INTERNATIONAL MONETARY FUND

NICARAGUA

Enhanced Structural Adjustment Facility

Policy Framework Paper, 1994-97 1/

Prepared by the Nicaraguan Authorities in Collaboration with the. Staffs of the International Monetary Fund and the World Bank

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I. Introduction

1. Nicaragua is the second poorest country in Latin. America, with a per capita GDP of about US$450 in 1993. Population growth is the fastest in the region (over 3 percent a year), creating severe pressures on the Government's ability to provide basic services. Infant mortality is high and the quality of education and health services 'is low. Traditionally, agriculture has been the most important economic activity, accounting for about 25 percent of GDP.

2. Between 1950 and 1970, Nicaragua's economic growth was based on the expansion of primary exports (particularly the cotton sector) and of import-substituting industries behind the tariff barriers'of the Central American Common Market. This strategy began to show signs of failure in the late-sixties and early-seventies and bhe country resorted increasingly to commercial borrowing to finance its persistent external 'current account deficits. During the 1980s, economic performance worsened severely as a

1/ This paper has been prepared in conjunction with a request for an arrangement under the.enhanced structural adjustment facility (ESAF).

result of the civil war, economic mismanagement, adverse external developments (including the U.S. trade embargo), and several episodes of inclement weather. Output declined by about 16 percent during 1982-88, while inflation accelerated to a monthly rate of over 60 percent by end-1988. As public sector imbalances increased, the country relied heavily on foreign assistance and incurred large arrears on external debt service obligations.

3. When the newly-elected Government of President Chamorro took office in April 1990, the economy was characterized by an overexpanded public sector, a small anb over-regulated private sector, and an obsolete and deteriorated physical infrastructure that reflected a decade of misdirected investment and lack of maintenance. Market institutions were weak or non-existent and many trained people had left the country in the wake of political and social upheaval. State-trading companies handled virtually all exports and more than half of imports, and foreign exchange transactions were performed under a system of multiple exchange rates and pervasive exchange controls. Financial intermediation also was in the hands of state entities, bank supervision and prudential regulations were virtually nonexistent, and credit was allocated largely according to political criteria. Most of the enterprises in agriculture, manufacturing, and minina were state-owned and worked under soft budget constraints financed with subsidized credit from the Central Bank. By 1990 exports had fallen to half their pre-1980 level, and the country had accumulated an external debt (including arrears) equivalent to more than nine times its GDP.

II. Recent Economic Developments

4. Shortly after assuming office the new Government took steps to stabilize the economy but the attempt was not successful because of the impact of a large increase in wages granted by the previous administration and widespread strikes that thwarted efforts to reduce government expenditure. This was followed in March 1991 by a more comprehensive stabilization program involving fiscal restraint, tight wage and credit policies, a devaluation of the cordoba from CO$1 to CO55 per U.S. dollar, and flexible public sector pricing policies. This program, which was supported by an 18-month stand-by arrangement from the International Monetary Fund in September 1991, resulted in a rapid stabilization of the economy. The 12-month rate of inflation fell from-13,500 percent during 1990 to an annual rate of 4 1/2 percent in the post-devaluation period May-December 1991, and to 3 1/2 percent during 1992. However, economic activity was weaker than originally envisaged. Real GDP dropped slightly in 1991, partly because of a severe drought, and increased by only 0.4 percent in 1992, in reflection of a slump in the international prices for some key export products (on average export prices fell by 10 percent in 1992), shortfalls in external assistance, continued unfavorable weather conditions, and remaining problems of disputed land rights in the agricultural sector.

5. In parallel with the stabilization effort, the new Administration also embarked on a structural adjustment program aimed at eliminating distortions and reducing state intervention, facilitating private sector development through economic deregulation, reforming the financial system, and

liberalizing foreign trade. In September 1991, the Government's program of structural reform was supported by an IDA Economic Recovery Credit and by a Trade and Finance Adjustment Loan from the Inter-American Development Bank.

6. There was a substantial improvement in the public sector finances in 1991-92. As a result of a strengthening of the public sector savings, the overall cash deficit of the public sector before grants (including the operational losses of'the Central Bank) was reduced from 33 1/2 percent of GDP in 1990 to 8 1/2 percent of GDP in 1992. This improvement reflected a number of tax measures implemented in late 1990, better tax administration, an increase in the operational surplus of the public utilities, and a substantial reduction in military outlays and government employment. -(military and internal security outlays were reduced from 22 percent of GDP in 1990 to less than 3 percent of GDP in 1992). As a result of the . demobilization of troops, the number of military personnel was reduced from 98,000 in April 1990 to about 15,000 at end-1992, and the number of civilian government employees declined by almost 30,000 through the implementation of a voluntary retirement scheme financed by US AID.

7. The improved fiscal performance facilitated a more stable financial . environment. The nominal rate of increase in the monetary aggregates slowed sharply but money and quasi-money denominated in local currency increased by almost 90 percent in real terms from March 1991 to December 1991, reflecting a return of confidence, an increase in real interest rates following the adoption of a mostly market-determined rate structure, and the opening of

private commercial banks. The deepening of financial intermediation continued through 1992, when money and quasi-money denominated in local currency increased further by 16 percent in real terms, despite uncertainties related to political developments and to delays in the disbursement of external aid.

8. The external currentaccount deficit (excluding official transfers and interest obligations) increased from US$320 million in 1990 (21 percent of GDP) to US$570 million in 1992 (31 percent of GDP). The'sharp reduction in public consumption and a substantial increase in external financing (official disbursements of loans and grants increased from US$420 million in 1990 to about US$760 million on average in 1991-92) facilitated both an increase in public investment and a recovery in private consumption in 1991-92. Exports were affected adversely by lower international prices for Nicaragua's key export products and unfavorable weather conditions. Imports increased as the trade system was liberalized and the public investment program gathered momentum.

9. -Paced with the prospects of a reduction in external assistance, at the start of 1993 the Government took steps to reinforce macroeconomic policies by adopting a package of measures which included (i) actions aimed at strengthening the savings performance of the public sector by 5 percentage points of GDP in 1993; and (ii) a devaluation of the cordoba from C$5 to C$6 per U.S. dollar, which was followed by the adoption of a crawling peg system. Several factors precluded the achievement of the fiscal objectives

for 1993, including the postponement of some of the revenue measures announced in January, the effect of sluggish economic activity on tax revenue, an unplanned increase in pension payments approved by the National Assembly, and a lower than envisaged operating surplus of the public utilities. Notwithstanding these problems, public sector savings increased by 1.7 percent of GDP in 1993, while the combined public sector deficit before grants (including the central bank losses) remained unchanged compared with the previous year at about 10 percent of GDP.

10. Real GDP is estimatsd to have declined by about 0.9 percent in 1993 because' of a further decline in coffee prices, some problems of lack of security in the countryside, and a slowdown in the commercial sector. associated with lower import activity. Following the devaluation implemented in early January, consumer prices increased by almost 18 percent in January-February, but rose by only 1 1/2 percent during the rest of the year. A substantial reduction in the external current account deficit (excluding official transfers and interest obligations) from 31 percent of GDP in 1992 to 24 percent of GDP in 1993 was more than offset by a sharp decline in external assistance in 1993 (total disbursements of loans and grants dropped from US$200 million in 1992 to US$390). As a result, net . international reserves declined by US$100 million in 1993 (at end-1993 freely usable reserves amounted to US555 million or less than 1 month of imports of goods and nonfactor services). Exports rose in 1993 because of the sale of two years of gold production and an increase in exports of

nontraditional products, while imports declined as credit policy was tightened to compensate in part for the reduction in foreign assistance.

