</b></p> <p>Comprehensive health care networks, Phase II (20.0)</p> <p><b>TCs</b></p> <p>Development and implementation of a methodology for calculating child malnutrition rates (0.35)</p>

Objective and IDB strategic lines	Portfolio (US\$ millions)	Operations program BCS-NI 2008-2012 (US\$ millions)
ii. To bolster the institutional capacity of MINSA. iii. To modernize the infrastructure and equipment of the service network and promote the design of a master plan for investments in health care.	<b>TC</b> Program to design a model integrated health system for Jinotega (0.3)	Regional initiative for the eradication of chronic child malnutrition in Central America and the Dominican Republic (0.13) <b>NFPs</b> Cost of the strategy for extending health care coverage in Nicaragua
<b>Strategic area IV: Productive development</b>		
<p><b>Objective:</b> To continue financing rural development initiatives involving micro, small, and medium-sized producers; and providing support through a sector-wide approach to boost competitiveness and increase exportable supply.</p> <p><b>Strategic lines:</b></p> i. To promote comprehensive support programs for the rural sector that promote employment (and include technical assistance and training, institutional strengthening, modernization of agricultural health services, incorporation of international standards, expanded facilities for access to credit, and others) and address gender gaps in the rural economy. ii. Financing for the productive sector will be provided through the private sector windows (SCF, IIC, OM, and SEP) and MIF resources will be used to finance technical assistance. iii. Given the country's tourism potential and to complement efforts aimed at diversifying the rural economy, sustainable rural tourism development will be promoted.	<p><b>Loans</b></p> Rural production reactivation program (60.0) Modernization of agricultural health services (7.3) Support for implementation of the National Development Plan (40.1) <p><b>TC</b></p> Financial and environmental sustainability (0.17)	<p><b>Loans</b></p> Agrifood sector support program (20.0) Implementation of the Caribbean Coast development plan (10.0) Support for foreign trade and private investment (10.0) <p><b>TCs</b></p> Preparation of a national tourism development program in Nicaragua (0.55) National tourism program (0.75) Support for the Caribbean Coast development plan (0.25) Innovation and development in the industry (0.30) Support for the Seed Fund (3.0) Preparation of the Caribbean Coast Support Program (0.1) Job training and placement strategy (0.2) Support for CONYCIT (0.35) Information on financial system clients (0.15) Strengthening of the Financiera Nicaragüense de Inversiones (FNI) (0.25) <p><b>NFPs</b></p> Identification of mechanisms and incentives to formalize SMEs Optimization of financing mechanisms for SME sector



Objective and IDB strategic lines	Portfolio (US\$ millions)	Operations program BCS-NI 2008-2012 (US\$ millions)
<b>Strategic area V: Institutional management for natural disaster prevention</b>		
<p><b>Objective:</b> To mitigate vulnerability to natural threats and strengthen institutional management for disaster prevention</p> <p><b>Strategic lines:</b></p> <p>(i) To finance interventions that help strengthen institutional management for natural disaster prevention and management</p>	<p><b>Loan</b></p> <p>Socioenvironmental and forest development program (32.7)</p> <p><b>TC</b></p> <p>Risks of natural disasters and their management (0.75)</p> <p><b>NFP</b></p> <p>Study on the feasibility of establishing a reserve fund for natural disasters</p>	<p><b>Loan</b></p> <p>Storm drains and management of subbasin development III Managua (9.8)</p> <p><b>TC</b></p> <p>Risks of natural disasters and their management (0.75)</p> <p>Environmental protection (0.75)</p>