III. Objectives and Strategies of the 1994-97 Program 1/

11. Substantial progress has been achieved over the last three years in improving the public finances, stabilizing domestic prices, and re-establishing relations with international financial institutions and external creditors. However, the external situation remains weak and highly dependent on concessional financing, the public sector still absorbs a large portion of available resources, and the investment climate is clouded by unresolved property rights and law enforcement issues. The program for 1994-97 aims at consolidating the stabilization gains achieved in 1991-93, intensifying the process of structural reform required for the efficient functioning of a competitive economy, and moving further toward the achievement of external viability. The program will be supported by. substantial financing from the Fund (through an ESAF arrangement), the World Bank (through an Economic Recovery Credit II, an Economic Recovery Credit III, and IDA reflows), the Inter American Development Bank (through a Public Utilities Reform Loan and an Investment Sector Loan), and donor countries.

12. The Government's program puts particular emphasis on developing an appropriate climate for private investment and the expansion of employment in productive activities, further reducing the size of the public sector in the economy, and improving the living conditions of the poorer segments of the population. The principal macroeconomic objectives of the three-year program are: (i) to lay the basis for a sustained growth in real per capita income of 1 to 1 1/2 percent a year by 1996 (with real GDP growth of 2

1/ The three-year ESAF covers the period July 1, 1994 to June 30, 1997.

percent in 1994, 3 percent in 1995, and 4 1/2-5 percent in 1996-97; (ii) to reduce inflation to single digit levels over the same period; and (iii) to strengthen the reserve position of the Central Bank, with gross reserves increasing to the equivalent of 3 months of imports of goods and nonfactor services by the end of 1996. Central to the achievement of these objectives will be an improvement in the Government's institutional capacity to design and implement policies, a further strengthening of the public sector finances -in particular public sector savings, the redeployment of public assets to more productive uses through privatization, a substantial reduction in subsidies through the financial system, and a continuation of the process of deregulation of the economy.

13. The Government's three-year program will aim at expanding traditional exports such as coffee, fish products and beef, and developing the conditions for the sustained growth of nontraditional exports. To this end, the Government plans to create the necessary conditions for increased investment in the tradable goods sector through a rapid resolution of the property rights issue, improve external competitiveness through the pursuit of appropriate macroeconomic and exchange rate policies, and further liberalize foreign trade. In addition, the improvement in public sector savings would permit the rebuilding of the country's infrastructure, while the implementation of actions to reduce labor market rigidities will facilitate an increase in labor productivity and the generation of new employment opportunities.

IV. Economic Policies for 1994-97

Fiscal policy

14. To achieve its medium-term macroeconomic objectives, the Government intends to increase public sector savings (including net interest paid) by 5.8 percent of GDP in 1994-97. To move in that direction, in October 1993 the Government identified a package of fiscal measures, most of which have already been implemented; This package, together with other actions identified subsequently, would permit an improvement in public sector savings (excluding net interest paid) of 3.2 percentage points of GDP in 1994 (after interest, public savings are projected to increase by 2.3 percentage points of GDP). As public investment is projected to increase by about 2 percent of GDP, the overall cash deficit of: the public sector. before grants (including the losses of the central bank) would decline slightly to 9.7 percent of GDP in 1994.

15. The fiscal package for 1994 consists of a number of revenue measures in conjunction with a reduction in current outlays in relation to GDP. The revenue measures are expected to yield 1 1/2 percent of GDP in 1994. They include a reduction in import duty exemptions, including those applicable to government entities; a broadening of the base of the tax on luxury consumption; an increase in fees charged for the issuance of visas and passports and for the licensing of forestry activities; and stiffer penalties for tax arrears and traffic violations. Also, in June, 1994 the Government will adopt a mechanism of monthly adjustments in gasoline prices aimed at keeping these prices unchanged in U.S. dollar terms (gasoline

prices were raised by 25 percent in the period July-August 1993 and by a further 2 percent in January 1994). In addition, the public enterprises have taken actions to recover payments in arrears and to better enforce the collection of charges for their services, and the Government is implementing administrative measures to increase revenue from the general sales tax outside the Managua area. 1/

16. Noninterest current expenditure is projected to decline by 1.3 percent of GDP in 1994. The expenditure measures include the implementation of a voluntary program to reduce the number of public sector employees by 13,500 or about 13 percent of total public sector employment in 1994-96 (within this total the reduction in 1994 will amount to 7,000). In addition, the program contemplates a freeze of public sector wages and salaries (with the exception of selective adjustments for a small group of Central Government employees), the closing and streamlining of certain government entities, further reduction in the current number of military personnel by about 600 persons, and the broadening of the application of fees on.a selective basis (according to income) on certain services; Notwithstanding the envisaged partial privatization of the state-owned telephone company (TELCOR), the operating position of the'public enterprises will improve during.1994 because of recent and prospective adjustments in public sector prices, the implementation of the employment reduction program, the containment of other operating expenditure, and the streamlining of some activities in the energy

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1/ Presently, the Managua area alone accounts for more than 90 percent of the revenue collected from this tax.

sector. Also, the operational losses of the central bank will be reduced through the implementation of a mechanism of automatic debiting of interest payments from the accounts of the commercial banks at the central bank, the introduction of a commission fee on central bank sales of foreign exchange, the realignment of central bank interest rates according to market developments, and a stricter enforcement of interest recovery from the National Investment Fund (FNI) through measures to he implemented before end-June 1994.

17. In light of the prospects for declining external aid in 1995-96, 'achievement of the medium-term objectives of the program would require an additional increase in public sector savings of 3 1/2 percentage points of GDP in 1995-97. To this end, tax revenue will be increased by a further reduction of indirect tax exemptions, taxation of the telephone company following its privatization, the strengthening of tax enforcement in the interior of the country, and the continued pursuit of an appropriate tariff policy in the public enterprises. To reduce tax evasion, the Government intends to increase the number of inspectors assigned to external auditing, introduce a strict control system on autonomous state entities, and implement an effective system of control on large taxpayers. Tax administration improvements will' be supported by a technical assistance program from the Fiscal Affairs Department of the Fund,. while the Customs Office will benefit from technical assistance to be provided by the IDB starting in July 1994.

18. Non-interest current expenditure, including military and internal security outlays, would be reduced further in 1995-97 relative to GDP through the continued implementation of the employment reduction program, the containment of vage expenditure and pension payments, and a lowering of expenditure in some Ministries, defense and general services and administration. In addition, the Government intends to review total education expenditure, giving priority to primary education and reducing the subsidies to secondary and higher education. The operational losses of the Central Bank are expected to decline further in 1995 as a result of the full-year effect of the measures implemented during 1994, and will be totally eliminated in 1996. To carry out the employment reduction program, the Government will receive technical support from the World Bank through a Technical Assistance Credit.

19. With technical support from the World Bank, the IDB, the US AID and the UNDP, the Government also intends to implement a Public Sector Reform Program. To that effect, before presentation of the Economic Recovery Credit II to the Executive Board of the World Bank the Government will prepare a policy statement outlining the main elements of the reform program and will create a Project Management Unit to design and coordinate its implementation. The Public Sector Reform Program will focus on (a) the restructuring of public sector institutions, including through the merging or elimination of public entities in order to increase efficiency; (b) the improvement of budgetary and expenditure management; (c) the decentralization of services by increasing the autonomy and accountability

of local governments and communities; (d) the strengthening of the Judicial and Legislative Branches; and (e) the reform of the civil service structure and pay scale. The Government also will take steps to reduce discretionality and render policies more transparent. To that effect, before June 1994 the power of Ministries to change domestic and trade taxes as well as to create new commercial enterprises will he abrogated and transferred to the Presidency by presidential decree. Moreover, starting June 1994 any changes 'in tax, trade, pricing, and regulatory policies will have to be published in the Official Gazette to be legally binding. In addition, as part of the spending management effort, starting in 1995 the Government will review the public investment program with technical assistance from the World Bank before presentation-of the draft budget to the National Assembly.

Financial sector policies

20. When the administration of President Chamorro took office in April 1990 all commercial banks were state-owned and highly dependent on central bank rediscounts, interest rates were negative in real terms, and credit contracts were not enforced. One of the new Government's priorities was to reform the financial system in order to restore an efficient intermediation of financial savings. In March 1991 the National Assembly enacted a Superintendency law allowing private banks and financial institutions and setting forth the functions of the Superintendency of Banks (seven private banks accounting for 50 percent of deposits are already 'in operation) and in July 1992 the Government approved A new Central Bank Charter Law that was

prepared with technical assistance from Fund staff. Also, in the context of IDA's Economic Recovery Credit I, a number of steps were taken in 1991-92 to reduce the high operating costs of state-owned banks. This 'was followed in July 1992 by the formulation of a strategy to reform the state-owned banks under terms of technical assistance from U.S.AID, which consisted of writing-off the loans with low probability of repayment, recapitalizing the state-owned banks, and subjecting them to the application of prudential regulations set by the Superintendency. In addition, measures adopted in September 1991 and early 1992 allow commercial banks to set interest rates at market determined levels.

21. The lending policy of the Central Bank changed significantly during 1992 and 1993. In 1992 the previous rediscount system based on the direct allocation of central bank credit by bank and by activity was discontinued and central bank financing of the cotton and sugar sectors, which had resulted in the accumulation of a large amount of nonperforming loans, was reduced substantially.

22. The monetary program assumes that money and quasi-money denominated in local currency will grow in line with inflation which is projected at 10 percent during 1994, and that it will increase somewhat in real terms during 1995. The envisaged fiscal adjustment as well as the on-lending of external resources to be provided mostly by the Central American Bank for Economic Integration (CABEI) would allow for an increase in credit to the private sector of about 10 percent a year in 1994-95 in real terms, compared with a

decline of 3 1/2 percent in 1993. Starting in 1994 there will be no further net central bank financing of the state-owned banks with the central bank's own resources (except for seasonal reasons) and state-owned banks will need to finance new credits through improved 'loan recoveries, increased deposits, and the on-lent external resources that they could channel without violating the prudential norms of the Superintendency (the Government will make every effort to give priority to the private banks for channelling these resources). Moreover, incremental central bank financing of the FNI would be strictly limited to the on-lending of the resources to'be provided by CABEI and other external creditors for specific programs minus programmed repayments to the Central Bank. In addition, the financial system will be kept free of directed credit policies (with the exception of credits for specific programs financed with external resources), and starting in 1995 the Central Bank will use open market operations as an instrument of monetary control on a more regular basis.

23. Interest rates on bank loans and deposits will be kept free of controls during the program period. To realign the structure of central bank interest rates according to market developments, in late December 1993 the Central Bank established a new policy by which interest rates on central bank loans to financial institutions: are set quarterly on the basis of an average of the rates offered by commercial banks on 30-day deposits plus a apread'of 1/4 of one percentage point. Also, central bank loans have been made subject to the maintenance of value clause, which establishes a mechanism of indexation to the U.S. dollar that is not mandatory but in

practice applies to all commercial bank loans and deposits. Some credit operations of the central bank still take place at below market rates but the application of the new interest rate policy established by the central bank will be broadened to all central bank operations before end-May 1994.

24. The Qovernment is of the view that the future growth of state-owned banks should be based only on further improvements in their operating efficiency and the generation of profits. Consistent with this view, over the next three years the Government will continue to address the problems of high operating costs and poor loan recoveries of the two largest state-owned bankb--the National Development Bank (BANADES) and the Bank for Industry and Commerce (BANIC)--and to foster the conditions for-a more rapid expansion of private banking.

25. In the case of BANADES, in mid-1993 the Government embarked on a restructuring plan with technical support from the Inter American Development Bank. As part of the plan several actions have been taken to change the bank's organizational structure, a detailed analysis of the bank's portfolio has almost been completed; and a new charter law establishing the administrative and financial autonomy of the bank has been approved. During the program period the plan contemplates steps to reduce further the bank's staff and .the number'of its branch offices, and to enforce new loan and 'loan recovery guidelines. In the case of BANIC, early this year the Government replaced the management and some of the Directors of the bank. An audit of the bank's portfolio and a plan to improve loan

recovery, cut down on operating costs, and reduce loan concentration (to be formulated with technical assistance from the World Bank) will be prepared before end-May 1994. Both banks will continue to comply with the norm3 established by the Superintendency (in particular the capital-adequacy ratio) and any new recapitalization of either bank with government resource3 will be avoided. Also, any revaluation of the banks' assets will be limited to cover a deficit in loan provision requirements and the indemnization expenses that could arise as a result of the downsizing of the banks' structure. During the program period the FNI will continue to operate as an autonomous second-tier institution specialized in long-term lending. The Government will-make its best efforts to strengthen the FNI's loan recovery procedure3 and will proceed to clean-up its portfolio before end-1994. In addition, the Government will proceed with the recapitalization of the Central Bank before end-June 1995.

26. The recent growth of the private banking sector together with the need to subject state-owned banks to the same prudential regulations applied to private banks underscores the importance of a well-functioning Superintendency of Banks. Since its creation in 1991, the Superintendency has made progress in developing it3 organizational structure and. in preparing and issuing prudential regulations. Recently, the Superintendency ha3 identified functions that its Board of Director3 will transfer to the Superintendent to increase his autonomy in super-vising banks, has revised the prudential norm3 and the criteria for loan classification and provisioning of restructured loans (the revised norms will be issued before

end-May 1994), and has prepared an accounting manual that was distributed to banks. Further actions to be taken by June 1995 include the issuance of a decree or, if necessary, the presentation of legislation to the National Assembly increasing the penalties for non-compliance with prudential norms; the inclusion of the FNI and the Nicaraguan Insurance Institute (INISER) in the Superintendency's inspection program: and the design of a centralized management information system of debtors.

Exchange rate and trade policies

27. The fixed exchange rate system that was in place between March 1991 and January 1993 provided the anchor for the achievement of price stabilization. As a step in the direction of liberalizing foreign exchange transactions for invisibles and capital flows, in October 1991 the Central Bank authorized the establishment of foreign exchange houses that operate at market-determined rates and in January 1993 it extended this authorization to commercial banks. Most export receipts, official receipts and payments, import payments and foreign investment remittances continue to be transacted in the official market, while certain operations for invisibles and capital transactions take place in the free market. The spread between the exchange markets has fluctuated around 1-2 percent in recent months.

28. The real effective exchange rate based on consumer prices reflected a slight-weakening in competitiveness through December 1992 as the nominal exchange rate was maintained at C$5 per U.S. dollar after the devaluation of March 1991. To improve external competitiveness, following the devaluation

implemented in January 1993 the central bank adopted a crawling peg with an annual rate of depreciation of 5 percent, which was accelerated to 12 percent in November 1993. As a result of these actions and the pursuit of a prudent wage policy during 1993, the exchange value of the cordoba has depreciated by 6 percent in real effective terms since December 1992, consistent with the Government's objective of export competitiveness and promoting investment in the tradable goods sector. In this context, during the program period exchange rate policy will be kept under close surveillance in order to ensure the achievement of the balance of payments objectives of the program.

29. Nicaragua has made considerable progress in reducing exchange and trade restrictions but still maintains some restrictions on the making of payments and transfers for current international transactions, including as evidenced by external payments arrears. In addition, the country engages in a potential multiple currency practice arising from the operation of foreign exchange houses. Given the fragile external situation, the Government is not in a 'position to proceed with an immediate full unification of the exchange markets. However, before concluding the review of the first-year ESAF arrangement the Government intends to lift the existing restrictions on the making of payments for certain invisibles (education; health, and travel expenses) in the official market, which will be followed by the elimination of the multiple currency practice through the full unification of the exchange markets before June 30, 1995.

30. The Government has made substantial progress in the area of foreign trade liberalization. In 1991 the monopoly of certain state enterprises in the marketing of Nicaragua's main exports and in importing key products was eliminated and access to foreign exchange for imports was freed at the official exchange rate. In addition, a legal framework for the establishment of duty-free zones and a new foreign investment law that provides for nondiscriminatory treatment of foreign investors and allows for the repatriation of profits were enacted. During 1992, import taxes were reduced from a range of 10-60 percent to 10-40 percent, export taxes 'were abolished,-almost all quantitative restrictions on imports were eliminated (some ad-hoc restrictions, ostensibly to cope with dumping practices of trading partners, are being replaced by tariffs), and quantitative . restrictions on exports of basic grains, beans, and live cattle were phased out.

31. During 1994-97, the Government intends to proceed with its liberalization program at a more. gradual pace than had been envisaged previously, partly because of fiscal considerations. To render the trade regime more transparent, the Government issued a decree in April 1994 that abolishes the Selective Consumption Tax (ISC) and the Luxury Consumption Tax (IBS), and replaces them by a Temporary Protection Tariff (applying to 750 import items with rates ranging from 5 to 15 percent! and by a Specific Consumption Tax (applied to all products that were previously subject to the ISC and IBS, but without discriminating against-imports in favor of domestically produced goods). The Temporary Protection Tariff, which will

apply equally to products imported from Central America and from outside the region, will be gradually phased out by 1999, as agreed in a treaty with the other Central American common market members that grants temporary preferential treatment to Nicaragua.

32. The revised trade liberalization program contemplates a reduction of import taxes (including' the Common Central American Tariff, the Temporary Protection Tariff and Stamp Duty) from the present range of 10-40 percent to . 10-37 percent by June 1995, 10-35 percent by January- 1996, and 10-32 percent by January 1997. All imports will be subject to this general reduction in nominal protection rates, with the exception of 18 items denoted "fiscal industries" , pending a review of the fiscal implications of this measure. In any event, no industry will receive a nominal effective protection rate above the current ceiling of 40 percent. During the program period the Government will refrain from introducing any non-tariff barriers on exports or imports not justified by health or security reasons.

33. An export promotion mechanism introduced in 1992 established a duty draw-back mechanism for all exports outside Central America and income tax rebates and tax benefits. in the form of tax certificates for nontraditional exporters. This mechanism has been incorporated in contracts between the Government and exporters that are scheduled to expire in 1996. Before end-June 1995 the Government will formulate a proposal for the replacement of the existing mechanism by an automatic drawback system applicable to all exports.

Private sector development

34. In 1990-93 the Government took several measures to improve competition and facilitate the development of private sector activities. All legal state monopolies except for public utilities were eliminated, price controls were phased out (except for fiscal goods and natural monopolies), support prices for food grains and price ceilings for basic consumption goods in state-owned outlets were discontinued, the state agency in charge of regulating supplies of 'consumption goods ceased trading in all but food grains and the state-owned bus company (ENABUS) was pcivatized. In addition, a government agency (CORNAP) was endowed with responsibility for managing and privatizing a large number of state entities (excluding those in banking and public utilities) which in 1990 accounted for about 30 percent of GDP. Since its creation, CORNAP has privatized, returned to former owners, or liquidated 289 out of a total of 351 entities.

35. In the area of property rights, starting in September 1992 the Government has taken steps to address the issue of disputed land rights derived from confiscations and illegal land assignments carried out by the previous'administration during the transition period between the presidential election and-the assumption of power by President Chamorro. For that purpose, the Government issued decrees reestablishing the National Review Commission (in charge of reviewing claims and recommending 'compensation or the return of properties when warranted), broadening the functions of the Office of Territorial Ordering (in charge of reviewing the legitimacy of appropriations of houses, urban lots and agricultural

landholdings), establishing the Office for the Quantification of Compensation (in charge of determining the amount of compensation for those cases that the National Review Commission decide should be compensated), and introducing a bond mechanism to clear the Government's financial obligations derived from the compensation process.

36. In the future the Government will focus on completing the privatization effort and resolving the issue of confiscations or illegal land assignments. In the area of privatization, before end-October 1994 the Government will bring to the point of sale at least 40 percent of the shares of the state-owned telecommunications.company (TELCOR) and will transfer the management of the company to the private sector (nine foreign companies have already been pre-qualified to participate in this operation). To that effect, before end-May 1994 the Government will proceed with the issuance of regulations pertaining to the privatization law and will present to the National Assembly a specific law proposal for the telecommunication3 sector permitting the privatization of TELCOR.. The Government 'also will complete the divestment of all but 38 of the enterprises that are still managed by CORNAF by June 1994 and of the remaining CORNAP enterprises by December 1994.

37. The Government is conscious that a rapid resolution of the property rights-issue is essential to establish the basis for increased private sector economic activity and investment. To tackle this issue, the Government has formulated a program to complete the administrative revision

of land claims corresponding to confiscations during the transition period and to extend an adequate offer of compensation or return the property to claimants cleared by the National Review Commission (dissatisfied claimants can pursue their claims through the judicial system). According to this program, 10,229 cases of houses and 10,382 cases of agricultural landholdings without clear title will be resolved administratively by June 1995; while 90,264 cases of urban lots without clear title will be resolved administratively by June 1996 (with the possible exception of some extreme cases). Moreover, the National Review Commission is expedted to review and extend an offer of compensation or return of property to 5,420 property claimants by June 1996 (with the possible exception of some extreme cases). In addition, before consideration of the Economic Recovery Credit II by the Executive Board of the World Bank, the Government will establish a mechanism in the Ministry of Finance to carry out random inspections in order to verify compliance with established procedures to resolve property rights conflicts. The Government also intends to propose and promote mechanisms to accelerate the judicial instance of resolution of property claims and, if necessary, will prepare draft legislation to be presented to the National Assembly before March 1995 for that purpose.

38. Compensation payments are being financed by issuing 20-year cordoba denominated bonds indexed to the U.S. dollar, which would be redeemed with the resources obtained from the privatization of a number of public entities. A Presidential decree already has established that the proceeds from the partial privatization of the state-owned telephone company

(TELCOR), and a number of state-owned entities and enterprises will be used for this purpose. The Government also intends to explore options, including the use of proceeds from sales of other state-owned assets, to increase the market value of compensation bonds. Available options will be reviewed carefully to ensure consistency with the fiscal targets of the program.

39. To promote efficiency in the allocation of resources, the Government is committed to maintaining all prices (except for fiscal goods, natural monopolies, books and medicines) free of controls and interference during 'the whole period covered by the program.

Natural resources deregulation

40. Mining and fisheries have significant potential for expansion. Presently, production in these sectors is equivalent to one fifth and one half, respectively, of the levels of a decade ago. The drop in production is largely attributable to the expropriation of major enterprises in the early 1980s and to lack of managerial and technical expertise. The Qovernmdnt intends to complete the privatization of all mining enterprises by August 1994 (privatization of the fisheries' sector was virtually completed in December 1993) and will limit subsequent involvement in these industries to regulatory functions. A legal/regulatory framework for the rational development of natural' resources, will be completed before end-1994.

Infrastructure

41. The Government believes that the performance of the public utilities and their capacity to satisfy the growing demand for basic services has to be improved substantially in 1994-97. As part of its strategy in this area, the Government is preparing a Public Utilities Reform Program to be supported by a sectoral loan from the Inter American Development Bank starting in 1994; The program envisages reforms in the energy, water and telecommunications sector. In the energy sector, the program contemplates the restructuring of the electric and hydrocarbon subsectors through the establishment of an appropriate regulatory framework allowing private sector participation. To that end,'the Government is preparing a hydrocarbon law (which will regulate exploration and exploitation) and a new electricity law, which will be presented to the National Assembly before'end-December 1994. In addition, a- contract-plan will be prepared between the Government and the state-owned electricity Institute (INE) establishing monitorable targets for financial performance and operating efficiency. As part of its efforts to make the energy sector more efficient, before end-May 1994 the Government intends to bring to the point of sale or privatize two subsidiaries of the oil distributing company. (ENIGAS and LUBNICA). In addition, the Government will divest some of the activities of the state oil company (PETRONIC), including its gas stations, and separate its regulatory from its operational functions before end-June 1995. In the water sector, the Government is embarked in a program aimed at decentralizing the provision of water and sewerage services at the territorial level, with increased participation of the municipalities. A regulatory framework for

the sector will be prepared with technical support from IDA (through a Water and Sewerage Project) and the IDB.

42. When the present administration took office, the transport sector was organized in a centralized fashion. State-owned enterprises were over-staffed and had limited technical capabilities, capital expenditure was only a fraction of the level necessary to provide for an adequate infrastructure, and operational and maintenance expenditure was insufficient. Moreover, port services ranked among the most expensive in Central America owing to a welter of regulations, overstaffing, and powerful labor unions. Since then, the Government has privatized the state-owned bus company (ENABUS) and has privatized, liquidated, or downsized 17 companies under the Ministry of Transport and Communications (MTC). Over the period 1994-97, the MTC will focus on the strengthening of its capacity for selecting and monitoring project execution and the streamlining of central and regional activities to avoid duplication. Moreover, before end-1994 the Government will bring to the point of sale or liquidate one additional MTC enterprise. The Government also intends to restructure the Nicaraguan ports and to reduce their-operating costs--pre-feasibility studies for this purpose were completed in 1993 with IDA assistance.

Agriculture

43. The agricultural sector is the major source. of potential growth., particularly in the short term. The sector represents 25 percent of GDP, employs 30 percent of the labor force and generates more than half of total

exports. During the 1980s, agricultural production slumped as a result of excessive controls and regulations, social conflict, the trade embargo, and direct allocation of credit on the basis of political criteria. In addition, the high price variability for the main export crops has created the need to diversify production and develop new agricultural export products.

44. In 1991-92 foreign trade in agricultural products was liberalized and almost all non-tariff import restrictions were eliminated and domestic commerce was opened to private traders. Despite this progress, significant problems still hinder agricultural development. The sectoral policy framework needs to be strengthened, along with the sector's research and extension services; the insecurity in land tenure stemming from deficiencies in the agrarian reform legislation should be eliminated; and the process of cadastring, titling and registration needs to be-accelerated.

45. During 1994-97 the Government intends to address the institutional, land rights, and technological issues that are hindering agricultural sector growth. Institutional issues are being addressed with the creation of the. National Agricultural Council (CONAGRO) in June 1993, which is in charge of coordinating sectoral planning and policy analysis in the context of an IDB technical cooperation project. The project includes a clearer definition of the functions'of the Ministry of Agriculture (MAG), the Agrarian Reform Institute (INRA) and the Natural Resources Ministry (MARENA), as well as an action plan for modernizing these institutions.

46. To address uncertainty over land rights, agricultural policy will focus on reviewing the land titles of beneficiaries of past agrarian reforms and validating these titles for legitimate reform beneficiaries. The validation process includes (i) establishing land ownership criteria and technically sound land titling procedures; (ii) issuing land titles to agrarian reform beneficiaries who lack documentation and legalizing provisional land titles; and (iii) developing a legal/administrative framework to consolidate agrarian property rights. Explicitly excluded from this process are the cases of illegal land assignments made during the transition period. Once this framework is in place, the Government will implement a national cadastre, titling and registering program. These efforts are being supported by an IDB Agricultural Sector Credit and by an IDA Agricultural Technology and Land Management Credit.

47. To strengthen agricultural research and extension, the Government has decided to overhaul the management of these activities. The coffee, cotton, and livestock research centers will be privatized and the centers for basic grains, pastures and nontraditional crops will be consolidated into an autonomous institute of agricultural technology (INTA), governed by an independent board. In addition, centrally budgeted research grants for hiring private extension assistance will be provided on'a competitive basis,

Environment

48. The two major environmental issues in Nicaragua are water pollution and deforestation. Water pollution in urban and rural areas ensues from lack of

treatment of municipal and industrial discharges that percolate the underground aquifers which are the main source of water supply for human consumption. Deforestation, which takes place in the tropical vet land, in the Atlantic region, and in the dry forests of the Pacific, reflects population pressures on agricultural lands, the widespread use of firewood as a source of energy, and uncertainties over land rights. Other problems include soil erosion in the North Pacific region, pesticide poisoning, and the deterioration of coastal and marine ecosystems.

49. To address these problems, the Government has prepared an Environmental Action Plan, which is being implemented with donor support, and will prepare environmental norms and regulations for water, fisheries and mining before end-1994. Deforestation problems will be addressed by eliminating uncertainty about land rights and expanding private sector participation in the forestry industry under a clearly defined regulatory framework for sustainable exploitation which will be ready before end-1994. Water pollution problems are being tackled within the framework of an IDB project and an IDA Water and Sewerage Project; Soil erosion is being addressed by incorporating soil conservation practices in research and extension programs supported by an IDA agricultural credit. Pesticide poisoning is also being dealt through stronger enforcement of the prohibition against illicit pesticide use and by incorporating pesticide management. training in INTA's extension program. In addition, the Government intends to tackle green issues through a Natural Resources Management Project to be financed by IDA starting in 1997.

Social sectors and noverty reduction

50. Poverty in Nicaragua is widespread. Data from 1993 reveal that 50 percent of the population is living in poverty and 19 percent in extreme poverty. Social indicators are among the lowest in Latin America: infant mortality was 72 per thousand live births in 1990 (caused mostly by diarrhea and acute respiratory infections), maternal mortality is 159/100,000, total fertility averages 4.6 children per woman of childbearing age, and 28 percent of children experience moderate or severe malnutrition. Poor water and sanitation services expose the population to water-borne diseases, particularly in the rural areas where water coverage-is only 20 percent and sanitation coverage 9 percent. Over 20 percent of the population is illiterate, the repetition and dropout rate between first and second grade is 45 percent, and only 22 percent of the children entering school complete grammar school.

51. Social spending increased from 3 1/2 percent of GDP in 1970 to about ... percent of GDP in 1993--a share higher than in most Central American countries and much higher than typical for an economy with Nicaragua's GDP level. However, there are still serious inefficiencies in the allocation of resources and weak institutional. capacity in the line ministries. Resource allocation favors curative health care and higher education at the expense of the delivery of basic services, and wage expenditure at the expanse of outlays on operations and maintenance. In addition, there is a need to strengthen the budgeting and control mechanisms to achieve an efficient

management of foreign aid, which represents . . . percent of total public funding in health and . . . percent in education.

52. Given the country's critical social situation, the Government places a high priority on strengthening its social program for 1994-97. To facilitate the elaboration and implementation of its social strategy, in January 1993 the Government crested the Ministry of Social Action (MAS). This new Ministry will coordinate the activities of the Social Cabinet, execute social safety net and relief programs, and introduce a social information and monitoring system.. The Government's social strategy consists of two components. The first component will focus on medium-term reforms in the line ministries to improve the provision of basic social services, particularly primary health care (PHC) and primary education,.and on the reform of the Social Security Institute. The second component of the strategy will focus on short-term poverty alleviation programs targeted to the most vulnerable'groups. The Government's social strategy will be described in .a policy and strategy document to be submitted to IDA in mid-1994, which will be used as the central instrument'for coordinating donor efforts in the social sector.

53. In the health sector,' the Government is strengthening the delivery of primary health care (PHC) by rehabilitating infrastructure and introducing an integrated 'model of PHC that includes pre- and post-natal care, vaccinations, and education on family planning and nutrition. The Ministry of Health (MINSA) is also improving the management of the health sector

through a process of administrative decentralization to 19 local health services and national reference hospitals. To increase the resources available to the sector, MINSA has established a mechanism to sell differentiated services to the private sector and health insurance providers. In addition, MINSA is reforming its information, personnel, budget, medical supplies, and medical supervision systems. Over the program period, budgetary funds and donor resources will be targeted to priority programs and the share of PHC in the domestic health budget will be increased by 2 percent per year.

54. In the education sector, the Government is rehabilitating infrastructure, strengthening basic education through curricular reform and training programs for teachers, improving the quality of preschool programs in the most disadvantaged rural areas, and institutionalizing automatic promotion from first to second grade to reduce the dropout rate. In addition, to improve sector management and encourage the local finance of schools, the Ministry of Education (MOE) is implementing two models of administrative decentralization via municipal administration of schools and secondary school autonomy. A better allocation of resources is being achieved by improving targeting and exploring cost recovery mechanisms, reviewing the incentive system for teachers, and promoting private sector participation in the provision of education services through the deregulation of licenses and fees. As referred to'earlier, one of the Government's objectives is to review total education expenditure, giving

priority to primary education and reducing subsidies to secondary and higher education.

55. The Nicaraguan Social Security Institute (INSSBI) is developing a new model of social security and human development targeted to the most vulnerable groups. As a first step, INSSBI is separating the administrative, financial and budgetary aspects of its Social Insurance programs and Social Welfare programs.- For the Social Insurance programs, INSSBI is identifying incorrectly assigned pensions, exercising better control over employers' contributions, developing a new legal framework for social security management, and reestablishing a health insurance system based on the free selection of public and private providers., In the area of Social Welfare, program targeting emphasizes children, pregnant adolescents, the elderly, and war victims.

56. The Government's short-term poverty alleviation programs include: (i) the Emergency Social Investment Fund (FISE), a fund to rehabilitate economic'and social infrastructure and to provide temporary employment in poor areas; and (ii) the National Reconciliation and Rehabilitation Program (PRRN), a program to support vulnerable groups' in regions affected by the war. In addition, in January 1993 the Government created the Community Employment Fund, which provides temporary employment in local communities. In 1994-96 FISE is expected to double its expenditures tied to external financing to 'about US$75 million, compared with US$37 million in 1991-93. This is expected to allow for the creation of 25,900 jobs in 1994-95. Also,

the voluntary public employment reduction program to be implemented in 1994-96 contemplates that public sector employees would continue to draw their full salary for up to three years, depending on length of service in the public sector.

Labor market policies

57. Achieving a more efficient'and flexible labor market in Nicaragua is crucial for increasing productivity, improving external competitiveness, encouraging investment in human capital, and reducing unemployment. Most collective bargaining agreements ,of the state-owned enterprises and large private or recently privatized enterprises contain provisions that increase labor costs, depress labor productivity and reduce labor mobility. Labor productivity also is adversely affected by high severance payments, and the large share of fringe benefits that flattens the wage structure and de-links wages from work effort.

56. The National Assembly is currently discussing reforms to the labor code. . In the context of the discussions, the Government is promoting draft legislation aimed at permitting temporary contracts of determined duration as an important step to reduce entry-exit barriers, developing more balanced strike regulations., reducing severance payments, and giving powers to the Ministry of Labor (MITRAB) to pronounce on the legality of strikes. The Government's policy intentions in this area are described in a letter of Labor policy that was prepared in April 1994. The Government also will take steps to modernize the civil service and its salary structure, including the

monetization of fringe benefits to reduce wage indexation. These actions will be supported by an IDA technical assistance credit;

Women in development

59. The Government is committed to improve the welfare of women and to set the conditions for a full and productive role of women in the Nicaraguan society. Since the end of the civil strife, important efforts have been made to reduce birth and maternal mortality rates and illiteracy rates among women, and a legal framework to protect women's civil rights has been enacted. However, women still face several constraints in achieving equal opportunity. The socioeconomic conditions of women in rural areas remain critical, unemployment rates among women are very high, especially at the entrance level, and women's legal rights are not adequately enforced.

60. The Government will review the existing safety net programs and, based on the Living Standards Measurement Survey (LSMS), will target these programs to the poor with special attention to women and their dependents. The delivery of maternal., child care, and reproductive health services in the rural areas will be improved and special emphasis will be given to reducing the high maternal death rate by improving the health situation of women.of child-bearing age. In addition, the. Government will strengthen the National Institute for Women (INIM) in order to address the legal barriers that currently limit the effective attainment of women's rights. The INIM

also will develop proper mechanism3 to improve enforcement of the existing legislation.

Technical assistance reauirements

61. In the past, the Government has received substantial technical support from the International Monetary Fund in the areas of financial sector reform, tax administration, balance of payments statistics, and public finance statistics. In addition, a reform program for the Central.Bank of Nicaragua managed by the Fund and funded by the IDB has been under implementation since late 1991., In the next few months the Fund will open a resident representative post in Managua and will identify a banking expert that will provide technical support on the reform of state-owned banks. In addition, the Public Sector Reform Program will be supported by IDA (through a technical assistance credit), the IDB, US AID, and UNDP, The IDB will also provide technical support to improve Customs Administration starting in July 1994.

V. External Financing Requirements

62. As a result of the country's very small export base and its very high debt service ratio (accrued debt service obligations would amount to 235 percent of exports of goods and nonfactor services in 1994-97), Nicaragua's external financing requirements will remain large over the medium term. Based on a continuation of the process of fiscal consolidation along the lines referred to above and the intensification of structural reforms, the current account deficit (excluding official transfers and interest obligations) is projected to narrow from 24 percent of GDP in 1993 to 22 1/2 percent of GDP -in 1994, and to about 16 percent of GDP in 1997. Exports in U.S. dollars are projected to grow at an average rate of 11 percent through 1997 as a result of an improvement in external competitiveness and the consolidation of land rights in the agricultural sector. Imports are projected to remain about unchanged in 1994 as a result of lower import prices, and to increase by 4 1/2 percent on average in 1995-97.

63. Total disbursements of non-project related grants and loans are projected at US5248 million in 1994. Disbursements from multilateral institutions, mostly in the form of concessional loans, are projected at about US5122 million, including lJS524 miliion corresponding to one disbursement under the ESAF arrangement with the Fund, US552 million from IDA (of which. US545 million corresponds to the Economic Recovery Credit II), and US540 million from the IDB (corresponding to a Public Utilities Reform Loan). Disbursements from bilateral donors, including in the form of grant

aid and cofinancing of the ERC II, would be in the order of US$126 million in 1994. Based on the need to rebuild net international reserves by US545 million, Nicaragua would still face exceptional financing needs of US$588 million in 1994 (excluding the resources that would be needed for a buyback of its commercial bank debt). Preliminary projections for 1995-97 indicate that official non-project related grant and loan disbursements, including Fund disbursements, might decline to US5225 million in 1995 and to US5190 million in 1996-97 and that Nicaragua's exceptional financing needs would amount to more than US5560 billion in 1995 (excluding the regularization of outstanding arrears with non-Paris Club official bilateral creditors), and to US5476 million on average in 1996-97. These projections assume no debt service payments to commercial banks and no payments to non-Paris Club official bilateral creditors prior to the conclusion of the debt negotiations with these creditors. Private capital inflows, which are estimated to have reached some US5140 million in 1993, are projected to increase to a level of US5150 million a year in 1994-97, representing mostly direct investment, private sector credits, and inflows associated to the privatization process.

64. Filling the exceptional financing needs for 1994-95 would require the concessional rescheduling of debt service obligations to Paris Club creditors and the rescheduling of arrears and current obligations to non-Paris Club official bilateral creditors on terms comparable to those already obtained from certain Latin American countries, which 'provided for debt cancellation equivalent to 90-95 percent in present value terms.

65. Since 1991 the Government has maintained discussions with non-Paris Club official bilateral creditors and commercial banks to obtain a substantial reduction of Nicaragua's external debt. These discussions will continue during the second half of 1994. Regarding the debt with the commercial banks, IDA has committed US525 million from its Debt Reduction Facility for a possible debt reduction operation and the Government is now seeking to obtain additional concessional support from donors for such operation. Although the continuous rescheduling of obligations on highly concessional terms would cover Nicaragua's exceptional financing needs in 1994-97, the achievement of external viability would require* a substantial debt stock reduction from official and commercial creditors and continued concessional support from donors for several years.

Nicaragua: Policy Matrix
tlacroeconomic and Structural Adjustment Policies, 1994-97

Policy **Area**	**Objectives**	**Strategies/Measures**	**Timetable**
1. Fiscal **sector**	Consolidate stabilization, **reduce the** size **of the** public sector, **and** improve efficiency in **the production of government services.**	Increase public sector savings by **2.3 percent of GDP** in **1994 and by at least 3 1/2 percentage** points of GDP in 1995-97.	1994-97
		Reduce noninterest current expenditure, by 1.3 percent of GOP in 1994 **and by an** additional 4.2 **percent of GDP** in 1995'97 **through the** continued implementation of **the employment** reduction program; the containment of wage expenditure and pension **payments;** a lowering of expenditure in some Ministries, defense and general services **and** administration; and **lower outlays on goods and services.**	**1994-97**
		Reduce the number of public sector employees by at least 13,500 in 1994-96 through the implementation **of the voluntary** employment reduction program. Within this total, the cumulative reduction will **amount to 7,000 through end-1994; 11,000 through end-1995; and 13,500 through** end-1996.	1994-96
		Continue reducing remaining indirect tax exemptions.	1995-37
		Adopt mechanism of monthly **increases** in **gasoline prices aimed** at keeping prices unchanged in **U.S. dollar terms. The mechanism** will be reviewed at **the** time of' **the first** review **of the program.**	**June 1st, 1994**
		Widen the application **of fees** (according to income) for certain **health** and education services.	**1994-9-i**

Nicaragua: Policy tlatrix
Macroeconomic **and** Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
1. Fiscal sector (continued)		Review total education expenditure, giving priority to primary education end reducing subsidies to secondary and higher education.	1995
		Implement tax administration program with technical assistance from the Fund.	1994-97
		Implement program to improve custom3 administration with technical support from the IDB.	1994-97
		Implement Public Sector Reform program with technical support from IDA, IDB, US AID and UNDP.	1994-97
		Review public investment program with the technical assistance of the World Bank prior to budget presentation.	1995-97
		Issue Presidential decree abrogating the powers of ministries and government agencies to change tax and tariff policies as well as to create new commercial enterprises.	June 1994

Nicaragua: Policy Matrix
Ilacroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
2. Financial sector	Improve loan recovery and develop a competitive financial system.	Maintain an interest rate policy of market-determined rates for bank deposits and loans.	1994-97
		Maintain all interest rates on short- and long-term central bank financing to banks above the 30-day deposit rote and central honk financing to banks subject to the maintenance of value clause.	1994-97
		Keep the financial system free of directed credit policies (with the exception of credit3 for specific programs financed with external resources.)	1994-97
		Implement. actions aimed at eliminating the loss& of the Central Bank by 1996.	1994-96
		Implement mechanism of automatic debiting of interest payments from the accounts of the commercial banks at the central bank.	Before April 1st, 1994
		Clean-up FNI's portfolio.	Dec. 1994
		Recapitalize the Central Bank.	June 1995
		Implement satisfactorily the plan to restructure BND under IDB's assistance, including measures to reduce operating costs and enforce new loan and loan recovery guidelines.	1994-96
		Complete audit of BANIC's portfolio.	End-Hay 1994'
		Formulate a plan to reform BANIC with technical assistance from the World Bank (the plan will contcmploto measures to improve loan recovery and reduce operating costs and loan concentration).	End-flay 1994

Nicaragua: Policy Matrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
2. Financial sector (continued)		Implement the action plan to restructure BANIC	1994-95
		Any new recapitalization of the state-owned banks with government resources will be avoided, any revaluation of their assets will be limited to cover provisions required by the Superintendency and indemnization payments to personnel, and their' continued compliance with the norms of the Superintendency will be enforced.	1994-97
		Eliminate net central bank financing of the state-ouned banks with the central bank's own resources (financing could.change during the year because of seasonal reasons>.	1994-97
		Limit central bank incremental financing of the FNI to the on-lending of external resources for specific programs minus programmed repayments to the Central Bank.	1994-97
		Issue revised prudential norms, including those establishing adequate criteria for portfolio classification and provisioning of restructured loans.	End-Hay 1994
		Issue a decree or, if necessary, present legislation to the National Assembly increasing the penalties. for non-compliance with prudential norms.	June 1995
		Include the FNI and INISER in the Superintendency's inspection program;	June 1995
		Design a'centralized management information system of debtors,	June 1995

Nicaragua: Policy Matrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
3. Trade and exchange policies	Improve overall economic efficiency and international competitiveness.	Eliminate restrictions on the making of payments for certain invisibles through the official market.	Before review of the first year ESAF arrangement
		Eliminate multiple currency practice through full unification of the exchange markets.	Before June 30, 1995
		Keep exchange rate policy under close review to achieve the balance of payments objectives of the program.	1994-97
		Reduce nominal effective protection (with the exception of the fiscal industries pending a detailed study of fiscal implications) from the current range of 10-40 percent to a range of:	
		10-37 percent	June 1995
		10-35 percent	Jan. 1996
		10-32 percent	Jan. 1997
		No industry will receive a nominal effective protectionabove the current ceiling of 40 percent.	
		Refrain from imposing non-tariff restrictions on imports or exports.	1994-97
		Prepare a proposal for the introduction of a drawback mechanism applicable to all exports to replace the existing export promotion mechanism for nontraditional exporters.	June 1995

Nicaragua: Policy Matrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
4. Private sector development	Address the issue of disputed land right from confiscations and illegal land assignments.	Implement program contemplating administrative resolution of former property-owner claims by June 1996, cases of houses and land-holdings without clear title by June 1995, end cases of urban lots without clear title by June 1996 (with the possible exception of some extreme cases).	Apr. 1994-June 1996
		Establish mechanism in the Ministry of Finance to carry out random inspections in order to verify compliance with established procedures to resolve property rights.	June 1994
		Promote mechanisms to accelerate the judicial instance of resolution of property claims and, if necessary, prepare draft legislation to be presented to the National Assembly for this purpose.	Mar. 1995
		Issue regulations pertaining to the privatization law;	Hid-Hay 1994
		Present to the National Assembly a specific law proposal for the telecommunications sector, permitting the privatization of TELCOR.	Hid-Hay 1994

Nicaragua: Policy Matrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
4. Private sector development (cont.)		Bring to the point of sale at least 40 percent of TELCOR's shares and a management concession. Use the proceeds to redeem compensation bonds.	Oct. 1994
		Bring to the point of sale, liquidate, or divest all but 38 of the CORNAP enterprises that have not yet been divested.	June 1994
		Bring to the point of sale, liquidate, or divest all CORNAP enterprises that have not yet been divested.	Dec. 1994
		Keep all prices free of controls and government interference (except for fiscal goods, books, medicines and natural monopolies).	1994-97

Nicaragua: Policy Matrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
5. Natural resources	Promote rational development of natural resources.	Bring to the point of sale, liquidate, or divest mining enterprises that have not yet been divested.	Aug. 1994
		. Prepare Legal/regulatory framework for the rational exploitation of resources in the fisheries, mining, and forestry sectors.	Dec. 1994

Nicaragua: Policy Hatrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
6. Infrastructure	Improve quality of infrastructure services and eliminate barriers for sector expansion through private sector participation.	Present draft of a hydrocarbon law, and electricity law allowing private sector participation to the National Assembly.	Dec. 1994
		Bring to the point of sale or privatize ENIGAS and LUBNICA.	End-Hay 1994
		Divest some of PETRONIC's activities, including gas stations, and separate its regulatory from its operational functions.	June 1995
		Prepare regulatory framework for the uater sector.	1995
		Implement decentralization of water and sewerage services at the territorial level, with increased participation of the municipalities.	1995-96
		Strengthen 'the capacity of the Ministry of Transport for selecting and controlling project execution. Streamline the Ministry's central and regional offices.	1994-97
		Increase the use of competitive bidding procedures for the allocation of road maintenance.	1994-97
		Bring to the point of sale or liquidate one additional HCT enterprise.	End-1994
		Restructure the Nicaraguan ports and reduce their operating costs.	1994-96

Nicaragua: Policy **Matrix**
Macroeconomic **and Structural Adjustment** Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
7. Agricultural sector	Eliminate land rights **uncertainty, upgrade research and** extension services **and develop an** appropriate institutional **framework to promote sectoral growth.**	Implement actions to eliminate land rights uncertainty by reviewing the land titles issued during the transition period and validating titles for legitimate reform beneficiaries.	Dec. 1994
		Propose a legal/administrative framework to consolidate agrarian property rights.	**June** 1994
		Implement the cadastring, titling, **and** registering **program.**	1994-96
		Enforce property rights;	1994-97
		Actions to **upgrade research and** extension: **(i)** consolidate dispersed research and extension services in **an autonomous** institute **(ii) upgrade, human** capital base,. physical facilities **and** information services in' the area of research and extension.	**1994-95**

Nicaragua: Policy Matrix
Macroeconomic- and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
8. Environment	Improve the regulatory framework for protecting the environment and promoting a sustainable development of natural resources.	Implement Environmental Action Plan and strengthen sector institutions.	1994-97
		Prepare environmental norms and regulations for water, fisheries and mining within the framework of the sectoral reforms of the public utilities and fisheries and mining.	End-1994
		Prepare a neu regulatory framework for the forestry sector.	Dec. 1994
		Establish regulatory framework to permit rational exploitation and private sector participation in the forestry industry.	June 1995
		Enforce the prohibition to use illicit pesticide application techniques.	1994-97

Nicaragua: Policy Matrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
9. Social sectors and poverty alleviation	Reduce poverty levels and gradually improve living conditions and the human capital base.	Complete a detailed social sector strategy, specifying policy measures and operational and budget arrangements.	Sep. 1994
		Health	
		Implement a PHC policy and operational strategy focusing on rehabilitation of PHC facilities, health promotion, and disease prevention..	1994-97
		Improve the management of the health sector by consolidating MINSA's decentralization and streamlining management of pharmaceutical supplies.	1994-97
		Introduce intensive family planning education and maternal and child care programs as an integral part of basic primary health care services.	1994-97
		Reorient staffing patterns at the primary level toward nonphysician personnel, and improve management information and supervision systems.	1994-97
		Reallocate expenditure from wages and salaries to operation and maintenance.	1994-97
		Redefine financing arrangcmonts for the sector by channeling donor resources toward PHC. . Increase the share of PHC in the domestic health budget by 2 percent a year over' the next fbur years and improve MINSA's capacity for budgeting qnd financial management.	1994-97

Nicaragua: Policy **Matrix**
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
9. Social sectors and Poverty alleviation (cont.)		Education	
		Improve the efficiency and quality of primary education through: automatic promotion in grades I and II, assignment of the most experienced teachers to grades I and II, training of primary school teachers, and rehabilitation of primary education infrastructure.	1994-97
		Improve education sector management by implementing decentralization and divestiture strategy.	1994-97
		Improve intrpsectoral resource allocation through cost recovery measures at the secondary and tertiary levels and promotion of private sector participation. Deregulate licenses and fees for private sector provision of education.	1994-97
		Safetv Net Programs	
		Review existing safety net programs (including PRRN, FASO, FISE, and nutrition programs) for better targeting, coverage, and cost effectiveness.	June 1994
		Implement safety net strategy to protect the most vulnerable groups, as identified by LSMS and other data.	1994-95

Nicaragua: Policy Matrix
Macroeconomic and Structural Adjustment Policies, 1994-97

Policy Area	Objectives	Strategies/Measures	Timetable
10. Labor market policies	Increase labor productivity and reduce labor market rigidities.	Take actions aimed at restructuring remuneration packages in the public sector, linking compensation to productivity, developing balanced strike regulations, reducing mandatory severance payments, and facilitating entry-exit.	1994-97
		Promote legislation to revise Labor Code in a manner that facilitates more flexible operation of labor market following principles and procedures specified in the Letter of Labor Policy.	1994-97